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State Auditor

An Audit Report on
**The Port of Houston Authority's
Promotion and Development Fund**

January 28, 2002

Members of the Legislative Audit Committee:

The Port of Houston Authority's (Authority) monthly reports on expenditures from its Promotion and Development Fund (Fund) provide a reasonably accurate picture of Fund activity and contain the required elements (check number, amount, payee, and general purpose) for each expenditure. For the two-year period ending August 31, 2001, the Authority wrote approximately 3,200 checks totaling \$7 million from the Fund. Most of the expenditures were for advertising and professional fees and services.

The Authority is required to provide monthly expenditure reports for the Fund to the Harris County Auditor, whose role is to ensure that the Fund is segregated from other Authority funds, receives no tax money, and does not receive more than 5 percent of Authority revenues. In calendar year 2000, the Authority transferred approximately 2.6 percent of current operating revenues into the Fund. In addition, Senate Bill 1680 (77th Legislature, Regular Session) authorized the Harris County Auditor to audit expenditures from the Fund.

Although the Authority's monthly expenditure reports provide a reasonably accurate picture of Fund activity, in reviewing expenditures from the Fund we noted the following:

- The Authority has made expenditures from the Fund that would have been questionable if they had been paid for with state funds. These expenditures would have been questionable because of the nature of the expenditure, the amount of the expenditure, or both. (The Authority is not subject to state purchasing laws and regulations, and these expenditures appear to be consistent with the purpose of this Fund.) The Authority also has made expenditures from the Fund that do not appear to be directly related to promotion and development, such as expenditures for cell phones, utilities, and an employee picnic.
- There are opportunities for the Authority to strengthen controls over the use of the Fund, including ways to improve the monthly reports provided to the Harris County Auditor.

Texas Water Code, Chapter 60, specifies that the purpose of the Fund is to allow Texas port authorities to compete with public and private ports, waterways, harbors, and terminals. The statute allows the Authority to set aside up to 5 percent per calendar year of its gross income for promotion and development of the port. These funds are to be used for "unusual purposes and occasions not covered by other law."

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We conducted this audit in response to a legislative request. The attachment to this letter provides additional detail regarding our audit. The Authority agreed to review the issues about which we made recommendations, and its responses are included in the attachment. We appreciate the assistance and cooperation of Authority management and staff throughout this audit. If you have any questions, please contact Julie Ivie, Audit Manager, at (512) 936-9500.

Sincerely,

Lawrence F. Alwin, CPA
State Auditor

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Attachment

cc: Port of Houston Authority Commission
Mr. James Edmonds, Chair
Mr. Vidal Martinez, Commissioner
Mr. Steve Phelps, Commissioner
Mr. James Fonteno, Jr., Commissioner
Mr. Kase Lawal, Commissioner
Mr. Jimmy Burke, Commissioner
Ms. Cheryl Thompson-Draper, Commissioner
Port of Houston Authority
Mr. H.T. Kornegay, Executive Director
Harris County Auditor's Office
Mr. Tommy J. Tompkins, CPA, Harris County Auditor

The Authority's Monthly Expenditure Reports for the Promotion and Development Fund Are Reasonably Accurate and Contain the Required Elements

The monthly expenditure reports that the Port of Houston Authority (Authority) submits to the Harris County Auditor contain the required elements and provide a

reasonably accurate picture of the Promotion and Development Fund's (Fund) activity. This conclusion is based on our analysis of the comparability of the reports over time, tests conducted to trace 32 expenditures to source documents, review of various Authority policies and procedures, and a comparison of the expenditure reports to an extract from the Authority's accounting system. For the two-year period ending August 31, 2001, the Authority wrote approximately 3,200 checks totaling \$7 million from the Fund.

Monthly Expenditure Report

Texas Water Code, Section 60.204(c), requires the Authority to submit a monthly expenditure report for the Fund to the Harris County Auditor.

