

City of Galveston

Management and Operating Agreement for the Downtown Intermodal Transportation Terminal

PORT-SP2019-3

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**CITY OF GALVESTON
MANAGEMENT AND OPERATING AGREEMENT
FOR THE DOWNTOWN INTERMODAL TRANSPORTATION TERMINAL
PREPARED BY THE CITY OF GALVESTON CITY AUDITORS OFFICE**

October 9, 2019

The Management and Operating Agreement for the Downtown Intermodal Transportation Terminal (M&O – DITT) is a *development and facilities agreement* between the City of Galveston and the Board of Trustees of The Galveston Wharves. This *development and facilities agreement* refers specifically to the occupancy, construction, and development of the land and improvements located at 25th and The Strand, Galveston, Texas. The agreement provides that this location will serve as the central hub for:

1. The City of Galveston’s bus, trolley, and tourist oriented transit operations.
2. Parking spaces (162) for downtown mobility.
3. Retail / Commercial space for compatible uses.

This audit of the M&O – DITT is a direct result of the request from the Deputy City Manager on February 20, 2019. This audit began on March 28, 2019 when The City Auditors Office pulled excerpts from the M&O - DITT and then gathered information to prove conformance to those excerpts. The information gathered ranged from May 10, 2012 through September 23, 2019. The City Auditors Office would like to make City management aware of three opportunities for improvement that we noticed during this audit. They are:

1. The City of Galveston could develop procedures to receive the Business Plan and Operating Budget annually as mentioned in the M&O - DITT from the Wharves Board of Trustees.
2. The City of Galveston could enhance procedures to receive quarterly payments from the Wharves Board of Trustees in a timely manner pursuant to the M&O - DITT.
3. The City of Galveston could improve procedures to ensure that development costs charged to the City are materially accurate.

The remainder of this report explains these three opportunities for improvement to the City of Galveston.

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Opportunity for Improvement 1

City management has not implemented procedures to ensure timely receipt of documentation pursuant to the M&O – DITT. The testing portion of this audit reveals that the Business Plan and Operating Budget for calendar year 2019 is still due from the Port of Galveston as of the date of this report. Receipt of this documentation from the Port of Galveston in a timely manner is necessary in order to fulfill this condition of the M&O – DITT agreement.

Paragraph 3. (j) of the M&O - DITT sets the standard for receipt of the Business Plan and Operating Budget as:

“.....Port and City agree that the Port, in its capacity as manager of the Commercial Space, shall create a business and marketing plan for the Commercial Space (“Business Plan”), containing an operating budget for the Facility for the upcoming calendar year (“Operating Budget”), a minimum of sixty (60) days prior to the beginning of each calendar year, which will be reviewed and approved by the City Finance Director and City Manager.”

This problem occurs when the City does not establish a process for sufficient internal communication channels. A sufficient internal communication process effectively conveys the duties and control responsibilities of employees. Specific to this situation is that financial (Finance Department) and departmental (Island Transit) personnel did not meet to determine control standards for the M&O – DITT. Employees should receive a clear message from top management that they consider both internal control over financial reporting and individual control responsibilities as soon as practical for new contract agreements.

Lack of a process for tracking communications and control responsibilities will risk the detection of potential non-compliance with contracts and agreements. City management also incurs the risk that relevant operating information will not be available to serve as a basis for reliable financial reporting. Please review City Auditors Office Recommendation 1 for suggestions to develop efficient tracking communications and control responsibilities located at the end of this report.

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Opportunity for Improvement 2

Pursuant to the *Disposition of Revenues* clause in the M&O – DITT, the City of Galveston received \$16,733.56 and \$26,196.96 in a lump sum amount for the 2017 and the 2018 fiscal year ends respectively. The Port of Galveston should pay 4% of the gross receipts collected from the Facility to the City of Galveston each quarter of the fiscal year instead of a lump sum payment. Receipt of this payment on a timely basis is necessary to satisfy the obligations of the M&O – DITT.

