

Port of Galveston CAFRS

PORTSP2019-1b

GLENN BULGHERINI, CPA, FCPA, CICA, CCS

**CITY OF GALVESTON
REPORT ON PORT OF GALVESTON CAFRS
PREPARED BY THE CITY OF GALVESTON CITY AUDITOR'S OFFICE**

June 11, 2019

The City Auditor's Office is submitting this report as an addendum to the audit report *"Receipt and Use of Hurricane Ike Insurance Proceeds"* dated April 19, 2019. This report focuses on the responsibility that City Council, the Wharves Board, and the Citizens of Galveston expect from Port management. These expectations have a corresponding effect on the Port of Galveston's CAFRs. We are bringing forth two (2) findings that we consider important. They are:

1. Requirement of Board Approval.
2. Information to External Auditors.

The following explains these findings in greater depth.

REQUIREMENT OF BOARD APPROVAL:

The City Auditor's Office is aware of a prior period adjustment made to write off the FEMA Receivable. This prior period adjustment reduces the FEMA Receivable by \$8,279,129 and shows up in the draft copy of the Port's 2018 CAFR. The draft 2018 CAFR gives the reason for this prior period adjustment as *"Based on an extensive review of this receivable by management along with advice received from the new disaster recovery consultant, a determination was made that these outstanding claims were questionable as to the timing and possible collection of the receivable"*. We conclude that this prior period adjustment should receive board approval before it can enter onto the Port's 2018 CAFR.

The external auditors identify this prior period adjustment as an error correction. The Wharves Board currently does not have a written policy for board approval to address the correction of an accounting error. However, The Wharves Board does have written policies regulating performance of duties. These policies include: *"The following described actions are deemed policy matters and require Board approval: Any other matter which is customarily recognized in business circles as normally requiring approval by a board of directors in the orderly management of a business of comparable magnitude and complexity"*. We conclude that Port management did not abide by this policy before writing off the \$8,279,129 FEMA Receivable.

Port management is responsible for initiating the FEMA Receivable write off in the draft 2018 CAFR for the Port. Therefore, Port management should have adequate knowledge of the Wharves Board's written policies regulating their performance of duties. The City

Auditor’s Office determines that this disregard is due to Port management not placing a high enough level of importance on the significance of the Wharves Board’s written policies regulating the performance of duties. The Wharves Board’s written policies requiring board approval intends to put the necessary controls in place to fully disclose the financial transactions at the Port of Galveston to the public. The override of this policy by Port management does not set the standard for public perception as one of transparency.

The risk for not bringing this prior period adjustment to the Wharves Board for a vote of approval will result in failure to comply with The Wharves Board’s written policies on behalf of Port management. Port management should communicate to the board that the FEMA Receivable is on the Port of Galveston CAFRs as a current asset from fiscal year 2012 through fiscal year 2017. The Port of Galveston has collected less than 10% of this FEMA Receivable through those six (6) years. The Wharves Board should consider if there is any duty to report these findings to any third party entities that may have relied upon these CAFRs for this six-year period. The graph below illustrates the current asset balances stated in the Port’s CAFRs for the FEMA Receivable.

<u>FISCAL YEAR END</u>	<u>FEMA RECEIVABLE STATED IN CAFR</u>
2012	\$3,472,086
2013	\$7,258,257
2014	\$7,999,056
2015	\$8,841,080
2016	\$8,092,253
2017	\$8,402,636

Please see City Auditors Office Recommendation 1 at the end of this report.

INFORMATION TO EXTERNAL AUDITORS:

The external auditors did not initially have a chance to perform all risk assessment procedures for the Port’s 2018 audit engagement. The risk assessment procedures not initially performed were inquiries of the internal audit function of the City Auditor’s Office. The external auditors should have an opportunity to inquire about information that the City Auditor’s Office may have and determine its relevancy regardless of whether or not the internal audit function is used. The determination of relevancy concerning the internal audit function inquiry does not lie with Port management or the Wharves Board, but rather with the external auditors.

The AICPA (American Institute of Certified Public Accountants) auditing standards pertinent to this finding is effective for audits of financial statements for periods ending on or after December 15, 2014.

AU-C 315:06 (a.)

“The risk assessment procedures should include the following:

Inquiries of management, appropriate individuals within the internal audit function (if such function exists), others within the entity who, in the auditor's professional judgement, may have information that is likely to assist in identifying risks of material misstatement due to fraud or error".

Also pertinent to this finding are the powers and duties of the City Auditor stated in the City of Galveston Code Section 2-126.

Scope of Work (1) (f)

"The City Auditor is empowered to conduct performance and financial related audits, investigations and other audit work to determine whether: Financial and performance reports are being provided that disclose fairly, accurately, and fully all information that is required by law or other established or stated criteria that is necessary to ascertain the nature and scope of programs and activities, and that is necessary to establish a proper basis for evaluating the results of programs and activities".

The Port of Galveston management did not communicate to the external auditors any knowledge of the internal audit function. This knowledge would have likely been assistance to the external auditors in identifying risks of material misstatement due to error. Neither Port management nor Wharves Board members should have the power to interfere with the performance of the internal audit function inquiry by the external auditors.