The report must contain the following elements:

- Check number
- Amount
- Payee
- General purpose of the expenditure

Each month the Authority also prepares an additional report for the Harris County Auditor. This report summarizes Fund receipts and disbursements and documents a running balance for the Fund. The Harris County Auditor uses the report to ensure that not more than 5 percent of Authority operating revenues are transferred to the Fund. We used this report as a crosscheck on the monthly expenditure report and to check the reasonableness of the amounts transferred to the Fund. In calendar year 2000, the Authority transferred approximately 2.6 percent of current operating revenues into the Fund.

Although the manually prepared monthly expenditure reports are reasonably accurate, we identified minor discrepancies in them that were primarily the result of clerical errors and the ad hoc nature of the reports. Specifically, we noted the following:

- Inaccurate check numbers
- Gaps in check number sequence
- A high number of voided checks (the Authority voided approximately one out of thirty checks)

The inaccurate check numbers we identified were the result of transposition errors. The Authority accounted for the gaps in the check numbers and the voided checks.

Recommendation:

The Authority should automate the generation of the monthly report to eliminate or reduce clerical errors and to ensure that the report lists the disposition of all checks.

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Management's Response:

We intend to automate the generation of the report as recommended.

Section 2:

Some Expenditures Would Have Been Questionable Under State Purchasing Rules or Did Not Appear to Be Directly Related to Promotion and Development

The law affords the Authority significant discretion in making expenditures from the Fund (see Section 4), and we identified no illegal expenditures. Most of the expenditures were for advertising and professional fees and services. However, some of the expenditures we reviewed would have been questionable if they had been paid for with state funds because of the nature of the expenditure, the amount of the expenditure, or both. (It should be noted that the Authority is not subject to state purchasing laws and regulations and that these expenditures appear to be consistent with the purpose of the Fund.) Other expenditures did not appear to fall within the definition of "promotion and development." Combined, such transactions represented more than 30 percent of our sample of 32 expenditures. The judgmental sample covered the period from September 1, 1999, through August 31, 2001, and represented approximately \$1.25 million (18 percent) of the \$7 million in expenditures from the Fund.

From this sample, we identified the following:

- Five expenditures would have been questionable if they had been paid for with state funds because of the nature of the expenditure, the amount of the expenditure, or both. While these appear to be consistent with the purpose of the Fund, they would exceed public expectations for a government agency. These expenditures included:
 - \$43,000 for a customer reception in Houston
 - \$32,000 for golf outings at a country club (two expenditures)
 - \$19,000 for three promotional luncheons in New York
 - \$12,000 for coaster sets that were given as gifts
- Six expenditures did not appear to be related to promotion and development. These expenditures included:
 - \$22,000 for an annual picnic for current and former employees (two expenditures)
 - \$9,000 for a business meeting for employees at a Houston hotel
 - \$5,670 for a special commission meeting at an Austin country club
 - \$2,540 to a Houston jeweler for cuff links or earrings given as gifts to Authority commissioners (two expenditures)

Many of the expenditures from the Fund are routine and operational in nature (such as expenditures for cell phones and utilities) and could be paid for from the Authority's general operating fund. The Authority's policy since at least 1994 has been to pay from the Fund all non-payroll expenditures for the Trade Development Division and the *M/V Sam Houston* (a public port tour boat). However, the statute states that expenditures from the Fund are to be for "unusual purposes and occasions" not covered by other law. The Authority's current interpretation may not be consistent with this aspect of the law.

Recommendation:

The Authority should further define allowable uses of the Fund and consider limiting use of the Fund to only those expenditures that would not be allowable from another public funding source (that is, for unusual purposes and occasions). The key to determining whether an expenditure relates to "promotion and development" would be community involvement, thus disqualifying those expenditures that benefit primarily Authority employees or Commissioners.

Management's Response:

As is pointed out, these funds are not governed by the same rules as a State Agency's funds and the law which does govern these funds gives the Port Commission significant discretion over the use of the funds. Had the Authority been subject to the same rules as State Agencies, the Port Authority would have complied with them.

