

ISSUE 4

Unclear and Outdated Statutes Prevent the Authority From Having an Effective Internal Audit Function.

Background

The Port of Houston Authority's strong historical connection to Harris County, beginning with its origin as the Harris County Ship Channel Navigation District in 1911, is reflected throughout the statutes governing the Authority, even though it has since evolved to a more independent organization accountable to four different appointing entities. At the same time, Harris County taxpayers have a vested interest in the Authority's financial health, as they approve and pay property taxes to support the Authority's bonds, and they benefit from the economic activity generated by the Authority's capital investments. Currently, Harris County taxpayers pay approximately \$50 million per year to fund debt service on the Authority's general obligation bonds.

Statute designates the Harris County Auditor as the Authority's auditor, and describes specific routine duties, such as pre-approving all Authority expenditures and certifying funds availability. However, statute does not explain how internal audit at the Authority should work in relation to the County Auditor's general auditing role. Over the last two years, as the Authority has sought to establish an internal audit function, the County Auditor and Authority have come to an impasse in interpreting the proper role of each party. As a result of this conflict, on June 25, 2012, the County Auditor formally requested a Harris County Attorney opinion regarding the County Auditor's responsibilities at the Authority and whether her statutory independence as it relates to Harris County government also extends to her relationship with the Authority.¹ This request currently remains outstanding.

Internal auditing is a standard oversight and management tool used in both the public and private sectors. Internal auditing allows for regular, independent evaluation and scrutiny of an organization's financial, managerial, and compliance risks; and provides an organization's management and governing bodies with accurate and consistent information to evaluate operations and identify potential risks before they result in more serious problems. The scope of internal auditing is broad, including activities such as those listed in the textbox, *Internal Audit Activities*. The Institute of Internal Auditors has developed internal auditing standards to provide guidance for internal audit professionals.²

Internal Audit Activities

- Financial audits
- Performance audits
- Investigations
- Advisory services
- Coordination of all audit activity, including external auditing

Findings

Without an internal audit function, the Authority lacks a critically needed risk management and oversight tool.

The Authority has never had a standard internal audit function, unlike many public and private sector organizations. The textbox, *Benefits of Internal Auditing in the Public Sector*, lists some of the overarching reasons internal audit is a best practice for governmental entities. Without a robust internal audit function, the Authority misses these benefits that it needs now more than ever due to the current circumstances described below.

**Benefits of Internal Auditing
in the Public Sector**

- Helps achieve accountability and integrity.
- Improves operations.
- Instills confidence in government among stakeholders and the public.

Source: Institute of Internal Auditors, *The Role of Auditing in Public Sector Governance* (Altamonte Springs, FL: Institute of Internal Auditors, January 2012), p. 5.

The Authority's complex operations and \$292 million in annual expenditures demand the oversight internal audit provides.

- **Historical lack of operational and risk-based auditing.** The Authority's complex business operations and \$292 million in annual expenditures, including a significant amount for contracts, require financial oversight as well as performance and compliance oversight. In comparison, all state agencies with operating budgets greater than \$10 million must have an internal audit function.³ Internal auditing standards direct that an organization's internal audit activity cover not only financial matters, but also operations, including governance, ethics, information technology, and other non-financial areas.⁴ While the County Auditor and the Authority's statutorily required annual financial statement audits have provided some measure of oversight, these audits have focused strictly on financial transactions, leaving the Authority without more complete oversight of its operational performance. The Authority has recently contracted for two performance reviews of its procurement process and a separate audit of its Channel Development Department, indicating an interest by the staff and the Commission for independent performance information upon which to make operational improvements.

The financial audit activity at the Authority, while significant, has not been done in a coordinated, risk-based fashion and has focused primarily on individual financial transactions and yearly financial statements, not the Authority's overall financial processes and systems. The County Auditor's audit role at the Authority has been mostly limited to pre-approval of all Authority expenditures, certifying availability of funds before approving expenditures and contracts, and other duties specified in statute as well as some discretionary duties. The County Auditor has conducted occasional audits of financial processes and systems, but these have been sporadic, isolated audits, not part of an overall audit plan based on assessment of risk and input from management and the Commission.

- **Organizational flux.** An internal audit function could help the Authority ensure new processes and changes to existing ones are working as intended and recommend improvements. The Authority is in a state of transition and faces significant challenges, as described throughout this report. The Authority is currently attempting to implement a multitude of new processes and procedures and is reviewing others to evaluate the need for improvements. This report highlights several of these initiatives, including the Authority's new strategic planning process, a whistleblower and complaints process, and procedures to guide Promotion and Development Fund expenditures. The Sunset review also identified other concerns with the Authority's approach to safety, procurement, and public involvement. Each of these areas will likely result in additional changes needing ongoing attention to fully implement.
- **Public trust and balance in governance.** Public trust in the Authority has been damaged in recent years. An internal audit function would help re-establish trust by providing an independent review of operations to identify and address areas of concern before they mushroom. It also gives a clear indication that the organization has a mechanism in place for addressing concerns going forward. As described in Issue 1, the Port Commission has become too intimately involved in operations, out of line with its role as a policymaking body. Internal audit can help the Commission maintain a more appropriate oversight role by providing an independent check on staff's day-to-day management responsibilities. Establishing an internal audit function would better allow the Commission to focus on high level policy and not be so involved in operational decisions.

Stronger oversight through internal audit would help the Commission focus on policy and not operations.

Ambiguous statutes have created an unresolvable conflict between the Authority and the County Auditor, but generally accepted internal auditing standards provide a clear structure for moving forward.

In February 2010, the Authority and the County Auditor began discussing how to establish an internal audit function at the Authority. The internal audit charter proposed by the County Auditor provides for the County Auditor to report to the District Judges, as she does as part of her oversight of Harris County government. In 2011, the Port Commission established an Audit Task Force and adopted a conflicting Task Force charter that maintains Commission oversight and control of its internal audit function. The Authority and the County Auditor have been unable to resolve this disagreement regarding oversight of the internal audit function, and have made little progress in establishing an internal audit function at the Authority in recent months, resulting in the County Auditor's recent request to the County Attorney for clarification.

The County Auditor recently requested a legal opinion to clarify her statutory duties at the Authority.

Both the Authority and the County Auditor have valid concerns regarding the appropriate oversight of internal audit at the Authority. While these

differing statutory interpretations are both justified as described in more detail below, internal auditing standards are clear on this issue. These standards, developed by the Institute of Internal Auditors, clearly specify that internal audit activity should report to an organization's governing body. Specific oversight duties of the governing body according to auditing standards are listed in the textbox, *Governing Board Duties: Internal Auditing Standards*.

**Governing Board Duties:
Internal Auditing Standards**

- Approve internal audit charter.
- Approve risk-based annual internal audit plan.
- Provide direct oversight of the chief audit executive.
- Determine adequacy of internal audit resources.

Source: Institute of Internal Auditors, International Standards for the Professional Practice of Internal Auditing (2010), p. 3.

- **County Auditor's perspective.** Chapter 84 of the Texas Local Government Code establishes the office of County Auditor for all Texas counties. Under this statute, the County Auditor is appointed by the Harris County District Judges, who set the County Auditor's salary and approve the overall budget. This reporting relationship makes the County Auditor independent of the County Commissioners Court, and is intended to allow the County Auditor to provide independent financial oversight of county government. The County Auditor believes this statute requires her, as the Authority's auditor, to be independent of the Port Commission, and instead report to the District Judges.⁵ This interpretation of statute is reflected in the County Auditor's proposed internal audit charter, under which the budget for the Authority's internal audit function would be approved by the District Judges, and the annual audit plan would be prepared and approved by the County Auditor.

Further confusing matters, the Texas Water Code generally designates the Harris County Auditor as the Authority's auditor, but does not clearly define this role.⁶ For example, statute does not explicitly require the County Auditor to be the Authority's internal auditor nor does it specify whether the County Auditor should report to the Port Commission or the District Judges.

- **Authority's perspective.** The Authority is an autonomous political subdivision authorized by the Texas Constitution, and overseen by an independent Commission appointed by four entities. The Authority is not a Harris County department and is not overseen exclusively by the Commissioners Court. As the Port Commission is the governing body of the Authority, it has ultimate responsibility for the Authority's affairs, including responsibility for ensuring that operations are efficient and effective. Internal auditing standards clearly require an organization's governing board to control the internal audit function. For these reasons, the Authority believes the Port Commission should oversee the internal audit function, as reflected in the Commission's Audit Task Force Charter.⁷

Internal auditing standards clearly require an organization's governing board to control the internal audit function.

The Harris County Auditor is not well positioned to provide the full range of internal audit services the Authority requires, but continues to have a vested interest in maintaining some oversight of the Authority's finances.

Internal auditing standards include operational auditing as a part of an internal audit activity's responsibilities. However, the County Auditor cannot fulfill this role due to statutory limitations. A 1990 Harris County Attorney opinion, reaffirmed in 2003, concluded that the County Auditor has no statutory authority to perform non-financial audits.⁸ The County Auditor's proposed internal audit charter for the Authority provides that the County Auditor will only conduct financial audits, in accordance with the County Attorney's opinion on her statutory authority. Given this limitation, the County Auditor is not well-suited to perform the Authority's internal audit function because strictly financial auditing will not meet the Authority's needs.

While the County Auditor cannot completely fulfill the role of internal auditor, Harris County still has a vested interest in maintaining some oversight of the Authority's financial matters. Because the Authority receives about \$50 million annually in ad valorem taxes collected from Harris County property owners to pay debt service on its infrastructure investments, the County should retain clear authority to access information about the use of these funds and audit the Authority's finances if concerns exist. Precedent for this type of audit oversight relationship exists on the state level. State agencies maintain their own internal audit functions, while the State Auditor's Office provides an additional layer of state oversight independent of agency governing boards. The State Auditor's Office audits agencies as it deems necessary based on its own risk assessment and resulting audit plan, and reports directly to the Legislature.

Statutorily prescribed County Auditor duties are outdated, unnecessary, and divert resources from more meaningful internal auditing activities.

The textbox, *County Auditor Statutory Audit Duties at the Authority*, lists specific statutory duties of the Harris County Auditor relating to the Authority.⁹ Most of these required duties were initially passed by the Legislature in 1945, and no longer make sense in today's world. These pre-audits of all Authority expenditures and contracts check for compliance with statute and Authority procedures, but are not based on risk and a sample of expenditures, as most modern financial audits are. This approach does not question the operational need or efficiency of the expenditures. In 1990, independent

The County has an interest in monitoring the Authority's finances, given the \$50 million per year provided by property taxpayers.

County Auditor Statutory Audit Duties at the Authority

- Certify funds are available to pay contracts when due.
- Pre-audit and approve all expenditures.
- Pre-audit payroll for reasonable accuracy and funds availability.
- Develop inventory procedures and review inventory counts and records.
- Continuously audit the Promotion and Development Fund's 5 percent statutory allowance.

auditors who reviewed the operations of the County Auditor recommended discontinuing the practice of pre-auditing Authority expenditures and contracts, but a subsequent County Attorney opinion concluded the County Auditor needed to continue these functions because they are required by law.¹⁰ Also, the audits of the Promotion and Development Fund are narrowly focused on assuring the Authority stays within the 5 percent spending cap and auditing disbursements. Issue 5 of this report discusses the need for improved oversight of the Fund beyond this basic check. The Authority spends about \$120,000 annually to pay the salary, benefits, and other expenses of one County Auditor staff person to perform these outdated functions. Elimination of these duties from statute would allow the Authority to redirect these resources to establishing an internal audit function.

Internal auditing is a standard management and governance tool in Texas state government, other political subdivisions, and the private sector.

Chapter 2102 of the Texas Government Code, also known as the Texas Internal Auditing Act, provides a statutory framework requiring internal auditing at state agencies. The Act requires agencies meeting certain size criteria to have an internal audit function based on accepted internal auditing standards. The textbox, *Texas Internal Auditing Act Requirements*, lists basic requirements state agencies must follow.

