

**Performance Audit of Accounts Receivables Function
Harbor Department of the City of Los Angeles
For Activity for Fiscal Years 2015, 2016, and 2017**

January 3, 2018

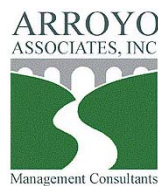


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Executive Summary

Arroyo Associates (Arroyo) was engaged by the Harbor Department of the City of Los Angeles, California, the Port of Los Angeles (Port), to conduct a performance audit of the Accounts Receivable Section of the Accounting Division (Finance Bureau). The purpose was to review the efficiency, effectiveness and internal controls of the unit. The scope of the audit included all invoicing, cash receipts, collections, and related activities for the fiscal years 2015, 2016, and 2017.

The process involved:

- Meeting with the Director of Management Audits to review the scope and timing of the audit.
- Conducting a preliminary assessment, including a review of all available policies and procedures, all financial reports, and all external reports relevant to the audit.
- Conducting interviews with the Accounts Receivable staff.
- Performing preliminary testing of procedures and controls.
- Developing an audit plan, and performing procedures to test and verify that procedures and controls were in place, and that activities are accurate and properly performed.
- Compiled results of test work, and developed findings on system deficiencies.
- Draft report of findings and recommendations.
- Reviewing initial findings with department head, and other identified bureaus.
- Present report to Port management and Audit Committee of the Board of Commissioners.

The Port of Los Angeles is one of three enterprise operations of the City of Los Angeles. The Port is a \$442 million operation. \$368 million or 84% of its revenues come from its shipping operations and over 90% of that is derived from seven container terminals. The Port is totally dependent on customer generated information. It is Arroyo's understanding that all container counts are received from the terminals, with no verification by the Port. As such, any misstatement of activity, whether in error or intentional misstatement, will never be capture. A 1% variance in container activity could result in up to a \$3.4 million change in revenues.

While the review and evaluation of the wharfage and the related revenue process was outside the scope of this performance audit, this issue is significant to the Port. Our review of the accounts receivable process noted that there are a high number of invoices generated, in excess of 22,000 per year. And that there is a large portion of credit invoices prepared, approximately 1,200 per year. It should be noted that invoice reversals in FY 2016-2017 were higher than in previous years due to a special situation related to one terminal. This high level of activity may

be a risk to errors occurring, but also may be an opportunity for improvements in efficiency and accuracy. An assessment of operational strengths and weaknesses, based on complete, written policies and procedures, could identify opportunities to improve systems, and strengthen internal controls.

The operating expenses of the Port are fairly fixed. Salaries, as a percent of operating expenses were 50.7%, 47.7% and 54.6% for fiscal years 2016, 2015, and 2014, respectively. Unlike a manufacturing or retail enterprise, there is not a significant variable cost component. As a result, one would expect higher container activity to result in greater revenues, and ultimately higher operating income.

Critical to improving revenues and operating income, is having in place an infrastructure, both physical and organizational, that allows for capitalizing on market opportunities, and thwarting operational threats. This is not possible when the activities and processes of the organization are not clearly defined, and not known throughout the organization. Without clear, specific written policies and procedures, the processes of the organization are not known. That is to say, specific staff personnel may have in-depth knowledge, but the organization does not. Unexpected changes in staff, due to terminations, resignations, deaths or other issues can leave major holes in the day-to-day operations. Additionally, senior management's ability to understand, evaluate, and improve operations is limited without written descriptions of activities, accounting and operational processes.

Summary of Findings & Recommendations

No.	Finding (Responsible Section)	Recommendation	Impact
1	<p>Accounts Receivable Section - The Accounts Receivable Section does not utilize a formal, written policies and procedures manual. The policies and procedures should include clear language on approving credit invoices for wharfage, dockage, and other container revenue fees.</p>	<p>The Port should develop written policies and procedures related to the activities of the Accounts Receivables section. The Port should specifically evaluate the current credit memo process in relation to the terms in its current Permits, to determine if the issuance and approval process is in line with overall Port and City policies.</p>	<p>Lack of formalized policies and procedures precludes executive management and the Board from identifying opportunities to improve operations, more easily evaluating management and staff, and ensuring that internal controls are effective. The issuance of credit memos (invoices) is very complex, and the process and purpose of issuing credit memos is not readily discernable, making the evaluation of the efficiency and effectiveness of the credit memo process difficult.</p>
2	<p>Collections Section - The administration of accounts receivables and delinquent accounts collections is not performed utilizing approved policies and procedures. As a result, the final disposition of delinquent accounts is not very efficient.</p>	<p>The Port should develop, and/or update the existing Credit and Collection procedures and submit them to the Board of Commissioners for formal approval. It should enact specific procedures to ensure that all delinquent accounts are resolved, and action taken to collect or write-off. A timely decision on action to be taken should be made, based on an assessment of the likelihood of collection and the associated costs.</p>	<p>As evidenced by the dramatic rise in Bad Debt Allowance, the Port is not actively managing the administration of this process. The lack of direction and formal policies and procedures, leaves the unit without clear direction on resolving and concluding account issues.</p>

<p>3</p>	<p>Accounts Receivable Section – Financial Management Division- The methodology used to calculate the year-end true-up for Eagle Marine did not fully assess alternative approaches. Additionally, there is no documentation of the rationale for the calculation used to determine the credit.</p>	<p>Port management should: Set a policy of annual reviews of the year-end true ups that would include the year-end analysis/true-up, prior year freight volumes, and anticipated freight volumes and proposed billing rates for the coming year. Work with the Real Estate Division to move to a similar approach for billing rates for all terminals and that the approach be included in the revised permits. Set a policy where any transactions (debit or credit) above a certain threshold be presented to senior management for periodic review. And if deemed significant, subject to approval at specified levels.</p>	<p>There was a one-time credit to Eagle Marine of \$13.2 million. Arroyo noted several different approaches to determining the credit. One alternative analysis indicated a credit of only \$1.2 million. Since there were no clear guidelines, such as policies and procedures, the methodology used does not necessarily represent the approach that is in the best interest of the Port.</p>
<p>4</p>	<p>Cargo/Industrial Real Estate Division - The Everport Terminal Permit is written such that the Port will almost always issue a significant credit memo at the end of each calendar year.</p>	<p>Port should evaluate and restructure terms of Permit(s) to reduce, or eliminate the need for year-end credits. Review language in Permit and develop mechanism that does not result in on-going credit balances owed to the terminal operator(s). Utilizing a mid-year billing adjustment, which projects actual billing activity for a terminal operator and computes a “standard” billing rate for the balance of the year that approximates the true calculated billing rate based on the activity discount structure in the Permit. Change language in Permit to allow for using the calculated “efficiency rate” computed in the prior-year true-up analysis at the billing rate for the current year. It does not need to be tied to a specific Efficiency Table tier; as it is used only for costing each TEU billing.</p>	<p>The use of extremely complicated revenue structures increases the difficulty of determining proper revenues. Also, when combined with the lack of verification of activity, it further increases the risk of under-reporting of revenues.</p>

<p>5</p>	<p>Wharfingers Division- There is no independent, on-site, review of amounts and support for wharfing revenues related to container activity, and related accounts receivable invoicing. The Port relies on the reported container loading and unloading activity as provided by the terminal operators.</p>	<p>The Port should undertake a review of the process for the reporting of container activity by the terminals. It should attempt to identify other means of verifying the level of activity. This may involve a test of reasonableness based on the time a ship is in port, the use of historical data to verify activity for given routes, or the use of other external data to ascertain the level of activity. It may also perform “surprise” audits of ship loading and unloading activity. This would involve monitoring all loadings and un-loadings of containers for a particular ship docking. The objective here is to establish an atmosphere of unexpected inspections, which would help to influence the operators to be accurate and honest in their reporting of activity.</p>	<p>The City and Port’s policy on review and approval of transaction is inconsistent.</p> <p>While it audits such activities as revenues related to property rentals with revenue sharing,, the Port does not audit or verify its container shipping transactions, representing revenues of about \$340,000,000. Additionally, it audits all Port expenditures above \$5,000, A one percent under-reporting of container activity represents approximately \$3.4 million in lost revenue.</p>
<p>6</p>	<p>Information Technology Division- Processes for administering IT system controls for transaction processing and approvals are not clearly defined.</p>	<p>The Port should: Implement a more formal review of access to the system, including a complete review of all employees who have access and the functionality they require to do their work. Ensure that the Accounts Receivable Section and the Wharfingers Division are fully versed in the capabilities of the systems and require employees to enhance their system skills, including attending user conferences, on-line education and in-house training.</p>	<p>Inconsistent management of access to the information systems could result in unauthorized individuals, including terminated employees, initiating unapproved and harmful transactions.</p>

Process Audit Scope

The focus of the audit was the activities and functions of the Accounts Receivable Section, within the Accounting Division of the Finance and Administration Bureau.