The section of the law which does apply to these funds, titled 60.203 Expenditure of Funds (and is a part of this report), states, in part:

Money in the promotion and development fund shall be spent by the commission or as the commission may direct to pay any expenses connected with:

- 1. any activity or matter incidental to the advertising, development, or promotion of the district or its ports, waterways, harbors, or terminals;*
- 2. furthering the general welfare of the district and its facilities; or*
- 3. the betterment of the district's relations with steamship and rail lines, shippers, consignees of freight, governmental officials, or others interested or sought to be interested in the ports, waterways, harbors or terminals.*

Furthering the general welfare and betterment of the district's relations include, as was intended, a very broad area and therefore we believe all of the expenses paid for out of the fund are covered by the law.

However, the Port Authority intends to review the guidelines for usage of the funds.

Strengthening Controls Would Improve Accountability Over the Fund

We offer the following observations and recommendations to help ensure that the Authority manages the Fund appropriately:

- Documentation of expenditures – The Authority’s accounts payable files do not always include detailed evidence of the purpose of the expenditure, receipt of the good or service at a specific level of quality and quantity, or evidence of bidding and bid tabulations. In addition, the files do not consistently contain references to applicable contracts or purchase orders. Insufficient documentation will make it more difficult for the Harris County Auditor to audit expenditures from the Fund.

| Expenditure Authorizations | |
|--|----------------------|
| Texas Water Code, Section 60.204(b), specifies that the Fund is under the “exclusive control” of the Port Commission. The Commission has delegated most expenditure approval and control to Authority management. The Authority’s executive management, in turn, has established approval limits for individual managers. Authorization levels are as follows: | |
| <u>Position</u> | <u>Authorization</u> |
| Director | up to \$10,000 |
| Trade Director | up to \$15,000 |
| Managing Director | up to \$20,000 |
| Executive Director | up to \$25,000 |
| Commission | more than \$25,000 |

- Authorizations – The Authority generally follows its policies regarding the authorization of expenditures from the Fund. We noted 2 exceptions out of 32 transactions tested.
- Segregation of duties – The Authority allows authorized individuals to request and approve expenditures up to their approval limits. In addition, nothing prevents the requestor from also receiving the good or service. This lack of segregation increases the risk of fraud and abuse.

- Method of procurement – The Authority relies heavily on requests for checks as a method of procurement. Although the Authority has circulated a memorandum on its preferred use of purchase orders rather than requests for checks, the spirit of the memorandum is not being followed. Purchase orders, rather than requests for checks, could have been, but were not used, for 16 percent of the transactions from our sample and for an estimated \$1.18 million in Fund purchases recorded in the Authority’s accounting system. Approximately 69 percent of all transactions and 58 percent of total expenditures from the Fund occurred via requests for checks instead of purchase orders. Using a purchase order rather than a request for check is preferred because a purchase order is, in effect, an enforceable contract between the Authority and the vendor and better protects the Authority’s interests.
- Accounting procedures – Our analysis of data from the Authority’s accounting system revealed vendors with multiple identification numbers. This would not affect production of the monthly expenditure report but could affect the Authority’s internal analysis of Fund activity.

While certain controls should be strengthened, we noted a number of positive controls that help to provide oversight and accountability. These controls included:

- Active oversight by the Harris County Auditor – The Harris County Auditor’s role is to ensure that the Fund is segregated from other funds, receives no tax money, and does not exceed 5 percent of operating revenues. In addition, Senate Bill 1680 (77th Legislature, Regular Session) authorized the Harris County Auditor to audit expenditures from the Fund.
- A procedure outlining use of the Fund – The procedure was recorded in an accounting manual that is no longer maintained, but the Authority reports that the procedure is still followed.
- A \$2 million threshold on the uncommitted Fund balance – The Fund is replenished through monthly transfers from the Authority’s current operating fund. According to an Authority memorandum, if the uncommitted balance of the Fund is greater than \$2 million, no transfer is to be made.
- Policies governing travel expenses by commissioners and employees – The policies identify limitations on expenditures. For example, the policy for Commissioners states that:

All domestic air travel of less than two and one-half hours in duration should be booked in coach class. All domestic air travel in excess of two and one-half hours in duration and all international travel may be booked in either business or first class. Should a Commissioner desire to take a guest on any trip, such Commissioner must pay, and will not be reimbursed for, the extra cost of including such additional person
- Monthly reconciliation of checks – Authority accounting employees reconcile the Fund’s checking account on a monthly basis.

