

SUNSET ADVISORY COMMISSION

STAFF REPORT

*Port of Houston
Authority*

AUGUST 2012



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Cover photo: The Texas Capitol is a marvel of craftsmanship down to the smallest details. The beautifully carved wood door frames are emphasized with elaborate, custom-designed bronze hinges and hardware produced especially for the building by Sargent and Co. of New Haven, Connecticut, in the late 1880s. The eight inch by eight inch hinges are inscribed with the words "Texas Capitol", decorated with incised designs of geometric and stylized floral motifs, and weigh over seven pounds each.

PORT OF HOUSTON AUTHORITY

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SUMMARY

SUMMARY

The Port of Houston Authority is not a broken organization, despite the image that may appear through the harsh glare of the media spotlight or a cursory reading of this report's findings. Certainly, the Authority has had its missteps and the scrutiny and criticism those missteps attract are justified. However, nothing is gained from dwelling on the details of past controversies, except to learn from them and guide the way forward. The negative attention and resulting Sunset review were a wake-up call for the Authority. It has work to do to restore public trust and respond creatively to the challenges ahead.

The Authority faces a period of continual growth brought on by anticipated increases in freight movement due to the booming Texas population, continued advancements in the petrochemical industry, and pending completion of upgrades to the Panama Canal. This growth brings opportunity, but also significant challenges as it coincides with increasingly scarce federal funds for maintenance of the Houston Ship Channel, and a need for alternative funding for infrastructure improvements beyond the taxpayer-supported bonds upon which the Authority has traditionally relied. In addition to these more immediate challenges, the Authority must continue to weigh its responsibilities as a governmental entity with the reality of its competitive operating environment, a difficult balance requiring great care to achieve success.

These challenges and the scale of the Channel's impact on the state's economy require the Authority to have forward-looking vision and public confidence to do its job. To this end, the Sunset review focused on restoring trust in the organization and helping it move ahead by recommending improvements to its governance structure and internal controls, and modernizing other aspects of its operations. Chief among these changes is bringing predictability, accountability, and a larger view to the Commission's governing structure by specifying clear appointment terms and term limits, and adding a member appointed by the Governor to provide a statewide viewpoint. The recommendations also include requiring stricter controls over use of the Authority's Promotion and Development Fund, a nagging source of controversy; allowing for a robust, standard internal audit function; and upgrading its approach to strategic and financial planning, public involvement, and procurement. The Authority has already identified some of these areas for improvement and has begun work to address them, turning the organization in the right direction. Ultimately, however, only a committed leadership at the top can reset the culture of the organization to ensure these critical changes are meaningful and lasting.

The Authority has work to do to restore public trust and address the challenges ahead.

An area of interest not addressed in the Sunset review of the Authority, but which may merit further consideration by the Legislature, is the State's approach to ports generally. Unlike many other states, Texas leaves the strategic vision, funding, and coordination of port activities up to locally created organizations, mostly county navigation districts. While this approach has historically produced a wealth of local economic development successes, a more comprehensive regional or even statewide approach could offer real advantages for the movement of goods through the broader transportation infrastructure and economy. Current trends in freight logistics combined with projected growth will likely stretch the limits of the State's current piecemeal approach to transportation planning, which lacks focused integration of discrete modes of transportation such as roads, rail, and waterways. These topics are currently being studied by many entities, including the House and Senate transportation committees and a special workgroup organized by the Texas Department of Transportation.

Unlike state agencies, the Authority is not subject to abolishment under the Texas Sunset Act, but is instead subject to an evaluation of its governance, management, operations, and compliance with legislative requirements. The material on the following pages summarizes staff recommendations on the Port of Houston Authority.

Issues and Recommendations

Issue 1

Clear Actions Must be Taken to Restore Trust in the Port Commission's Ability to Carry Out Its Important Mission.

Over the last 100 years, the Authority has evolved from a city-county entity to a broader organization representing the interests of four different appointing entities plus having responsibility for the regulation of Houston port pilots. Despite this evolution, the organization's basic governance structure has remained largely unchanged and does not reflect the Authority's significantly expanded modern scope and impact. Recent media scandals have contributed to a tangible public skepticism about the Authority that the organization's governing body is ultimately responsible for addressing. A lack of clarity in the Authority's enabling laws and governance practices creates additional confusion that can also undermine confidence. Clear parameters for Commissioner terms and other standard good governance practices would help improve accountability for the Commission and enhance trust within the organization and with the public. Adding a Governor-appointed member with business experience would provide needed perspective and a link to state-level policy and planning.

Key Recommendations

- Modernize the Commission's appointment structure by providing for a Governor-appointed member with required business experience, having members elect the Chair instead of a joint appointment by the City of Houston and Harris County, and putting clear parameters around Commissioner terms, including limiting tenure to no more than 12 years.
- Require standard best practices to promote ethics and good governance for the Commission and Authority staff, such as clear separation of duties between Commissioners and staff, standards of conduct, a code of ethics, and additional financial disclosure and conflicts of interest requirements.

Issue 2

The Authority Lacks a Proactive Public Engagement Strategy Necessary to Improve Stakeholder Trust.

To carry out its mission, the Authority needs public support, since it operates in the midst of a number of local communities and relies on government permits and taxpayer-supported bonds to expand and maintain its facilities. However, recent events highlight the Authority's lack of a comprehensive approach to engage its stakeholders, contributing to a pervasive cynicism about the Authority by the public that was apparent throughout the Sunset review. More fully embracing an active public involvement strategy going beyond minimum requirements for transparency and openness would help repair trust and provide better information to management for future decision making.

Key Recommendations

- Require the Authority to develop and implement a policy to guide and encourage more meaningful stakeholder involvement efforts.
- Require the Authority to develop a standard process to receive, respond to, document, and analyze complaints.

Issue 3

A Formal and Comprehensive Strategic Planning Process Is Critical to the Authority's Future Success.

The Authority faces unique challenges as a public entity operating in a competitive environment, requiring it to constantly weigh its various and sometimes conflicting responsibilities as it plans for the future. Ongoing infrastructure financing challenges will require creative solutions and increased trust in the Authority's business practices, demanding a robust and well-documented planning process. However, the Authority currently lacks such a developed process, despite its recent efforts at improvement. A more comprehensive and formalized approach to all aspects of strategic planning, including long-range planning, mid-range financial and capital planning, and short-range budgeting would help the Authority better explain and measure its goals, appropriately engage stakeholders and the Commission in planning, and ultimately, achieve its mission.

Key Recommendation

- Require the Authority to create a comprehensive strategic planning process, including long-range strategies and shorter-range implementation plans tied to financial and capital planning.

Issue 4

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

As a reflection of the Authority's strong historical connection to Harris County, statute designates the Harris County Auditor as the Authority's auditor, and prescribes specific duties aimed at reviewing individual financial transactions and performing a basic check on compliance with laws and policies.

However, the Authority has never had a risk-based internal audit function including both financial and operational auditing, a standard oversight tool for both public and private sector organizations. Over the last two years, as the Authority has sought to establish an internal audit function, the County Auditor and the Authority have come to an impasse in interpreting the proper role of each party due to ambiguous statutes that do not clearly define how the Authority's internal audit function should work. Clarifying the role of each party in statute would ensure the Authority establishes a needed internal audit function according to accepted internal auditing standards, while authorizing the County Auditor to play a more appropriate and occasional oversight role, given the Authority's use of property tax funds.

Key Recommendations

- Require the Authority to establish an internal audit function following accepted internal auditing standards.
- Repeal outdated provisions prescribing the Harris County Auditor's day-to-day audit duties at the Authority, but authorize County Auditor oversight of the Authority's finances based on risk.

Issue 5

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

Due to competitive business functions unique to a governmental entity and with clear statutory authorization, the Authority is certainly justified in spending its Promotion and Development (P&D) Fund for many purposes, such as lobbying for federal dredging dollars and travel to promote trade development. However, some of the Authority's expenditures allowed under the P&D statute are unusual for governmental agencies, and have repeatedly involved the Authority in various media exposés over the years, blemishing its reputation. Despite these repeated controversies, the Authority has not yet set clearly defined purposes and strict parameters for uses of the Fund, and has not made sufficient efforts to ensure its use of the Fund is transparent both within the organization and to stakeholders and the public. The Authority also lacks basic controls to ensure ongoing accountability and efficiency of Commissioner and staff travel and expenses, typically paid from the Fund. A more transparent and clearly defined approach to P&D spending would help the Authority defend its spending decisions, defuse criticism, and minimize the cost of these activities.

Key Recommendations

- 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.
- 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 Commission travel.

Issue 6

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

Procurement is a crucial function at the Authority, totaling \$122 million in 2011. Procurement practices at the organization have not matured to match this high level of expenditures. The Authority's organizational approach does not have a clear, central point to coordinate procurement oversight. Some long-standing policies and practices, such as those dealing with small business contracting and legal and lobby services, have not been systematically examined to determine their continuing relevance or structure. Finally, procurement practices do not include various standard contracting elements. Addressing these issues would promote consistency, efficiency, and fairness, ultimately saving money and improving the quality of Authority procurements.

Key Recommendations

- The Authority should better manage and align its organizational approach to procurement by establishing a central point of procurement authority and moving the small business function into the new procurement office.
- The Authority should re-evaluate its goal of annually awarding 35 percent of funds for formal procurements to small businesses; eliminate its contracted Special Counsel and Litigation Counsel services; and more actively manage its lobby activities.
- The Authority should implement standard practices to prohibit Commission communication with vendors involved in active procurements; change procedures so that the Commission may only accept or reject a staff-recommended vendor in a procurement award; implement an appeals process for vendors; and establish a systematic and ongoing training program to address conflicts of interest and other aspects of contracting for Commissioners and staff.

Issue 7

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

The Authority has a basic responsibility to ensure the safety of its operations, which include high-risk activities involving specialized skills, heavy equipment, and hazardous material. However, the accident rate for its employees is unacceptably high in some areas, and 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. Despite ongoing efforts, the Authority's safety program is neither comprehensive nor complete. The Authority rarely exercises its broad enforcement powers beyond informal measures, and does not have standard, organization-wide safety policies or systems for monitoring, documenting, and reporting safety issues. A more fully developed and comprehensive program would promote the health and safety of employees and others on Authority property and likely lower workers' compensation costs for the Authority.

Key Recommendation

- The Authority should take aggressive steps to implement a coordinated and comprehensive safety program. This effort should address both Authority employees and tenants, make use of internal and external resources, encompass standard best practices, and have a timeline for implementation.

Issue 8

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

Pilots serve a crucial role in ensuring safety and the continued flow of commerce along the Houston Ship Channel, which requires about 20,000 piloted ship movements per year. In the Commission's dual role as the Board of Pilot Commissioners for the Ports of Harris County, it approves pilot applicants and submissions for required state commissions, establishes pilotage rates, and investigates incidents involving pilots. Pilot regulation is not like licensing for most occupations because it is closely intertwined with the Houston Pilots Association, which plays a large role in vetting pilot applicants, scheduling work assignments, providing training, and ultimately asserting more regulatory powers than the Pilot Board. As a common practice for pilot associations in U.S. ports, and given the lack of major incidents in Houston, this basic structure and approach are not significant causes for concern. However, the arrangement does result in concentrating information at the Association that the Board needs to effectively monitor the pilots and carry out its clear statutory responsibility to provide oversight. Directing the Pilot Board to take basic actions to better assert its regulatory responsibilities over pilots would ensure this important activity receives the attention and oversight it deserves.