Texas Internal Auditing Act Requirements

- Annual audit plan based on a risk assessment.
- Periodic audits of major systems and controls.
- Periodic review of adequacy of internal audit resources by the governing board.
- Direct reporting relationship between the internal auditor and the governing board.
- Conformance of internal audit program to accepted auditing standards and code of ethics developed by the Institute of Internal Auditors.

Other political subdivisions of the State, such as the Lower Colorado River Authority (LCRA), have internal audit functions that operate according to accepted standards. LCRA's internal audit department reports directly to the Board of Directors, which approves the annual audit plan and hires LCRA's chief audit executive. LCRA's internal audit program performs approximately 35 audits annually, with a staff of seven and annual budget of \$1.1 million.

As a result of scandals involving companies like Enron and WorldCom, the private sector is experiencing a major shift in corporate governance and financial practices. The Sarbanes-Oxley Act of 2002 provides publicly traded companies with guidelines for corporate governance and spells out regulations they must follow, and serves as a model for any company, even those not subject to this law. For example, the Sarbanes-Oxley Act requires companies to establish an audit committee and implement auditing standards.¹¹ In 2004, the New York Stock Exchange began requiring publicly traded companies to maintain an internal audit activity to assess internal controls and risk management. Private sector companies that are not publicly traded are not required to have an internal audit activity, but many do so as a good business practice.¹²

Recommendations

Change in Statute

4.1 Require the Authority to establish an internal audit function following accepted internal auditing standards.

This recommendation would require the Authority to establish an internal audit function, similar to requirements of the Texas Internal Auditing Act and following standards developed by the Institute of Internal Auditors. Under this recommendation, the Authority's internal audit function would report to the Port Commission's Audit Task Force. The Commission would hire the chief audit executive, and approve a risk-based annual audit plan. As part of this recommendation, the Commission should hire a core staff for its internal audit function, but could contract out individual audits or expertise as necessary. The Authority's internal auditor would also coordinate all audit activity, including compliance and internal control review, the Authority's annual financial statement audit, any County Auditor audits, and contracted audits or performance reviews. The Auditor should also be the main point of contact for the Authority's new whistleblower process. This recommendation would require the Authority to provide its internal audit reports to the Harris County Auditor and other appointing entities upon request. The Authority would also be required to make its internal audit plan available on its website. This recommendation would ensure the Authority establishes and maintains an internal audit program adequate to cover its areas of risk in accordance with accepted internal auditing standards.

4.2 Authorize audit oversight of the Authority by the County based on risk and clarify related statutory provisions.

This recommendation would authorize the Harris County Auditor to perform financial audits of the Authority in an occasional oversight role, much like the role of the State Auditor's Office in auditing state agencies. The County Auditor would no longer have a day-to-day auditing function at the Authority. Statute would require any such audits of the Authority be part of the County Auditor's overall risk assessment and annual audit plan for Harris County. Statute would continue to require the Authority to reimburse the County Auditor for any audits performed, at standard rates agreed to by the Authority and the County Auditor and updated periodically, in advance of any audits being scheduled or performed. This recommendation would remove the statutory designation of the Harris County Auditor as the Authority's auditor. This change would clarify the persisting confusion and disagreement that has prevented establishment of an internal audit function by the Authority.

4.3 Repeal outdated provisions prescribing the Harris County Auditor's Authority-related audit duties.

This recommendation would repeal all session law and Texas Water Code audit-related provisions applying to the Port of Houston Authority. These provisions include requirements to pre-approve all Authority claims and contracts, certify funds availability, and prescribe inventory procedures. This recommendation would also repeal provisions for the County Auditor to monitor and audit the Promotion and Development Fund by ensuring the Authority stays within the 5 percent expenditure cap, auditing disbursements, and receiving monthly reports on expenditures. Audit of the Promotion and Development Fund would become part of the new internal audit function's ongoing responsibility. Repealing these provisions would allow for more efficient use of resources to help defray the cost of implementing a standard internal audit function.

Fiscal Implication

These recommendations would likely result in a net cost of approximately \$380,000 annually to the Authority to establish an internal audit program.

Authority staff estimate an annual cost of approximately \$500,000 to establish the internal auditing function required by Recommendation 4.1. This figure includes salaries, benefits, training, and equipment and supplies for three Authority staff, in addition to contracted expertise. Although hiring internal audit staff requires the Authority to invest resources, internal audit can potentially help the Authority save significant funds in the long run by identifying inefficiencies to be corrected.

The Authority currently pays approximately \$120,000 per year to Harris County for one full-time staff person who performs the County Auditor's statutory duties. Recommendation 4.3 would eliminate the current on-site County Auditor position, saving \$120,000 the Authority could use toward hiring its own internal auditors.

The potential cost of any future County Auditor audits of the Authority's finances under Recommendation 4.2 cannot be estimated. The Authority paid \$41,398 in 2011 to the County Auditor for one non-routine audit of the Authority's accounts payable system. This audit represents the only time in the last five years that the County Auditor has performed an audit of this type.

1 Opinion request from the Harris County Auditor to the Harris County Attorney, June 25, 2012.

2 Institute of Internal Auditors, *International Standards for the Professional Practice of Internal Auditing*, accessed June 24, 2012, https://na.theiia.org/standards-guidance/Public%20Documents/IPPF_Standards_2011-011.pdf.

3 Section 2102.004, Texas Government Code.

4 Institute of Internal Auditors, *International Standards for the Professional Practice of Internal Auditing*, p. 10.

5 Opinion request from the Harris County Auditor to the Harris County Attorney, June 25, 2012, p. 4.

6 Section 61.174, Texas Water Code.

7 Port of Houston Authority, *Audit Task Force of the Port Commission of the Port of Houston Authority Charter*, October 2011.

8 Op. Harris County Attorney. No. MD-90-2083 (1990).

9 Chapter 90 (S.B. 310), Acts of the 49th Legislature, Regular Session, 1945; and Section 60.204, Texas Water Code.

10 Op. Harris County Attorney. No. MD-90-2083 (1990).

11 "Executive Summary of the Sarbanes-Oxley Act of 2002 P.L. 104-204," Conference of State Bank Supervisors, accessed July 9, 2012, <http://www.csbs.org/legislative/leg-updates/Documents/ExecSummary-SarbanesOxley-2002.pdf>.

12 "Is it mandatory to have an internal audit activity?" Institute of Internal Auditors, accessed June 26, 2012, <http://www.theiia.org/theiia/about-the-profession/internal-audit-faqs/?i=3083>.

ISSUE 5

Use of the Authority's Promotion and Development Fund Requires Additional Controls and Transparency to Avoid Future Controversy and Distraction.

Background

Texas law authorizes navigation districts, including the Port of Houston Authority, to set aside income for promotional activities in a Promotion and Development (P&D) Fund.¹ The textbox, *Promotion and Development Fund Statute*, describes the very broad statutory parameters governing use of these funds. This law was established by the Legislature in 1949 and, except for codification in 1971, has never been changed.

The Authority uses its P&D Fund for a range of purposes, as described in the textbox, *Major Promotion and Development Fund Expenditures*. The Authority's Public Affairs, Trade Development, and Small Business Development divisions spend the majority of P&D funds. Many of these expenditures are recurring, such as for federal and state lobbyists, trade development travel, advertising, and operation of the *MV Sam Houston*, the Authority's public tour boat. The Authority also spends P&D dollars on other items at the request of Commissioners, staff, or outside groups, such as sponsorships of various community and industry events, community groups, schools, universities, and other entities. The Authority sets an overall budget for these types of expenditures, but approves individual sponsorships throughout the year as applicants request funds. The Authority's reported P&D Fund expenditures for 2010 and 2011 were \$4.8 million and \$3.5 million, or 2.6 percent and 1.7 percent of revenues, respectively, well below the 5 percent statutory cap.

Promotion and Development Fund Statute

- Purpose: Provide Texas navigation districts with authority to spend a limited amount of their income on promotional activities to enable competition with other ports.
- Expenditures must not exceed 5 percent of gross revenues.
- Allowable expenditures:
 - any activity related to advertising, development, or promotion of the district or its ports, waterways, harbors, or terminals;
 - furthering the general welfare of the district and its facilities; and
 - betterment of the district's relations with steamship and rail lines, shippers, governmental officials, or others.

Major Promotion and Development Fund Expenditures – CY 2011

- \$972,965 for consulting fees, mostly for lobbyists and international business marketing
- \$852,537 for advertising and public relations art and printing production
- \$356,667 for economic development support
- \$330,857 for special events
- \$186,767 for trade development travel
- \$90,029 for table sponsorships

Source: Port of Houston Authority

Findings

The broad P&D Fund statutes make nearly any expenditure allowable, leading to continual controversy for the Authority.

Many of the Authority's expenditures are reasonable, but some have blemished its reputation.

Due to its business functions unique to a governmental entity and clear statutory authorization, the Authority is certainly justified in spending P&D funds for many purposes. For example, as the local sponsor of the Houston Ship Channel, hiring lobbyists to advocate for federal funds for dredging is a given. Other reasonable business purposes include contracting with trade consultants in other countries to help generate new business, international travel by staff focused on specific marketing goals, and sponsoring or attending conferences addressing maritime commerce.

However, some of the Authority's expenditures allowed under the P&D statute are unusual for governmental agencies, and have involved the Authority in repeated media exposés over the years, blemishing its reputation. The harm to its public image likely exceeds any benefit derived from the expenditures. Lavish travel and a wide range of event and table sponsorships may be legal, but their very nature causes ongoing concern among the public and the media that such expenditures contradict the Authority's responsibility as a government agency to be a steward of these public funds. The textbox, *History of Controversial Spending*, provides a description of several of these events dating back to 1986.

History of Controversial Spending

- **1986:** Annual promotional trip to New York draws press attention due to \$89,000 cost and attendance by some Houston City Council members at Authority expense.
- **1990:** Authority travel expense records subpoenaed by the Harris County District Attorney after TV news reports raise questions about Commissioners' and spouses' travel at Authority expense.
- **2001:** Houston press reports question first class air travel for Commissioners and a \$7,400 retirement party for a former Commission Chair. State legislators request an audit of the Authority's use of the Fund by the State Auditor's Office.
- **2002:** The State Auditor's Office publishes an audit report on the Fund. The audit found no illegal expenditures due to the broad nature of the statute, but recommended the Authority better define allowable uses of the Fund.
- **2010:** A former senior-level Authority staff member receives a \$380,000 severance package approved by the Commission, raising concerns by local officials and the media. The contract provides for the Authority to receive public relations consulting services upon request, but requires no specific deliverables. The Authority makes monthly \$15,000 payments to the former employee's public relations firm out of the P&D Fund.
- **2011:** Allegations surface, later cleared by the Harris County District Attorney, regarding the Authority's special uses of the *MV Sam Houston* tour boat, paid out of the Fund. These allegations, the former employee's severance package, and other issues surfacing in the Houston media led to a report by the Harris County Attorney and the Legislature ultimately placing the Authority under Sunset review.

The 1949 P&D statute was modeled after the way private businesses operated during that era. Much has changed since then, and private businesses have many more controls over how they spend funds on P&D items, such as travel, entertainment, and business meals. The statute, and the Authority, have yet to follow suit.

The Authority has not set clearly defined purposes and strict parameters for uses of the Fund.

Because the P&D statute allows nearly any expenditure, clear guidelines and internal controls over use of the Fund would be a reasonable way for the Authority to focus spending and reduce temptation to spend the money too freely, particularly in light of recent and older controversies. So far, however, it has failed to adopt clearly defined or comprehensive policies and procedures. In fact, ten years ago, the State Auditor's Office recommended the Authority better define allowable uses of the P&D Fund and consider limiting uses to only those expenditures not allowable from another funding source.² Preferring the flexibility to use the Fund as it sees fit, the Authority has struggled to define its use in a concrete way.