Recommendations:

The Authority should:

- Establish clear records retention policies that are sufficient to ensure that expenditures are thoroughly documented and, therefore, can be audited by the Harris County Auditor. At a minimum, the records should indicate how an expenditure relates to promotion and development.
- Follow Authority policy regarding the authorization of payments.
- Clearly segregate expenditure requests and approvals, as well as the receipt of the item purchased, so that no single individual can control all aspects of a transaction. The Authority’s comptroller should be required to approve all director requests for expenditures from the Fund.
- Examine its recurring expenditures to identify expenditures that could be made through purchase orders rather than through requests for checks.-

Management's Response:

- *Establish clear records retention policies ... – The Port Authority intends to expand our procedures to require additional documentation to indicate how the expenditure relates to promotion and development.*
- *Follow Authority policy regarding the authorization of payments. – Two transactions were mentioned in the audit. We are told they relate to a payment without appropriate authorization documentation in the file and a payment made by a check request. The employee in Payables who permitted the payment of the partially authorized invoice states that she received verbal approval from an appropriate source. One of the persons who could have authorized the payment has an approval log in their office showing they received the check request for approval and has confirmed they recall approving the payment; however the approval is not in the file in Payables. The employee who allowed the payment has been reprimanded and all of Payables has been reminded that verbal authorizations are not a substitute for written authorizations. The second item, of the two noted, was a payment on a contract approved by the Port Commission and therefore we believe the transaction had all the approvals needed.*
- *Clearly segregate the expenditure requests and approvals, as well as the receipt of the item purchased ... – The Port Authority has a process, independent of the approval and receipt process, which records and tracks any purchases of assets. The payments for goods and services are recorded and tracked to ensure that expenditures are within the limits approved by the Port Commission. The County Auditor reviews the payments to ensure they are within the scope of the contract awarded. However, we will review the existing procedures for approval and receipt to determine if they can be improved without adding inefficient bureaucracy to the procedures.*
- *Examine its recurring expenditures ... – The procedures of the Port Authority call for recurring purchases to be paid for by a Purchase Order. We already have taken several steps to re-enforce this procedure to staff and to further ensure that the procedure is followed. Additionally, purchases which have recurring payments typically are covered by an enforceable contract which protects the Authority's interests.*

Relevant Statutes and Overview of Fund Expenditures

The Fund's statutory basis, as amended by Senate Bill 1680 (77th Legislature, Regular Session), is shown below:

Excerpts From Texas Water Code, Chapter 60

§ 60.201. Purpose

Districts in this state which operate ports or waterways and harbor and terminal facilities are in keen competition with other ports, waterways, harbors, and terminals outside the state and with privately owned port and terminal facilities inside the state. Well-situated and well-equipped ports and waterways in other nearby states and owners of substantial port and terminal facilities located inside and outside the state are advertising, promoting and developing their competing ports, waterways, harbors, and terminals through expenditure of large amounts of money without any audit or restriction on expenditure of the money. This activity or expenditure is thwarting and impeding the use, progress, and development of the ports, waterways, harbors, and terminals of this state. Continuation of this hardship and injustice can best be met and coped with by more liberal use of some relatively small fund set aside from the gross income from operations of the ports of this state to be used in the manner provided in this subchapter.

Acts 1971, 62nd Leg., p. 110, ch. 58, § 1, eff. Aug. 30, 1971.

Amended by Acts 1993, 73rd Leg., ch. 114, § 1, eff. Aug. 30, 1993.

§ 60.202. Creation of Fund

A district organized under general or special law may set aside out of current income from its operations a promotion and development fund of not more than five percent of its gross income from operations in each calendar year.

Acts 1971, 62nd Leg., p. 110, ch. 58, § 1, eff. Aug. 30, 1971.

Amended by Acts 1993, 73rd Leg., ch. 114, § 1, eff. Aug. 30, 1993.