Key Recommendation

- Direct the Commission, acting as the Pilot Board, to take a more active role in overseeing Houston pilots by specifying needed information relating to required training, fatigue mitigation, criminal history background checks, and complaints.

Fiscal Implication Summary

The recommendations in this report would not have fiscal implications for the State because the Authority does not receive state appropriations. Many recommendations in the report are designed to improve internal operations and efficiency at the Authority, but their exact impact could not be estimated since any savings would depend on implementation. However, the following recommendations would have a direct fiscal impact on the Authority, as summarized below.

Issue 4 — The recommendations to eliminate the Harris County Auditor's day-to-day audit functions at the Authority, and instead have the Authority establish its own in-house internal audit function would likely result in a net annual cost of approximately \$380,000, according to the Authority.

Issue 6 — The recommendation to eliminate the Commission's Special Counsel and Litigation Counsel contracts could result in savings of about \$282,600 per year if the Authority instead performed these functions in-house using current resources.

— **PORT AUTHORITY AT A GLANCE**

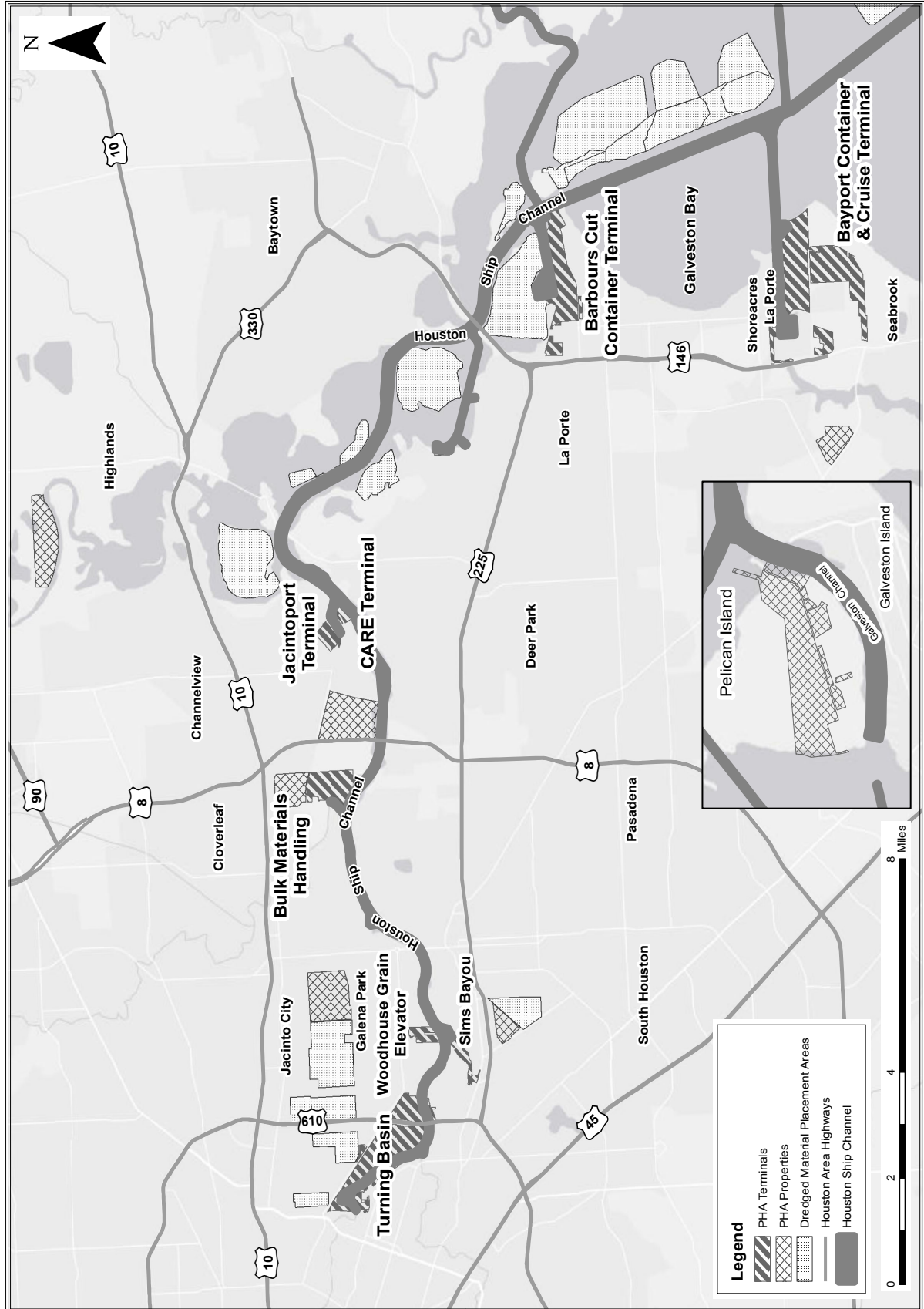
PORT AUTHORITY AT A GLANCE

The Port of Houston Authority has roots stretching back more than one hundred years. Originally formed as the Harris County Ship Channel Navigation District in 1911, and merged with the City of Houston City Harbor Board in 1921, the Authority has the dual mission of supporting the entire 52-mile Houston Ship Channel, with its more than 150 public and privately owned terminals and industrial facilities, and owning and operating a handful of these facilities itself. The map on the following page shows the Authority's property in relation to the overall Channel. The scope of the Authority's responsibilities and the Channel is immense, with impacts reaching far beyond the Houston region. In 2011, economic activity along the Channel contributed to more than one million jobs and \$178 billion in total economic activity in Texas.¹ Trade along the Channel, much driven by the thriving petrochemical industry, consistently puts Houston at the top of a variety of port industry rankings. In 2011, activity on the Channel ranked number one in total foreign trade and imports, and number two in total trade, exports, and total domestic trade among all U.S. ports.²

The Authority is a public governmental agency organized through powers set forth in the Texas Constitution, Texas Water Code, and various general and special laws of Texas.³ To achieve its diverse mission, the Authority performs the following key activities:

- acts as the federally designated local sponsor of the Channel, partnering with the U.S. Army Corps of Engineers (Corps) to oversee development and maintenance of the federal waterway;
- owns and operates two container terminals and five public-use general cargo facilities, requiring engineering and construction of major capital improvement projects and managing a diversity of tenants and maritime industries through real estate operations and setting public tariffs according to federal regulations;
- markets and develops trade opportunities for Authority facilities and the Channel generally;
- maintains police and fire departments to monitor and respond to security and safety threats, partners with industry and governmental entities on security issues, and complies with U.S. Coast Guard regulations;
- acts as the regulatory body for the Houston port pilots;
- ensures compliance with environmental regulations for activities occurring on Authority property, and participates in other environmental stewardship activities along the Channel generally; and
- participates in a variety of community development activities, including promoting small business participation in Authority contracts, maritime education programs, charitable causes, and community outreach.

Port of Houston Authority Properties



Map provided by the Port of Houston Authority

Key Facts

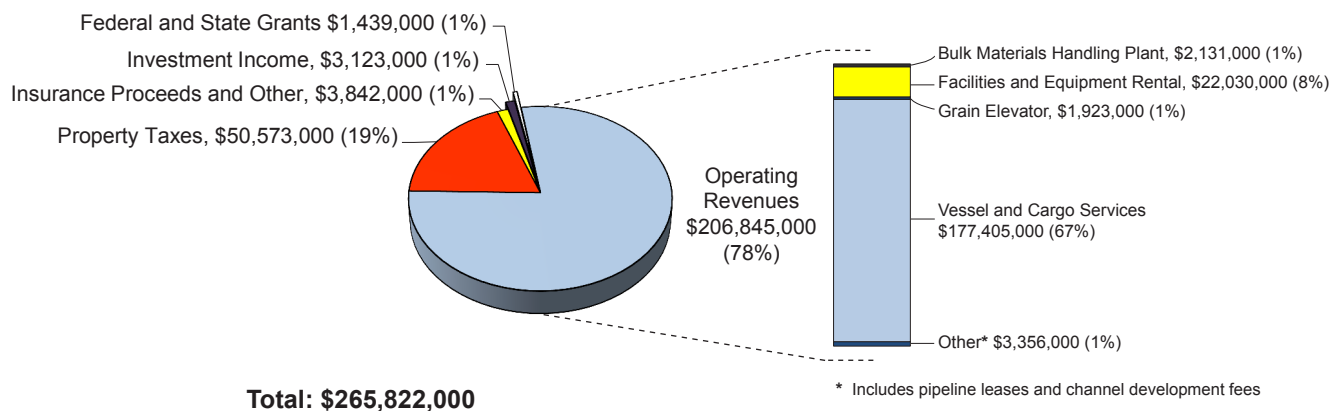
- Port Commission.** A seven-member Port Commission oversees the Authority. The City of Houston and Harris County jointly appoint the Chair of the Commission. The other six members are appointed as follows: two by Harris County; two by the City of Houston; one by the Harris County Mayors' and Councils' Association; and one by the City of Pasadena. Members serve two-year terms.

Since 1923, the Authority's governing body also serves as the Board of Pilot Commissioners for the Ports of Harris County. In this capacity, Commissioners approve the rates for ship pilots to bring foreign flagged vessels into the port, and oversee pilot rules, training, and state commission recommendations to the Governor.⁴

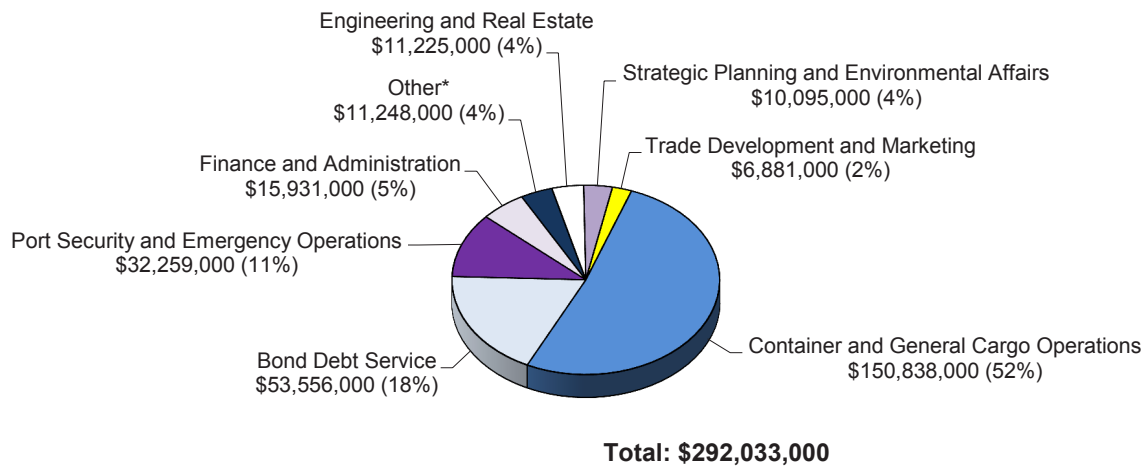
- Funding.** The Authority's revenues totaled about \$266 million in calendar year (CY) 2011, the Authority's fiscal year. The majority of these revenues consisted of vessel and cargo service fees generated from the Authority's container and general cargo facilities. The Authority does not receive state appropriations, but does rely on Harris County property taxes to pay debt service on bonds issued for many of its capital projects. At the end of calendar year 2011, the Authority had about \$1.4 billion in outstanding general obligation bonds, including interest. The Authority uses about \$50 million in tax funds per year to pay the associated debt service and has \$21.5 million of available funds remaining from bonds issued as authorized by voters in 1999 and 2007. The accompanying pie charts show the types and amounts of revenues the Authority collected and its expenditures by function in 2011. The Authority has accumulated about \$236.5 million in unrestricted net assets, not including bond proceeds, which it sets aside for operational needs and future infrastructure investments.