M&O – DITT Paragraph 5. (a) Sets the standard for the payment to the City of Galveston as:

“.....In order to provide the City immediate cash flow from operation of the Facility, the Port will pay the City a quarterly cash payment (the “City Payment”), in an amount equal to 4% of the actual monthly gross receipts (“Gross Receipts”) of the Facility.”

City management can help to mitigate these delinquencies through enhancement of controls over financial reporting through ongoing monitoring, independent evaluations, and remediation of identified deficiencies for the M&O - DITT. Managements ongoing monitoring would provide feedback on the effective operation design of controls integrated into processes needed for the M&O - DITT. Findings of an internal control deficiency should be reported to (1) the appropriate person who is in the position to take corrective actions and, if applicable, (2) at least one level of management above that person.

Managements ongoing monitoring serves as a primary indicator of both control design and operating effectiveness and of risk conditions. Management should choose ongoing monitoring for the M&O – DITT or risk the following:

1. Delinquent accounts receivable will not be available for management review.
2. Aging accounts receivables will not be complete for reconciliation.
3. Cash receipts will post to the general ledger upon receipt rather than the date earned.

Please review City Auditors Office Recommendation 2 for suggestions to develop efficient tracking communications and control responsibilities located at the end of this report.

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Opportunity for Improvement 3

Amounts charged to the City of Galveston for M&O – DITT development costs are not proceeding through a level of control activities. The appropriate level of controls by City personnel would validate the authenticity and correctness of these development costs. This validation could receive approval by City management in a timely fashion to help ensure receipts from the Port of Galveston are genuine and correct.

M&O – DITT Paragraph 5. (b) Defines the rules for the Port of Galveston’s Recovery of Development Costs as:

“Port is entitled to use Net Receipts (defined below) to reimburse itself for (i) all acquisition costs relating to the land on which the Facility is located and (ii) any funds advanced or used by the Port to construct the Facility”

This weakness is a symptom of the design and implementation of control activities for the M&O - DITT. The City’s personnel must possess adequate knowledge and experience to discharge their responsibilities over contracts and agreements. Management should always design control activities for the information system to monitor contracts and agreements. The control activities for adequate performance would include necessary staff meetings with written checklists, information review, and discussions of the results of control activities.

Approval of the development costs charged to the City is a part of ongoing monitoring that should be a part of operations for explicit identification of what constitutes a deviation from expectations, thereby signaling to management an unacceptable level of risk. Otherwise, the City would be accepting the risk for the M&O – DITT that deficiencies that affect internal control over revenue collections will fail regular and necessary communication to management. Management should establish procedures to ensure that all reimbursable costs are correct to avoid levels of intolerable risk.

Please review City Auditors Office Recommendation 3 for suggestions to develop efficient tracking communications and control responsibilities located at the end of this report.

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City Auditors Office Recommendation 1

The City Auditors Office suggests the use of a Control Standards Manual for use by City management and personnel. The Control Standards Manual should document the internal control objectives for each business process, as well as the specific procedures used to meet those objectives. This Manual can also observe how different control points support each other and what happens when specific controls do not exist in the process. The Control Standards Manual can include flowcharts of the processes, date reminders, as well as forms used for processing. Upper management should walk process managers through the Manual to highlight its key points. By this constant emphasis on the importance of the Control Standards Manual, the City's process managers will take the time to review and implement it.

The Control Standards Manual should integrate with a Document Management Manual. The Document Management Manual should index, store, secure, and retrieve City documents. Examples of Document Management Manual rules and processes could be:

1. Confidential documents are restricted.
2. Current operating documents do not include expired or cancelled documents.
3. Users can retrieve requested documents in a timely manner.
4. The Document Management Manual utilizes the same retention policies to match the City of Galveston's retention policies.
5. Periodically conduct a records inventory to ensure that all pertinent documents are included in the Document Management Manual.