Specifically, within the Revenue Cycle, the preparing and submitting of invoices, the recording of revenue, and the receipt of payment. The years reviewed were fiscal years 2014-2015, 2015-2016, and 2016-2017.

The preparation of invoices involves other units, primarily the Wharfinger Division. While this division was not included in the scope of this audit, the review and evaluation of the invoicing process necessitated that certain activities of the Wharfinger Division be reviewed. Our assessment was limited specifically to areas and activities directly related to interaction with the Accounts Receivable Section.

A review of the Wharfinger Division invoicing process was performed by another consultant. See Appendix I for a discussion on the results of that review.

Activities of the Port of Los Angeles

Port of Los Angeles – The Port of Los Angeles is a department of the City of Los Angeles. It operates primarily as a landlord. Its docks, wharves, transit sheds, and terminals are leased to shipping and/or terminal companies, agents, and to other private firms. Although the Port owns these facilities, it has no direct hand in managing the daily movement of cargo. In addition to major terminal operators, other tenants include marinas, fish markets, railroads, restaurants, and shipyards. In all, the Port is a landlord to close to 300 entities.

The major sources of income for the Port are from shipping services (wharfage, dockage, pilotage, assignment charges, etc.), land rentals, fees, concessions, and royalties. It currently serves approximately 80 shipping companies and agents with facilities that include 270 berthing facilities along 43 miles of waterfront.

Table 1 - Schedule of Revenues by Major Category for Fiscal Years 2016, 2015, 2014:

(\$000)	Fiscal Year Ending June 30					
	2016		2015		2014	
	Amount	% of Rev.	Amount	% of Rev.	Amount	% of Rev.
Shipping Services						
Wharfage	\$ 341,765	77.5%	\$ 336,090	75.2%	\$ 349,953	82.2%
Dockage and Demurrage	5,845	1.3%	6,426	1.4%	5,153	1.2%
Pilotage	7,064	1.6%	7,110	1.6%	7,540	1.8%
Assignments & Other Charges	13,796	3.1%	15,273	3.4%	14,567	3.4%
Total Shipping Services	\$ 368,470	83.5%	\$ 364,899	81.7%	\$ 377,213	88.6%
Rentals						
Land	\$ 45,763	10.4%	\$ 45,255	10.1%	\$ 38,189	9.0%
Other	808	0.2%	978	0.2%	1,967	0.5%
Total Rentals	\$ 46,571	10.6%	\$ 46,233	10.3%	\$ 40,156	9.4%
Royalties and Other Fees						
Fees, Concessions & Royalties	\$ 10,655	2.4%	\$ 14,968	3.3%	\$ 2,767	0.6%
Clean Truck Program Fees	2,384	0.5%	3,520	0.8%	2,119	0.5%
Other	13,169	3.0%	17,275	3.9%	3,696	0.9%
Total Royalties & Other Fees	\$ 26,208	5.9%	\$ 35,763	8.0%	\$ 8,582	2.0%
Total Operating Revenues	\$ 441,249	100.0%	\$ 446,895	100.0%	\$ 425,951	100.0%

Shipping Services

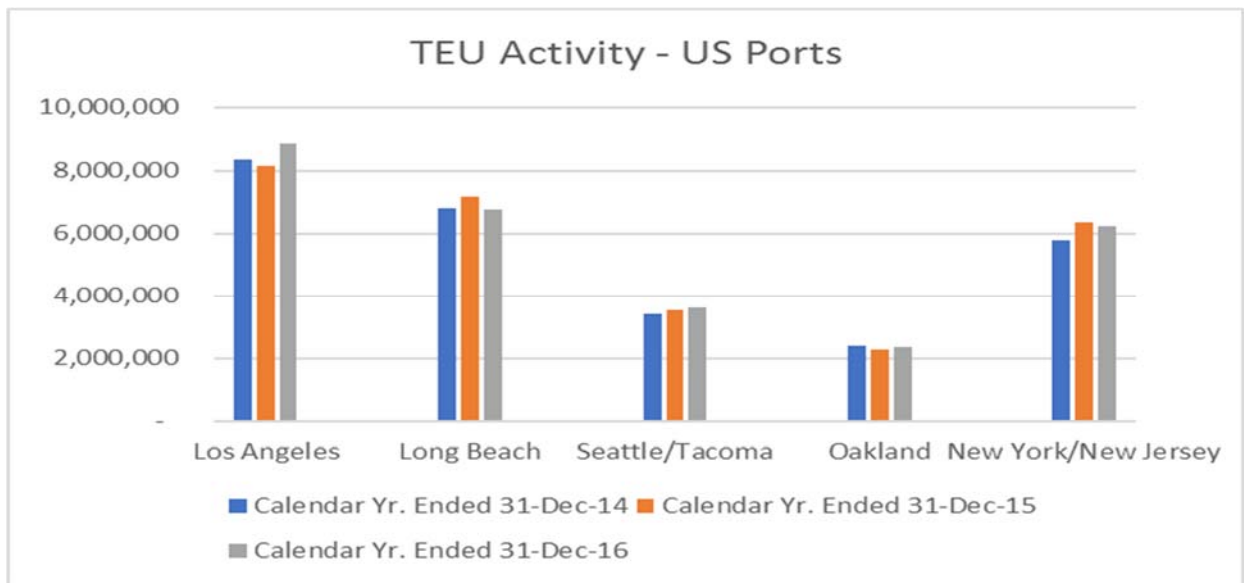
Wharfage Services - Wharfage fees are charged for the use of wharves or wharf premises and are assessed against inbound and outbound merchandise. The fees are based on either goods-based tariffs or twenty-foot-equivalent (TEU) containers.

Docking Services- Dockage are fees for being moored to a berth. Charges are for each 24-hour day or fraction of the day. The dockage is based on overall length of the vessel, per Tariff No. 4, Item [A] 480.

Pilotage Services - Pilotage fees are charged for vessels requiring a pilot to help navigate the harbor to dock at the Port. Fees are based on the overall length of the ship, the type of movement (e.g. entering, leaving, and inter-harbor or intra-harbor movements) and gross tonnage. There is a surcharge for each move requiring a POLA pilot, as well as miscellaneous fees, if needed.

The following graph shows container activity for the Port, and for the other major ports, for the last three calendar years.

Chart 1 - Port Container Activity for Fiscal Years 2014, 2015, 2016



Rentals

The Port generates revenues from various types of rental properties such as land, buildings, warehouses, wharves, and sheds. Independent appraisals are performed periodically to establish benchmark rates for these properties. Rates ultimately set in land rental agreements may be adjusted, within reason, to reflect general market conditions. Rates for other categories of properties are also set taking into account the condition, location, utility, and other aspects of the property.

