THE PORT OF VIRGINIA

VIT Due Diligence Review Summary

November 19, 2013

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Overview

The Board of Commissioners initiated a Due Diligence Review of the Virginia International Terminals Corporation further to the direction of Governor McDonnell and subsequent to the decision to restructure the Virginia Port Authority and the Virginia International Terminals Corporation in lieu of proceeding with the unsolicited Public Private Partnership offer.

The accounting firm of KPMG was selected to conduct the review after evaluation responses to a detail RFP.

The following ad hoc Audit Steering Committee was appointed by VPA Chairman William Fralin in May, 2013.

- Scott Bergeron, VPA Commissioner (Committee Chairman)
- Greg Whirley, VDOT Commissioner
- Craig Coy, VPA Commissioner
- Richard Steinke, Port Practice Lead, Moffatt & Nichol & Former Executive Director of the Port of Long Beach

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Background

VPA Board / Fralin Letter to Governor McDonnell – March 26, 2013

As part of this corporate restructuring, the VPA Board will request its outside accounting firm, Clifton Larson Allen LLP, to conduct a comprehensive audit of VIT. Given the proposed new structure of VIT, it is imperative that the Board identify any supplemental issues as it assumes total responsibility and liability over the port's operations. Such audits are a routine part of any private sector acquisition or merger, and it is important that the Board conduct due diligence as part of the restructuring. Further, these audits can, and typically do, involve recommendations that can improve financial practices and lead to further cost savings.

Governor Letter to VPA Board / Fralin – April 2, 2013

Third, as part of the corporate restructuring, the comprehensive audit of VIT referenced in your letter must occur. We have had much success with such audits of other state agencies. It would be inappropriate for a state entity to assume all operational liabilities of what is technically a private entity (VIT) without first conducting such a review. Equally important, this audit may help identify additional ways to improve performance and reduce costs.

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Audit Purpose

The purpose of the due diligence review was to ensure that the financial management procedures are efficient, effective, economic and conducted in a manner that are in the best interests of the Commonwealth.

The review also sought to ascertain that financial disclosures and information regarding financial operations are accurate, reliably presented and transparent with regard to assets, liabilities, source and use of revenues, expenses, incentives and subsidy practices.

All contractual liabilities including incentives and subsidy practices (whether contractual or not) were to be identified.

Results of the due diligence review are to be used to identify areas that need additional analysis and review.

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Audit Objectives

The Committee defined the due diligence review to include, but not be limited to, the following activities:

Revenue Growth - Review of business practices / polices that generate revenues for services rendered; examine major categories of revenue;

Cost Control - Examine means and methods to adjust for the volatility in demand for services that minimizes cost while providing a quality service that meets time and quality performance metrics; examine major categories of cost;

Procurement / Contracting Practices – Verify that processes used to procure goods and services yields the best value for the Commonwealth's port operations; examine contract compliance on a sample basis;

Human Resource Practices - Verify that processes used to hire, retain, motivate, and dismiss employees, are consistent, effective and appropriate;

Monitoring Performance - Evaluate performance metrics that serve as guides / targets for operations; determine if there are other comparable port operations in other states that may be used for bench marking/best practices;

Audit Objectives (continued)

Trend Analysis and Key Business Ratios – Analyze trends to identify opportunities for improvement; analyze key business ratios to identify areas for further analysis;

Incentives - Review the effectiveness of incentives designed to increase cargo volume and profitability;

Financial Integrity – Identify key business processes; examine the internal controls to ensure financial resources and assets are safeguarded and the reliability and accuracy of information reported; conduct transaction testing on a sample basis; and

Transparency / Accountability - Examine the operating agreement and reporting practices to ensure that VIT and the Authority are providing the governing board information needed to develop policy and guide the operations and that identifies potential areas in this relationship that may be improved; examine operations to determine that VPA has appropriate oversight and governance.

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Summary

Findings	Plan of Action
Inconsistent Goals & Objectives between VPA & VIT	Restructure, resulting in alignment. Clearly communicate goals and objectives.
Dysfunction in relationship, communication and leadership between VPA & VIT	Restructure and appoint new executive leadership.
Lack of Effective Internal Controls	Clear, effective procedures. Appointment of Internal Auditor that reports to VPA Board.
Performance Monitoring & Communications with VPA Inadequate	Establish: 1. Concise and standard measurements and reporting; 2. Decision making policy; and 3. Clear procedures and action plans.
Loose Procurement Practices	Develop comprehensive procurement and contracting policies, establish roles and internal control functions
Ineffective Contract Administration, Billing & Invoicing Procedures	Develop coherent and objective based policies. Implement system changes.
Difficulty is assessing monitoring and control of Union Labor, Poorly designed incentive/reward compensation for non-union personnel	Establish metrics and monitoring controls. Consider third party monitoring. Establish effective reward/motivation policies.
Liberal Liability Valuations	Apply GAAP, FASB and/or GASB recommendations to operating arm as appropriate and with consistency
Unclear Business Strategy & Objectives Resulting in Inconsistent Business Applications and Poor Financial Performance	Restructure, Leadership, Communication of Objectives, Development of Coherent Strategy, Procedures, Consistent Application & Measurement