In 2011, the Authority spent about \$122 million on procurements, with \$32 million of that amount committed to small businesses through the Authority's small business program. The Authority also uses a Promotion and Development Fund for marketing, advertising, and other business-related promotional activities, and spent about \$3.5 million for these purposes in 2011.

Port of Houston Authority Revenues CY 2011



Port of Houston Authority Expenditures CY 2011



* Includes public affairs, legal, small business development, and executive

Note: The Authority's 2011 expenditures exceed revenues because the Authority funds capital expenditures using revenues accumulated during prior years, and may receive federal or state grant reimbursements in future years to offset some of these costs.

- **Staffing.** As of March 1, 2012, the Authority employed 578 staff with 606 authorized positions. All staff are located in Houston. Additionally, the Authority hires about 150 members of the International Longshoremen's Association at any given time, including crane operators, truck drivers, clerks, and others.
- **Channel maintenance.** The Authority partners with the Corps to maintain the Channel for all users, not just the Authority's terminals, which handle only about 15 percent of the total cargo passing through the Channel. The Authority plays a role in advocating for federal appropriations, shares costs with the Corps, and manages the placement of dredge material on more than 5,400 acres of Authority-owned or federal sites. Funding for dredging is primarily a federal responsibility, and particularly important for the Channel, which is not a naturally deep water port and requires a significant amount of maintenance to preserve adequate depth. The Corps has allocated \$31 million for Channel dredging for federal fiscal year 2012, which is funded by the federal Harbor Maintenance Tax assessed on industries along the channel.⁵ Maintenance dredging of the Channel is entirely the Corps' responsibility, but the Authority typically pays about 25 to 35 percent of the cost of certain projects, such as widening and deepening or building dredge material placement sites.
- **Terminal operations.** The Authority operates two types of terminals: container and general cargo, which combined handled about 42.5 million tons of cargo in 2011. The Authority generates the majority of its revenues from these facilities, mostly collected from steamship lines that pay fees based on the volume of cargo crossing the Authority's docks, as set out in the Authority's public tariffs.

The advent of shipping containers in the 1970s revolutionized international trade, providing for standardization of cargo. The Authority owns and operates two container terminals, which dominate the Gulf Coast container market and ranked ninth overall among container operations at U.S. ports in 2011.⁶ The Authority built its first container terminal at Barbours Cut in 1977, and opened a second terminal at Bayport in 2007, which can accommodate larger vessels.

Cargo that does not fit into containers is considered general cargo, also called breakbulk cargo. The textbox, *Types of General Cargo*, describes types of cargo flowing through the Authority's five general cargo terminals. Unlike the container terminals, the Authority does not directly operate these facilities, but rather leases or assigns space to a variety of maritime industries that perform the day-to-day work. Steel is the primary type of cargo flowing through these facilities, mostly driven by the petrochemical industry. In 2011, the

Types of General Cargo

- Steel
- Vehicles
- Grain
- Cotton
- Wind turbine components

Authority's general cargo terminals handled about 4.3 million tons of steel; 10.1 million tons of liquid and dry bulk; 77,000 automobiles; and 1.4 million tons of other breakbulk cargo.

- **Trade and economic development.** To support its terminal operations, the Authority engages in a variety of marketing activities typical of business entities, including market research, customer management, sponsorship of conferences and other events, and direct marketing. In 2011, the Authority also spent \$360,000 to contract with two international trade consultants and one agency to help promote its facilities in Central and South America, China, Thailand, Indonesia, and Japan, among other countries. These activities also include actively pursuing cruise lines or alternative uses for the Authority's unused cruise terminal facility at Bayport, completed in 2009.

The Authority plays a role to promote economic activity along the Channel generally, and works with a variety of organizations such as the Greater Houston Port Bureau, Greater Houston Partnership, and other organizations to promote regional economic development. The Authority also manages Houston's Foreign Trade Zone No. 84, a federally designated area allowing delayed or reduced taxes for certain foreign trade activities.

- **Security and emergency operations.** The U.S. Coast Guard is the lead agency in regulating security of maritime facilities, and the Authority must comply with a range of federal regulations governing access management, perimeter security, and emergency response, among others. The Authority is frequently audited by various outside entities, including the U.S. Coast Guard and the International Standards Organization (ISO), and passed its most recent Coast Guard security audit in April 2012 with the highest rating. The Authority has its own police force and marine fire department, employing 49 sworn officers and 46 firefighters.
- **Environmental program.** All operations on the Authority's property must comply with a range of local, state, and federal environmental regulations, such as those relating to its storm sewer permits and conditions associated with specific facilities such as its Bayport facility permit. To ensure compliance, the Authority has developed an Environmental Management System certified to ISO standards. The Authority periodically conducts compliance audits of its own facilities and approximately 80 tenants. The Authority also participates in a variety of voluntary programs, such as the Texas Commission on Environmental Quality's Clean Texas Program.

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- ¹ Martin Associates, *The Local and Regional Economic Impacts of the Port of Houston*, accessed July 2, 2012, <http://www.portofhouston.com/static/gen/about-us/Misc/PHA-EconomicImpact-2012.pdf>.
 - ² “U.S. Port Ranking by Cargo Volume, 2010,” American Association of Port Authorities, accessed July 2, 2012, <http://aapa.files.cms-plus.com/Statistics/2010%20U.S.%20PORT%20RANKINGS%20BY%20CARGO%20TONNAGE.pdf>.
 - ³ Section 52, Article III and Section 59, Article XVI, Texas Constitution; Chapter 292 (S.B. 222), Acts of the 40th Texas Legislature, Regular Session, 1927; Chapter 97 (H.B. 131), Acts of the 40th Texas Legislature, 1st Called Session, 1927; Chapter 117 (H.B. 641), Acts of the 55th Texas Legislature, Regular Session, 1957; Chapter 1042 (S.B. 63), Acts of the 70th Texas Legislature, Regular Session, 1987; and Chapters 60, 61, and 62, Texas Water Code.
 - ⁴ Chapter 66, Texas Transportation Code.
 - ⁵ Port of Houston Authority, *Update to Self-Evaluation Report* (Houston, TX: Port of Houston Authority, March 2012), p. 2.
 - ⁶ “North America Container Traffic 2011 Port Ranking by TEUs,” American Association of Port Authorities, accessed July 1, 2012, <http://aapa.files.cms-plus.com/Statistics/NORTH%20AMERICA%20PORT%20CONTAINER%20TRAFFIC%20RANKING%202011.pdf>.

ISSUES

ISSUE 1

Clear Actions Must be Taken to Restore Trust in the Port Commission's Ability to Carry Out Its Important Mission.

Background

The Port of Houston Authority is a public entity, technically established as a navigation district under the Texas Constitution and various general and special laws of Texas.¹ Each port is unique, and so is the Authority, with roots in City of Houston and Harris County predecessor organizations originally established in the early 1900s. The textbox, *Port of Houston Authority Key Dates*, shows the evolution of the organization. Currently, the seven-member Commission is appointed by four different entities and the members serve as both the Authority's governing body and the Board of Pilot Commissioners for the Ports of Harris County.

As a governing body of a public entity, the Port Commission has a clear role to serve the public regarding sponsorship of the 52-mile Houston Ship Channel, economic development efforts along the entire Channel, stewardship of property tax revenue and the other public funds generated from its operations, and safety and security of the

Channel through regulation of the Houston pilots and other efforts. The Authority is currently facing a number of significant challenges it must address to maintain its status as an economic engine for the local region, as well as the state and nation. These challenges include increased freight traffic caused by the booming Texas population, renewed oil and gas industry expansion, the pending completion of upgrades to the Panama Canal, and the always fiercely competitive nature of international trade and commerce.

The Authority must have the trust and support of the local population to respond effectively to these challenges with the kinds of facility upgrades, dredging projects, and possible general obligation bonds that will be needed in the future. Therein lies another complicating factor for the Authority — its impact extends well beyond the boundaries of the population whose trust and support it needs to succeed. The Authority may be a local entity by name and organization, but its importance has clearly grown beyond that now.

Port of Houston Authority Key Dates

- 1911** Voters authorize creation of the Harris County Ship Channel Navigation District to develop the Houston Ship Channel.
- 1913** City of Houston creates the City Harbor Board to develop wharves and docks along the Channel.
- 1914** Official opening of the Houston Ship Channel.
- 1921** Legislature merges the city and county organizations into a single Harris County Ship Channel District with five Commissioners: two appointed by the City, two by the County, and a jointly appointed Chair.
- 1923** Legislature puts regulation of the Houston pilots under the Port Commission's jurisdiction.
- 1971** Legislature renames the organization the Port of Houston Authority.
- 1987** Legislature adds two additional members to the Commission representing communities along the Channel, one appointed by the City of Pasadena, and one by the Harris County Mayors' and Councils' Association. Other appointments including Chair remain the same.

Findings

The Port of Houston Authority Commission is ultimately responsible for reestablishing needed trust in the organization.

During the last few years, harsh media attention has surrounded the Authority and partly resulted in this Sunset review.² Regardless of the ultimate truth behind some of the reported events, which included allegations of misconduct by top officials later cleared by the Harris County District Attorney, the Commission is responsible for ending the dysfunction and moving the Authority forward in these challenging times.³ Nothing is gained by rehashing specific stories in detail, except to note the toll they have taken on the organization's reputation in the eyes of the public. The events have undoubtedly contributed to a tangible public skepticism about the Authority that extends beyond the news reports and was strongly reflected in comments to a survey and other feedback received during the Sunset review. As the following material describes, much of the mistrust regarding the Authority relates to the lack of accountability resulting from having four appointing bodies for the Commission and a generally confusing set of governing laws, much of which reside in uncodified session law. This unique structure under which the Commission operates, and the need for a broader perspective on the Authority's statewide impact require focused efforts to restore trust and improve oversight of this important organization.

The Commission's four separate appointing entities and confusing governing laws contribute to a lack of accountability.

Unclear parameters and short two-year terms encourage ongoing reappointments and reduce accountability.