P&D policy is a patchwork of memos and other guidelines.

Today, the Authority's policies governing P&D expenditures remain a patchwork of agency memos and other documents, making it difficult to ascertain which policies currently apply or track if they are actually being followed in practice. As described in the textbox, *Promotion and Development Fund Policymaking History*, the Authority has made several past and recent attempts at establishing spending guidelines and other parameters for its use of P&D funds. Sunset staff studied these policies and compared them to current Authority practice, and could not clearly determine a straightforward, comprehensive definition of P&D expenditures or a clear expenditure approval process.

***Promotion and Development Fund
Policymaking History***

- 1994:** Compilation of Authority policies includes a broad summary of the P&D statute
- 2002:** Promotion and Development Fund Policy
- 2003:** Sponsorship Policy and Procedures
- 2008:** Port Commission Travel and Expense Reimbursement Policy
- 2009:** Sponsorship Policy and Procedures
- 2011:** Accounting and Finance Guidelines
- 2012:** Updated Accounting and Finance Guidelines

The most recent P&D policy, the 2009 Sponsorship Policy and Procedures, requires detailed reporting of sponsorships and a sponsorship budget for each Commissioner which is not current practice. With the exception of the 2003 Sponsorship Policy and Procedures, none of these policies have been formally approved by the Commission. Authority staff indicate they are currently working to develop a comprehensive update to P&D policies, but these were not available for evaluation during the Sunset review.

The lack of clear policies leads to a hodgepodge of approvals and accounting decisions which minimize accountability and transparency for this spending. Sunset staff observed multiple pathways for approval and tracking of expenditures which tend to frustrate complete understanding of overall P&D activities.

The Commission approved separate multi-million dollar contributions to university and community projects that were not classified as P&D.

- **Commission approval.** The lack of clear policies for approving these expenditures invites confusion as to what is actually a P&D expenditure. Through the annual budget approval process, the Commission approves much of the routine P&D expenditures, such as advertising and trade development consultants. The Commission also approves *all* expenditures of more than \$50,000. These approvals are clear. However, the Commission has also approved significant projects that seem like community contributions typically included as P&D expenses, but which the Authority does not classify as P&D. These expenditures have included multi-million dollar contributions to universities and local capital improvement projects. For example, the Commission approved a \$2 million donation to Texas Southern University in 2009 to establish a Maritime Transportation Management and Security Program, paid in two separate \$1 million installments in 2009 and 2010.³ Authority staff indicated this was not classified as a P&D expenditure because it was a contribution to a governmental entity. However, the Authority has previously used the P&D Fund to sponsor programs at governmental entities such as the Houston Independent School District and the University of Houston. Other community-related expenditures similar to P&D uses include a commitment of up to \$2 million to the Economic Alliance Houston Port Region to participate in grant funding for improvements at the San Jacinto Monument in 2009; and a \$400,000 budgeted 2012 expenditure to build sidewalks in Morgan's Point, a community located near one of the Authority's facilities. Both of these projects are included in the Authority's current capital projects list but not classified as P&D expenditures. Such expenditures for apparent P&D purposes from non-P&D funds obscures proper accounting of true P&D expenditures and threatens to deprive actual port operations of needed funds.
- **Line item additions.** Commissioners also bring forth proposed P&D expenditures at Commission meetings outside the regular budget development process. Minutes from a November 2011 special Commission meeting show that a Commissioner brought forth a proposal for a \$25,000 contribution to San Jacinto Community College for its maritime program. This type of expenditure is in line with other P&D spending by the Authority related to supporting education at community institutions, but went through a different path to approval than most sponsorships of this type, making it difficult to track.
- **Task Force and Chair approval process.** As of July 2011, the Commission's Small Business and Community Relations Task Force approves most P&D sponsorships under \$25,000 and all *MV Sam Houston* special tour requests, although this practice is not yet documented in any official policy. The Task Force's approval of P&D sponsorships is inconsistent with the Commission's stated intent of using the task forces as strictly advisory bodies.⁴ The 2009 policy

also states that sponsorship requests under \$25,000 from individual Commissioners may be approved directly by the Commission Chair, but staff indicated this is not currently Authority practice.

- **Other exceptions.** The Commission adopted broad priorities for event sponsorships in 2003 to ensure these types of expenditures directly relate to the Authority's maritime commerce and economic development mission. The policy, however, does not have a process for handling exceptions to these priorities. As an example, in 2012, the Small Business and Community Relations Task Force approved a \$6,000 sponsorship of the American Heart Association Heart Beat Ball where a Commissioner was being honored. In the absence of a clear process for exceptions to its policy, the Authority may be inclined to take an ad-hoc approach to decision making that misses the priorities designed to best target this spending.

The Authority sponsors some community events that do not relate to its adopted priorities.

The Authority has not made sufficient efforts to ensure its use of the P&D Fund is transparent both within the organization and to stakeholders and the public.

P&D expenditures are not reported publicly and transparently, leaving opportunity for both negative public perception in addition to the potential for inefficient use of the Authority's public funds. The Authority has included language in its 2009 Sponsorship Policy and Procedures, 2008 Port Commission Travel and Expense Reimbursement Policy, and 2012 Accounting and Finance Guidelines requiring detailed reporting of expenditures, but this has not occurred, except for basic budget-to-actual expenditure comparisons in P&D Fund reports circulated monthly to management.

Other recent efforts by the Authority to provide more financial transparency do not include specific steps regarding P&D expenditures. For example, the Authority recently began posting summary documents for its 2012 budget on its website, but these postings do not contain separate P&D budget information, even though Commissioners receive such information in their detailed budget documents. Instead, P&D expenditures are embedded into division budgets in the public documents. The Authority also recently began posting significant amounts of financial information on its website, including a summarized budget document and check register. While posting this information is a positive step, the Authority does not provide easily identifiable information about P&D expenditures, including special use of the *MV Sam Houston*. P&D spending in general, and special boat tours, sometimes including catering, have been a source of recurring controversy for the Authority. Providing complete visibility into these activities and expenditures would encourage prudent business decisions and help restore public trust in the organization.

Visibility into P&D spending would encourage prudent business decisions.

The Authority has made efforts to reduce P&D spending for staff and Port Commissioner travel and expenses, but still lacks basic controls to ensure ongoing accountability and efficiency of these expenditures.

Despite recent trends in the Authority's travel and related expenditures which show reductions from \$635,750 in 2010 to \$460,428 in 2011, the Authority lacks standard or consistently enforced policies relating to Commissioner and staff travel and expenses to ensure ongoing implementation of improved business practices into the future. The recent reductions were possible, in part, due to the Authority's efforts to be more strategic with expenditures relating to trade missions and cutting back on Commissioner travel on business marketing trips, which have in recent years included extravagant expenditures on hotels, customer luncheons, and other costs, explained below. However, expenditures on travel and expenses are still substantial, and should be an ongoing focus of improved efficiency and control.

- **Overall policies lack basic controls.** People have been traveling on government and private business for many years, resulting in standard best practices for travel and related expenses, such as events with outside parties, whether by staff, elected officials, or governing board members. Travel and expense policies must contain a mix of proper accountability and controls, accommodation for traveler needs, and attention to achieving the business goals of the travel. However, some of the Authority's travel practices miss the mark, as described below.

Spending guidelines for meals, lodging, and entertainment. Government organizations usually use an adopted standard, such as those set by the General Services Administration for domestic travel or the U.S. Department of State for international travel.⁵ Expenses are usually paid by the individual and reimbursed, and any costs incurred in excess of the guidelines are generally the individual's responsibility. Private sector companies also provide clear guidance for business travel and entertainment expenditures as a basic function of controlling costs.⁶

Contrary to these basic standards, Authority policy does not provide for per diem allowances or clear spending guidelines for meals, lodging, or entertainment, but instead states that employees and Commissioners may incur only "reasonable" expenses while on Authority business, and this term is not defined. For lodging, rooms are often booked and paid directly by the Authority, and the bill is generally left open for additional charges to the room. This process does not provide accountability for such charges, whether food or other incidentals, and potentially allows for inappropriate purchases, or purchases for outside persons, to be paid by the Authority. The lack of specific guidelines has led to examples of significant expenditures.

Unlike many organizations, the Authority does not set spending limits for travel or entertainment.

Cash advances. With the availability of corporate credit cards, travel advances are no longer allowed in most organizations. Exceptions may exist for purchase of foreign currency in certain markets. By comparison, Authority policy allows cash advances for any type of travel, as long as the advance is approved by division officers.

Expense reports. Expense reports should follow specific approval paths to provide accountability for all reimbursed expenses and these reports should be part of an internal audit plan for random audits. The Authority has established an approval process for expense reports, but does not separate Commission and staff expense reports. The Authority also does not ensure the most senior employee submits expense reports resulting from events attended by other, more junior staff. Placing responsibility for submitting expense reports on junior staff for events involving their superiors or Commissioners blurs lines of accountability and does not ensure an independent check on these reports. In addition, while Authority policy discourages submission of expense reports for meals involving staff or Commissioners that are not part of approved travel, such as a dinner in the Houston area, it does not prohibit such spending. Finally, as discussed in Issue 4, the Authority has no internal audit function that could help monitor the appropriateness of these types of expenditures.

- **Commissioner travel and expenses lack accountability.** Commissioner travel clearly does not follow the Authority's existing policies designed to encourage accountability and limit spending, most recently outlined in the 2008 Port Commission Travel and Expense Reimbursement Policy.⁷ This policy and the Commission's bylaws require Commissioners be *reimbursed* for their expenses, which would allow ease of tracking and reporting. However, in practice, reimbursement is rarely the process used. Instead, Commissioner travel and related expenses are usually paid directly by the Authority, or through the expense reports of Authority staff with whom Commissioners travel. Commissioners sometimes reimburse the Authority for some of these costs and costs associated with expenses paid on behalf of spouses, as required by policy. However, the Authority has no formal invoicing or tracking process for these reimbursements, so Sunset staff could not verify whether this was consistently occurring.

The Authority has no way to easily track and report summary information about Commissioner travel and expenses. Sunset staff requested data on Commissioner travel and expenses for the last three years, but the Authority was unable to provide summary amounts spent on or by individual Commissioners, or even the Commission as a group. Instead, the Authority provided copies of about 70 individual expense reports and invoices from trips and business meals involving Commissioners, but could not assure this information was complete. Trips involving

*The Authority
does not track
or report
Commissioner
travel and
expenses.*

Commissioners often result in substantial costs, including significant expenditures for events with outside parties, as shown in the textbox, *Cost of Recent Authority Trips Involving Port Commissioners*. In each of these examples, Authority staff paid for Commissioner expenses and was later reimbursed, or the Authority paid directly for some expenses, such as airfare and hotel.

The Authority must make a more concerted effort to control and justify its use of public funds.

While marketing and advocating on behalf of the Authority's interests is reasonable and necessary, some of the expenses reviewed in these reports show why these types of expenditures have been a recurring theme in the media for many years and point to the need for more comprehensive, enforceable travel and expense policies. This closer look revealed the following examples of expenditures occurring after the Authority's 2008 policy directing Commissioners to make "reasonable" efforts to minimize costs: \$966 for a dinner for seven people, including Commissioners, staff, and spouses at the 2009 conference in Italy; \$23,327 on hotel rooms during the 2009 New York trade mission at a cost of more than \$900 per night per room; \$6,600 on a humorist to entertain at three luncheons during the same trip; and a 2010 meal attended by eight people costing \$1607, including \$566 on alcohol. The Authority incurred all these expenses using public funds and should make a more concerted effort to control and justify these types of costs.