Royalties and Other Fees

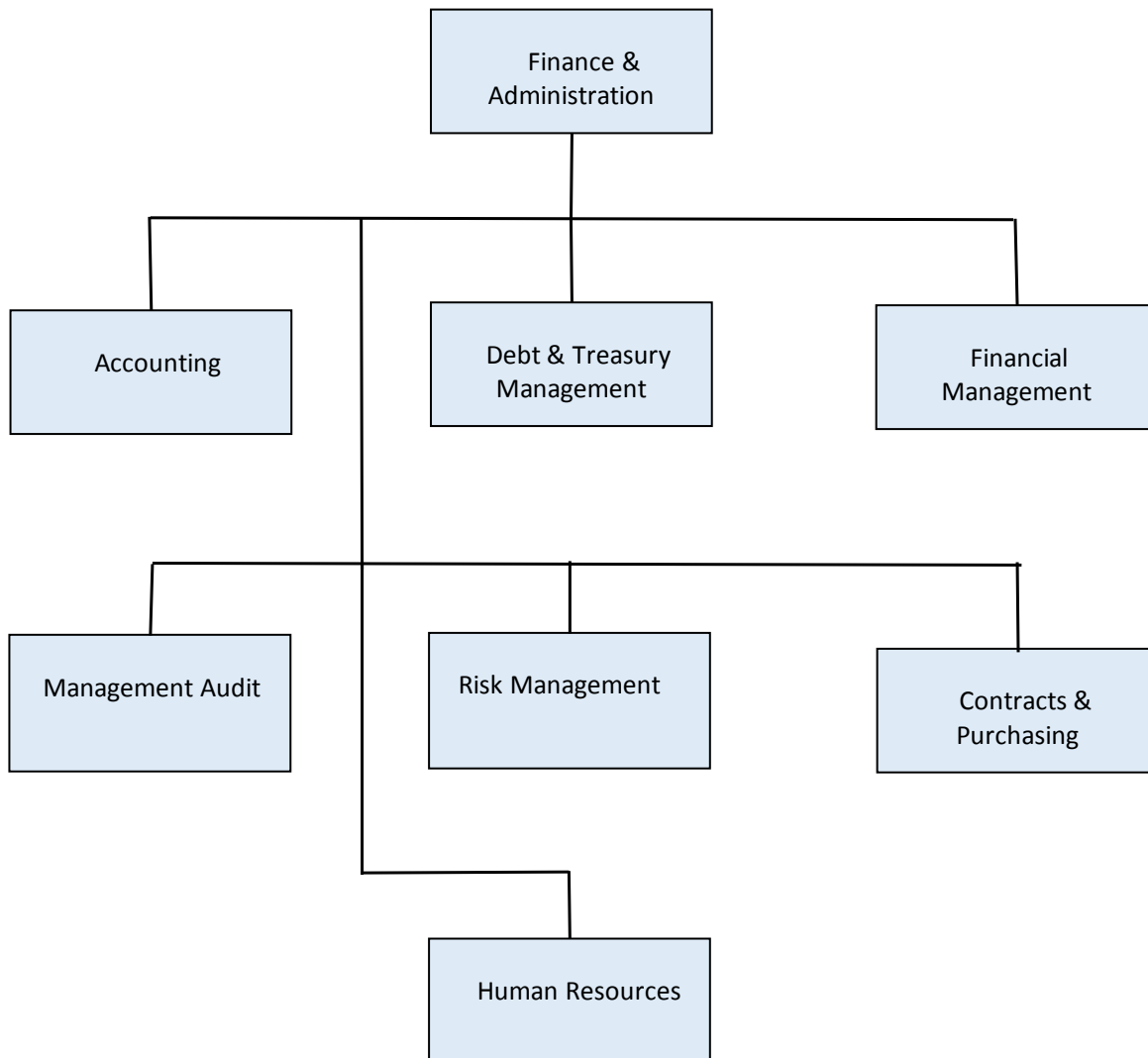
The Port levies fees for a variety of activities conducted on the Port properties. Examples include royalties from the production of oil and natural gas, fees for parking lots, motion picture productions, foreign trade zone operations, miscellaneous concessions, distribution of utilities, and maintenance and repair services conducted by the Port at the request of customers.

Description of Finance & Administration Activities:

Finance & Administration Bureau – The Finance & Administration Bureau is one of five bureaus within the Harbor Department. It is responsible for all financial, treasury and budget activities of the Port.

The Finance & Administration Bureau Organization Chart is as follows:

Chart 2 - Finance & Administration Bureau Organization Chart

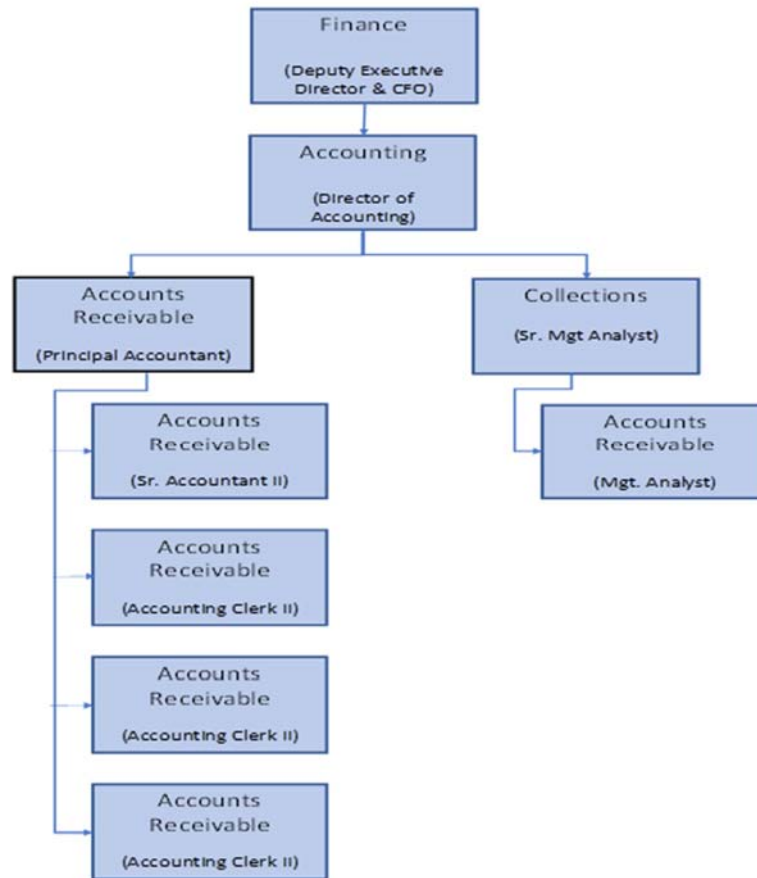


Accounting Division

Under the Finance & Administration Bureau, the Accounting Division includes Accounts Receivable; Collections; Payroll; and Budget.

Accounts Receivable Section – This section is responsible for processing and distribution of invoices to customers for services and facilities provided by the Port. In addition, it addresses billing adjustments and records payment data into the ERP system.

Chart 3 - Finance Bureau, Accounting Division, Accounts Receivable Section Organization Chart:



Invoice Processing:

Invoicing Process: The Port prepares shipping related invoices when the activity occurs. Invoices for non-shipping activities are typically prepared monthly, or as required by contract. Invoices must be prepared and presented to terminal operators within a specific time frame, as outlined in the permit agreement.

The high activity level for shipping results in a large number of invoices being prepared. Invoicing for shipping typically involves three to five invoices for each docking. The table below shows the number of total invoices (with credits shown separately) prepared for each of the last three fiscal years.

Table 2 - Accounts Receivable Unit – Summary of Invoices Prepared

**Port of Los Angeles
Accounts Receivable Review
Yearly Summary of Invoices Prepared**

	Invoices	Credit Invoices	Invoice Reversals	Total
FY 2014-2015 Total	22,961	812	588	24,361
FY 2015-2016 Total	22,410	373	572	23,355
FY 2016 -2017 Total	22,521	135	1,832	24,488
Three FY Total	67,892	1,320	2,992	72,204

Note: The large number of Invoice Reversals in FY 2016-2017 result from the conversion of billing for Eagle Marine Terminal from pricing under Tariff 4 to a per container billing method. To effect this change a large number of invoices, billed under the tariff method, had to be reversed, and rebilled using the container method.

Phase 1 – Risk Assessment

Overall Objectives: To evaluate the reasonableness, timeliness, and accuracy of all aspects of Port of Los Angeles billing, invoicing and collections processes.

Overall Scope and Methodology for Risk Assessment:

- Review of policies and procedures for department.
- Review of job descriptions of department staff.
- Interview department staff.
- Review accountings receivables aging for period of review.
- Review all other relevant reports, POLA documents, and other documents related to accounts receivable operations.
- Review relevant professional literature.
- Conduct a review of best practices.