- **Unclear statutory framework.** A lack of clear statutory parameters for Commissioner terms has led to haphazard appointment dates and a trend of continually reappointed members. Provisions applying to Commissioner terms specify only basic information that the terms should be two years or until a successor is qualified.⁴ The actual start and end dates of each Commissioner's term are not described in law, and are left to each appointing entity to determine. The result is a confusing scheme in which reappointment dates can slip and actual service time can be stretched indefinitely without the member having to go through the appointment process. Over time, this practice limits accountability for the members and appointing entities. By contrast, most state agency boards have staggered terms that clearly expire on a date specified in statute to encourage the orderly transition of members. The chart on the following page, *Current Port Commissioner Terms*, shows how the terms for each of the current members have slipped since their original appointments. One Commissioner's last term expired in 2009, but he has never been reappointed, and yet continues to serve.
- **Downside of longevity.** Because long service on oversight bodies is generally not a problem for most entities, term limits are not a common approach in Texas. However, for the Authority, the dynamic of having

Current Port Commissioner Terms

Name	Appointed By	Original Appointment Date	Most Recent Appointment Date	Current Term Ends/Ended	Length of Time on the Commission
James Edmonds (Chair)	Jointly by City and County	October 8, 1996 (by Harris County); As Chair: June 27, 2000	June 22, 2010	June 22, 2012	16 years
Steve Phelps	City of Pasadena	July 29, 1997	September 18, 2007	September 18, 2009	15 years
James W. Fonteno	Harris County	December 22, 1998	June 26, 2012	June 26, 2014	14 years
Kase L. Lawal	City of Houston	May 19, 1999	September 14, 2011	September 14, 2013	13 years
Jimmy A. Burke	Harris County Mayors' & Councils' Association	July 15, 1999	December 15, 2011	January 1, 2014	13 years
Janiece Longoria	City of Houston	September 4, 2002	November 17, 2010	November 17, 2012	10 years
Elyse Lanier	Harris County	February 21, 2006	October 12, 2010	November 20, 2012	6 years

four different entities appointing Commissioners may actually create an incentive to continually reappoint an incumbent who would naturally wield more power through seniority than a new member. As the chart of *Current Port Commissioner Terms* shows, five Commissioners have served longer than 12 years. In addition, the nature of the position and the insulation from accountability of a single appointing entity can contribute to a natural tendency to develop a power base and the possible loss of a larger strategic vision for the Authority.

While no clear standard regarding term limits exists in Texas or other U.S. ports, precedents certainly exist. The Port of Corpus Christi, the most comparable Texas port also with multiple appointing entities, has term limits of no more than four three-year terms for its Commissioners, for a total of 12 years. A justification for imposing term limits on the Port of Corpus Christi, according to the House Research Organization analysis of the bill in 1995, said, "Over the years, many Commissioners have stayed on for dozens of years, garnering an inappropriate amount of power over this lucrative government entity."⁵ What was true for the Port of Corpus Christi in 1995 is also true for the Port of Houston Authority. An analysis of historical Commissioner terms shows instances of individuals serving lengthy terms over the organization's history, in several cases, more than 20 years.⁶ The Port of Long Beach in California also limits its Commissioners to 12 years total in office, in the form of two six-year terms. Also, results of a survey conducted during the Sunset review clearly indicated that placing some reasonable limitation on Commissioner terms would go a long way in restoring trust in the organization by a wide range of the Authority's stakeholders.

Placing some reasonable limitation on Commissioner terms would go a long way in restoring trust.

- Terms too short.** The Commission's two-year terms have been in place since the creation of the organization in 1911 and have never been revisited.⁷ In today's world, given the complex nature of the Authority's \$292 million per year budget, two years is simply not enough time for a person to learn the organization and make a meaningful contribution, and so further encourages ongoing reappointments. The Texas Constitution allows for terms of up to four years for the governing bodies of navigation districts.⁸ Among other ports in Texas and the U.S., no clear standard exists for term length, but four-year terms are fairly common, while two-year terms are very rare.⁹

Interests represented on the Commission do not reflect the Authority's complex operations or its statewide impact.

Activities occurring along the Channel make the Port of Houston, by far, the largest port in Texas, and a major player among U.S. and international ports. Being integral to the U.S. petrochemical industry and a significant export port contributes to the enormous impact commerce along the Channel has to the state's economy. A recently released study estimated this impact at \$178.5 billion of total economic activity and one million Texas jobs related to activity along the Channel in 2011. Authority-owned, leased, or affiliated facilities were reported to contribute \$115.4 billion and 651,284 jobs to this total.¹⁰

Only local interests are represented on the Commission despite its \$178.5 billion in statewide economic impact.

Despite this far-reaching impact, only local interests are represented on the Commission, leaving the Authority without a more direct link to state-level policymaking and oversight. Members of the Commission are not required to have any specific qualifications beyond being property owners living in Harris County.¹¹ Local representation is certainly merited and should be continued, given the impact of the Channel on local communities and the significant contribution of Harris County taxpayers to support the Authority's general obligation bonds. However, a representative of state interests with expertise directly related to overseeing complex business operations similar to the Authority's would provide needed perspective, and would also establish a more direct link to state-level policy discussions on issues that can have great impact to the Authority's operations, even though the State does not provide any direct funding. To be sure, adding another appointing entity for the State's perspective could appear to further diffuse accountability on the Commission, and no other Texas ports have Governor-appointed members. However, the Authority has no equal among Texas ports in statewide impact and justifies the need for such a unique approach. Also, the Governor regularly appoints members to other local boards, including water districts.¹²

The Port Commissioners also have a role in regulating state-commissioned pilots on one of the most difficult channels to navigate, yet this function currently gets minimal attention from the Commission, as discussed in Issue 8 of this report. A state appointee would also help bring attention to this secondary yet critical duty of the Commission, reflecting the Governor's ultimate responsibility to issue pilot commissions.

The current method for selecting the Commission's chair does not promote cohesiveness among the Commission's membership.

Recent issues facing the Commission have resulted in a real crisis of trust within the Commission and between Commission members and staff, culminating in the former executive director announcing his resignation in December 2011 after pressure by Commissioners.¹³ The Commission has made some changes to begin restoring trust among members of the governing body, such as reinstating additional Commission task forces, and recently selecting a new, permanent Executive Director. However, these events show the difficulty of maintaining cohesion with so many different appointing entities and interests represented on the Commission. The method of appointing the chair also does not promote cohesion. Harris County and the City of Houston select the Commission's chair by joint appointment, an approach that dates back to 1921, when the Authority was created through a merger of city and county organizations. This structure does not reflect the two additional appointing entities added to the Commission in 1987, and would not reflect a statewide representative, should one be established.

In the Authority's case, the lack of a consensus approach by Commission members to select the Chair can affect the ability of members representing various interests to function as a unit to promote the best interests of the Authority overall. While having members elect the Chair differs from a standard Sunset recommendation favoring a Governor-appointed chair for state agency boards, these boards generally comprise all Governor-appointed members with a single line of accountability to the Governor, unlike the Commission.

Other ports and governing bodies allow members to select their own chair and other board officers through an annual election. The Port of Corpus Christi probably has the most similar structure to the Authority among Texas ports, with appointments made by two counties and a city. Members of the Corpus Christi Port Commission elect their own Chair and other board officers on an annual basis. Among other U.S. ports, direct comparisons are difficult due to a wide variety of operating structures, but several other major port governing bodies use this method to select the chair, including the Los Angeles Harbor Commission, Port Authority of New York and New Jersey, Tampa Port Authority, and Georgia Port Authority.

Many governing bodies, including ports, elect their own chair on an annual basis.

The roles and responsibilities of the Authority's staff versus Commissioners are out of balance and need clarification according to standard best practices.

One of the Sunset Commission's standard provisions applied across the board to state entities requires a clear delineation between the policymaking duties of an agency's governing board, and the day-to-day operational duties of its staff. The provision rests on the concept that a board should focus on oversight, providing an overarching vision and policy direction to staff, which

A part-time, unpaid board like the Commission should focus on oversight and not get involved in operations.

should have leeway to carry out day-to-day operations. A board, especially a part-time, unpaid board such as the Commission, should focus on oversight and developing rules and policies for staff to follow. The board can then have confidence to vote on business matters developed by staff under the board's policies. Further, the board can trust staff to implement decisions without board member involvement in operations. Many agencies have adopted clear rules delineating these duties in order to implement this standard Sunset provision, including the Texas Department of Transportation and Texas Facilities Commission.¹⁴

Achieving the appropriate balance between Commission and staff roles has become a particular challenge of the Authority. The history of long-serving members on the Commission, combined with recent turmoil leading to a lack of trust, has led to a situation where the Commission's and staff's roles are out of balance, as shown in the examples below.

- **Roles of Executive Director, Chair, and Commission generally not clearly defined.** A unified description of the respective roles and responsibilities of the key groups involved in the Authority's governance does not exist. Currently, this description can only be derived through a tedious review of multiple documents, including the Authority's enabling laws, the Executive Director's contract, various policies and procedures, some of which have not been updated for many years, and agency memos on various topics such as purchasing authority delegation. Recognizing the need for a more transparent set of governing rules, the Commission adopted its first-ever bylaws in February 2012, but these are high level and do not capture in one place detailed responsibilities and duties.
- **Executive Director's authority over staff unclear.** Following the high-profile termination of one of the Authority's senior officers by the former Executive Director in September 2010, the Commission adopted a senior manager appeals process for employment actions taken against senior staff by the Executive Director. The process essentially allows the Commission to override the Executive Director's decision to terminate a senior-level employee if it determines the facts warrant such a reversal. While perhaps intended to provide a forum of redress to avoid potential controversy, the policy contradicts the essential duty of the Executive Director to employ, supervise, and discharge employees, and to organize the Authority as needed to face the challenges ahead. Such an appeals process also stands apart from existing procedures and legal remedies designed to deal with wrongful job actions. For a board to interfere in the employment decisions of its executive undermines the authority of the director and is disruptive to operations. If a board is unhappy with decisions made by the Executive Director, its authority should rest with the ability to hire, evaluate, and fire the director, not to get involved in individual employment decisions.
- **Commission too involved in operations.** As discussed further in Issues 5 and 6 of this report, the Commission has taken on too much of an

The Commission can essentially override the Executive Director's personnel decisions.

operational role in several important areas. For procurement awards, the Commission has the option to reject the staff's recommendation and choose among other ranked proposals. A standard practice is for staff to evaluate, rank, and recommend a single candidate for contract award with the Commission making the final decision to confirm the selection or require a re-procurement. Commission members are also heavily involved in selecting projects for Promotion and Development Fund expenditures. In 2011, the Authority's related expenditures were no small sum, totaling about \$107 million for procurements over \$50,000, and \$3.5 million in Promotion and Development Fund expenses. Being involved to this level of detail is another example of how the Commission compromises its role as an oversight entity and final decision maker. These Commission practices also open the door for pressure from individuals seeking to benefit from Authority contracts and contributions, and can create a perception that these important Authority functions are not objective. Finally, as discussed in Issue 5, the Commission has traveled extensively in the past to perform marketing functions more appropriately carried out by staff. Besides incurring significant expenses, the Commission should trust staff to have the expertise to effectively perform these functions.

- **Commission not focused on setting overall strategic vision for the organization or its regulatory duties over pilots.** As discussed further in Issue 3, the Commission does not formally adopt the organization's strategic plan or capital plan, instead focusing on approval of individual projects as they are ready for procurement. Also, as discussed in Issue 8, the Commission has not taken an active enough role in its duty to oversee the Houston pilots. This lack of focus on key duties of the governing body further shows how the Commission's focus has strayed from the high-level policy making and oversight role in which it should be engaged.

The Commission has taken initial steps to strengthen its governance and ethics policies, but further work is needed to restore trust.

Over the last year, the Commission has made genuine efforts to respond to public criticism and concerns regarding its operations, but these efforts are far from complete. For example, the Commission adopted its first formal bylaws ever in February 2012, but these do not comprehensively document the various roles and responsibilities currently scattered in myriad policies and procedures, and they are not publicly available on the Commission's website. Also, the Commission approved a whistleblower policy in January 2012, but this policy was not fully implemented until very recently, on July 12, 2012. Authority staff are currently working on a comprehensive update to the organization's ethics policies, last compiled in 1994, but these were not completed before the end of the Sunset review. Finalizing these policies is critical to restoring trust in the organization and would put into place the basic mechanisms to ensure ongoing accountability.