City Auditors Office Recommendation 2

A reasonable solution to avoid missed billings is to create a business process inside the Control Standards Manual mentioned in Recommendation 1. These processes could include:

1. Automated emails set up to remind process managers for upcoming collections as well as notifying appropriate billing personnel for the City.
2. Automated emails set up at fixed intervals to remind responsible parties of the payee. It would make sense to create this reminder one or two weeks in advance of the date when it is actually due. By doing so, the invoice has more time to flow through the payee organization for accounting and authorized signatures and back to the organization's accounts payable staff for payment. Therefore, it will be much more likely that payment is on time, which improves cash flow and reduces the

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City's investment in accounts receivable.

3. The assignment of overdue invoices to a collections person for collection activities.
4. The issuance of Dunning Letters.
5. The initiation of direct contact. Management could make a call to the payee organization to discuss the reasons for lack of payment. Documentation of each call should exist for the date, contact person, reasons for late payment, and promises to pay if any. Any potentially large collection issues that requires accelerated action should have communication with upper management.
6. The requirement of collections record keeping in a Collections Management File. The Collections Management File should also integrate with the Aged Accounts Receivable File, if necessary, to increase efficiency of the City's designee for assignment of each collection. In addition, a consolidation of all collection notes should reach process managers and upper management for review.

City Auditors Office Recommendation 3

A reasonable solution to verify the validity and accuracy of costs paid by a third party and charged to the City is to create a business process inside the Control Standards Manual mentioned in Recommendation 1. This business process would focus on construction auditing. Construction auditing can be very labor intensive. It is often an inefficient process to audit line by line of each invoice. Usually the cost does not outweigh the benefit. The solution to this problem is to do a periodical analytical review of specific construction assignments and costs. This analytical review can receive professional expertise found in the City's Engineering Department. Specific construction assignments and costs could include:

1. Preparation of Control Schedules - investigation of the following documents should be:
 - Contractor's application for bid.
 - Port's payments reconciled to Invoices.
 - Contractors Request for Information (RFI) and scope changes.
2. Reconcile Project Expenditures - obtain all project related financial or accounting transactions that document expenditures. The sum of the total payments made to each vendor should reconcile to costs charged to the City.

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In addition, a review of invoices paid directly by the contractor to third parties for services, materials, or other costs to determine if the costs were actually the responsibility of the contractor(s).

3. Direct Labor Analysis - compare direct labor payroll costs to industry standards.
 4. Change Order Analysis - reviews and recalculates backup documentation for the legitimacy of a change in scope and the correctness of additional costs associated with the change order.
 5. Pricing Analysis - ensures third party legitimately purchased all goods and services used.
 6. Subcontract Analysis - confirms receipt of unconditional lien waivers.
 7. Material Purchases – examines for purchases of excessive amounts of material and comparisons to inspection reports.
 8. Verification of Contracted Scope – identifies unacceptable alternatives to the agreed upon scope.
 9. Equipment Rental Analysis – determines equipment rental rates charged to the project are necessary and reasonably compare with industry standards.
 10. Permit Analysis – ascertains proper permitting.
- Bonds and Insurance Analysis – determines adequate insurance and bonding requirements for contractors.

City Manager’s Response to Downtown Internal Transportation Terminal Management and Operations Agreement Audit

The Manager has completed his review of the Transit Terminal Audit report. This Audit was performed at the request of the Deputy City Manager to determine compliance with the agreement by the Port along with a test of the City’s internal controls and processes related to tracking reporting requirements and payments due from the Port.