§ 60.203. Expenditure of Fund

Money in the promotion and development fund shall be spent by the commission or as the commission may direct to pay any expenses connected with:

- (1) any activity or matter incidental to the advertising, development, or promotion of the district or its ports, waterways, harbors, or terminals;
- (2) furthering the general welfare of the district and its facilities; or

- (3) the betterment of the district's relations with steamship and rail lines, shippers, consignees of freight, governmental officials, or others interested or sought to be interested in the ports, waterways, harbors, or terminals.

Acts 1971, 62nd Leg., p. 110, ch. 58, § 1, eff. Aug. 30, 1971.

§ 60.204. Management and Control of Promotion and Development Fund

- (a) The money in the promotion and development fund shall be kept separate from all other funds and accounts of the district, and no money collected from assessing or levying taxes may be mingled with the fund.
- (b) The promotion and development fund shall be under the exclusive control of the commission, and the commission shall have full responsibility for auditing, approving, and safeguarding the expenditure of money from the fund.
- (c) The county auditor shall exercise his usual supervision and control to assure that the commission sets aside no more than five percent of its gross income from operations in each calendar year in the promotion and development fund. The county auditor may ~~shall not~~ audit disbursements from the fund ~~but~~ and shall be entitled to a monthly statement showing the:
- (1) date of each disbursement from the fund;
 - (2) amount disbursed;
 - (3) person or concern to whom disbursed; and
 - (4) general purpose of each disbursement.

Acts 1971, 62nd Leg., p. 110, ch. 58, § 1, eff. Aug. 30, 1971.

§ 60.205. Other Expenses Not Affected

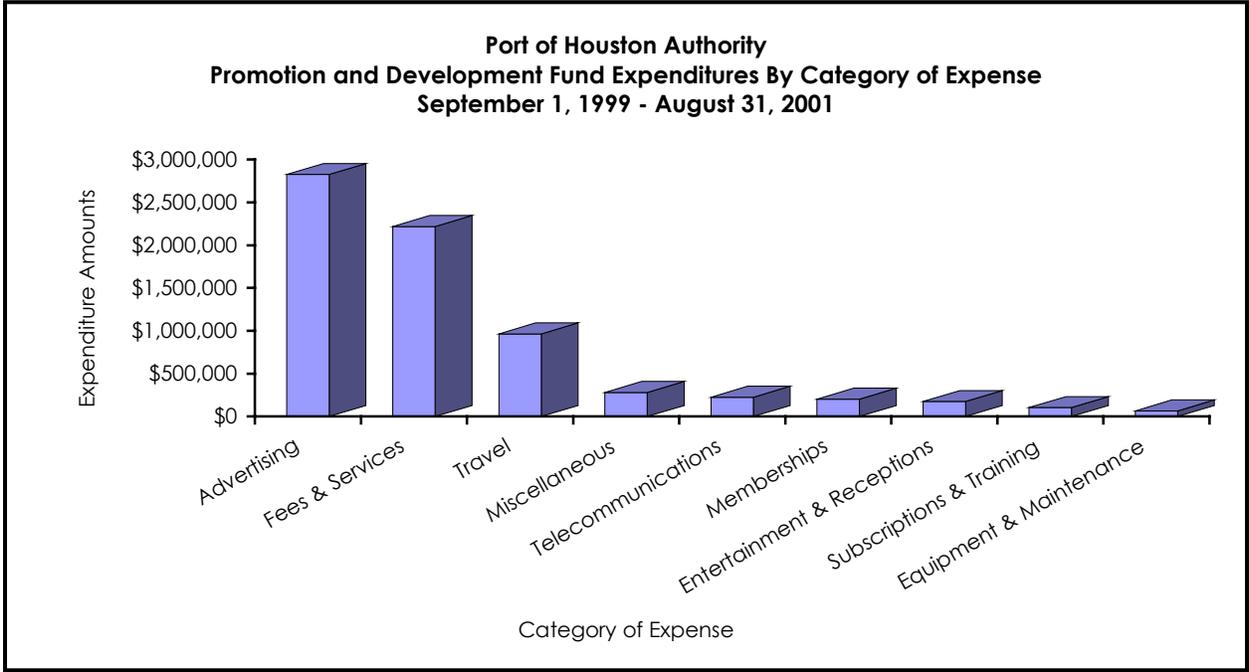
Since this subchapter authorizes disbursements from the promotion and development fund for unusual purposes and occasions not covered by other law, the setting aside of the fund and disbursements from the fund shall not affect payment of other expenses customarily approved, audited, and paid out of the regular funds of the district.