The Commission's involvement in operations compromises its role as final decision maker.

The Commission's bylaws and other policies are not available on the Authority's website.

*The Authority
would
benefit from
comprehensive
codes of ethics
and business
conduct.*

Ethics requirements are commonplace in public agencies and private companies. Texas law requires state agency officers and employees to abide by specific standards of conduct and requires state agencies to adopt written ethics policies according to model standards.¹⁵ The Lower Colorado River Authority (LCRA) and the Texas Department of Transportation (TxDOT) are examples of two public agencies that have developed ethics policies and made other governance matters more transparent. For example, LCRA's website includes detailed board procedures, and TxDOT has adopted comprehensive standards of conduct.¹⁶ Among private companies, increased emphasis on ethical conduct and internal control in recent years has brought about a myriad of new standards through the passage of the Sarbanes-Oxley and Dodd-Frank Acts and other regulations.¹⁷ For example, the New York Stock Exchange requires domestically listed companies to adopt and disclose a code of business conduct and ethics for directors, officers, and employees addressing a range of related issues.¹⁸

Beyond these standard governance policies the Commission must adopt to improve trust, the Authority would also benefit from clear, specific guidelines in law such as standard financial disclosure and conflict of interest provisions. These specific provisions, described below, would promote accountability and transparency, and help protect against the potential misuse of public office for personal gain. While general statutes contain similar concepts, applying specific provisions to the Authority would clarify their application to the Commission in one place and promote greater public trust.

- **Financial disclosure.** In 2003, the Legislature recognized the need to ensure financial accountability among governing bodies of Texas navigation districts, and passed a law requiring members of port governing bodies to file the State's standard financial disclosure form.¹⁹ This provision was repealed in 2005 in favor of an alternative process specific to ports, but this new process was then repealed one session later, in 2007.²⁰ Currently, the Authority and other Texas ports follow general disclosure requirements in the Texas Local Government Code for local government officers and certain vendors to file conflict disclosure statements reactively, if a conflict exists.²¹ Reinstating a more comprehensive and proactive financial disclosure requirement specific to the Authority in addition to existing requirements would provide a basic accountability tool required for many public officials.
- **Conflict of interest provisions.** The Sunset Commission has adopted standard across-the-board recommendations for state agency governing boards to prevent potential conflicts of interest resulting from board member ties to business entities regulated by or receiving money from the agency; professional trade organizations; and lobbying activities. While general provisions in various Texas statutes exist, prominently and clearly stating the applicability of these specific provisions to the Commission would add a clear layer of assurance.²²

- **Grounds for removal.** The Sunset Commission has adopted a standard provision specifying conditions and a process for removing members of governing bodies. The Texas Water Code includes very basic provisions relating to removal of navigation district governing boards, but these provisions lack detail or a specific process for how a board member would actually be removed.²³ Applying the standard Sunset language to the Authority's enabling law would clearly define how this process should work for members of the Commission.
- **Training for Commission members.** The Sunset Commission has adopted a standard provision to require specific types of training for state agency board members so that they have adequate information to properly discharge their duties. Currently, Commissioners are not subject to any training requirements beyond general compliance with the Open Meetings Act. Applying this standard Sunset language to the Authority's enabling law would ensure Commissioners receive more complete information about the Authority's enabling law, operations, and requirements before taking office.

Recommendations

Change in Statute

1.1 Modernize the Commission's appointment structure by providing for a Governor-appointed member, having members elect the Chair, and limiting terms.

The recommendation would maintain a seven-member Port Commission but change its makeup and impose term limits. The changes are designed to enhance trust among Commission members and between the organization and the public; provide a much-needed link to the State; and instill predictability and accountability around the tenure of Commissioners. As part of this recommendation, related existing provisions in the Authority's current enabling law would be repealed to prevent duplication or confusion going forward.

- Eliminate the position for the joint Chair appointment shared by the City of Houston and Harris County and instead provide that the members of the Commission elect the Chair and other board officers on an annual basis.
- Add one member appointed by the Governor with the advice and consent of the Senate. Require this member to be a person with demonstrated general business and financial management expertise in an organization similar to the Authority's size and scope.
- Lengthen Commissioner terms from two to four years.
- Allow any person to serve no more than twelve total years on the Commission, or a maximum of three four-year terms, consecutively or non-consecutively. Current and past Commissioners who have already served 12 years or more on the Commission would not be grandfathered under this provision, except for certain initial appointments described below.
- Clearly establish staggered Commissioner terms expiring February 1 of odd-numbered years.

- To allow for staggering of terms, provide that all current Commissioner terms expire on September 1, 2013, and require each appointing entity to make appointments not later than September 2, 2013. Initial appointments would be made as follows to establish staggered terms and allow for transfer of current expertise of members.
 - The following entities would each appoint one Commissioner, for a total of four, to initial terms expiring February 1, 2015: City of Houston, Harris County, City of Pasadena, and Harris County Mayors' and Councils' Association. Existing members of the Commission who have already served 12 years or who by serving this term would reach or exceed 12 years of service would be eligible for these appointments, but this would be their last possible appointment to the Commission.
 - The following entities would each appoint one Commissioner, for a total of three, to initial terms expiring February 1, 2017: Governor, City of Houston, and Harris County. Any person who has already served a total of 12 years or more on the Commission or who would reach 12 years by February 1, 2017 would be ineligible for these appointments.

1.2 Require the Commission to develop and implement policies clearly separating the policymaking responsibilities of the Commission and the management responsibilities of the Authority's Executive Director and staff.

This recommendation, based on a standard Sunset provision applied to state agencies, would require the Commission to clearly describe its role in policymaking and oversight of the organization and make the Executive Director and staff responsible for the day-to-day operations of the agency. This policy should adjust and clearly spell out, in one place, all relevant duties currently existing in various Authority laws, contracts, bylaws, and policies. The new policy should, among other factors, clearly establish the Executive Director as solely responsible for employment and personnel decisions and any other specifically delegated authorities granted by the Commission. As part of this recommendation, current statutory provisions relating to the Executive Director or "general manager" of the Authority would be repealed or clarified to be in line with standard practice.

1.3 Require standard best practices to promote ethics and good governance for the Commission and Authority staff.

This recommendation, based on a combination of best practices, general state laws, and standard Sunset provisions, would promote accountability and trust in the Commission and the organization generally. These provisions would complement but not duplicate or conflict with other provisions applying to the Authority through various session laws, the Texas Water Code, or the Texas Local Government Code. While placing these provisions in law is important to ensure ongoing implementation, the Authority does not need statutory authorization to implement many of these changes and should take immediate steps to complete implementation sooner, if possible. Required elements would include the following.

- **Standards of conduct and code of ethics.** The Commission would be required to adopt and abide by a formal policy governing standards of conduct and ethics for Commission members and employees, similar to provisions applying to state agencies generally and the Texas Department of Transportation specifically. When developing its specific policies, the Commission should also make an effort to incorporate applicable best practices common in private industry.

- **Whistleblower policy.** The Commission would be required to adopt and maintain a whistleblower function according to standard best practices. The internal auditor recommended in Issue 4 should ultimately be the central point of coordination for this function.
- **Board governance policies.** The Commission would be required to adopt detailed board policies comprehensively documenting its governing practices, and make these available on its website. The Commission would also need to revise its current bylaws to more comprehensively document its governing practices according to this recommendation.
- **Financial disclosure.** This recommendation would reinstate the application of personal financial disclosure requirements found in Chapter 572, Texas Government Code for Commission members.
- **Conflict of interest.** This recommendation, based on standard provisions generally applied to all state agencies undergoing Sunset review, would prohibit a person from serving as a member of the Commission if the person or the person's spouse uses or receives a substantial amount of tangible goods, services, or money from the Commission other than compensation or reimbursement authorized by law for Commission membership, attendance, or expenses. In addition, this recommendation would prohibit a person employed by or participating in the management of a business entity or other organization regulated by or receiving money from the Commission from being a member on the Commission. The recommendation would also define "trade association" and prohibit an individual from serving as a member of the Commission or serving as a high-level agency employee if the person or the person's spouse is an officer, employee, or paid consultant of a trade association in fields relating to maritime commerce.
- **Grounds for removal.** This recommendation, generally applied to all state agencies undergoing Sunset review, would specify the grounds for removal for Commission members and the notification procedure for when a potential ground for removal exists.
- **Commissioner training.** This recommendation, generally applied to all state agencies undergoing Sunset review, would clearly establish the type of information to be included in Commission member training. The training would need to provide Commission members with information regarding the legislation that created the Authority; its programs, functions, rules, and budget; the results of its most recent formal audits; the requirements of laws relating to open meetings, public information, administrative procedure, and conflicts of interest; and any applicable ethics policies.

Fiscal Implication

These recommendations would not have a fiscal impact to the Authority. Commissioners would continue to serve without pay, and staff could implement needed updates to policies and procedures within the Authority's current resources.

1 Section 52, Article III and Section 59, Article XVI, Texas Constitution; Chapter 292 (S.B. 222), Acts of the 40th Texas Legislature, Regular Session, 1927; Chapter 97 (H.B. 131), Acts of the 40th Texas Legislature, 1st Called Session, 1927; Chapter 117 (H.B. 641), Acts of the 55th Texas Legislature, Regular Session, 1957; Chapter 1042 (S.B. 63), Acts of the 70th Texas Legislature, Regular Session, 1987; and Chapters 60, 61, and 62, Texas Water Code.

2 For examples of media reports about the Authority, see: Wayne Dolcefino, "The Port of Plenty?" *KTRK-TV Houston 13 Undercover*, May 6, 2011; Mike Morris, Nolan Hicks, and Jenalia Moreno, "Texas Senate orders review of embattled port authority," *Houston Chronicle*, May 26, 2011; Mike Morris, "County attorney blasts the way Port does business," *Houston Chronicle*, September 8, 2011; Editorial, "Pointing the way to reforming the port," *Houston Chronicle*, September 14, 2011.

3 Closed investigation letter issued by Patricia R. Lykos, Harris County District Attorney, December 12, 2011. The letter stated the investigation "revealed no criminal conduct" by the Authority's former Executive Director, and that "the investigation into conflict of interest allegations against" the Commission's Chair resulted in "a finding of no criminal culpability."

4 Section 61.159, Texas Water Code; and Section 13, Chapter 30 (S.B. 93), Acts of the 37th Texas Legislature, 1st Called Session, 1921.

5 House Research Organization, *Bill Analysis: HB 3211*, May 2, 1995, p. 2, accessed July 9, 2012, <http://www.hro.house.state.tx.us/pdf/ba74r/hb3211.pdf#navpanes=0>.

6 Since 1922, 11 people have served 12 years or more on the Port Commission, excluding current Commissioners. Robert J. Cummins served for 24 years (1922 to 1946); W.D. Haden, II served for 20 years (from 1964 to 1984); and Howard J. Middleton, Jr. served for 18 years (1978 to 1996).

7 Chapter 15 (S.B. 43), Acts of the 31st Legislature, Regular Session, 1909 authorized the formation of navigation districts in Texas. Harris County voters later approved the formation of the Harris County Houston Ship Channel Navigation District as authorized by this law on January 10, 1911.