The Report identified deficiencies that will result in changes in the way the City manages its relationship with the Port for this agreement. The first steps will be an immediate aggregation of the delinquent reports and reconciliation of the payments received from the Port. In addition, procedures will be established within Island Transit to delineate reporting deadlines and monitoring requirements. Further discussion of the Report’s findings are listed below:

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Opportunity for Improvement Number 1

“City Management has not implemented procedures to ensure timely receipt of documentation pursuant to the M&O-DITT. ...the Business and Operating Budget for calendar year 2019 is still due from the Port of Galveston as of the date of this report. Paragraph 3. (j) of the M&O-DITT sets the standard for receipt of the Business Plan and Operating Budget” as follows:

“.....Port and City agree that the Port, in its capacity as manager of the Commercial Space, shall create a business and marketing plan for the Commercial Space (“Business Plan”), containing an operating budget for the Facility for the upcoming calendar year (“Operating Budget”), a minimum of sixty (60) days prior to the beginning of each calendar year, which will be reviewed and approved by the City Finance Director and City Manager.”

Management Response Number 1

The City’s Finance Department received the Business Plan and Operating Budget for calendar year 2019 on August 2, 2019. The Operating Budget did not provide a reconciliation of the Port’s development cost recovery as of any date and this information has been requested. As of the writing of this response, October 17, 2019, the 2020 Business Plan and Operating Budget have not yet been received.

On October 18, 2019 the Manager sent a letter to the Port Director detailing the Port’s contractual obligation to provide the 2020 Business Plan and Operating Budget by close

of business on Monday, November 4, 2019 to the City Finance Director. This letter also cited deficiencies outstanding with respect to the reconciliation needed to document the status of the recovery of the Port’s Development costs for the Terminal as a part of the 2020 Operating Budget. If the Port’s response is received timely, the Finance and Island Transit Departments will jointly place the Business Plan and Operating Budget on the November or December City Council agenda with accompanying recommendations from the Manager for approval or denial by that body. If the 2020 Business Plan and Operating Budget are not provided by COB November 4, 2019, the Mayor and Council will be notified at its November meeting of the Port’s noncompliance with the Terminal M&O Agreement.

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Opportunity for Improvement Number 2

“Pursuant to the Disposition of Revenues clause in the M&O – DITT, the City of Galveston received \$16,733.56 and \$26,196.96 in a lump sum amount for the 2017 and the 2018

Fiscal year ends respectively. The Port of Galveston should pay 4% of the gross receipts collected from the Facility to the City of Galveston each quarter of the fiscal year instead of a lump sum payment. Receipt of this payment on a timely basis is necessary to satisfy the obligations of the M&O – DITT.”

Management Response Number 2

As of October 17, 2019, actual payments due from the Port to the City when measured using 4 percent of gross revenues on an annual basis are as follows:

Calendar Year	Estimated City Payment	Actual City Payment	Date Received	Source/ Comment
2015	\$1,235.14	\$0.00	N/A	Estimated as part of 2016 Business Plan; no record of the City having received any payment for 2015
2016	\$18,691.82	\$0.00	N/A	Estimated as part of 2016 Business Plan; no record of the City having received any payment for 2016
2017	N/A	\$16,733.56	6/20/2018	Accompanying report listing Terminal income only in summarized form.
2018	N/A	\$26,196.96	1/25/2019	Accompanying report listing Terminal income only in summarized form.

Therefore, as of December 31, 2018, it appears that the Port owed the City approximately \$20,000. We will work with the Port to ascertain if the chart above is accurate.

As of October 17, 2019, the City has received no monthly reports from the Port as required by section 3 (i) of the M&O Agreement:

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“(i) Payment/Records. Port shall manage the cash flow and records of the Facility in a comprehensive and efficient manner. Port shall promptly pay all bills or invoices for the Facility where satisfactory service or supplies have been received so as to maintain good credit for the Facility. Port shall maintain a comprehensive system of office records, books, and accounts, which records (as they pertain to the Facility) shall be subject to examination by City, or its authorized agents, attorneys, and accountants during normal business hours. No later than the last day of each calendar month, with respect to the preceding month, Port shall render to City, or to whomever City shall designate, with respect to the Facility: (i) detailed statements of receipts and disbursements; (ii) aging of accounts receivable and payable 30, 60, 90, and 120 days, showing creditor and/or debtor; (iii) a comparison of income and expense to the Operating Budget on a form or forms acceptable to City and Port; (iv) bank statements as of the last day of the preceding month reconciled with the cash flow; (v) a security deposit statement; (vi) a rent reconciliation statement in a form acceptable to City and Port; and (vii) any other form, statement, or information reasonably requested by City. Port shall also, if requested, forward to City or to whomever City shall designate, copies of all paid invoices, vouchers, or bills pertaining to the Facility's disbursement statement for that month. Port shall preserve with respect to the Facility originals of such invoices, vouchers, and bills for a minimum of five (5) years from the end of each calendar year during the term of this Agreement. At the request of City, all such original invoices, vouchers, bills, and statements pertaining to the Facility shall be transferred to City, if permitted by applicable law.”

Monthly reports as conceived in this section of the 2013 M&O Agreement clearly were intended to provide the basis for comprehensive financial oversight of the Port's management of the Terminal. Taken in conjunction with the requirement for quarterly reports, the annual planning and reporting cycle for the Terminal under the terms of the M&O Agreement is as follows:

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**FINANCIAL PLANNING AND REPORTING CALENDAR
DOWNTOWN INTERMODAL TRANSPORTATION AGREEMENT
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MONTH	MONTHLY REPORT(1) DUE	QUARTERLY PAYMENTS DUE TO CITY	BUSINESS PLAN AND OPERATING BUDGET
January	January 31 for January	By January 10 for 4% of gross receipts collected during the October to December Quarter	
February	February 28 for February		
March	March 31 for March		
April	April 30 for April	By April 10 for 4% of gross receipts collected during the January to March Quarter	
May	May 31 for May		
June	June 30 for June		
July	July 31 for July	By July 10 for 4% of gross receipts collected during the April to June Quarter	June monthly report (six months through current year) used as basis for management level discussions between City and Port
August	August 31 for August		
September	September 30 for September		
October	October 31 for October	By October 10 for 4% of gross receipts collected during the July to September Quarter	Submission of Business Plan and Operating Budget to City by November 1 using estimates for year end totals for current year and subsequent year
November	November 30 for November		City approves or disapproves Plan and Budget
December	December 31 for December		City approves or disapproves Plan and Budget

As of October 17, the Port has missed nine monthly reports (January-September), and three quarterly payments of the 4 percent of gross receipts amount due the city. Therefore, The City has requested a monthly report as described in section 3(i) of the M&O Agreement for the month of September 30 including calendar to date totals, and calculations of the 4 percent of gross receipts due to the City for the January 1-September 30 period, such report to be due the City by October 31, 2019, as well as, regular monthly reports as described in section 3(i) of the M&O Agreement, beginning with the October month ending report, due on October 31, 2019.

Opportunity for Improvement Number 3

“Amounts charged to the City of Galveston for M&O – DITT development costs are not proceeding through a level of control activities. The appropriate level of controls by City personnel would validate the authenticity and correctness of these development costs. This validation could receive approval by City management in a timely fashion to help ensure receipts from the Port of Galveston are genuine and correct.”

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“M&O – DITT Paragraph 5. (b) Defines the rules for the Port of Galveston’s Recovery of Development Costs as:

“Port is entitled to use Net Receipts (defined below) to reimburse itself for (i) all acquisition costs relating to the land on which the Facility is located and (ii) any funds advanced or used by the Port to construct the Facility

Management Response Number 3

Based on the review of detailed backup documentation either provided to the City and/or made available to the City under the terms of 3(i), Island Transit staff will contact the Port to schedule regular reviews of documentation maintained by the Port in support of the financial activity reported monthly. Regular monthly meetings will be conducted and exception items that are identified through this process will be documented and resolved in writing.