Acts 1971, 62nd Leg., p. 110, ch. 58, § 1, eff. Aug. 30, 1971.

Overview of Fund Expenditures

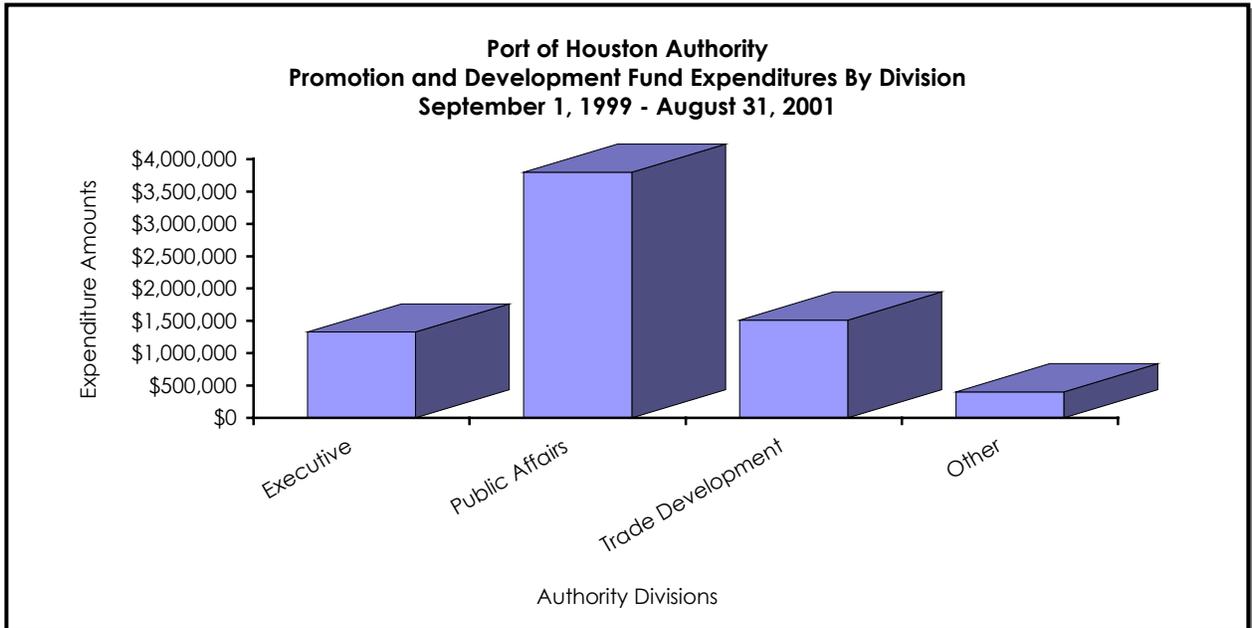
Figures 1 and 2 provide an overview of Fund expenditures from September 1, 1999, through August 31, 2001.

Figure 1



Source: Port of Houston Authority, Promotion and Development Fund, monthly cash reports

Figure 2



Source: Port of Houston Authority, Promotion and Development Fund, accounting data

Summary of Objectives, Scope, and Methodology

Our objectives were to verify the accuracy of the Authority's monthly expenditure reports and to review and comment on the nature of expenditures from the Fund.

The scope of this audit was limited to expenditures from the Authority's Promotion and Development Fund.

Audit procedures included reviewing applicable laws, policies, and procedures; analyzing data from the Authority's accounting system; and testing selected transactions occurring between September 1, 1999 and August 31, 2001. Fieldwork took place from October through mid-December 2001.

This audit was conducted in response to a legislative request and in accordance with generally accepted government auditing standards.