8 Section 30, Article XVI, Texas Constitution.

9 American Association of Port Authorities, Director of Research and Information Services, email message to Sunset staff, including spreadsheet titled "Port Authority Board Structure," June 19, 2012.

10 Martin Associates, *The Local and Regional Economic Impacts of the Port of Houston, 2011* (Lancaster, PA, 2012), p. 5, accessed July 9, 2012, <http://www.portofhouston.com/static/gen/about-us/Misc/PHA-EconomicImpact-2012.pdf>.

11 Section 61.160, Texas Water Code.

12 For example, the Governor appoints board members to the following entities: Lower Colorado River Authority, Section 8503.006, Texas Special District Local Laws Code; Gulf Coast Waste Disposal Authority, Chapter 409 (S.B. 225), Acts of the 61st Texas Legislature, Regular Session, 1969; and Coastal Water Authority, Chapter 601 (H.B. 373), Acts of the 60th Texas Legislature, Regular Session, 1967.

13 Employment of the Authority's Executive Director was placed on the Commission's May 24, 2011 agenda following media reports alleging wrongdoing and pressure from Commissioners. The Executive Director eventually announced his resignation in December 2011 after being cleared of wrongdoing by the Harris County District Attorney. See: Wayne Dolcefino, "Port of Houston officials in hot water?" *KTRK-TV Houston 13 Undercover*, May 13, 2011; and Mike Morris, "Dreyer: Too much politics in Port CEO job." *Houston Chronicle*, December 13, 2011.

14 1 T.A.C. Sections 111.1 and 111.2; and 43 T.A.C. Sections 1.1 and 1.2.

15 Section 572.051, Texas Government Code.

16 "LCRA Board Policies," Lower Colorado River Authority, last modified June 20, 2012, <http://www.lcra.org/about/leadership/board/policies.html>; and "Reporting Fraud – Office of Compliance and Ethics," Texas Department of Transportation, http://txdot.gov/about_us/compliance_ethics.htm.

17 Holly J. Gregory and Rebecca C. Grapsas, *Comparison of Corporate Governance Principles and Guidelines: United States* (New York, NY: Weil, Gotshal & Manges LLP, 2012), p. 62.

18 New York Stock Exchange, *Listed Company Manual*, Section 303A.10, Code of Business Conduct and Ethics, accessed July 9, 2012, <http://nysemanual.nyse.com/LCMTTools/PlatformViewer.asp?selectednode=chp%5F1%5F4%5F3%5F10&manual=%2F1cm%2Fsections%2F1cm%2Dsections%2F>.

19 H.B. 1606, 78th Texas Legislature, Regular Session, 2003.

20 S.B. 945, 79th Texas Legislature, Regular Session, 2005; and S.B. 1396, 80th Texas Legislature, Regular Session, 2007.

21 Chapter 176, Texas Local Government Code.

22 Chapters 553 and 573, Texas Government Code; and Chapters 171 and 176, Texas Local Government Code.

23 Sections 61.074 and 61.159, Texas Water Code.

ISSUE 2

The Authority Lacks a Proactive Public Engagement Strategy Necessary to Improve Stakeholder Trust.

Background

As a governmental entity, the Port of Houston Authority is charged with effectively using its extensive holdings of facilities and land for public benefit, and promoting safe, efficient, and environmentally sound uses of the Houston Ship Channel generally. To carry out this mission, the Authority must interface with the public on multiple levels, both formally and informally. Formally, the Texas Open Meetings Act requires the Authority to take specific steps to make its decision making accessible to the public, by methods such as holding open meetings, posting meetings and agendas in advance, and documenting the proceedings.¹ For its construction and dredging activities along the Channel, the Authority must seek permits through the U.S. Army Corps of Engineers (Corps). While the Corps is ultimately responsible for carrying out the public involvement components of permit review, the Authority also has responsibility during this process to address public concerns raised regarding its proposed projects.² For example, the Authority has developed a noise mitigation program to respond to such concerns regarding the impact of the Bayport container facility's operations on neighboring communities.³ Finally, the Authority also benefits from general obligation bonds funded by Harris County taxpayers, and must receive public approval in the form of voter acceptance of these issuances, which currently amount to \$1.4 billion in outstanding debt.⁴

More informally, the Authority has focused on developing its relationship with the community through educational outreach activities, small business development, and providing financial support to a range of organizations. In recent years, some of these activities included providing more than 26,000 passengers per year free public tours of the Channel on the Authority's boat, the *MV Sam Houston*; more than \$90,000 for table sponsorships at community events and \$30 million expended with small businesses through the Authority's procurements in 2011; and a \$2 million partnership with Texas Southern University to establish a Maritime Transportation Management and Security Program, announced in 2009.

Findings

Current events indicate a need for the Authority to focus on improving trust so it can move forward with its mission.

Public trust is directly tied to the Authority's ability to effectively accomplish its mission for several reasons. On a basic level, the Authority's facilities, which provide most of the revenue to support its operations, are located within and alongside a number of cities and neighborhoods. In some locations, residential areas are very close to the Authority's facilities, putting it in constant contact with these communities. As the region's economy and population continue to grow and activity along the Channel increases, interactions between the Authority, neighboring communities, and other stakeholders will only become more frequent. Building and maintaining

relationships with these communities and stakeholders is essential if the Authority is to secure governmental approval for additional permits to expand or maintain its operations, or voter approval for additional bonding authority to fund infrastructure improvements. These communities can also have a direct impact on the Authority through passage of ordinances that can curtail its operations.

Ongoing controversy surrounding the Authority's Bayport facility shows community relations remain tense.

Beyond the recent events that have eroded public trust in the Authority and led to general skepticism about its operations, discussed elsewhere in this report, specific issues related to the Authority's relationship with neighboring communities and other stakeholders were also apparent during the Sunset review. This tension is exemplified by the ongoing controversy over the Authority's handling of a permit application to dredge the channel near its Bayport facilities.⁵ Public concern about permitting processes for a project of this magnitude is not surprising, but issues regarding its Bayport facilities are one area where the Authority has professed to have learned some lessons about community involvement from its past experience, which led to palpable disenchantment in the community. Ongoing controversy regarding the Authority's operations at the Bayport facility indicates relations between the Authority and these communities are still tense and require attention.

This disenchantment was also captured in an informal survey conducted by Sunset staff. Of the approximately 770 responses received from the Authority's stakeholders, about 120 private individuals and community groups responded and rated the Authority the most negatively compared to other groups. Up to 50 percent of these respondents rated the Authority poorly in the following categories: openness and responsiveness to the public; effective use of the Promotion and Development Fund; management and use of taxpayer-supported bond money to fund capital projects; and environmental stewardship. Other feedback received in the course of the Sunset review from a spectrum of interested parties and stakeholders indicates the Authority has not built trusting relationships that would make them feel their concerns or interests are being represented or taken seriously. Recognizing the unscientific nature of such sources of feedback and the propensity of the disenchanted to voice opinions the loudest, this theme was pervasive throughout the Sunset review.

The Authority does not proactively engage its stakeholders according to best practices.

Involving the public, to be meaningful, should be more than simply following minimum requirements set out in laws and regulations or focusing on promotional activities. These efforts should include early and frequent contact between organizations and stakeholders, beginning with planning and continuing through implementation. Activities should include outreach tied to decision making and use a variety of techniques targeting different groups and individuals. While the Authority has made recent efforts to improve its approach to public involvement, the following material highlights areas of concern.

- **No organization-wide public involvement strategy for gathering and responding to stakeholder input.** The Authority does not have a clearly communicated or comprehensive public involvement strategy. Without such a plan, it lacks focus on this important function, which must include clear buy-in from senior management and the Commission to be effective. As a result, the Authority's public outreach efforts are too focused on community development and promotional activities, with ad hoc reactions to specific controversial issues as they arise, which puts the Authority on the defensive in its relationship with stakeholders in many cases. This defensive posture is detrimental to both the local communities needing open and honest information about the Authority's impact on people's daily lives, and on the Authority's reputation and business interests.

Through recent Sunset reviews, the Legislature has required organizations to adopt formal public involvement policies, including the Texas Department of Transportation and Capital Metropolitan Transportation Authority.⁶ Adopting such a policy, and featuring related strategies prominently on its website, would help promote understanding of how stakeholders can engage with the Authority and what to expect from these interactions. By making the effort more comprehensive and proactive, the Authority could consider ways to develop regular and more meaningful public interactions through all of its activities and programs. Elements could include formal public comment and input procedures for Commission meetings, increased stakeholder involvement in strategic planning, as discussed in Issue 3, and the use of advisory committees, citizen panels, or regular town hall meetings to promote ongoing dialog and trust. Further, public involvement need not be something to fear. By formally providing people affected by its policies and activities real opportunities for meaningful input, the Authority gains additional information and perspective to improve the overall decision-making process.

- **Not embracing the full spirit of openness.** In September 2011, the Harris County Attorney reviewed the Authority's operations and questioned whether it was complying with the Open Meetings Act.⁷ The Authority has made changes to address the County's concerns, and appears to be complying with the Act. However, the Sunset review revealed an additional concern regarding the Commission's reinstatement of five standing Commission subcommittees, or task forces. While the use of task forces promotes transparency by providing more opportunities for meaningful policy discussions, currently, the chair of each task force can decide if each meeting should be open to the public on a case-by-case basis. This practice of selective openness can create a level of anxiety that does not help gain acceptance of any ideas developed in closed sessions. These task forces do not represent a quorum of the Commission, nor do they have expressly delegated decision making authority, so the Act does not technically require the Commission to make these meetings public.⁸ However, given the detailed nature of deliberations occurring

The Authority's public outreach efforts are too reactive to best serve local communities' needs.

Selective openness of Commission task force meetings does not send a welcoming message of inclusion.

in all task forces and the clear statutory intent for liberal construction of the Act, the decision not to post all task force meetings does not send a welcoming message of inclusion. Further, Sunset staff observed one task force approve expenditures without clear authority to do so. Although this action occurred in an open meeting, it raises the potential that actual decision making could occur in a closed meeting, and could put the Authority in a potential grey area regarding technical compliance with the Act.

Other practices by the Authority indicate something less than a full embrace of open and accessible government. The Authority's Commission meetings occur at its headquarters building, which requires a person to present photo identification and pass through security gates to enter, a necessary but somewhat intimidating process. Unlike many other governmental entities, the Authority has not taken steps to provide easier access to its meetings such as posting live or archived video feeds online, but did recently begin recording audio of its meetings. However, the Authority has not made this audio available on its website. Nor has the Authority made its Commission meeting minutes promptly available; in July 2012, the most recent minutes posted on the Authority's website were more than five months old, from the December 2011 meeting.⁹ Meeting notices, while technically only required to be physically posted in the Authority's lobby and in the Harris County Courthouse, also are not routinely provided to stakeholders requesting this information through an email notification in time to be of use. While the Authority is not legally required to do any of these things, improving these procedures would go a long way to provide transparency into the Commission's activities.

The Authority has not made Commission meeting audio, minutes, or notices easily available to the public.

- **Website not fully developed and lacks basic information.** A comprehensive and user-friendly website has become a central component to any organization's public outreach efforts, as it is the first and often primary source of information about the organization and how to get involved. The Authority recently launched a new website, which is a major improvement over its previous version, but still lacks several key components. For example, current information about public involvement on the Authority's website is spread among different links limited to specific procedures, such as appearing at Commission meetings and requesting public documents. The "Community Outreach" link only provides information on promotional and sponsorship activities.¹⁰ The Authority also maintains several websites in addition to its main website to provide information about dredging and mitigation projects relating to its Bayport facilities.¹¹ While these websites contain useful material, maintaining this information on sites separate from the Authority's main page complicates understanding of the Authority's role in these activities and how the public can get involved.