There are two (2) negative outcomes for this finding. First, the external auditors were not aware of the absence of Port accounting procedures for the deobligation of FEMA funds. Organizations accounting for FEMA funds normally keep records on deobligations. FEMA deobligations are funds that FEMA will not reimburse to an organization for a specific project. FEMA deobligations associated with The Port of Galveston are due to noncompliance issues. An organization that receives advance funding from FEMA could owe money back to FEMA should funds be deobligated. FEMA can request this money back even if the organization has already spent those funds.

Second, the City Auditor's Office has information concerning the Port of Galveston and FEMA. This information results from an interview with the new disaster recovery consultant conducted by the City Auditor's Office. This interview revealed that the new disaster recovery consultant has notified the Port of Galveston of a minimum liability that the Port will owe back to FEMA in the estimated amount of \$800,000. The disaster recovery consultant also stated that the estimated liability to FEMA could go as high as \$2,000,000. The City Auditor's Office concludes that this is information that the external auditors should have been able to obtain from an initial inquiry of the internal audit function.

Please see City Auditors Office Recommendation 2 at the end of this report.

City Auditors Office Recommendation 1

Port management should fully disclose all information in regards to the prior period adjustment to the Wharves Board and then seek board approval before reducing the FEMA receivable by \$8,279,129. Disclosure of all information will allow the Wharves Board to consider if there is a duty to report any information to third party entities that may have relied upon the Port's CAFRs between fiscal years 2012 through 2017. Prior board approval will give the Wharves Board an opportunity to determine if there should be a policy to address error corrections. Presenting all of the facts first and then seeking prior board approval from the Wharves Board in accordance with written policies will help to ensure transparency and confidence to the public.

City Auditors Office Recommendation 2

The Port of Galveston should create and enforce written policies for *"requiring communication to the external auditor's"* concerning knowledge of appropriate individuals within the internal audit function. These policies will help to:

1. Ensure that the external auditors fully understand the Port's internal control structure and the risks associated with the financial reporting.
2. Avoid time delays and additional cost to the Port in finalizing the annual CAFR.
3. Stay in compliance with generally accepted accounting principles prescribed by the Governmental Accounting Standards.



GALVESTON WHARVES

- 123 Rosenberg Avenue 8th Floor, Galveston, Texas 77550
- Galveston (409) 765-9321 • Houston (281) 286-2484
- Fax (409) 766-6171 • Website: <http://www.portofgalveston.com>

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Rodger Rees

Mr. Glenn Bulgherini
City Auditor
City of Galveston
823 Rosenberg
Galveston, TX 77550

Re: Draft Report on Port of Galveston CAFRs Prepared by the City of Galveston City Auditor's Office, dated June 11, 2019

Dear Mr. Bulgherini:

Receipt is acknowledged of the referenced draft report. This letter constitutes the response to said report by the Board of Trustees of the Galveston Wharves, also known as the Port of Galveston (referred to below as either the "Board of Trustees" or the "Port"). The Board of Trustees appreciates your time and effort in preparing the report. This response is being provided to you per your request.

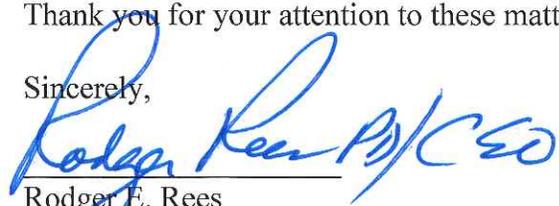
The FEMA Receivable referenced in the report was discussed during the July, August, September, October and December 2018 monthly Board of Trustees Workshop Meetings. Management further advised the Board of Trustees at the January 2019 Board of Trustees Finance Committee Meeting of management's recommendation that the FEMA Receivable be written off. There were no objections to this action by any members of the Finance Committee or other Trustees, who regularly attend Finance Committee meetings. The Board of Trustees received the draft 2018 CAFR in February 2019, which included the write-off of the FEMA Receivable. The Board of Trustees received and approved the CAFR in June 2019. The CAFR is not "final" until approved by the Board of Trustees. The final CAFR was the same as the draft received in February 2019.

In response to the "City Auditors Office Recommendation 1," the Port will adopt a formal policy under which management will present to the Board of Trustees at a Regular Monthly Meeting any material delinquent accounts receivable that management recommends be written off during each year, on or before the Board of Trustees' January Regular Monthly Meeting in the following calendar year. The Trustees will review and consider approval of management's recommendation by a recorded vote, so that there is no question about Board of Trustees approval of such action.

In response to the "City Auditors Office Recommendation 2," the Port will adopt a formal policy requiring management to provide contact information for the City Auditor's office to the firm selected to perform the Port's annual external audit, so that the external auditing firm can contact the City Auditor's office as that firm deems appropriate in exercising its professional judgment.

Thank you for your attention to these matters.

Sincerely,

A handwritten signature in blue ink that reads "Rodger E. Rees" followed by a stylized "PD/CEO". The signature is written over a horizontal line.

Rodger E. Rees
Port Director/CEO

Cc: Board of Trustees of the Galveston Wharves