Cost of Recent Authority Trips Involving Port Commissioners*

- **2009 New York Trade Trip.** Total cost – \$90,475. Included: \$38,919 in hotel and airfare; \$37,469 in event costs; \$6,600 in entertainment; \$5,240 in employee expenses; and \$2,247 in other expenses.
 - **2009 International Association of Ports and Harbors Conference in Italy.** Total cost – \$45,861. Included: \$23,423 in conference-related costs; \$18,000 in airfare and transportation; and \$4,438 in employee expenses, including meals.
 - **2010 Federal Advocacy Trip and Congressional Reception in Washington, D.C.** Total cost – \$71,474. Included \$50,037 in event costs; \$16,276 in hotel; \$10,691 in airfare and transportation; and \$573 in employee expenses. The Authority ultimately received \$6,104 in related reimbursements, reflected in the total.
 - **2011 State Advocacy Trip and Legislative Reception in Austin.** Total cost – \$30,538. Included \$27,587 in event costs; \$5,156 in hotel and meals; and \$3,870 in airfare and transportation. The Authority ultimately received \$6,075 in related reimbursements, reflected in the total.
- * Totals include Commissioner, staff, and other individuals' expenses.

Recommendations

Change in Statute

5.1 Require the Port Commission to adopt comprehensive and publicly available policies and provide detailed reporting on the Authority's use of the P&D Fund.

The recommendation would require the Commission to adopt clear, complete policies and procedures to govern the Authority's use of the P&D Fund. These policies would provide needed internal guidance on the appropriate and strategic use of P&D monies. Once publicly discussed, adopted, and placed on the website, these policies would be available to the public to see how the Authority uses its public funds for P&D purposes, and the Authority would have a basis to defend its spending decisions and defuse criticism. The policies should, at a minimum:

- define acceptable uses of P&D funds with a more narrow, direct tie to the Authority's mission than current general statute and Authority policy provides;
- define a clear and consistent budget and process for requesting sponsorship funds by Commissioners, outside groups, and staff;
- define proper approval procedures for all types of P&D expenditures, including the proper level of approval or notification among staff, task forces, and the full Commission;
- require each approval to demonstrate the expected impact of the expense and how the expense meets the approved strategic direction for P&D funds previously adopted by the Commission;
- address how the Authority will handle any exceptions to established policies, and provide that any exceptions should be reported in the same manner as any other P&D expenditure;
- provide for evaluation of the policy's effectiveness and regular updates approved by the Commission in a public meeting; and
- provide for regular tracking and reporting of all P&D expenditures to the full Commission and on the Authority's website, including detailed information about Commissioner travel, special uses of the *MV Sam Houston*, and all sponsorship and other similar spending. This report should include individual P&D expenditures, the name of the requester and the organization sponsored, if applicable, as well as the amount, date, and the purpose of the expenditure. This information should be sorted by division. The special tour segment of the report should contain the name of the person or organization requesting use of the *MV Sam Houston*; the date; and catering costs, both food and alcohol, and if these are paid by the Authority. The reports should also contain year-to-date summary information on the Authority's P&D expenditures for different expenditure categories.

5.2 Require the Authority to adopt travel and expense policies to include generally accepted expenditure control elements with clear lines of accountability for both staff and Commissioners.

This recommendation would ensure the Authority revises existing policies to put in place additional controls on staff and Commission travel and other expenses to minimize the cost of these activities. In implementing this requirement, the Authority should:

- establish specific spending guidelines for meals, lodging, and entertainment, such as per diem limits established by state or federal agencies;

- authorize a process for handling exceptions from these limits when and if business needs require, with a documented justification for such deviations;
- limit or eliminate the use of cash advances in most cases;
- clarify expense report protocols in its travel and expense policies by requiring separation of Commissioner and staff expense reports, and clarifying that the most senior staff member involved submit the expense report for approval to ensure clear lines of accountability; and
- specifically prohibit use of P&D or any Authority funds for staff and Commission meals not part of approved Authority travel or part of a business-related function with outside parties.

These changes will help the Authority establish some basic parameters to limit expenditures, and strengthen the lines of accountability for Commissioner and staff travel and expenses.

Fiscal Implication

These recommendations could be implemented within existing resources and only have positive fiscal impacts by strategically focusing the use of P&D funds and eliminating unnecessary expenditures.

¹ Section 60.201, Texas Water Code.

² State Auditor's Office, *An Audit Report on the Port of Houston Authority's Promotion and Development Fund*, accessed July 10, 2012, <http://www.sao.state.tx.us/reports/main/02-019.pdf>

³ Port of Houston Authority, *Request for Port Commission Action*, "Agreement with Texas Southern University," March 31, 2009.

⁴ Port of Houston Authority, *Request for Port Commission Action*, "Consideration of, and possible action regarding, the formation of Port Commission Task Forces," May 24, 2011.

⁵ For example, the State's General Appropriations Act provides spending guidelines for state employee travel expenses according to various federal guidelines. For international travel, the State Department provides similar guidelines. See: Part 5, Article IX, Chapter 1355 (I.L.B. 1), Acts of the 82nd Legislature, Regular Session, 2011, General Appropriations Act; U.S. General Services Administration, "Per Diem Rates," accessed July 12, 2012, <http://www.gsa.gov/portal/category/21287>; U.S. Department of State, "Foreign Per Diem Rates by Location," accessed July 12, 2012, http://aoprals.state.gov/web920/per_diem.asp; and Internal Revenue Service, *Notice 2012-1: 2012 Standard Mileage Rates*, accessed July 12, 2012, http://www.irs.gov/irb/2012-02_IRB/ar09.html.

⁶ See, as one example of corporate standards for travel, American Express Business Travel, *Building a Best in Class Travel and Entertainment Policy* (2007), accessed July 12, 2012, http://corp.americanexpress.com/gca/travel/us/docs/WP_CreatingATFPolicy-us.pdf.

⁷ Port of Houston Authority, *Port Commission Travel and Expense Reimbursement Policy*, October 2008.

ISSUE 6

Procurement at the Authority Lacks Consistent Practices to Ensure Fair, Cost-Effective Purchasing.

Background

Procurement at the Port of Houston Authority is big business, demonstrated by estimated purchases of \$122 million in calendar year (CY) 2011. The Authority's operations lend themselves to procurement because of its large construction program; purchase of heavy machinery and equipment; police and fire forces; insurance-related purchases for employee benefits and risk management; development and maintenance of an extensive information technology network; and promotional activities.

Picture of procurements. The statute applying to the Authority and other navigation districts authorizes delegated staff to make routine purchases or contracts up to \$50,000, termed "informal procurements" by the Authority.¹ Procurements of more than \$50,000, called "formal procurements," must be approved by the Commission in public, and must follow competitive bidding requirements and proposal procedures found primarily in the Texas Water Code but extending into other statutes as well.² Emergency and certain other purchases are exempt from the competitive bidding requirements and proposal procedures.³

Formal procurements represent the majority of Authority purchases by far, totaling about \$107.3 million, or 88 percent, of the organization's procurements in 2011, with informal purchases making up the remaining \$14.7 million, or 12 percent. The pie chart, *Formal Awards by Type of Procurement*, shows that construction is by far the largest category of contracts, with goods and services a distant second.

**Formal Awards by Type of Procurement
CY 2011**



Source: Port of Houston Authority

August 2012

The Authority makes these formal purchases through several purchasing methods, as authorized by statute. The table, *Primary Purchasing Methods at the Port of Houston Authority*, describes these procurement types and related Authority awards for 2011.

**Primary Purchasing Methods at the Port of Houston Authority
(Formal Procurements)
CY 2011**

Method	Primary Uses and Description	Award (Millions)	Percent
Competitive sealed proposal	Used primarily for construction, but also goods and services. Can consider factors other than price in making a best value selection.	\$51.9	48%
Request for proposal	Used for purchases of insurance, information technology, and some professional services. Can consider factors other than price in making a best value selection.	\$25.6	24%
Cooperative and catalog purchases	Used for supplies and equipment, such as paper, information technology purchases, and other goods. Typically structured through intergovernmental agreements or contracts.	\$10.7	10%
Non-competitive selection or exempt selection	Used for sole source purchases when competitive alternatives are not available (\$6.2 million) and other miscellaneous purchases (\$1.1 million).	\$7.3	7%
Informal selection of most highly qualified professional service provider	Used for obtaining certain professional services such as legal services.	\$6.0	6%
Request for qualifications	Used for selection of certain professional services, primarily engineers, architects, and land surveyors. Selection based on qualifications first, after which price may be negotiated.	\$5.8	5%
Competitive sealed bid	Used for construction in situations where a third party is paying for construction needed because of property damage. Selection based on lowest responsive bid. Not used in 2011, but has been used in other years.	\$0	0%
Total		\$107.3	100%

Small Business Development Program. The Authority strongly promotes the participation of small businesses in its procurements through its Small Business Development Program. A firm must be certified according to adopted procedures to participate in the program as a small business.⁴

Established by the Commission in 2001, the program has an annual goal of awarding 35 percent of the dollar amount of eligible procurements to small businesses. These procurements include formal purchases of more than \$50,000, with exceptions primarily for sole source items, federally funded contracts, and contracts with governmental entities.⁵ Informal procurements do not have such a formalized goal, although Authority practice has been to award procurements to a small business if its bid is within 10 percent of the lowest bid, other factors being equal.

In 2011, small businesses received about \$30 million, or 55 percent, of eligible formal procurements totaling about \$54.2 million, well exceeding the Authority's goal of 35 percent. Small businesses received another \$2.3 million, or 33 percent, of eligible informal purchases totaling \$6.9 million.

August 2012

The Purchasing Office is currently located within the Legal Division, but this office's function is largely ministerial and not aimed at active procurement oversight. The Legal Division's attorneys help structure procurement instruments, advise on procurement issues, and perform other procurement tasks, but the division is not responsible for active management and monitoring of the procurement process. Besides, the Legal Division is not the best place for a centralized procurement office because of concerns about mixing roles of legal representation and contract development. The Small Business Division has a large view of procurements in the organization, given its responsibilities to promote small business contracting across all procurements and monitor the small business program's effectiveness, but its role is limited to that focus. Other divisions, such as Finance and Administration, are involved in procurement administration, but from their financial and accounting perspective.

Each division manages its own contracts, with no system to ensure consistency.

The end result of this approach is that each division is left to manage its own procurement process. This system leads to inconsistency in approach, with divisions performing similar functions differently. Though some informal coordination does occur, no systematic, Authority-wide process exists for developing and managing training programs, managing contracts, or ensuring that other elements of procurement occur consistently throughout the organization.

The Texas Department of Transportation (TxDOT) also has a highly decentralized procurement system, with contracts originating from district offices or various divisions within its central office. The agency has established a point of central services for many of its negotiated contracts, including high risk comprehensive development agreements. This office of 22 employees includes four lawyers, 16 contract specialists, and two office technicians. The office develops templates primarily for different contract types and internal forms, provides training, maintains a contracts policy manual, and updates Internet information. The office also reviews contracts with private entities, such as engineering contracts or purchase orders, to ensure use of the right template and other standard information that should be included.

Authority staff had to torturously compile basic contract information by hand.

- **Poor systems for contract reporting and management.** The Authority has separate software systems that handle aspects of contracting for the Purchasing Office, the Finance and Administration Division, and the Small Business Division. Together, these three systems do not provide the reporting capabilities necessary to effectively track and manage Authority procurement functions. For example, to provide a list of formal contracts, including the award amount, the contract term, and the originating division for the most recent three years, Authority staff torturously compiled the information over a period of several weeks from Commission agenda items and hard copy purchase orders.

The Authority recognizes this deficiency and is working to correct it, but continuing attention is needed to ensure that management receives timely information to quickly monitor and control its very large procurement function.

- **No comprehensive, up-to-date contracting rules and procedures.** The Authority does not have well-defined, updated, and easily accessible high-level rules and procedures that apply to contracting across the organization. Various policies and procedures have been developed over time dealing with staff-related conflicts of interest and certain contracting procedures, but they are not compiled into a consistent format or easily accessible to staff, the public, or vendors. Instead, they exist in a policy manual dating to 1994, memos, policy statements, and other formats. The Authority is updating and compiling at least some of these procedures, but that work is ongoing and sufficient progress had not been made to judge its adequacy. Some are being updated for the first time in years.