The Authority's website also contains almost no information about its cruise terminal, a source of intense, ongoing public scrutiny and concern.

A search for “cruise” on the Authority’s website during the Sunset review returned only one result, to the Authority’s *Tariff No. 15 – Rates, Rules, and Regulations Governing the Bayport Container and Cruise Terminal*. By not providing basic, proactive information about the terminal, the Authority invites continued criticism and even misinformation about what is actually occurring with the property. By clearly posting information about the cost of the cruise terminal’s construction, ongoing maintenance expenses and revenue received, and the Authority’s current activities to find uses for the facility, the Authority could help promote transparency into this nagging issue that has critically affected public trust, especially regarding the use of taxpayer-supported bond funds.

The Authority does not have an effective system to accept, track or manage complaints.

Despite its potential direct impact on local communities, the Authority does not have a comprehensive system in place to track, respond to, or analyze complaints regarding all of its facilities. The Authority’s website has a general comment form, but no information about how to file a specific complaint or what to expect once a complaint is filed. A search for “hotline” or “complaint” on the website during the Sunset review returned no results. The Authority has developed a hotline promoted in the area around the Bayport container facility for tracking and responding to complaints and other issues, but this hotline is limited to one geographical area. The structure and administration of this hotline could be used as the basis for an expanded, organization-wide system for handling complaints. Maintaining a system for acting on complaints and keeping proper documentation of complaints would provide useful information to management and provide a simple mechanism for addressing public concerns before they mushroom.

The Authority’s website contains almost no information about the cruise terminal despite intense public interest.

Recommendations

Change in Statute

2.1 Require the Authority to develop and implement a policy to guide and encourage more meaningful stakeholder involvement efforts.

This recommendation would require the Authority to develop an official policy providing a clear structure for its overall approach to public involvement including each of the areas described below. In implementing this provision, the Authority should consider specifically addressing the elements described to encourage a comprehensive and proactive effort.

- **Stakeholder engagement.** The policy should include a description of how the Authority will seek to engage stakeholders more proactively, including through strategic planning efforts, and the possible use of advisory committees, community panels, town hall meetings, or other more formal and ongoing strategies.
- **Open meetings.** The Authority should develop specific actions it will take to go beyond minimum Open Meetings Act requirements, such as requiring all task forces to hold open meetings, unless

specific reasons covered by the Act would justify an exception; providing opportunities for public input to the Commission; and posting audio, minutes, and meeting agendas in a timely fashion on the Commission's website and through electronic notifications.

- **Online information.** The Authority should develop a strategy for how it will use the website to provide clear, updated information on issues of public concern, such as clear summary information about how the public can interact with the Authority overall, and ensuring topics of major interest such as the cruise terminal are adequately addressed.

2.2 Require the Authority to develop a standard process to receive, respond to, document, and analyze complaints.

The recommendation would require the Authority to develop policies and procedures to formally document and effectively manage complaints organization-wide. The Authority would maintain a system for receiving and acting on complaints, maintain documentation on all complaints, and periodically notify complaint parties of the status of complaints. The Authority would be required to develop a standard form for the public to use when making a complaint, and make this form available on its website, along with clear information on what to expect once a complaint is filed, including timelines for response and resolution. As part of this recommendation, the Authority should compile detailed statistics and analyze complaint information trends to get a clearer picture of the problems identified through the complaints received. This data should include information such as the nature of complaints and their disposition, and the length of time to resolve complaints. Authority staff should report this information on a regular basis to senior management and the Commission.

Fiscal Implication

The recommendations would not have a significant fiscal impact to the Authority. The Authority already has dedicated public affairs, communications, and community relations staff who could work to implement a more proactive public involvement strategy and make improvements to the website. Also, the Authority already has a basic structure in place for a complaint system and hotline and could expand this to be a more comprehensive system.

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- ¹ Chapter 551, Texas Government Code.
 - ² 33 C.F.R. Section 320.4.
 - ³ “Bayport Mitigation Solution,” Port of Houston Authority, last modified May 15, 2012, <http://www.bayportmitigationsolution.com/>.
 - ⁴ Section 2, Chapter 117 (H.B. 641), Acts of the 55th Legislature, Regular Session, 1957.
 - ⁵ Kiah Collier, “Yacht club disputes role in port proposal,” *Houston Chronicle*, June 13, 2012.
 - ⁶ Sections 201.811 and 451.138, Texas Transportation Code; See also: “Public Involvement,” Texas Department of Transportation, accessed July 11, 2012, http://www.txdot.gov/public_involvement/; and “Public Outreach and Community Involvement,” Capital Metropolitan Transportation Authority, accessed July 11, 2012, <http://www.capmetro.org/public.aspx>.
 - ⁷ Office of Vince Ryan, *Report Regarding Review of The Port of Houston Authority* (Houston, TX: Office of the Harris County Attorney, 2011), pp. 2-3.
 - ⁸ 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.
 - ⁹ “Minutes,” Port of Houston Authority, accessed July 11, 2012, <http://www.portofhouston.com/the-port-commission/public-meetings/minutes>.
 - ¹⁰ “Community Outreach,” Port of Houston Authority, accessed July 11, 2012, <http://www.portofhouston.com/community-outreach>.
 - ¹¹ “Bayport Mitigation Solution,” Port of Houston Authority, accessed July 11, 2012, <http://www.bayportmitigationsolution.com/>; and “Port of Houston Deepening and Widening,” Port of Houston Authority, accessed July 11, 2012, <http://www.deepeningportofhouston.com/>.

ISSUE 3

A Formal and Comprehensive Strategic Planning Process Is Critical to the Authority's Future Success.

Background

The Port of Houston Authority (Authority), like many other ports, operates with an internal conflict as a public entity that must respond to competitive pressure. As it develops and executes its plans for the future, the Authority must constantly weigh its stewardship responsibilities with its need to creatively respond to challenges presented by the business environment in which it often operates, which occasionally requires taking some risks. The Authority's first century is replete with examples of how this challenge has played out — from the forward thinking idea to dredge the Houston Ship Channel (Channel) in the first place, and later to invest early in the advent of containerization, to other, more controversial decisions such as building a grain elevator that sat empty for most of the 1930s, and completing a cruise ship terminal in 2009 that sits empty today.¹ As the Authority moves into its second century, it must carefully consider how to maintain this delicate balance while responding to a new range of challenges and opportunities brought on by expected increases in freight movement at the same time that funding for Channel dredging and capital investment in its infrastructure has become scarce.

Strategic planning, as defined in the State's formalized process for Texas agencies to follow, is "a long-term, iterative, and future-oriented process of assessment, goal setting, and decision-making."² Strategic planning is a common activity in a range of organizations, from Fortune 500 companies to public agencies and nonprofit organizations, and takes on a variety of forms in these different contexts. However, most strategic planning processes generally share the same key concepts of developing a vision for the future, assessing where the organization is currently, identifying strategies for how to accomplish the mission, and evaluating progress towards those goals.³ The textbox, *Elements of Successful Strategic Planning*, describes the basic concepts in more detail. Strategic planning by its nature is a high-level process looking at a long-range horizon, but to be successful, must also clearly tie to specific and measurable action plans, and shorter-range budget processes, including capital planning, that guide implementation.

Elements of Successful Strategic Planning

- Identification and evaluation of external opportunities and challenges.
- Assessment of strengths and limitations.
- Inclusion of wide range of internal and external stakeholders.
- Commitment to change by senior leadership and governing board.
- Survey of industry best practices.
- Clear priorities and detailed implementation plan including methods to evaluate progress.
- Reassessment on a regular basis.

Adapted from: Richard A. Mittenenthal, "Ten Keys to Successful Strategic Planning" (TCC Group, 2002).

Findings

The Authority faces infrastructure financing challenges requiring creative solutions and improved planning.

The Authority is facing a new era of financial challenges requiring focus and vision. While its business operations and associated operating revenues have weathered the nation's recent economic downturn well, other key funding sources are less certain, such as federal funding for maintenance of the Channel and additional general obligation bonds approved by Harris County taxpayers. The Authority has about \$21.5 million of uncommitted bond funds remaining for capital projects from voter approvals in 1999 and 2007, and is not planning to pursue additional taxpayer supported bonds at this time. The Authority currently has access to an additional \$236.5 million in available discretionary funds for capital projects, but estimates it will exhaust its current capital budget capacity by September 2013. Currently, Authority staff are working on a short-term plan for financing capital needs beyond that date, with scheduled completion as part of the budget adopted in January 2013. While covering its short-term capital budget gap will likely not be a problem, the Authority will require more comprehensive long-term financial planning to address its estimated five-year capital budget needs of approximately \$1.1 billion. Potential options include pursuing a combination of alternative sources such as revenue bonds, revolving lines of credit, bank loans, equipment financing, or other authorized tools such as public-private partnerships, beyond its traditional reliance on taxpayer supported general obligation bonds, which remain an option for the future.

The Authority expects to run out of new capital budget capacity by September 2013.

Regardless of how the Authority ultimately determines to finance its future capital projects, several factors point to a need for more thorough and documented planning. Alternative financing options relying on third parties such as banks will naturally demand greater scrutiny into the Authority's business and financial practices to protect lender interests. Also, to secure additional taxpayer-supported bonds in the future, the Authority needs the trust and support of Harris County voters. This trust has been tenuous in recent years due to the empty cruise terminal partially financed with the last issuance of bond funds, and other media scandals discussed elsewhere in this report. A more complete, justifiable planning process would provide validity and accountability to the Authority's future plans and help provide the measure of trust needed for the Authority to have access to a full range of financing tools.

Outside financing, whether public or private, demands trust in the Authority's planning process.

Despite ongoing improvements, the Authority lacks a fully developed, comprehensive strategic and capital planning process.

Historically, planning at the Authority has been generally informal, lacking a unified view of the organization's priorities or documented financial analysis associated with long-range planning and capital project approval. Recognizing this deficiency, the Authority began making concerted efforts

to develop a more objective and formalized planning process beginning in 2010. As a result, the Authority has developed several iterations of a *Strategic Initiatives* document, reworked its mission statement and core values, and established a formal process for evaluating and approving individual capital projects.⁴ While these efforts have moved the Authority in the right direction, they are still in their infancy, and the kinks are obviously still being worked out. In June 2012, the Authority postponed its planned annual strategic initiatives workshops because of significant recent organizational changes and anticipated recommendations from ongoing external audits and the Sunset review. Instead, the Authority made only minor updates to its plan this year, and will take up a more comprehensive reevaluation of its priorities and planning process during 2013, leading up to a revamped plan to be adopted in 2014. This moment provides an opportunity for the organization to rethink and retool its planning efforts, which would benefit from the following considerations.