Summary of Assessment Objectives:

1. Timeliness of Invoicing
Performance Audit Objective – Invoices for goods and services are accurately prepared, reviewed, recorded and presented to customers within a reasonable time.
2. Processing Delinquent Payments
Performance Audit Objective – Delinquent payments, including the timeliness and accuracy of determination are accurate and consistent in application.
3. Proper Processing of Invoices, Including Adequate Supporting Documentation
Performance Audit Objective – Invoices for goods and services are accurately prepared, and are properly supported and appropriately reviewed.
4. Proper Review of Accounts Receivables Balances, Including Timely and Accurate Reconciliations and Account Adjustments.
Performance Audit Objective – Recording of account receivables is accurate and timely, and properly reflect all adjustments.
5. Accounts Receivables Interaction with the Collections Staff
Performance Audit Objective – All procedures being performed in collection process. Support responses and documentation are accurate and timely.
6. Adequacy of Klein Billing System and Oracle ERP System
Performance Audit Objective – All processes in (1) the Klein Billing System and (2) the Oracle ERP System are being properly and effectively utilized. The systems have sufficient processing capabilities and features to meet the needs of the account Receivable department. Control and operating documentation is up-to-date and accurate.
7. Adequacy and effectiveness of Internal Accounting Controls

Performance Audit Objective – All processes in (1) the Klein Billing System and (2) the Oracle ERP System are being properly and effectively Utilized. The systems have sufficient processing capabilities and features to meet the needs of the account Receivable department. Control and operating documentation is up-to-date and accurate. See Appendix II for Detail Listing of Internal Controls.

8. Identify (evaluate) Staff Assignment and Assess Overall Span of Control.

Performance Audit Objective – All staff members are knowledgeable about duties, properly trained and properly supervised in their functions. There are timely and relevant performance appraisals conducted on all staff.

Audit Procedures Performed:

1. Timeliness of Invoicing

Procedures Performed – Reviewed all available policies and procedures. Selected sample of 60 invoices. Examined underlying support for accuracy and timeliness of preparation.

2. Processing Delinquent Payments

Procedures Performed – Reviewed all available policies and procedures and desk procedures. Requested and reviewed accounts receivables aging for accuracy and timeliness. Interviewed staff regarding responsibilities.

3. Proper Processing of Invoices, Including Adequate Supporting Documentation

Procedures Performed – Reviewed all available policies and procedures and desk procedures. From sample of 60 invoices, noted above, reviewed support for completeness and proper approvals.

4. Proper Review of Accounts Receivables Balances, Including Timely and Accurate Reconciliations and Account Adjustments.

Procedures Performed – Reviewed all available policies and procedures and desk procedures. Reviewed all reconciliation for periods under review. Verified properly prepared, reviewed and approved.

5. Accounts Receivables Interaction with the Collections Staff

Procedures Performed – Reviewed all available policies and procedures and desk procedures. Discussed organization structure and level of interaction between AR staff and Collections staff. Verified that activities are independent, except for processing of late fee invoices, and addressing issues related to delinquent accounts.

6. Adequacy of Klein Billing System and Oracle ERP System

Procedures Performed – Reviewed policies and procedures, if any. Reviewed all internal and external reports, noting if any IT issues identified. None noted. Prepared and submitted to IT department a questionnaire on system protocols and controls. Interviewed IT support staff; reviewed questionnaire responses, and discussed control maintenance procedures. Requested and received additional documentation on the transaction and approval matrix; inquired of process for review and verification of users of systems and user rights. Finding of incomplete documentation of users’ rights review and approval.

7. Adequacy and effectiveness of Internal Accounting Controls

Procedures Performed – Reviewed all available policies and procedures and desk procedures. Reviewed internal and external reports, noting if any internal control deficiencies were identified. None were noted.

8. Identify (evaluate) Staff Assignment and Assess Overall Span of Control.

Procedures Performed – Reviewed policies and procedures, if any. Interviewed staff regarding level of activity. Analyzed workflow variation relative to monthly activity.

Phase 2 – Audit Test-work

Overall Objectives: To evaluate the reasonableness, timeliness, and accuracy of all aspects of Port of Los Angeles revenue billings.

Overall Scope and Methodology:

- Review of policies and procedures for department.
- Review accountings receivables aging for period of review.
- Review all other relevant reports, POLA documents, and other documents related to accounts receivable operations.
- Review relevant professional literature.
- Conduct are review of best practices.

1. Timeliness of Invoicing –

Performance Audit Objective – Invoices for goods and services are accurately prepared, reviewed, recorded and presented to customers within a reasonable time.

Procedures Performed – Selected additional sample of 17 invoices, and perform test work of accuracy and timeliness of preparation. No exceptions noted.

2. Processing Delinquent Payments –

Performance Audit Objective – Delinquent payments, including the timeliness and accuracy of determination are accurate and consistent in application.

Procedures Performed– Selected a sample of 13 delinquent accounts and reviewed documentation on disposition. Verified that polices were followed for timeliness of preparation and ultimate disposition of account. Noted exceptions.

3. Proper Processing of Invoices, Including Adequate Supporting Documentation –

Performance Audit Objective – Invoices for goods and services are accurately prepared, and are properly supported and appropriately reviewed.

Procedures Performed – Selected additional sample of 17 invoices, reviewed for accuracy and timeliness of preparation, evidence of approval, and adequate support.

4. Proper Review of Accounts Receivables Balances, Including Timely and Accurate Reconciliations and Account Adjustments.

Performance Audit Objective – Recording of account receivables is accurate and timely, and properly reflect all adjustments.

Procedures Performed– Reviewed all reconciliation for periods under review. Verified properly prepared, reviewed and approved.

5. Accounts Receivables Administration by the Collections Staff -

Performance Audit Objective – All procedures being performed in collection process. Support responses and documentation are accurate and timely.

Procedures Performed– For selected accounts, reviewed credit files noting evidence of collection effort activity; delinquent notices, point of determination of uncollectible, to ultimate disposition (write-off, or assignment to collection agency). Evaluated timeliness of reporting of delinquent accounts to senior management, via Red Flag Report and/or Accounts Receivable Dashboard. Sought to identify issues of missing documents, incomplete files, and overall organization. Exceptions noted.

6. Adequacy of Klein Billing System and Oracle ERP System -

Performance Audit Objective – All processes in (1) the Klein Billing System and (2) the Oracle ERP System are being properly and effectively Utilized. The systems have sufficient processing capabilities and features to meet the needs of the account Receivable department. Control and operating documentation is up-to-date and accurate.

Procedures Performed – Reviewed with IT personnel system protocols for authorizations and approvals of transactions. Documented general structure. Exceptions noted.

7. Adequacy and Effectiveness of Internal Accounting Controls -

Performance Audit Objective – Key processes in (1) the Klein Billing System and (2) the Oracle ERP System are being properly and effectively Utilized. The systems have sufficient processing capabilities and features to meet the needs of the account Receivable department. Control and operating documentation is up-to-date and accurate.

Procedures Performed – Reviewed with IT personnel system protocols for authorizations and approvals of transactions. Documented general structure, and exceptions noted.

8. Identify (evaluate) Staff Assignment and Assess Overall Span of Control.

Performance Audit Objective – All staff members are knowledgeable about duties, properly trained and properly supervised in their functions. There are timely and relevant performance appraisals conducted on all staff.

Procedures Performed – Inquired of Staff of issues related to work delays, or processing concerns. Cross reference test work on invoice processing, noting invoice dates relative to required mailing date, and/or due date (for invoices due at beginning of month).

Process Review – Areas/Activities

Preparation and Processing of Invoices

The preparation of invoices falls into two categories, invoices originated by the Wharfinger Division of the Port, and the remainder prepared by the Accounts Receivable Section. This includes recurring rentals, of both berths for fishing and pleasure boats and cruise ships, and retail properties, as well as other income such as royalties and fees.

Processing of Credit and Adjustments and Credit Memos

Two processes generate credit memos: ongoing adjustments to shipping invoices and year-end true ups to adjust billed traffic to contractually agreed upon volume based rates at the end of the year.

For adjustments related to shipping activity either the Wharfinger Division or the Accounts Receivable Section (of the Finance & Administration Division) will initiate an adjustment. Adjustments related to incorrectly reported shipping (loading or unloading) activity are initiated by the Wharfinger Division. Adjustments related to changes in billing rates or adjustments for volume discounts for wharfage activity are initiated by the Accounts Receivable Section. The Financial Management Division typically does not review these credit memos.