The basic approaches underlying some of the Authority's procurement functions do not conform to typical contracting standards.

Staff procurement policies and organizational arrangements should not stray too far from typical practices except for good reason. Standard contracting approaches emerge because of their proven worth. Several aspects of the Authority's procurement policies and organizational arrangement of functions fall outside these bounds.

- **High contracting goal for small business.** The Authority has set, and often exceeds, an annual 35 percent goal for formal procurement awards to small businesses. Other public entities in Harris County also set goals for minority-owned, women-owned, and small business enterprises. Generally, these entities have not set a goal as high as the Authority, with the exception of Houston's Metropolitan Transit Authority with its overall 35 percent goal for its small/disadvantaged business program. Harris County sets no goal, but it encourages small business participation. The goals for the programs and contracts for the City of Houston and the Houston Independent School District range from 11 percent to 25 percent, according to the Authority. The federal government's Small Business Administration has established a goal of 23 percent for contracts awarded to prime contractors.⁶

The Authority established its small business contracting goal without detailed analysis as to its reasonableness, and has not historically estimated what additional costs may result from the policy, although that effort now appears to be underway. Additional costs could result from awards to businesses who gained winning evaluation points from their small business status while not otherwise having the best value bid, a factor that should be carefully considered in adopting a goal.

The Authority has not yet determined whether its high small business goal results in additional costs.

The small business program's community development role detracts from its core procurement responsibility.

- **Atypical organizational placement of the Small Business Division.** Programs for small or historically underutilized businesses are often conducted as part of an organization's procurement office rather than a separate organizational unit such as the Authority's Small Business Division. Separating these programs, especially at the Authority, risks misaligning these integrally related procurement activities.
- **Small business promotional efforts not directly related to Authority contracting.** The Small Business Division coordinates with public and private groups to develop small business capabilities generally, to provide educational opportunities related to maritime and small business employment, and to sponsor various events in the community. These expenditures, made from the Authority's Promotion and Development Fund and totaling about \$303,600 in 2011, do not always relate directly to contracting responsibilities of the organization. In addition, the Authority contributes funds to various entities, such as chambers of commerce, to develop economic opportunities in their areas and to organizations, including the University of Houston, to help educate and develop small businesses in various ways.

Use of these funds for purposes unrelated to contracting raises the question of whether such expenditures are appropriate for a small business program. In addition, the small business program's involvement in community development efforts blurs its focus on its core responsibilities of promoting small businesses contracting with the Authority. The Public Affairs Division makes expenditures from the Promotion and Development Fund for other promotional or community development programs and is better positioned to focus such efforts in one place.

- **Unusual concentration of procurement functions in the Legal Division.** The Legal Division has assumed an uncharacteristically involved role for a legal department in procurements. Placement of the Purchasing Office within its framework is one part of this role. A second part of the role is the involvement of attorneys in helping structure contracts, going beyond the more typical emphasis of review and advice that attorneys usually exercise.

The Legal Division took on these responsibilities in January 2012, in part to help the Authority strengthen its procurement operations. At some point, this role could bring into question whether the division is giving legal advice or has crossed over into substantively developing contracts. Moving too far into the latter category could affect attorneys' ability to maintain confidentiality for their client, the Authority, since attorney-client privilege attaches to legal roles of review and advice.

The Authority has not systematically examined certain long-term legal and lobby contracts to determine their relevance and efficient operation.

A public entity should carefully assess the need for outside services and use them only if in-house expertise is not available. Also, active evaluation should occur periodically to determine whether to keep or restructure ongoing consulting services, once established. Several areas emerge when considered in this light.

- **Questionable need for the Special Counsel function.** The Authority has employed the services of an outside Special Counsel since 1992. The Special Counsel consults with Commissioners, as well as the Executive Director and General Counsel on matters primarily related to Commission responsibilities. Such responsibilities have included advice on when and how to structure open meetings or executive sessions, the conduct of Commission meetings, attendance at all Commission meetings, and general legal advice. Employment of the Special Counsel is primarily the responsibility of the Chair, subject to Commission oversight and with input from the Executive Director and General Counsel. In 2011, the Authority paid about \$238,300 for these services.

The position came into existence when questions related to Commission members' travel became public, requiring legal assistance; however, no continuing need for this position is apparent today. The in-house counsel employed by most large public entities advises board members, without the need for outside assistance, particularly in matters involving open meetings requirements. Also, no special liability in comparison to other water district board members or state agency officials appears to attach to Commission members in the performance of their official duties, and state law limits their liability as it does for other public servants.⁷

- **Questionable need for the Litigation Counsel function.** The Commission has retained counsel to act as Litigation Counsel since at least 1989. The Litigation Counsel function, itself, does not include actual litigation, which various law firms hired by the Authority carry out. Rather, the Litigation Counsel reports and advises the Commission, Executive Director, and General Counsel on the status of Authority suits, which numbered 20 as of July 2012. The employment of the Litigation Counsel appears to be the primary responsibility of the Chair, with oversight by the Commission and input from the Executive Director and General Counsel. In 2011, the Authority paid about \$44,300 for litigation counsel services. General counsels in most large agencies usually would provide this function.
- **Need for evaluating outside lobbyist function.** The Authority employs lobbyists, a legal activity for political subdivisions such as the Authority as long as they do not use state funds.⁸ The Authority pays

In 2011, the Authority spent \$282,600 for Special and Litigation counsels, despite in-house counsel's ability to perform these duties.

The Authority contracted with seven lobby firms in 2011, costing about \$650,000.

for lobbyists from its Promotion and Development Fund, and uses these services to protect and promote the interests of the organization locally and at the state and federal levels. In 2011, the Authority contracted with seven lobby firms at a cost of about \$650,000. Five firms were assigned to state issues, and two to federal matters. Additionally, three in-house staff supervise the lobby program and also advocate for the Authority.

Quantifying what constitutes a reasonable lobby program, and judging the value received from the program and individual lobbyists are inherently subjective. The results are elusive and attribution of success to any one or group of individuals often impossible. Yet, entities should make an active effort to determine lobby needs and evaluate program performance periodically in some structured, systematic manner, even if subjectively.

The Authority has not engaged in this type of evaluation to test notions about the effectiveness of its advocacy program and lobbyists. While the Authority has made some assessments in the past, staff usually monitor the effort more passively, and trends from the past tend to carry into the future. State-level lobbyists currently working for the Authority first began service between 1998 and 2004, with the federal lobbyists starting in 2007. Continuation of these contracts occur by Commission approval, without much apparent analysis or Commission discussion about the overall lobby program.

The Authority's procedures for disclosure and communication with potential contractors need to be strengthened to promote fairness.

Clear disclosure and communications policies relating to procurements should direct the behavior of Authority staff and Commissioners to protect potential contractors from disclosure of privileged information and help avoid the introduction of bias or favoritism in contractor selection. Three areas where policies could be improved follow.

- **No written nepotism disclosure.** The Authority has policies requiring personnel involved in an active procurement to make nepotism disclosures related to the procurement, but does not require these in writing. The Authority has experienced at least one circumstance in a recent solicitation for security services which had to be rebid because of a nepotism issue between a subcontractor and an Authority employee.
- **No signed non-disclosure statement.** The Authority communicates to staff evaluating proposals the importance of not disclosing information about respondents' submissions to others. However, the Authority has not required such staff to sign non-disclosure statements, as best practices suggest, to cement this understanding.

- **No specific policies defining communication with Commission members.** The Authority informs staff and vendors about the appropriate channels of communication during an active solicitation. Bid documents define channels for asking questions or receiving information from staff, minimizing communication that would give one vendor an advantage over another. Other guidelines also are available defining proper staff interaction with contractors and consultants, including penalties for non-compliance.

While guidelines exist for staff, clear guidelines on this topic do not exist for Commissioners, who are free to communicate with potential contractors vying for selection during an active procurement. This type of communication, outside the formal evaluation process, could improperly influence Commission members in the selection of contractors and should not occur.

The Houston Independent School District has addressed this topic in its policies, which prescribe a “code of silence” between vendors and board members, as well as other school personnel who have influence in evaluation or selection in a competitive solicitation.⁹ The code prohibits communication about a solicitation between these parties from 30 calendar days before issuance of a solicitation until execution of the contract. The policy goes on to prohibit items of value from being exchanged between the parties.

Communication outside the evaluation process could improperly influence the selection of contractors.

The Authority does not provide a sufficient level of consistency and fairness in evaluating and awarding contracts.

Procedures for awarding contracts should ensure objective selection, provide an avenue of appeal to decisions, and have feedback mechanisms to improve future contracting. These features help ensure fair and efficient contracting. The review indicated the following areas for improvement.

- **Variation in contract evaluation committees.** The Authority uses evaluation committees to judge and rank vendor proposals, but processes vary across divisions, with no mandated and standardized approach used consistently. Some divisions, such as the Engineering and Real Estate Division, have a well-developed checklist to ensure completeness, fairness, and a consistent approach from one contract to the next. Other divisions use less regimented approaches. These differences could introduce variability in quality of judgments to the detriment of the contracting process.
- **Commission involvement in selection of contractors.** The Commission has approval authority on procurements of more than \$50,000. Under current practice, staff brings the Commission several ranked options, when available, with a staff recommendation. The Commission may choose the staff recommendation, select from other

alternatives, or reject all proposals. If the Commission chooses an alternative other than the staff recommendation, it does not rescure or have to provide additional documentation explaining the decision. The Commission has changed staff recommendations in five solicitations since September 2011.

The Commission's ability to choose an alternative proposal other than the one scored and recommended through the staff's evaluation process effectively places the Commission in the evaluation process and is an example of its tendency to involve itself in what are more typically staff-level functions, as discussed in Issue 1. From a contracting standards standpoint, the preferred approach is for a policy body to approve or reject the staff's recommendation without having the flexibility of choosing among alternatives, which had been the Commission's approach until recently. In this standard approach, the policy body sits as judge on staff's evaluation and does not involve itself in developing the evaluation itself. TxDOT, one of the state's largest public contractors, uses this approach in approving negotiated contracts that come before its Commission.

The Commission's power to select among multiple proposers invites vendor lobbying and puts it on a perilous path.

The ability to choose an alternative proposal introduces a level of subjectivity that could affect confidence in the selection process. First, staff has conducted a formal, documented analysis with procedures intended to produce an objective outcome for vendors and a suitable procurement recommendation that may simply be ignored without a clear rationale. Second, lack of a documented reason for selecting the alternative over the recommendation potentially raises questions regarding the basis for the decision. Finally, the process has the potential for inviting lobbying by vendors who wish to be selected and seek to influence contract decision making. The Commission risks going down a perilous path through this nonstandard process.

- **Lack of an appeals process.** The Authority's contracting procedures do not include a formal avenue of appeal for vendors. The organization reports that contracting issues have been handled informally and that issues rarely arise. Regardless of how much it may be used, an appeals process ensures a formal and visible point of accountability and promotes fairness in contracting decisions. An appeals process is a standard part of major state procurement systems, such as that used by TxDOT, the Comptroller of Public Accounts, and the Department of Information Resources.¹⁰
- **Contractor evaluation at closeout.** Authority processes do not provide for systematic feedback and documentation about vendor performance at closeout of a contract. The Engineering and Real Estate Division regularly notes contractor performance in their files at close-out and keeps track of this information, but this practice is not standardized across division lines. Availability of such information increases the information available for making good contractor selections in future procurements.

The Authority does not provide sufficient, systematic training related to contracting and conflicts of interest.

Personnel involved in contracting should receive standard, comprehensive training about conflict-of-interest policies and contracting procedures to help improve and maintain consistent quality. The Authority has training materials available dealing with topics of procurement, project management, and related subjects, and various divisions offer training from time to time on procurement and ethics-related topics. However, the Authority does not have systematic and ongoing training on contracting and conflicts of interest, either for Commission members or staff. A thought-out training program is especially important in high-risk, high-dollar contracting situations and decentralized contracting operations such as the Authority's.