- **Long-range planning process lacks key elements.** The Authority's efforts to produce a *Strategic Initiatives* document is a positive step towards better planning, but this effort does not yet represent a true long-range planning process that can guide the organization into the future. The current plan includes some key elements, such as an analysis of strengths, weaknesses, opportunities, and threats, but focuses more narrowly on specific action plans rather than overarching goals. Also, the Authority has not yet developed a robust stakeholder involvement process for both internal and external stakeholders to provide input into the plan's development. This process is important to gain buy-in and trust from external parties as well as the Authority's own employees who will be asked to implement change. Also, the Authority's one-year update cycle for this plan is too frequent. A more robust long-range planning process should only need to be updated every three to five years to allow time for the plan to work and progress to be measured without being bogged down in a continual review process.
- **No performance indicators or plan for measuring progress towards goals.** The *Strategic Initiatives* document describes a range of specific steps the Authority plans to take, but does not provide any clear scheme for how the Authority will set its long-term goals and measure its results, or how it will communicate this information to the Commission, internally to Authority staff, and to the public generally. Clearly establishing expectations is central to make planning efforts meaningful and hold the organization accountable to achieving its stated mission. Making this and other information relating to planning publicly available, such as on the Authority's website, also helps ensure accountability.
- **Lack of clear integration with other planning efforts.** Long-range planning is a needed first step, but is only effective if it ties clearly to the implementation stages that must follow. For the Authority, this primarily translates into a need for mid-range financial forecasting, capital planning, and facility master plans. Currently, these efforts are under

Recent organizational change provides an opportunity for re-evaluating priorities and planning processes.

The Authority needs to set long-term goals and measure results.

The Authority does not have a carefully documented or prioritized five-year capital plan.

development, but remain disjointed and incomplete. For example, the Authority does not have up-to-date master plans for all of its facilities, particularly its older general cargo facilities the Authority has recognized are in need of care and attention. Also, while the Authority's progress towards developing a justified, documented capital planning process has been significant, the Authority has only yet been able to accomplish solid analysis of projects making up a one-year plan. As a result, the Authority's current five-year capital project list still does not reflect a documented planning or strategic prioritization of the organization's needs, but is rather a listing of potential projects submitted by various divisions. Finally, as already noted, the Authority faces new challenges in how it will ultimately be able to finance its capital needs in the future. Given the stakes at hand and the high level of interest in how it will accomplish its goals, a more clearly defined, public financial planning process tied to its capital budget and long-range goals is critical.

- **Lack of Commission approval.** Being involved in the development and approval of an organization's overarching mission, goals, and strategies for the future is a key duty of any governing board. However, the Commission has not yet taken on this role, as it does not formally approve the Authority's current planning documents other than the annual budget. This leaves the Commission to focus more narrowly on its statutorily required role to approve individual projects over \$50,000 as they are ready for procurement, which tends to orient the Commission to operational concerns rather than overall strategy.⁵ Requiring the Commission to take a more active role in strategic planning would help refocus its attention at a more appropriate level.

Recommendation

Change in Statute

3.1 Require the Authority to create a comprehensive strategic planning process, including long-range strategies and shorter-range implementation plans tied to financial and capital planning.

The recommendation would require the Authority to develop a long-range strategic plan and shorter-range implementation plans, according to the following provisions. These efforts would solidify the Authority's current progress towards improved planning, and create a documented, justifiable approach to assist the Authority in explaining and measuring its goals and ultimately achieving its mission.

- **Long-range strategic planning.** The Authority would develop a long-range plan containing its mission and values statement, and including standard elements of strategic plans such as an assessment of the organization's current state and projected operating environment, discussion of high-level goals, strategies, and priorities, and a scheme for ongoing evaluation of progress towards those goals. The plan should span a long-term horizon of at least ten to twenty years, as determined by the Commission. As part of the planning process, the Authority would identify and work with key internal and external stakeholders to get formal input on the plan, and the Commission should discuss and adopt the plan in an open meeting. The Authority would provide annual

progress updates according to performance measures developed through the plan, and complete a comprehensive re-evaluation and update of the plan at least every five years, or more frequently as conditions warrant.

- **Mid-range implementation, including five-year financial and capital plans.** The Authority would develop a mid-range plan to carry out the vision and strategies contained in the long range plan. This would include, at a minimum, a five-year financial forecast and five-year capital plan, and other detailed action plans as the Authority determines is necessary to implement and hold itself accountable to progress towards its goals. The five-year capital plan should include a preliminary analysis and prioritization of each project's need. The financial plan should address future financial needs and financing options, and provide information about the relative cost of various options. As part of this recommendation, the Authority should consider updating and improving facility master plans to ensure these align with and complement other planning efforts. Authority staff would prepare and present these documents to the Commission in an open meeting, but these would not require Commission approval.
- **Short-range budget and capital plan.** The Authority would develop a one-year capital plan with associated financing plan, integrated with its existing budget, which would be adopted by the Commission in an open meeting. The Authority would include projects in the one-year capital plan only after a rigorous and documented process of analysis and approval. The Commission would also continue to approve individual projects and expenditures over \$50,000 as they are ready for procurement, as currently required by law.
- **Public information.** The Authority would be required to make its long-range plan, five-year capital plan and financial forecast, and one-year budget and capital plan available on its website. The Authority would be authorized to redact sensitive business information from these plans, but should make every effort to design the plans so that proprietary information is not included or can easily be excluded without making the plans incomprehensible.

Fiscal Implication

Implementation of these recommendations would not have a cost to the Authority. The Authority currently staffs its strategic planning efforts with a director; two staff members with a third expected to be hired; and a consultant. These and other existing resources would be sufficient to improve and formalize the organization's planning efforts.

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¹ Marilyn McAdams Sibley, *The Port of Houston: A History* (Austin: University of Texas Press, 1968), p. 175.

² Governor's Office of Budget, Planning, and Policy, and Legislative Budget Board, *Instructions for Preparing and Submitting Agency Strategic Plans, Fiscal Years 2013-2017*, p. 3, accessed July 10, 2012, http://www.lbb.state.tx.us/Strategic_Plans/Instructions%20for%20Preparing%20and%20Submitting%20Agency%20Strategic%20Plans.pdf.

³ Richard D. Young, *Perspectives on Strategic Planning in the Public Sector* (Columbia, S.C.: Institute for Public Service and Policy Research, University of South Carolina, 2003), p. 7.

⁴ Port of Houston Authority, *2013 Strategic Initiatives*, accessed July 12, 2012, http://www.portofhouston.com/static/gen/inside-the-port/2013_Strategic_Initiatives.pdf.

⁵ Section 60.403(a), Texas Water Code.

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

**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.

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*.

- **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.

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

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

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.

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

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

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.

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 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.

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.

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

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.

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.

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.

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

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 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.

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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 (H.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/gcs/travel/us/docs/WP_CreatingATEPolicy-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.

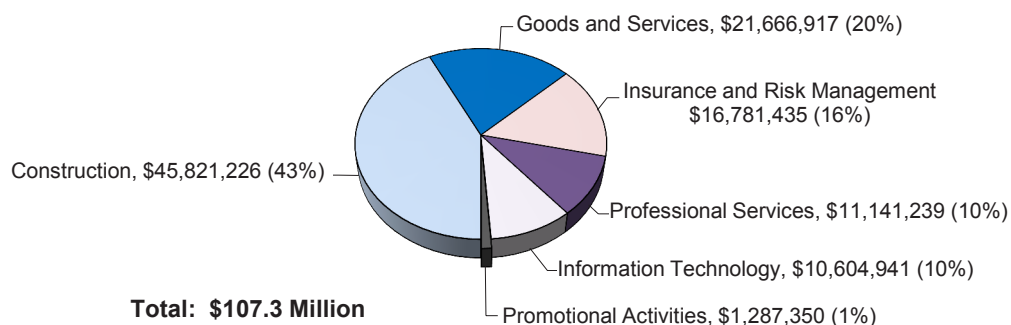
Background

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

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.

The Authority supports small business and economic development in other ways. These include buying tables at fundraising events tied to business and economic development, contracting with entities to promote Authority programs, educating small businesses on how to do business with the organization, and supporting educational programs related to the maritime industry.

Decentralized organizational arrangement. The Authority procures through a decentralized organizational structure, giving divisions primary responsibility for managing their own procurements. The table, *Formal Procurements by Division*, shows dollar amounts of procurements by division. The Engineering and Real Estate Division is the largest single contracting division due to its responsibilities for Authority construction projects and capital improvements.

The Authority maintains a small purchasing staff of three within its Legal Division. This staff primarily maintains a computerized information and advertising system for procurements and assists in processing awards. In addition, the General Counsel and five attorneys in the Legal Division assist with procurement needs, reviewing and helping structure solicitation documents and advising on other legal aspects of purchasing procedures. The eight staff of the Small Business Division administers the Small Business Development Program and manage other efforts to promote small business contracting with the Authority and develop the maritime workforce.

**Formal Procurements by Division
CY 2011***

Division	Amount (Millions)	Percent
Engineering and Real Estate	\$53.8	50%
Finance and Administration	\$24.9	23%
Operations	\$11.7	11%
Port Security and Emergency Operations	\$10.0	9%
Strategic Planning	\$4.3	4%
Public Affairs	\$1.2	1%
Legal	\$1.0	1%
Trade Development and Marketing	\$0.4	< 1%
Total	\$107.3	100%

* Several offices with procurements moved to other divisions during 2011. Amounts shown reflect the current organizational arrangement of offices and divisions.

Findings

The Authority's procurement system lacks formal and clear central coordination and direction, contributing to inefficiencies in operation.

A procurement system of the size operated by the Authority needs to be carefully structured and coordinated to promote efficiency and consistency. A system having these characteristics saves money by standardizing processes, avoiding duplication, and simplifying reporting. Just as important, a well-coordinated and consistent procurement system helps ensure that vendors are treated equally and fairly in a predictable procurement environment. The Authority's procurement processes have not yet evolved to meet these standards.

- **No formal point of clear control.** Although procurement functions can be structured in various ways, a clear point of control to integrate elements of the operation contributes to consistent and efficient procurement.

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

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.

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.

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

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.

- **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.

- **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.

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

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 for 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 rescore 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.

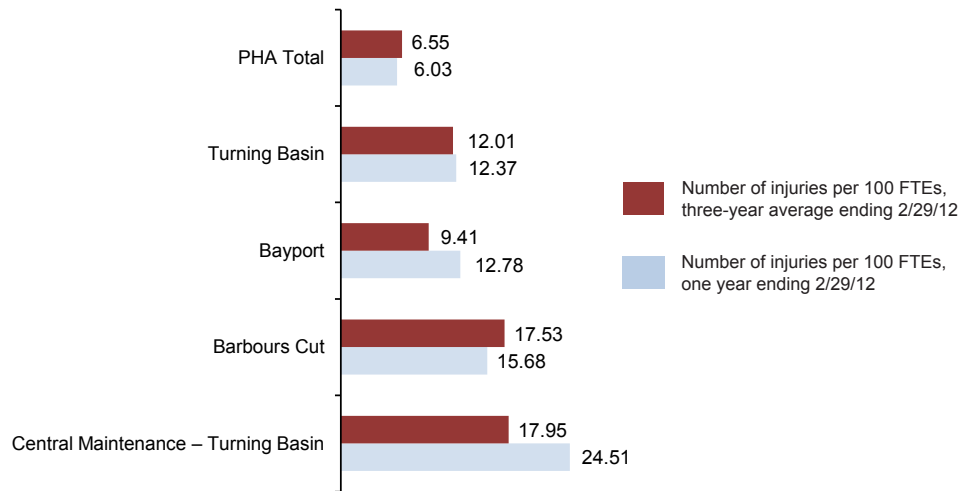
Port Security and Emergency Operations is responsible for safe and secure facilities, operating both police and fire departments.

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.

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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.

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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*

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