Credit memos can also be generated at year-end true ups when yearly traffic that has been billed by a previously agreed upon interim billing rate is compared to the contractual rate based on volume. Either an additional invoice or credit invoice is generated depending on whether the billing rate was greater or less than the yearly volume would warrant. The year-end true up is calculated by AR but is independently reviewed by Financial Management Division.

In addition, occasional ad-hoc reviews are done as necessary. The most recent example was to evaluate the one-time adjustment resulting from the change in billing method for the Eagle Marine terminal operator. In April, 2016 the permit with Eagle Marine was amended to provide for billing of wharfage activity on a container (TEU-rate) from the traditional tariff rate (which charge based on type of cargo and weight).

The work performed addressed two aspects. First, Arroyo looked at the credit memos issued by the Port to Eagle Marine Terminal (“Eagle”) related to the change in billing from a Tariff based structure, to a per container, TEU costing structure. While the credit memo was computed as part of the annual year-end true-up process, it differed from the typical in that the conversion to per container pricing occurred mid-year. As such the computation of the year-end credit was done using both costing structures. Our review of the Permit and amendments led us to conclude that there was no definitive language in the Permit on how to address costing using any efficiency discounts when there is a change in pricing structure. Arroyo reviewed the analysis performed by the Accounts Receivable Section (which was reviewed by the Financial Management Division). We could find no other documentation which provided a basis as to why this approach was used, or indicating that any other methodology was considered. We then endeavored to identify and

create alternative billing approaches which could be used to calculate the annual revenues due from Eagle, for comparison purposes.

The second review activity was to look at a select number of terminals over the years within the scope of the audit. Identified were three terminals, Eagle (which had previously been partially reviewed), Everport, and APM. This review procedure involved obtaining the year-end true-up analyses prepared in support of the credit memos (or additional invoices) to adjust billings to the actual cost, based on activity level. We then verified that the calculations were in accordance with the respective permits, and were mathematically correct. We respect to these other two terminals, we found no errors in the calculation of the credits.

The test work performed related to credit memo issuance was to focus on those items determined to be part of the year-end true-up process. This was driven by the large credit memos resulting from the Eagle Marine conversion to container unit pricing. The review of this analysis by the Management Audit Division highlighted that there were other significant credit memos being issued by the Accounts Receivable Section. This resulted in this audit team reviewing the activity and true-up process of the additional terminals. These were selected on a judgmental basis after reviewing credit memo activity of the years under review.

Our review highlighted that there were a significant number of credit memos issued outside the year-end true-up process. No specific test work was performed related to these types of credit memo. (It should be noted that credit memos were a component of the accounts receivable invoice testing performed related to internal controls of the division.) One observation, and factor as disclosed by the Accounts Receivable Section, was that a significant portion of the other credit memos were the result of the change in Eagle's pricing structure. For all invoices issued based on the Tariff structure, which should have been billed using the container structure, the initial invoices were reversed (via credit memo) and new invoices issued. No test work has been performed to determine the accuracy or completeness of this billing adjustment process.

Cash Receipts and Posting to Accounts Receivable in Oracle

The cash receipts process and posting to accounts receivable utilizes electronic data files for processing. Cash receipts are via a lockbox with the Port's bank. Payments received by the bank are received and credited to the Port's account, and an electronic payment report is generated. The A/R staff accesses the bank account remotely, on a daily basis, and downloads the activity into the ORACLE system. The accounting clerk then posts payments to customer accounts. Any discrepancies are investigated and resolved, e.g. missing customer account number.

No detailed test work was performed, as the controls in place result in minimal risk of the misappropriation of cash. Specifically, the use of the lockbox system, and the monthly reconciliation of bank activity to payments posted in ORACLE.

Collection Process – Delinquent Accounts

Within the Accounting Division, the Delinquent Accounts and Credit Collections Section administers efforts to collect on delinquent accounts. This unit is responsible for the credit review process on new customer, the review and evaluation of unpaid invoices, the transmission of late payment notices, the administration of the credit review committee of the Port, and the administration and monitoring of accounts sent to outside agencies or to attorneys for legal action.

The Port does have in place Board resolutions pertaining to the administration of delinquent accounts. There is also a procedures manual which is used by the unit. It is an older draft of an Accounting Policies and Procedures manual developed by the Port, but never formally adopted

Uncollectable accounts are presented in a “Red Flag” report, to the Credit Committee of the Port that is comprised of the Chief Financial Officer, senior staff from the Real Estate Division and the Director of the Wharfing Division.

The Committee typically meets every other month to review the status of uncollectible accounts, to make a determination on the course of action on newly identified problem accounts (defined as more than 90 days past due).

Table 2- Accounts Receivable, Allowance for Doubtful Accounts and Net Receivables for Fiscal Years Ended June 30, 2014, 2015, 2016, and 2017.

	<u>FYE 2014</u>	<u>%</u>	<u>FYE 2015</u>	<u>%</u>	<u>FYE 2016</u>	<u>%</u>	<u>FYE 2017 *</u>	<u>%</u>
Accounts Receivables @ 6/30	\$ 46,752	100.0%	\$ 57,515	100.0%	\$ 62,719	100.0%	\$ 55,573	100.0%
Allowance for Doubtful Accounts	3,469	7.4%	13,752	23.9%	20,493	32.7%	26,403	47.5%
Net Accounts Receivables	<u>43,283</u>	<u>92.6%</u>	<u>43,763</u>	<u>76.1%</u>	<u>42,226</u>	<u>67.3%</u>	<u>29,170</u>	<u>52.5%</u>
Revenues	<u>425,951</u>		<u>446,895</u>		<u>441,249</u>		<u>449,338</u>	
Net A/R as a % of Revenues	10.2%		9.8%		9.6%		6.5%	

Table 3- Accounts Receivable, Allowance for Doubtful Accounts and Net Receivables for Fiscal Years Ended June 30, 2014, 2015, 2016, and 2017, Adjusted for BNSF account.

	FYE 2014	%	FYE 2015	%	FYE 2016	%	FYE 2017 *	%
Accounts Receivables @ 6/30	\$ 46,752	100.0%	\$ 46,615	100.0%	\$ 45,619	100.0%	\$ 32,073	100.0%
Allowance for Doubtful Accounts	3,469	7.4%	2,852	6.1%	3,393	7.4%	2,903	9.1%
Net Accounts Receivables	43,283	92.6%	43,763	93.9%	42,226	92.6%	29,170	90.9%
Revenues	425,951		446,895		441,249		449,338	
Net A/R as a % of Revenues	10.2%		9.8%		9.6%		6.5%	

It appears that no accounts identified as uncollectible have been removed from the accounts receivable balance. The allowance for uncollectible accounts has been properly increased for estimated write-offs, but no accounts have been written off for two or more years. As you can see from the Table 2 above, gross receivables have remained relatively level, but net accounts receivables have gone down. Conversely, the allowance for doubtful accounts has grown significantly over the last three years, from 7.4% of gross accounts receivable to 47.5%.

Based on discussions with the Director of Finance, and the Collections section staff, there is a single account that materially impacts the gross receivables and allowance for doubtful accounts balances of the Port. Included in the gross balance, and fully reserved in the allowance is a receivable from BNSF railroad in the amount of 23.5 million at June 30, 2017. Per Finance, this account is frozen due to an on-going lawsuit. As such, it is represented that the related amount should be excluded from any analysis of the trend in the allowance for uncollectible accounts. To that end, also presented in Table 3 is the receivables, allowance, and net receivable balances excluding the BNSF receivable. Arroyo did not review and evaluate the treatment of this account, and as such cannot assess the proper treatment of the receivable. It should be noted, however, that the balance in this account has grown in each of the last three years.

The cause of the ineffective management of the delinquent accounts is (1) an understaffing in the Collections Section, (2) lack of clear policies and procedures on the delinquent process, and (3) little or no delegation of authority to staff to effectively remove smaller uncollectable accounts.

Review of IT System Controls over AR Process

Arroyo reviewed the support given to Accounts Receivables by Information Technology (IT). This review was necessarily at a high level both because it is incidental to the primary scope of the engagement and the lack of technical expertise that would be necessary to do a thorough review of IT.