Recommendations**Management Action****6.1 The Authority should take steps to better manage and align its organizational approach to procurements.**

- **Establish a central procurement office.** The Authority should establish a clear point of coordination for its procurements. The office would oversee standardization of major aspects of procurement, with divisions continuing to manage projects in their areas. Management should give the office authority to oversee the development of basic procurement rules and procedures, standard procurement forms, evaluation structures for procurements, awards processes, training related to contracting, and other procurement processes. Management could also consider giving the office final approval on formal procurements before advertising them. These responsibilities should be carried out with support from the Legal Division due to the legal aspects of procurements, as well as other divisions, such as Engineering and Real Estate, that have a heavy involvement in procurement. A higher degree of centralization would help make processes consistent, improving procurement efficiency and helping to ensure fairness to vendors.
- **Move the small business procurement function into the new procurement office.** Consolidation would help ensure consistency in applying small business goals and alignment of the function with the Authority's overall contracting process.
- **Reduce involvement of the Legal Division in the procurement process.** Consideration should be given to moving aspects of the Division's current responsibilities related to contract development to the new procurement office, thus avoiding any questions that may arise that could limit the Legal Division's status to provide privileged counsel to its client, the Authority.
- **Consolidate and update contracting rules and procedures.** The Authority has started consolidating and updating these procedures, awaiting, in part, publication of the Sunset report. The Authority should press ahead quickly to complete this work to help give clear direction to procurement.
- **Improve computerized procurement information.** Better coordinated information is needed so that management can obtain timely information to track and manage procurements.

6.2 The Authority should review small business goals and selected functions.

- **Review the 35 percent goal for small business participation.** The Authority should conduct a more structured evaluation of its small business goal to determine its current reasonableness, given better information and consideration of its own values. The evaluation should include review of any additional cost added to procurements because of the goal, to determine its continuing appropriateness. The Authority would not need to conduct its own study to determine an appropriate goal, but could benchmark with other local entities as part of this evaluation.
- **Move promotional functions from the Small Business Division to Public Affairs.** This action would keep the small business function focused on promoting small business contracting while shifting responsibility for promotional funding to the Authority's organizational unit most responsible for this function.

6.3 The Authority should eliminate or better manage ongoing professional services contracts.

- **Eliminate the Special Counsel and Litigation Counsel functions.** These longstanding functions relating to general legal advice for Commission members, open meetings requirements, and ongoing summaries and advice on litigation could be performed by the Authority's General Counsel, as they are in many agencies. Elimination of these functions would save about \$282,600 annually.
- **More actively manage the Authority's lobby function.** The Commission and staff should take a more active, periodic approach in structuring its lobby program, including annually evaluating the organization's lobby needs and the program's cost-effective approach. The Authority could benchmark in a more formal fashion against other local entities and their programs. The Authority also could consider a more structured approach to judging lobbyist performance, such as evaluating their responsiveness to requests and usefulness of information returned. These activities should occur on a scheduled basis.

6.4 The Authority should improve disclosure and communications policies for solicitations.

- **Require written nepotism disclosure.** Staff involved in a procurement should complete a nepotism disclosure in writing to improve contracting transparency and avoid improper relationships with contractors.
- **Require signed non-disclosure form.** An affirmative process highlighting the importance of non-disclosure of information about proposal submissions is a standard and beneficial practice encouraging fairness, awareness of rules, and compliance.
- **Develop Commission policies prohibiting communications with vendors involved in active procurements.** The Commission should adopt policies prohibiting both staff and Commissioner communications with vendors during active solicitations. Such a policy would promote objective contracting decisions; offer a transparent view to the public, vendors, and staff on how the Commission is expected to interact with vendors; and send a clear message about the Commission's dedication to fair procurements.

6.5 The Authority should take steps to improve the evaluation and award of contracts.

- **Ensure a higher level of consistency in evaluation committees.** Care should be taken to standardize the evaluation committee process to ensure completeness, fairness, and consistent approach, regardless of which division is engaged in the contracting.
- **Change procedures so that the Commission may only accept or reject a staff-recommended vendor in a procurement award.** A clear up or down vote, as the Commission has used in the past, would eliminate the appearance of subjective decision making that could affect confidence in the Authority's contracting process, and avoid potential challenges to awards.
- **Implement an appeals process for vendors.** The Authority should implement an appeals process for resolving vendor protests to help ensure fair resolution of grievances.
- **Capture information about vendor performance at closeout.** Obtaining systematic feedback and documentation about vendor performance at contract closeout would be a useful addition to help in selecting vendors for future procurements.

6.6 The Authority should establish a training program on conflicts of interest and other aspects of contracting.

The Authority should provide a systematic and ongoing training program for both Commission members and staff. The importance of the procurement function to the Authority, as well as to vendors, suggests the need for establishing such a program.

Fiscal Implication

These recommendations would result in savings to the Authority of about \$282,600 per year from eliminating the Special Counsel and Litigation Counsel. Other savings could result from the evaluation of the lobby program, assessing the small business development goals, and a more efficient procurement environment resulting from more centralization. Implementing a computerized system to better manage procurements, an expanded training program, and potentially adding staff to provide a centralized procurement function would require additional expenditures. These costs would depend on the Authority's implementation and could not be estimated. Other procedural changes could be achieved within the organization's current resources.

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- ¹ Section 60.403(a), Texas Water Code.
 - ² Sections 60.406(a), 60.406(b), 60.404, 60.405, and 60.412(c), Texas Water Code.
 - ³ Sections 60.4035 and 60.412(a), Texas Water Code.
 - ⁴ Port of Houston Authority, *Port of Houston Authority Small Business Development Program Policy and Procedures (Revised)*, April 29, 2009, p. 3.
 - ⁵ *Ibid.*, pp. 3 and 6.
 - ⁶ "Statutory Goals Established by Federal Executive Agencies," Small Business Administration, accessed July 10, 2012, <http://www.sba.gov/content/goaling-guidelines>.
 - ⁷ Section 108.002, Texas Civil Practice and Remedies Code.
 - ⁸ Section 556.0055, Texas Government Code.
 - ⁹ Houston Independent School District, "Fiscal Management Goals and Objectives: Financial Ethics – CAA (Local)," issued February 9, 2012, pp. 11–14, accessed July 10, 2012, http://cms7.houstonisd.org/PolicyAdministration/Home/Governance/E-Rate/CAA_LOCAL.pdf.
 - ¹⁰ 43 T.A.C. Section 9.3, 34 T.A.C. Section 20.384, and 1 T.A.C. Section 201.1.

ISSUE 7

The Authority Could Reduce Injuries and Save Money by Implementing a More Proactive Safety Program.

Background

The Port of Houston Authority works with a range of individuals and entities at its two container facilities, five general cargo facilities, and other developed property, which span a total of 3,348 acres. The Authority is both an operating port and a landlord port, generally carrying out its own operations at its container facilities while leasing or assigning space to maritime industries such as stevedores and freight handlers at its general cargo facilities. The Authority also works with a range of other entities that operate on its property, including contractors, truckers, steamship lines, and railroads.

The Authority has a basic responsibility to ensure safe operations on its property, which is home to high risk activities involving specialized skills, heavy equipment, and hazardous material. Because it is a government entity, the Authority's 578 employees are not subject to federal safety regulations enforced by the Occupational Health and Safety Administration (OSHA), making its own oversight of safety practices more critical. For other groups operating on its property, the Authority's role as a landlord is more nuanced because OSHA regulations do apply to these private entities. However, the Authority has clear powers and duties set forth in the Texas Water Code and its own tariffs to promote basic safety practices on its property, minimize risk and damage to its property from incidents such as fires, and generally promote commerce, which suffers when accidents occur.¹ Also, unlike its occupational safety function, the Authority is responsible for all environmental issues occurring on its property and must ensure its employees and all other users comply with myriad local, state, and federal environmental laws that often involve safety.

Several divisions of the Authority have some active responsibility for safety, as shown in the textbox, *Authority Divisions and Offices With Safety-related Responsibilities*.

Authority Divisions and Offices With Safety-related Responsibilities

The following divisions and offices all include aspects of safety in their operations.

Operations includes in its staff of about 250 one Safety Manager who is responsible for coordinating and developing the Authority's safety program. The Safety Manager's emphasis is on Authority employee safety, with much of his attention focused on the Operations Division because of the use of heavy equipment and labor-intensive work. Major safety responsibilities for tenants or other private users are left largely to those groups.

Risk Management protects the Authority against loss by analyzing the cause of losses, making efforts to prevent future losses, and insuring against possible risks. Safety is closely related to these functions, since many losses, such as workers' compensation claims, flow from safety-related accidents.

Environmental Affairs spearheads the Authority's environmental functions, including an inspection program. Environmental concerns, such as proper disposal or storage of hazardous materials, often are closely related to safety.

Real Estate manages the Authority's real estate leases, which typically contain provisions requiring tenants to abide by applicable laws and regulations, including safety-related requirements. Lease agreements are subject to termination if terms are not followed.

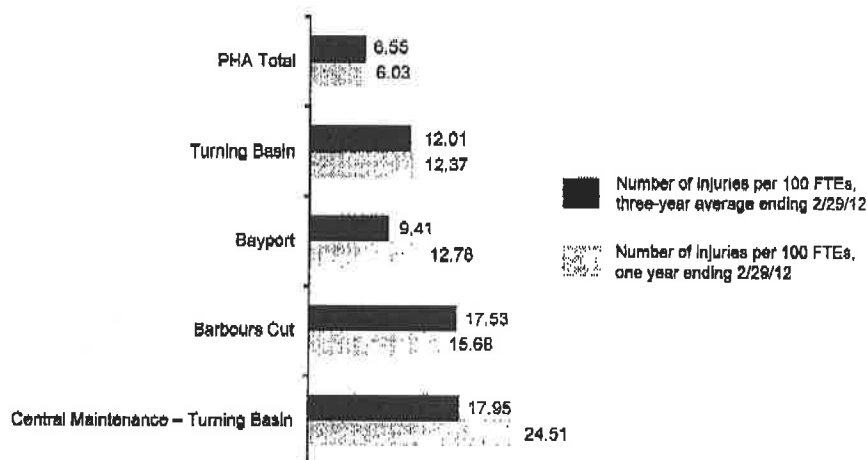
Port Security and Emergency Operations is responsible for safe and secure facilities, operating both police and fire departments.

Findings

Accident rates and recent incidents indicate a risk to safety and operations that can affect the Authority's performance.

- Accident rate for Authority employees.** A high-level review of accident rates at the Authority indicates opportunities to reduce injuries, an outcome that would benefit employees and save money. The graph, *Incidence of Injuries per 100 FTEs*, compares the rate of injury per 100 full-time equivalent employees of the Authority as a whole with that of several of its operations. An injury counted in this measure, called the Incident Frequency Rate (IFR), is one that requires medical treatment, such as a back sprain or eye injury. This measure for an agency or agency operation generally needs to be compared with similar activities to get a more complete understanding of actual safety performance.

**Incidence of Injuries per 100 FTEs
Authority Total Compared to Selected Agency Operations**



Source: Port of Houston Authority

The graph points to several divisions of the Authority with high IFRs meriting further review and attention, especially at the Central Maintenance Office of the Authority's Turning Basin facility, which had a one-year incident rate of 24.51, or about one incident requiring medical attention for every four employees in a year. Bayport and Barbours Cut container terminals also had IFRs that were significantly higher than the Authority's overall one-year rate of 6.03. Such rates should not be considered acceptable and must be addressed. Luckily, most reported injuries have been relatively minor in recent years. Fatalities among Authority employees have seldom occurred; the Authority reports one death of its own staff 22 years ago.

