

City of Galveston

Port of Galveston Insurance Proceeds Audit

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**CITY OF GALVESTON
RECEIPT AND USE OF HURRICANE IKE INSURANCE PROCEEDS
PEPARED BY THE CITY OF GALVESTON AUDITOR'S OFFICE**

April 19, 2019

Background:

The City Council of Galveston approved agenda item 12A on October 25, 2018 for the City Auditor's Office to audit the receipt and use of insurance proceeds on City owned assets and report the findings back to City Council. This action was taken by City Council in response to The Galveston Wharves Board September 25, 2018 Workshop. This Workshop included Discussion Item D1 in which The Port Director/CEO Roger Rees announced that the Port of Galveston had received \$55 million in insurance proceeds for Hurricane IKE and that he was not aware of where all of this money was spent. Hurricane IKE made landfall over Galveston, Texas on September 13, 2008 causing extensive damage to the Port of Galveston as well as the entire Galveston Island.

Objective:

The objective of this audit is to first verify the amount of Hurricane IKE insurance proceeds received by the Port of Galveston and second to document the disbursements of those funds.

Scope:

The audit scope included review of all documentation received from the Port of Galveston beginning January 1, 2007 through December 31, 2018.

Methodology:

To achieve the first part of the audit objective The City Auditor's Office obtained and reviewed documentation that related to the insurance carrier's adjustment of the Port of Galveston's Hurricane IKE claim. The Port of Galveston held for the year 2008, the year Hurricane IKE made landfall and caused damages to the Port, a total of \$55 million blanket insurance coverage between various insurance carriers as follows:

POLICY	INSURER	AMOUNT
Primary	Lexington	\$5.0 million
First Excess Layer	Lloyd's of London AWAC	\$7.5 million
Second Excess Layer	Lloyd's of London AWAC	\$12.5 million
Third Excess Layer	AWAC Lancashire	\$15.0 million
Fourth Excess Layer	Lexington	\$15.0 million
		<u>\$55.0 million</u>

The City Auditor's Office traced the insurance carrier's adjustment information to the Port's bank statements to validate and confirm the accuracy of the receipt of the insurance proceeds.

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Second, The City Auditor's Office established silos of funds relating to the Port. These silos are as follows:

- (1) Earnings and Profits of The Port of Galveston from Previous Years.
- (2) Earnings and Profits of The Port of Galveston from the Current Year.
- (3) Insurance Proceeds.
- (4) FEMA Proceeds.

The City Auditor's Office accounted for the receipts and disbursements within each silo based upon the Port of Galveston's accounting records.

Audit Results for First Objective:

The audit results proved that \$55 million was received from the insurance carriers and deposited into Port of Galveston bank accounts or paid directly to Hurricane IKE contractors on the following dates:

<u>DATE</u>	<u>AMOUNT</u>
September 25, 2008	\$ 1,500,000
October 28, 2008	\$ 1,000,000
December 31, 2008 (Paid Directly to Contractor)	\$ 2,500,000
January 22, 2009	\$ 6,513,074
February 11, 2009	\$ 723,675
May 7, 2009	\$ 525,767
May 7, 2009	\$ 4,494,979
May 13, 2009	\$ 236,926
June 10, 2009	\$ 4,971,631
June 18, 2009	\$ 552,403
October 7, 2009	\$ 904,614
October 8, 2009	\$ 1,783,390
October 13, 2009	\$ 504,614
October 20, 2009	\$ 807,382
December 21, 2009	\$ 1,225,000
December 24, 2009	\$ 2,275,000
June 22, 2010	\$ 1,349,762
June 22, 2010	\$ 1,889,667
July 2, 2010	\$ 2,159,641
October 19, 2010	\$ 1,428,873
October 21, 2010	\$ 1,020,624
October 26, 2010	\$ 1,632,978
* July 17, 2012 (Litigation Proceeds)	\$ 15,000,000
	<u>\$ 55,000,000</u>

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* The Port of Galveston was forced to take litigation against the insurance carrier responsible for the fourth layer of coverage. The insurance carrier claimed that the fourth layer of coverage was not applicable because (1) the policies provided for scheduled coverage rather than blanket coverage and the Port had only specific coverage in certain areas. (2) The insurance carrier put forward they were entitled to undertake post-loss underwriting to increase property values and correspondingly the deductible charged to the Port of Galveston. (3) The insurance carrier claimed that the Port was either not severely damaged or that damages were caused by wear and tear rather than from Hurricane IKE. The Port of Galveston prevailed in the litigation and Lexington paid the Port \$15 million.

Audit Results for Second Objective:

The audit results using the silos proved that the first \$40 million received by insurance carriers from September 25, 2008 through October 26, 2010 were disbursed for Hurricane IKE recovery expenses as follows:

RECOVERY ACTIVITY	AMOUNT
Debris Cleanup - Paid to Contractors	\$26.2 million
Internal Expenses for Debris Cleanup	\$3.3 million
Hurricane IKE Repairs - Paid to Contractors	\$10.5 million
	\$40.0 million

These audit results were further confirmed by the Port of Galveston's accounting records. However, the Port of Galveston's accounting records did not identify the disbursements for the \$15 million received on July 17, 2012 from the Lexington insurance carrier as a result of litigation. This \$15 million was transferred to an unrestricted investment pool account with TexSTAR, an investment service organization for local governmental units, the next day on July 18, 2012. The \$15 million in TexSTAR was later transferred back to the Port of Galveston's Operating Bank Account intermittently through the following two time periods as follows:

- (1) January 30, 2013 through December 22, 2014.
- (2) February 28, 2016 through April 28, 2016.

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The audit results proved using the silos explained earlier that this \$15 million was spent on Port operations not related to Hurricane IKE damages a follows:

PORT OPERATIONS	AMOUNT
Payroll	\$5.1 million
Employee Benefits	\$1.4 million
Payments to Parking Contractors	\$0.8 million
Sales Tax Payments for Parking	\$0.4 million
Attorney Fees	\$0.1 million
Office Expense	\$0.2 million
BMW Project Reimbursed by IDC	\$1.0 million
Payments to Railroads	\$0.2 million
Insurance Premiums	\$3.9 million
Port Repairs Non Recovery	\$0.9 million
Security Officers	\$0.3 million
Utilities	\$0.4 million
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\$14.7 million	

Please note that \$.3 million still remained in the TexSTAR account as of December 31, 2016, which was the last available records of the TexSTAR account that the City Auditor's Office was able to obtain.

City Auditor's Recommendations:

The City Auditor recommends the following:

- (1) The Port of Galveston management should review all business and casualty insurance policies to ensure the most efficient and effective insurance coverage for debris cleanup.
- (2) The Board of Trustees of the Galveston Wharves should deliberate if Hurricane IKE insurance proceeds were disbursed in accordance with the policies of The Port of Galveston.