Klein Billing System

Review and evaluate the effectiveness of the billing process through the KleinPort billing system. Assess whether the internal controls are effective, whether data processed is accurate, and that activity is processed in a timely fashion. The KleinPort software system (owned by Saab) is a dedicated port management system used by many ports in North America and internationally. The system handles all billing activities, including shipping and related cargo; property rental and restaurant rents and percentage sales; miscellaneous revenues, including permits, land leases, concessions, etc.

ORACLE – ERP

Review and evaluate the effectiveness of (1) the accounts receivable processing and reporting of revenues, and (2) the processing and reporting of payments through the ORACLE ERP system. Assess whether the internal controls are effective, whether data processed is accurate, and that activity is processed in a timely fashion. The ORACLE ERP system is an enterprise platform providing all financial processes.

The acronym ERP stands for enterprise resource planning. It refers to the systems and software packages used by organizations to manage day-to-day business activities, such as accounting, procurement, project management and manufacturing. ERP systems tie together and define a plethora of business processes and enable the flow of data between them. By collecting an organization's shared transactional data from multiple sources, ERP systems eliminate data duplication and provide data integrity via a single source.

Approach

Arroyo interviewed IT (Cynthia Ung, Information System Manager) reviewed a questionnaire focusing on the Accounts Receivable function and more generally to the accounting systems as a whole. There were also follow-up conversations and email exchanges about areas of concern.

Results

The Port's customers are managed on a day-to-day basis by the Wharfingers division which uses an off-the-shelf system, KleinPort, to manage billings. Upon approval of invoices by Wharfingers, the Accounts Receivable function then reviews and approves the billings in KleinPort. The invoices are then transferred overnight from KleinPort to the Oracle Accounts Receivable module

by a custom developed interface. Cash receipts are then posted against the billings within Oracle. Penalty invoices created by Oracle are also posted to KleinPort nightly.

The Port does not necessarily use the most recent version of either system, instead, analyzing the cost of the upgrade to its anticipated benefits. IT does ensure that the current versions are maintained by the vendors.

IT is unaware of unused capabilities within either system and suggested contacting the the “superusers” within the operating departments.

The systems are backed up nightly and there is an off-site, online emergency recovery backup on a large and widely used system, Barracuda.

All new users and existing employees that take on additional responsibilities in Oracle are approved by the Bureau Head (Frank Liu). (Division Head in Wharfingers approves for KleinPort.) Access is reviewed every year by Finance, however, the most recent report Arroyo received only showed employees, divisions, user ID and job class. There were no functionality listed. It appears from the correspondence that the only changes were for some terminated employees still active in the system. There were three generic names (PortPilots, FishboatPayments, and AcctgFundCk) active in the system.

According to IT, terminated employees are denied access to the Port’s network on termination but some employees are kept on the system as “inactive” employees for three to six months to ensure that existing transactions are completed.

Reports have been created in Crystal Reports. IT reported that most employees rely on IT to develop the reports instead of learning Crystal.

Supervisors can approve transactions remotely using email functionality, but cannot Add/Delete/Modify transactions remotely. IT developers also have access to the developmental domain.

Findings and Recommendations:

FINDING 1. Accounts Receivable Section does not have formal, written policies and procedures.

Criteria: The City of Los Angeles has established guidelines for the accounting function, including accounts receivable.

In addition, the Government Financial Officers' Association has developed Best Practice guidelines for preparing Accounting Policies and Procedures Documentation¹. Specific guidelines include:

- Agency should document its accounting policies and procedures. This typically takes the form of a manual.
- It should be implemented and administered by an appropriate level of management.
- Should be periodically reviewed (not less than every three years).
- Additional recommendations:
 - Should be readily available to all employees.
 - Should delineate the authority and responsibility of all employees.
 - Should indicate which employees are to perform which procedures.
 - Procedures should be described as they are actually performed.
 - Documentation of accounting policies and procedures should explain the design and purpose of control-related procedures.

The Port of Los Angeles has specific policies on the disbursement of checks, and the issuance of refunds. There is no policy on how credit memos (accounts receivable adjustments) are to be administered. Given that credit memos issued can be a significant amount, that terminals utilize the credits against future billings, the impact on revenues and cashflow in the succeeding year can be substantial. This information appears to be maintained within the Accounting Division, and not communicated to senior management or the Board.

Cause: While the Accounts Receivable Section has both (1) draft policies and procedures which have been informally adopted by staff for operating purposes, and (2) individual “desk” procedures created by staff to support them in the day-to-day processing of work, there is no written accounting manual which incorporates all the required accounting policies and

¹ Government Financial Officers Association – Policies and Procedures Documentation, August 3, 2017.

procedures in a single document. Additionally, such a document should be reviewed and approved by the Board of Commissioners.

The Accounting Division has undergone a major system upgrade, implementing an ERP (ORACLE) system. The division has not addressed, timely, the development and documentation of policies and procedures needed to operate in the new ERP environment.

Effect: The lack of comprehensive, written accounting policies and procedures can result in errors in, and ineffective controls of, accounting data. Staff turn-over, extended vacations or illness, or new, untrained employees can result in improper processing of accounting data, and errors. Additionally, the documentation of accounting policies and procedures allows for management, and other responsible parties, to evaluate the accuracy, integrity, and control environment of accounting data.

The procedures for performing year-end true-ups of annual billings to the adjusted revenues appears clearly understood by staff in the Accounts Receivable Section. These true-up adjustments are based on the terms of the various Permits with the terminal operators. They include adjustments for volume discounts, empty container discounts, and inter-terminal transfer discounts. The lack of written policies and procedures regarding these activities, however, has resulted in confusion by management and the Board as to the true financial impact on the Port. And any opportunity to assess the efficiency and effectiveness of the procedures is impaired by such procedures not being in writing.

Recommendation: We recommend that the Port develop policies and procedures that would set the guidelines for recording of transactions to the general and all subsidiary ledgers. In addition, the Port should consider creating or updating its Accounting Manual to include the aforementioned policies and procedures plus the following components;

- Description of functions performed by each staff position;
- Specific duties and responsibilities (desk procedures);
- Minimum required qualifications or standards;
- Port Board/management approved policies relating to specific transactions;
- Procedures for processing of specific financial activities; and
- Appropriate monitoring and review controls.

FINDING 2. The administration of accounts receivables and delinquent accounts collections is not performed utilizing approved policies and procedures.

As a result, the final disposition of delinquent accounts is not very efficient. Decisions to write-off accounts require Board approval, even for small balances. The oversight process for managing delinquent accounts is not formalized, and does not appear to be a priority.

The Port's management of its delinquent accounts receivable has not been timely. The FY 2017 balance of the allowance for uncollectable accounts is 47.5% of the gross accounts receivable balance. This compares to a percentage of 7.4% at June 30, 2014. The administration of delinquent accounts is handled by the Collections Section, part of the Accounting Division. There appears to be (1) insufficient policies and procedures in place relative to the handling of delinquent accounts, and (2) the limited policies authorized by the Board do not appear to be utilized by unit.

Over the three-year period of this review, no evidence was found that delinquent accounts have been written off. While there were meeting by the credit review committee, the "Red Flag" committee, and certain actions taken on certain accounts, there are a significant number of accounts that have not been resolved. Per the senior staff for the Collections unit, a resolution was drafted in January 2015 to recommend the writing-off of uncollectible accounts. To date, no action has yet been taken to have this resolution submitted and approved by the Board.

Criteria: Specific written policies and procedures for the Credit and Collection process were not provided. Per the senior staff in the Collections Section, previously drafted, but unapproved procedures were being utilized. In addition, there are two resolutions in effect related to credit administration. The first, Resolution No. 5400, provides direction and limits on the settlement of claims and litigation against the Port. It establishes the authority of the City Attorney to settle claims against the Port and/or the City up to \$50,000, without approval of the Board of Commissioners. Section 4 specifically address the resolution of uncollectible accounts receivable. The second resolution, Resolution No. 5402, authorizes the Chief Financial Officer (CFO) of the Harbor Department, or his designee, to compromise and write off uncollectible accounts receivable. The resolution allows the CFO to write-off accounts up to \$10,000, when such account is (1) over 90 days delinquent, and (2) has not been referred to the City Attorney. It also states that the Director of Finance & Administration Bureau and the Credit Manager are designated to exercise the authority of the resolution at the direction of the CFO. The resolution also requires the Chief Executive Officer to submit a report quarterly on all compromises and write-offs.