Comparisons with other agencies must be used cautiously because of differences in operations; however, comparisons also call attention to the Authority's higher incident rates, pointing to needed follow up by management. For example, the Texas Department of Transportation (TxDOT)'s Houston district office had a fiscal year 2011 IFR of 3.02, and this district's 999 current employees include 385 assigned to roadway maintenance, skilled craft, or ferry operations. This rate is much lower than the Authority's overall rate of 6.03. The Texas Department of Criminal Justice, considered by some as a high risk state agency because of its work with incarcerated populations, still had an overall incident rate lower than the Authority's at 5.02 in fiscal year 2010.

Besides the devastating effect on employees, the negative impact of injuries to both employee productivity and an organization's finances can be substantial. According to the Authority, its workers' compensation losses amounted to about 80 percent of all its claims payments in the last three years. Workers' compensation claims in the one-year period ending February 29, 2012 totaled \$353,275, with a three-year loss of about \$1.8 million. Average cost per claim in the one-year period was \$7,360, and the three-year average was \$11,178. While the Authority has worked to reduce these claims in recent years, these expenditures are still significant and reducing injuries further would result in direct savings.

- **Recent catalyst events highlight the risks involved.** Unfortunately, increased attention to safety programs often occurs as a reaction to specific incidents. At least two such recent incidents have caused the Authority to re-evaluate the strength of its safety program and its appropriate role in managing activities on its property. In June 2011, an Authority environmental auditor found a burned out cigarette, with ashes still attached, on the lid of a gasoline drum in a hazardous storage area. Reporting of this incident to management created a heightened focus on safety that has spurred the Authority to action.

In June 2012, a temporary worker employed by a private company was killed on the Authority's property by a falling steel pipe being loaded onto his truck. This event has recently sparked renewed internal discussions about whether the Authority could or should be doing more to promote safety at its facilities, even if indirectly. The Authority's tenants and other users may sometimes be exposed to higher risk than many of the Authority's own employees, given the physical and highly mechanized nature of their activities. While the Authority does not have a direct regulatory role over these private companies' safety practices, which come under OSHA's purview, about two deaths per year from these users occur on the Authority's grounds.

- **Fires.** The Authority also has a very basic interest in preventing fires on its property, which can cause significant human as well as economic harm. Tariffs spell out specific requirements expected of Authority tenants and

The Authority paid a total of \$1.8 million in workers' compensation claims over the last three years.

Private companies working on Authority grounds experience about two deaths per year.

authorize the Authority to levy fines for violations as needed. Events of the last few years show that fire safety and prevention should be a key concern to the Authority. The Authority reports that it experienced an unusually high 10 fires in 2011 as a result of the drought, with the majority being small grass fires apparently ignited by cigarettes. Two of these 10 fires were considered large, with damages to Authority property from one event totaling about \$3.6 million.

The Authority has clearly identified its safety program as needing greater focus and taken initial steps towards improvement, but these efforts are incomplete.

The Authority seems to recognize the importance of safety to the organization, and the need to implement a more coordinated, top down effort to actively promote a safety program. However, these efforts are still in flux and complete implementation of several key elements has not yet occurred, as described below.

The Authority only reinstated a safety manager position in early 2012.

- **Organizational arrangement and resources.** Staffing and organizational issues have reduced the effectiveness of the Authority's safety efforts in recent years. Before 2012, the Authority's organization-wide Safety Manager was part of its Risk Management Office. The function of Safety Manager was suspended in 2009 and did not resume again until early 2012 with the hiring of a staff person assigned to the Operations Division. This person has been actively working for several months to improve safety operations, including developing a safety program involving employees and managers at the Bayport and Barbours Cut facilities, but a complete safety program is still in the very early phases of implementation. Given the scope and breadth of the Authority's safety issues as discussed below, however, a single safety officer is insufficient for an active program across all divisions.

The Authority has not taken full advantage of the many resources in various divisions that could help in an expanded safety program. For example, the environmental program has a well-established, formal audit and inspection function that could be a starting point for developing a more active safety program or could be modified to include safety elements, as occurs in many private companies in which occupational health and environmental functions are combined in the same organizational unit. The Authority also has existing police and fire forces that could play a more active role, staff with maritime expertise in Operations, several certified safety professionals working on other subject matter in Risk Management, and many external stakeholders that could provide valuable input.

The Authority has not used many available resources to fully develop its safety program.

- **Incomplete implementation.** In addition to the organizational issues discussed above, the following specific elements show the need for further attention to achieve a fully developed program.

Mission and core values. The Authority has recently updated its mission and core value statements, but these do not address safety concerns.² In contrast, the Lower Colorado River Authority, an organization with its own safety risk because of water-related and electric generation functions, emphasizes safety as one of five principles in its foundation values.³ TxDOT, which is involved in maintenance work and other related transportation activities along Texas highways, also addresses employee safety as part of its philosophy.⁴ Emphasizing the importance of safety in the Authority's mission statement and other statements of the organization's values would better demonstrate management's commitment to safety for the organization and the public.

Specific policy statements. The Authority has developed policy statements signed by the Executive Director dealing with critical functions such as environmental protection and security, but no director has signed or effectively promoted the safety policy. Having such a policy reaffirms that executive management fully supports and expects compliance with a safety program. This top-down approach is recognized as key to any safety program's success.⁵

Goals and objectives. The Authority has not set specific safety goals and objectives to target areas for improvement and provide a way to measure progress. By contrast, TxDOT has established a goal of reducing its injury frequency rate by 10 percent from the average of the last three fiscal years.⁶ Without specific goals, holding management and staff accountable for continuous and quantifiable improvement in the safety program is more difficult.

Inspections and enforcement. The Authority has clear power to conduct inspections and enforce safety and fire safety rules.⁷ For example, the organization has identified progressive enforcement steps it could take against its own employees and other users for safety violations. For its own employees, action can start with a verbal warning and escalate to written reprimands, suspension without pay, or termination for repeated or flagrant failures. For tenants and other users, the Authority may start by pointing out safety issues; then meeting with employers or individuals to correct repeated problems; or ultimately issuing fines, terminating agreements and contracts, or withdrawing permission to enter Authority property.

Authority staff asserts monitoring and enforcement activity is occurring, although these efforts do not appear to be consistently carried out or documented. The level and extent of enforcement is primarily left to individual supervisors and managers, and the bulk of their enforcement action appears to be oral and informal, with few written reprimands or other more severe actions being taken against Authority employees. Although the Authority's tariffs also allow for formal corrective action and fines to be assessed against tenants for safety or fire violations, such

Safety needs to be a core value of the organization.

The Authority's safety enforcement efforts appear to be informal.

Information for analyzing safety issues and trends is not readily available.

actions are rare. The extent and effectiveness of enforcement cannot be easily determined because no common, standardized documentation system for safety reporting exists. As a result, no readily accessible, compiled information is available for analysis of safety issues and trends, either for outside entities or Authority management. A more structured and active enforcement and documentation system needs to be established to improve safety and reduce risk for the Authority.

Return to work program. The Authority has begun to develop, but has not yet started a formal organization-wide return to work program. Such programs have been standard in state agencies and private industry for some time.⁸ The aim of such a program is to return injured staff to work as soon as medically appropriate. Benefits include a more productive work environment as well as savings on workers' compensation costs, and the psychological and financial advantages to employees from getting back to work more quickly.

Recommendation

Management Action

7.1 The Authority should take aggressive steps to implement a coordinated and comprehensive safety program.

This recommendation would direct management of the Authority to take focused actions to finish developing a comprehensive, organization-wide safety program for the Authority's employees, tenants, and other users. Important considerations in completing development of such a program are outlined below.

- **Scope.** The Authority should develop a comprehensive program covering all aspects of its operations. The program would focus first on Authority employees, but should also actively address tenants and other outside users, although the nature of safety involvement with them would be different than involvement with its own employees.
- **Parties involved in developing a safety program.** In addition to the Safety Manager and Operations personnel, the Authority should consider involving other relevant divisions and users in the design and implementation of an organization-wide, coordinated safety program. Other participants could include Risk Management, Environmental Affairs, Port Security and Emergency Operations, and Real Estate as stakeholders and helpers in the organization's safety efforts. Outside user input from tenants or other parties would also be beneficial.
- **Organizational arrangement.** Management should consider where primary direction of the safety program should occur. Choices include, for example, continuing the program in Operations, moving it back to Risk Management, combining safety and environmental functions, or some other coordinated organizational arrangement. However, risk management is commonly an area where safety and workers' compensation functions are located. This location creates a degree of separation from management of operations where a majority of injuries happen. Consideration also could be given to greater involvement of existing staff, such as police personnel, and additional personnel dedicated to an active, Authority-wide safety program.

- **Elements of a safety program.** The Safety Manager in Operations has begun laying out and developing the basic components of an effective safety program. These, as well as other standard best practices, should be systematically addressed in implementing the program.
- **Return to work.** The Authority should quickly institute the return to work program that it has recently begun to develop. Many available resources exist that could assist in developing a best practices approach to return to work programs. These programs improve employee morale and save money.
- **Timeline for implementation.** Management should adopt timelines for developing and implementing the safety program to ensure quick and accountable implementation.

Fiscal Implication

An improved safety program may involve additional expenditures for training and potentially additional staff and equipment, depending on the Authority's level and method of implementation. However, many of these activities could be accomplished through better use and coordination of existing resources and efforts. Savings also would result from reduced injuries and less employee time lost.

¹ Sections 60.071, 60.072, and 60.073, Texas Water Code; Port of Houston Authority, *Tariff No. 8, Section Two – General Rules and Regulations* (Houston, TX: Port of Houston Authority, January 2012), pp. 14–28; Port of Houston Authority, *Tariff No. 14, Section Two – General Rules and Regulations* (Houston, TX: Port of Houston Authority, January 2012), pp. 12–21; and Port of Houston Authority, *Tariff No. 15, Section Two – General Rules and Regulations* (Houston, TX: Port of Houston Authority, January 2012), pp. 13–22.

² "Port of Houston Authority Approves Vision, Mission Statement and Core Values," Port of Houston Authority, posted July 27, 2011, <http://www.portofhouston.com/inside-the-port-authority/communications/business-news/port-of-houston-authority-approves-vision-mission-statement-and-core-values/>.

³ "LCRA's foundation values: Five principles define the culture of LCRA," Lower Colorado River Authority, updated February 24, 2012, http://www.lcra.org/about/employment/foundation_values.html.

⁴ Texas Department of Transportation, *Agency Strategic Plan for the Fiscal Years 2011-2015 Period*, p. 4, accessed June 29, 2012, ftp://ftp.dot.state.tx.us/pub/txdot-info/sppm/strategic_plan2011.pdf.

⁵ Texas Department of Insurance, *Accident Prevention Plan Program Guide for Small Business Employers*, p. 4, accessed July 1, 2012, <http://www.tdi.texas.gov/pubs/videoresource/wpapp.pdf>; Dupont, *Stop: Get Safety Going*, accessed July 5, 2012, http://www.training.dupont.com/pdf/dupont-stop/0112_stop_brochure.pdf.

⁶ Memorandum from TxDOT's Occupational Safety Division to agency management, October 18, 2011, p. 3.

⁷ Sections 60.071, 60.072, and 60.073, Texas Water Code; Port of Houston Authority, *Tariff No. 8*, pp. 14–28; *Tariff No. 14*, pp. 12–21; and *Tariff No. 15*, pp. 13–22.

⁸ "Return to Work Program," State Office of Risk Management, accessed July 11, 2012, http://www.sorm.state.tx.us/Workers%27_Compensation/Return_To_Work/overview.php.

ISSUE 8

The Commission's Role as the Pilot Board to Regulate Houston Pilots Lacks Focused Oversight and Standard Best Practices for Licensing Functions.