Cause: There are no formal and approved Policies and Procedures in place regarding the administration and processing of delinquent accounts receivables. There are Board Resolutions in place for certain authorization limits for negotiating, assigning to collections agency, initiating litigation, or writing account off. The charge-off of small dollar amount delinquent accounts does not occur in a consistent or timely fashion. With respect to large dollar delinquent accounts, it appears that each situation is handled differently, without clear guidance on a timely and cost-effective collection or settlement solution.

The primary factor in the less-than-effective administration of the accounts receivable collection process is the lack of formal, written policies and procedures. This has been exacerbated by what was a reduction in staffing of the unit. Up until recently, there was only one individual in the unit. Additionally, without clear procedures, it appears that third parties involved in the collections process were unclear on the priority of these activities. These issues combined to result in a situation where action was slow to be taken, and possibly, where there was insufficient communication with the Board.

Lastly, the Port maintains on its books, and continues to record revenue with respect to one customer, BNSF Railroad. The Port identified this as a unique situation, linked to a lawsuit. Arroyo was not provided with, and as such did not evaluate, documentation on the treatment of the accounts, and whether it should be included in evaluating the overall balance in accounts receivable. The balances presented in the CAFR included both the receivable and associated allowance for doubtful accounts.

Effect: The inconsistent and less than timely management of uncollectible accounts creates un-necessary work for the Collection staff to maintain records on inactive accounts. In addition, it may affect the effectiveness of the Red Flag committee. It is acknowledged that there is no financial impact to the delays in resolving, as the allowance for uncollectible accounts appears to capture to proper amount of delinquent accounts. As noted above, however, the magnitude of the uncollectible balance is disproportionate to the total receivables outstanding. And is inconsistent with the historical percentage of the Port. It was also noted that it is higher than the percentage of other comparable port operators.

Recommendation: The Port should develop, and/or update the existing Credit and Collection procedures and submit them to the Board of Commissioners for formal approval. It should enact specific procedures to ensure that all delinquent accounts are resolved, and action taken to collect or write-off. A timely decision on action to be taken should be made, based on an assessment of the likelihood of collection and the associated costs.

Actions on recommendations to the Board should be submitted in a timely fashion. Accounts deemed to be uncollectible should be written off as soon as practical. Where authority for taking

action has been delegated, there should be clear procedures in place to allow for the efficient and timely resolution to uncollectible accounts.

FINDING 3. The methodology used to calculate the year-end true-up for Eagle Marine did not fully assess alternative approaches to the calculation.

Additionally, there is no documentation of the rationale for the calculation used to determine the credit. In FY 2016, the permit for Eagle Marine Services wharfage charge methodology was renegotiated to both bring it in line with the other terminal operators in the Port and to simplify the processing of the invoices.

In the prior permit wharfage charges were based on the tariffs of the specific contents of the containers; the new permit is based on a fixed rate per twenty-foot equivalent (TEU) container. Since both permits had volume discounts based on yearly efficiency and volume benchmarks, it was necessary to do a year-end “true-up”, or analysis, to determine the exact amount owed by the terminal. The difference between what was owed, and the year-to-date payments, created either an additional invoice to the terminal or a credit to Eagle.

It is acknowledged that within in the Accounts Receivable Section and the Financial Management Division a review was made of the Permit at the time of the analysis. It was stated, that while the Permit is silent on the approach to use for the mid-year change in methodology, the proration concept is discussed with respect to the “first year” calculation of any discounts.

Criteria: The “true-up” process is based on the language in the Permit. Annual billing “true-ups” are done every year to reconcile the actual activity to the correct “efficiency-level” costs, and calculate the required revenues per the permit. These “true-ups” are considered to be a normal operating procedure and, therefore, not subject to reviewed by senior management. The typical process is for (1) Accounts Receivable (AR) to calculate the true-up adjustment to annual revenues, and (2) Financial Management (FM) to independently verify the calculation. This ensures both internal control and that the permit is followed.

In FY 2016 an analysis was unique in that it covered both the old and new permit and resulted in a credit of \$13.2 million.

Cause: In advance of the change in billing methodology, the Financial Management group performed an analysis on the activity level and revenues from Eagle Marine over the previous five years. It attempted to derive an equivalent TEU rate, based on historical container activity, that would have resulted in comparable revenues to the income generated using the tariff method. The analysis concluded that converting from a tariff based system to a TEU based system would be “revenue neutral” at a rate (based on historical volume) of \$40 per TEU.

The Eagle Marine permit did not address how the true-up is to be calculated under the unique circumstance of a mid-year changeover. Nor, based on our inquiries, was there any direction from Real Estate, Eagle Marine nor Port Management. Typically, terminal permits are based on calendar-year revenues, and any associated discounts are tied to total year activity. Again, Eagle Marines' permit was silent on any type of mid-year change in billing methodology. Additionally, the decision to enact a mid-year change, versus at the end of a calendar year, was not discussed or supported. It thus appears that an appropriate, but very favorable approach for Eagle, was chosen without consideration of alternative approaches.

Arroyo consultants initially interviewed Darian Chin and Mike Russell of Financial Management, Damian Young, Interim Director of Wharfingers, Pious Poozhikala of Management Audit, and Sumita Thappa of Real Estate on the history and construction of the Eagle Marine true-up that resulted in the \$13.2 million credit.

As part of the review, Arroyo reconstructed the \$13.2 million credit that pro-rated the annual benchmarks and then calculated the credit using the annual benchmarks (i.e., not pro-rated). Arroyo then did four other alternative analyses using different assumptions to set theoretical limits (e.g., what would the debit/credit be if the entire year had been done under tariffs or TEUs).

Effect: To summarize, Arroyo calculated the debit/credit amounts based on:

- Pro-rating the annual benchmarks \$13.2 million credit
- Not pro-rating the annual benchmarks 1.2 million credit
- Annualizing Tariffs (two versions) 5.6 to 10.0 million credit
- Annualizing TEUs (two versions) 24.1 to 30.2 million credit

Arroyo relied on an analysis done by the Financial Management unit for the negotiation that concluded that the change over from a tariff based system to a TEU based system was “revenue neutral” at approximately \$40 per TEU. However, the above analysis suggests that either (1) using the derived \$40/TEU as an equivalent revenue rate compared to historical tariff revenues is incorrect, or (2) the way that the efficiency levels (activity) and discounted rates were derived for container revenues are inconsistent with the method for discounting tariff revenues is not revenue neutral.

Recommendation:

Arroyo recommends that Port management:

- Set a policy of annual reviews of the year-end “true ups” that would include the year-end analysis/true-up, prior year freight volumes, and anticipated freight volumes, to calculate a billing rate for the coming year, which minimizes the amount of underpayments, or overpayments (credits).

- Work with the Real Estate Division to move to a similar approach for billing rates for all terminals and that the approach be included in the revised permits.
- Set a policy where any transactions (debit or credit) above a certain threshold be presented to Senior management for periodic review. And if deemed significant, subject to approval at specified levels.

FINDING 4. The Everport Terminal Permit is written such that the Port will almost always issue a significant credit memo at the end of each calendar year.

With respect to Everport Terminal Permit (Everport) (and other terminals), and the calculation of the billing rate for succeeding year, the accounting division states that the rate must be the efficiency bracket which is closest, and higher than, the calculated “efficiency rate.” The way that the efficiency brackets are developed usually has a large gap between the activity below 5,000 TEUs per acre and the next level. In the case of Everport, the rate at the 4,000 to 4,999 tier is \$46.56 per TEU. The next level, 5,000 and above, drops to \$35.85 per TEU. Given that the computation of the efficiency rate is an average of the two rates, historically the rate has fallen between the two steps. For the 2016 calculation, the efficiency rate was \$43.85. This being the case, the “equivalent” bracket utilized in the next year billings will be the higher rate closer to the actual efficiency rate. The impact of this is that, absent a decline in volume, the true-up revenues (based on the calculated efficiency rate) for the next will be less than the actual billings. The consequence is that there will always be an over-payment, resulting in a billing credit.