Background

Houston port pilots serve a crucial role in ensuring safety and the continued movement of commerce along the Houston Ship Channel. Pilots take direct command of or transfer directions to foreign-flagged vessels navigating the 52-mile long Channel, one of the more difficult to navigate due to its narrow width, shallow depth, winding nature, and heavy traffic. In 2010, Houston was the nation's busiest port, with 6,698 oceangoing vessel calls. This translates to about 20,000 ship movements per year by the pilots, who serve all facilities operating along the Channel, as shown in the chart, *Houston Pilot Ship Movements / Incidents Investigated for Pilot Error*. Incidents, though rare relative to the number of movements, have the potential to cause not only physical injuries and death but damage to public infrastructure, sensitive environmental areas, and millions of dollars of lost economic opportunity.

Houston Pilot Ship Movements / Incidents Investigated for Pilot Error 2008-2011

Year	Movements	Incidents
2008	21,120	1
2009	18,960	0
2010	20,008	5
2011	20,424	2

By statute, the members of the Port of Houston Authority Commission also serve as the Board of Pilot Commissioners for the Ports of Harris County (Pilot Board), the governing body responsible for Houston pilot oversight.¹ To become a pilot, a person must meet licensing requirements established by the U.S. Coast Guard and the Pilot Board, be accepted into the Houston Pilots Association, and receive a state commission from the Governor. Statute requires the Pilot Board to approve pilot applicants and submissions for state commissions, adopt rules to ensure efficient pilot operations, establish pilot rates, hear complaints relating to pilot conduct, and investigate incidents.² Staff located in the Authority's Security and Emergency Operations Division carries out the Pilot Board's day-to-day regulatory functions, including convening two committees, the Pilot Board Investigation and Recommendation Committee and the Application Review Committee, made up of Authority staff, pilots, and maritime industry representatives. These two committees play a central role in helping the Pilot Board provide oversight of pilot activities by reviewing pilot applications, investigating incidents involving pilots, and making recommendations to the Pilot Board.

The Pilot Board currently oversees the qualifications, training, and licensing of 86 pilots, who are all members of the Houston Pilots Association. All pilot services are provided through the Association, with members sharing operational costs, such as maintaining 24-hour, 7-day dispatch centers; pilot boats and crews; and providing insurance and other benefits to members.

Findings

The unique arrangement between the Pilot Board and the Houston Pilots Association should not deter the Pilot Board from its assigned oversight responsibility.

The credentialing process for Houston pilots is not like licensing for most occupations because it is closely intertwined with the Houston Pilots Association, which plays a large role in the vetting process for pilot applicants. This relationship is akin to a guild system in which the Pilots Association controls significant aspects of training, apprenticeship, and approval processes for Houston pilots. As distinct as the process is from occupational licensing, it is common among ports because the special knowledge needed generally ties the pilot to the specific port in which they trained. As noted, pilot associations also typically provide all pilot services for piloting ships in each port, from the pilot boats and crews, to the dispatch centers. Despite this special relationship between board and association, the Pilot Board should not be removed from its proper oversight of this important activity.

Statute provides the Pilot Board clear authority to perform any act or function necessary to carry out its powers and duties, which includes adopting rules and issuing orders to ensure safe and efficient pilot activities.³ Authority staff provides administrative support for processing pilot applications and reviewing incidents involving piloted ships along the Channel. However, the Board has not adopted rules specifying information the Association must provide to fully support these activities. The Association schedules work assignments, provides ongoing training opportunities, and generally asserts more regulatory powers than the actual Board. Recognizing that the common practice is for pilot associations to play such a role in U.S. ports, and given the lack of major incidents in Houston, the basic structure and approach are not significant causes for concern. The arrangement does, however, result in concentrating information at the Association that the Board needs to effectively monitor the pilots. A review of Pilot Board meeting minutes indicates a hands-off approach that gives the appearance that discussions and decisions made elsewhere are essentially being rubber-stamped. Meetings are typically short, with little discussion of issues or information sharing on a regular basis. In 2011, for example, of 11 meetings conducted by the Pilot Board, 10 convened and adjourned in one minute or less, not enough time for due diligence on the task at hand.

The Pilot Board has not actively pursued safety aspects related to its monitoring and oversight of pilots.

The Pilots Association's control over so many aspects of pilot regulation results in the Pilot Board not receiving information about key activities that can relate to pilots' ability to perform their job safely. In addition, some elements of state licensing programs are applicable to the oversight of pilots to help improve safety and public understanding of this function. These elements are described in the following material.

Meetings of the Pilot Board usually last only one minute or less.

- **Training.** When processing pilot license renewals, the Application Review Committee checks to ensure the pilot has the continuing competence to perform the work. However, the Committee does not have a standard way of sharing information about training received since last renewal with the Pilot Board so that it can make its own judgment to ensure that the pilots it recommends for renewal are, in fact, still capable of piloting the big ships such as the Post-Panamax vessels that the Panama Canal expansion will make possible. The Pilots Association has recently begun presenting quarterly information to the Board about training activities, but this still does not provide needed information about specific training received by individual pilots.
- **Fatigue mitigation.** In October 2011, the National Transportation Safety Board (NTSB) recommended state pilot oversight entities improve efforts to reduce pilot fatigue, but this recommendation has not yet been addressed by the Board.⁴ This report directed states to ensure pilot oversight organizations effectively monitor and, through their regulations, oversee the practices of their pilots to promote and ensure the highest level of safety. Specifically, the NTSB report recommended requiring pilot oversight organizations to implement fatigue mitigation and prevention programs that regularly inform mariners of the hazards of fatigue and effective strategies to prevent it, and develop hours of service rules that prevent fatigue resulting from extended hours of service, insufficient rest within a 24-hour period, and disruption of circadian rhythms. The Houston Pilots Association has developed work rules and shared information about fatigue indicators with its members on its own initiative. However, the Pilot Board has not requested and does not receive regular information from the Pilots Association on pilot activities, scheduling, work load or any information that would provide oversight information that could indicate fatigue factors.
- **Investigations.** The Investigation and Recommendation Committee investigates and takes action on incidents involving pilots and convened eight hearings between 2008 and 2011. The committee may recommend additional training for pilots based on incident investigations but has no mechanism in place to inform the Pilot Board of pending investigations unless the committee makes a recommendation to the Board. For example, the Pilot Board recently approved a pilot commission renewal while the pilot was being investigated for negligence in an incident. While the pilot was ultimately not found to be negligent and only required to take additional training, the Pilot Board should have been made aware of the investigative committee's review and pending recommendations at the time of the renewal consideration.
- **Criminal history background checks.** When conducting background checks for pilot applications or renewals, the Application Review Committee only checks criminal history in the applicant's or pilot's home county rather than a statewide check as most state licensing agencies do.

The Pilot Board does not receive training and workload information it needs to provide effective oversight.

The Pilot Board has not implemented NTSB recommendations to reduce pilot fatigue.

The current vetting process for pilots does not adequately research possible criminal history.

Current policy and process does not adequately research the possible criminal history of pilots, limiting the Pilot Board's ability to ensure that pilots are qualified for their dangerous jobs.

Pilot qualifications for license include requiring applicants to "have good moral character."⁵ As with many other state licensing programs, this vague requirement allows subjective disagreements about what should disqualify an applicant once information is discovered during a background check. A provision in the Texas Occupations Code gives some guidance to help state licensing agencies make such a determination that includes ensuring that an offense relates to the duties and responsibilities of the activity regulated.⁶ While Authority staff has indicated it is proceeding with a plan to address this issue, it should follow these Texas Occupations Code provisions to focus on behaviors that pose the greatest risk to the public.

- **Complaint process.** Other than the incident review process, the Pilot Board has not established a standard complaint process for use by the public or other maritime professionals who pilot vessels on the Channel, even though its statutory duties clearly require this function.⁷ By not having a complaint process, the Pilot Board misses an avenue for dealing with issues before they become more significant problems.
- **Public information.** As a state-created entity, the Pilot Board should inform the public of its statutory responsibilities and duties. The Authority's website does not mention the Port Commission's role as the Pilot Board and provides only minimal information about Board meeting minutes. The website provides no information, searchable or otherwise, on Board duties, how to submit a complaint about pilots, or the incident review process.

Recommendation

Management Action

8.1 Direct the Port Commission, acting as the Pilot Board, to take a more active role in oversight of the Houston Pilots.

Under this recommendation, the Pilot Board should take action under its existing statutory authority to more actively address safety and public information needs related to pilots, as described below. The Pilot Board should amend its adopted Rules and Regulations governing pilots to clearly specify the information it needs to adequately oversee the Houston pilots. This information should include reporting of pilots' training and continuing education since their last renewal and the results of any incident investigations involving pilots. This information is currently prepared by separate Authority-convened review and investigative committees, but is not routinely presented to the Pilot Board, which is largely responsible for issuing pilot commissions. This recommendation would provide for more complete information being provided to the Pilot Board, and would not change the process or any requirements for approving state pilot commissions or renewals.

The recommendation would also direct the Authority's staff to work with the Association to develop a formal fatigue mitigation program to educate pilots on best practices relating to rest guidelines needed to overcome or prevent fatigue resulting from scheduling patterns. This effort should include formally developing hours of service rules to prevent fatigue from extended work hours and insufficient rest within a 24-hour period. The staff would also determine the appropriate information to submit to the Pilot Board regarding the program, including the reporting of pilot work records and logs and any fatigue mitigation program activities.

In addition, the recommendation would direct the Authority to conduct, at a minimum, statewide criminal history background checks during the pilot application and renewal process. The Pilot Board would also need to adopt guidelines for using these criminal history checks according to the provisions in the Texas Occupations Code to help ensure that the consideration of past behavior relates to the duties and responsibilities of being a pilot.

The recommendation would direct the Pilot Board to implement a complaint process regarding pilots as required by statute and include information about the process and contact information on the Authority's website. The Pilot Board should also include information about its duties and oversight responsibilities on the Authority's website and in other appropriate Authority publications. This change would make its pilot oversight role more transparent to the public.

Fiscal Implication

No significant fiscal impact to the Authority is anticipated.

¹ Section 66.011, Texas Transportation Code.

² Section 66.017, Texas Transportation Code.

³ Section 66.016, Texas Transportation Code.

⁴ National Transportation Safety Board, *Accident Report: Collision of Tankship Eagle Otome with Cargo Vessel Gull Arrow and Subsequent Collision with the Dixie Vengeance Tow, Sabine-Neches Canal, Port Arthur Texas, January 23, 2010*, adopted September 27, 2011, accessed July 11, 2012, <http://www.ntsb.gov/doclib/reports/2011/MAR1104.pdf>.

⁵ Section 66.033(9), Texas Transportation Code.

⁶ Sections 53.021, 53.022, and 53.023, Texas Occupations Code.

⁷ Section 66.017(7), Texas Transportation Code.

APPENDIX

APPENDIX A

Staff Review Activities

During the review of the Port of Houston Authority, Sunset staff engaged in the following activities that are standard to all Sunset reviews. Sunset staff worked extensively with Authority personnel; attended Commission meetings, task force meetings, and met with Commissioners individually; conducted interviews and solicited feedback from key stakeholders and the public, including key state and local government offices having an interest in the Authority; reviewed agency documents and reports, state statutes, previous legislation, and literature; researched comparable organizations in Texas and other states; and performed background research using the Internet.

In addition, Sunset staff also performed the following activities unique to the Port of Houston Authority.

- Toured Authority facilities and the Houston Ship Channel.
- Attended a Town Hall Meeting organized by environmental and community groups in Pasadena regarding the Authority's activities.
- Conducted an online survey of the Authority's stakeholders, vendors, and staff; and reviewed and evaluated the 768 responses.
- Attended a Texas House Transportation Committee meeting regarding the State's preparedness for the expansion of the Panama Canal.
- Attended a meeting of the Port Authority Advisory Committee coordinated by the Texas Department of Transportation.
- Worked with staff from the Texas Legislative Council, who advised on the Authority's unique statutory framework and generously gave their time and assistance to the Sunset review team.

Sunset Staff Review of the *Port of Houston Authority*

————— *Report Prepared By* —————

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