Criteria: The basis for the calculation of the various rates and credits related to container handling is contained in the Permit (contract) for the terminal. These permits tend to be long-term agreements, and are very complex in the requirements and pricing of services to the terminals. The permits are created and negotiated by the Real Estate department. Each permit for the eight (8) container terminals is different. Not only are the specific rates applied to activity different, the formulas are all different.

Cause: It appears that the structure of the permits is to create a billing structure where the terminals overpay during the year, then receive a significant credit at the end of the year. One could assume that this is a positive strategy for the Port, as it is able to use of the terminal’s funds for a significant portion of the year. No information on the actual net benefit on this strategy was provided. Additionally, Arroyo understands that the large credit amount generated at year end is applied to invoices for services in the following year. This, then, results in a large decrease in cash revenues in the first quarter of the following calendar year.

Effect: While from a revenue and cash-flow perspective, the billing methodology does not have an impact on the Port, year over year, it does entail a significant amount of time and

effort to administer the billing and invoicing process. In particular, the effort to compile data and compute the annual year-end adjustment involves significant time and effort of the Port staff.

Recommendation: Port should evaluate and restructure terms of Permit(s) to reduce, or eliminate the need for year-end credits. Review language in Permit and develop mechanism that does not result in on-going credit balances owed to the terminal operator(s).

Utilize a mid-year billing adjustment, which projects actual billing activity for a terminal operator and computes a “standard” billing rate for the balance of the year that approximates the true calculated billing rate based on the activity discount structure in the Permit.

Change language in Permit to allow for using the calculated “efficiency rate” computed in the prior-year true-up analysis at the billing rate for the current year. It does not need to be tied to a specific Efficiency Table tier; as it is used only for costing each TEU billing.

FINDING 5. There is no independent, on-site, review of amounts and support for wharfing revenues related to container activity, and related accounts receivable invoicing.

The Port relies on the reported container loading and unloading activity as provided by the terminal operators. While the terminal operators submit two different documents with respect to a particular containership inbound and outbound activity, it is essentially the same information. There is no independent verification of the activity by either the Port or any other third party.

Criteria: Best practices would dictate that the activity of a customer which is the basis of billing for revenues of an entity should be verified, either by the entity, or independently. Verification of quantities and types of goods or services is essential to accurate revenues, and a key element of internal control.

Cause: The Port, currently, has no means of verifying the loading and unloading of containers from ships docking at the terminals. Given the high level of activity, the number of ships, and the volume of containers being move, there is currently no technology available to the Port which can track the movement of containers. Additionally, the Port does not have the manpower to visually track and count containers going through the seven terminals.

Effect: The potential exists for the number of containers loaded and unloaded at the terminals by the operators to be incorrect. Either errors could occur, or intentional underreport could take place, resulting in the Port losing revenues.

Recommendation: The Port should undertake a review of the process for the reporting of container activity by the terminals. It should attempt to identify other means of verifying the

level of activity. This may involve a test of reasonableness based on the time a ship is in port, the use of historical data to verify activity for given routes, or the use of other external data to ascertain the level of activity. It may also perform “surprise” audits of ship loading and unloading activity. This would involve monitoring all loadings and un-loadings of containers for a particular ship docking. The objective here is to establish an atmosphere of unexpected inspections, which would help to influence the operators to be accurate and honest in their reporting of activity.

FINDING 6. Processes for administering IT system controls for transaction processing and approvals are not clearly defined.

There are two major areas of concern:

Access and Authorization – The two systems, KleinPort billing system and ORACLE, are reviewed annually by Wharfingers and Finance, respectively. No documentation was provided on the procedures for the approval of access and the verification of transaction authorizations. While a yearly review of the system is documented, the information supplied to Arroyo on the review process does not include a detailed matrix of transaction rights at all functional levels. Additionally, it is unclear if there is a periodic review of all authorities for users by the appropriate manager(s).

Ownership of Systems – The Finance Bureau often relies on IT to generate reports even though many Finance users have access to Crystal Reports and can generate their own reports. In addition, Finance (and Wharfingers) look to IT to in assessing new and/or required system functionality and upgrades.

Criteria: The development of the IT infrastructure, upon which almost all businesses are reliant on, has been supported by numerous structural and operational guidances. These guidances provide IT managers and organizations key standards on administering an IT environment. As IT was not the focus of this audit, an in-depth review of the operating structure and related internal controls was not performed. But there are several industry best practice protocols which the Port can utilize to establish its IT infrastructure. Two examples are the Control Objectives for Information and Related Technology (COBIT) framework, administered by the IT Governance Institute, and the Information Technology Infrastructure Library (ITIL), administered by the British Office of Government Commerce (OGC).

Cause: Arroyo did not request nor reviewed any policies and procedures regarding the IT Division’s administration of IT controls. We understand that while IT complies with ISO (International Organization for Standardization) requirements, we are unaware of any Board approved policies and procedures. Again, an in-depth review of IT policies and procedures is outside the scope of this audit.

Effect: The identified issue with the administration and review of user authorization levels could result in unauthorized individuals processing or approving transactions within the Port's ERP and/or billing system and either creating incorrect or erroneous transactions, or information.

Recommendations

The Port should:

Evaluate, and if necessary, implement a more formal review of authorization levels, in the Oracle and KleinPort systems.

Ensure that the Accounts Receivable Section of the Finance Bureau, and the Wharfingers Division, is fully versed in the capabilities of the systems and require employees to enhance their system skills, including attending user conferences, on-line education and in-house training.

Compliance with GAGAS:

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

APPENDIX I

Summary of Wharfing Process Audit Report by Harvey M. Rose Associates, LLC. – December 14, 2014.

Conclusion and Recommendation for Accounts Receivable Process: The Process Auditors concluded that the billing and accounts receivable process within the Wharfing Division was operating properly, and in compliance with all Port and division policies and procedures. While there were a few exceptions in test work performed, they were not deemed deficiencies.

Description of Billing and Accounts Receivable Process: The Wharfing Division bills shipping agents and terminal operators' fees associated with the arrival, docking and loading/unloading of cargo by vessels at POLA. The fees are charged to terminal operators in accordance with Tariff No. 4 or the terminal operator's lease or permit agreement with POLA. The terminal operators pay these fees from charges they impose on the shipping lines that use their facilities.

The Wharfing Division is responsible for creating an invoice of gross charges for the terminal operators and shipping agents to capture wharfage, dockage and pilotage fees due POLA pursuant to each terminal operator's permit or agreement with POLA or based on the provisions of POLA's Tariff #4. The Division invoices pilotage and dockage based on information received from the terminal operators, Port Pilots and the Marine Exchange on vessel arrivals, departures and moves within POLA facilities. Wharfage is either based on the number of containers or the type of cargo being unloaded. This information is also provided by the terminal operators and is compared to the shipping lines' Manifests and Bills of Lading by Wharfing Division staff to ensure an accurate inventory of cargo is recorded and used as the basis of POLA fees charged. There is no independent, direct verification of activity by the Port.

APPENDIX II

Internal Accounting Control Objectives:

1. Proper segregation of duties should exist to safeguard assets and provide appropriate checks and balances.
2. Physical security safeguards should be maintained where cash should be stored and processed.
3. Receipts should be properly recorded and deposited promptly and in a timely manner.
4. Revenues due should be received, recorded, and properly deposited in a timely manner.
5. The amounts of gross revenues recorded should be reasonable in relation to contractual agreements.
7. Refunds should be recorded and deposited in accordance with applicable laws and regulations, agency policies, or good business practices.
8. Prompt and accurate recording of all receivables should be maintained.
9. The ability to determine and report sources and age of receivables should exist.
10. Continuous and timely attempts should be made to collect on accounts when due. Ongoing documentation should be made on delinquent accounts over \$5000.
11. The portion of receivables that may not be collected should be identified.
12. Validity of write-offs, conversions, and settlement, or forgiveness of receivables should exist.
13. Repayments should be collected, controlled, and reported in a manner consistent with applicable Laws, regulations, policies and procedures.
14. Effective accounting controls over revenues should be maintained.
15. Personnel are adequately trained and have written procedures on how to process credit card transactions.