

***Annual Audit Plan Report***  
***Fiscal Year 2017***

**December 6, 2016**

Prepared By:

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Chief Audit Officer

Approved By:

**Port Commission, and  
Audit Committee of the Port Commission**



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**To:** Port Commission of the Port of Houston Authority, and  
Audit Committee of the Port Commission

**Date:** December 6, 2016

**Subject:** Annual Audit Plan Report – Fiscal Year 2017

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Dear Commissioners:

I am pleased to submit to you the Fiscal Year 2017 Audit Plan. The basis of this year's Annual Audit Plan ("Audit Plan") was an Enterprise Risk Assessment (ERA) performed by the Internal Audit Department as required by the applicable professional auditing standards (ERA report under separate cover). Additional consideration is given to input from the Audit Committee, Executive Director, Chief Officers and Department Directors. This document will serve as the primary work plan to carry out the audit responsibilities in an efficient and effective manner. To enhance our effectiveness, our approach is balanced by conducting the audits using in-house staff, and where appropriate, by outsourcing some projects requiring certain technical or specialized skills.

This Audit Plan includes performance, compliance/contract, policies and procedures compliance and unannounced audits. The plan also provides for follow-up procedures and special projects. As the department develops we anticipate adding continuous auditing techniques to the program.

Updates will be provided to the Audit Committee of the Port Commission at least twice a year to review the status and progress of executing the Audit Plan and to discuss other pertinent audit issues.

Respectfully submitted,

/s/ Maxine N. Buckles  
Chief Audit Officer

cc: R. Guenther, Executive Director  
T. Heidt, Chief Operating Officer



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## BACKGROUND AND AUTHORITY

The Internal Audit Department (“IAD”) provides independent, objective assurance and consulting services designed to add value and improve the operations of the Port of Houston Authority (“Port Authority”). Attribute Standard 1000 of the International Standards for the Professional Practice of Internal Auditing as issued by the Institute of Internal Auditors (“IIA”) requires that the IAD “... *be responsible and accountable for the Internal Audit function using a systematic, disciplined approach to evaluate and improve the effectiveness of governance, risk management and controls processes, and incorporate a Code of ethics of the IIA by adopting an Internal Audit Charter*”. Audit results are issued to the Port Commission, the Audit Committee of the Port Commission (“Audit Committee”) and Port Authority Management.

## AUDIT DEPARTMENT ORGANIZATION

During FY2016, the IAD had a total headcount of 5, consisting of one Chief Audit Officer, two audit managers, one internal auditor, and an administrative assistant. No headcount increases are planned for fiscal year 2017. The IAD provides audit related services as its primary objective. However, the IAD will engage, as appropriate, certain third-party resources to conduct specialized auditing. As we receive additional training, certifications, and experience, we will continue to increase our ability to provide enhanced and value-added services.

The IAD utilizes internal and external audit resources to execute our mission and objectives and meet the needs and requests of our varied stakeholders

## APPROACH AND METHODOLOGY

The IAD adheres to: 1) the Government Auditing Standards (“GAS” – commonly referred to as the “Yellow Book”) as promulgated by the Government Accountability Office (“GAO”) and 2) the International Standards for the Professional Practice of Internal Auditing as issued by the Institute of Internal Auditors (IIA – known as the “Red Book”). To assure compliance with these professional standards, the IAD will undergo a peer review every 5 years, with the initial review anticipated to occur during FY2019.

The Annual Audit Plan is a flexible commitment to perform engagements in accordance with the responsibility and authority noted in the Port of Houston Authority Internal Audit Charter. The Audit Plan, which is approved by the Audit Committee, serves as a working document that considers items such as the Enterprise Risk Assessment (“ERA”), input from the Audit Committee, Department Management, and results from previous audits where applicable. Due to the continual requests for audit services, the increasing demand for non-audit services, and the required testing for planned activities, the Audit Plan will be monitored and revised as necessary throughout the year.

The professional standards noted previously require that the Audit Plan be rooted in risk-based methodology. In FY 2016, the IAD updated the ERA and utilized an electronic risk assessment tool to gather updates to departmental risks and controls. Going forward, the ERA will be executed annually for selected departments on a rotational basis. This process should provide for increased efficiency and ensure full coverage of all departments over a four to five year period.

Evaluating all of the various factors provides the IAD with indicators for project prioritization and scope. We then identify the available resources to determine the volume of activity to include in our plan (see Audit Resource Allocation section below).



## AUDIT RESOURCE ALLOCATION

The Audit Plan prioritizes the IAD's limited staffing resources and budgeted funds based on the previously referenced risk assessment. Higher risk profile ratings will be prioritized during the year.

The number of planned projects is based on consideration and an evaluation of:

- Current IAD headcount
- The existence or absence of established procedures (written and/or informal)
- Engagement manpower requirements
- Other types of ongoing audits, analyses and reviews performed by other Port Authority areas
- Unplanned requests from the Audit Committee, Executive Director, or other Department Management

## USE OF EXTERNAL CONSULTANTS

For projects that involve circumstances where: 1) The use of experts/specialists is required; 2) The independence of the Internal Audit Department as an organization is impaired; or 3) There is the potential for significant political sensitivity, the Chief Audit Officer may elect to use external consultants. NOTE: An estimated amount is included in the annual budget for the use of these types of resources.

## AUDIT PROGRAMS

Following the Audit Committee's approval of the Audit Plan, specific audit programs will be developed for each audit activity for fiscal year ending December 31, 2017. The audit programs will be designed with regard to business processes, compliance and other requirements, performance considerations, management input, and specialized skills in order to meet the specific audit objectives of each project. All audit programs, workpapers and reports will be prepared in accordance with:

- The Institute of Internal Auditor's International Standards for the Practice of Internal Auditing ("Red Book")
- Relevant standards issued by the American Institute of Certified Public Accountants
- Government Auditing Standards ("Yellow Book")

## STATUS AND UPDATES TO THE ANNUAL AUDIT PLAN

The specific projects conducted throughout the year may be a subset of the list provided in the Audit Plan. The nature, extent and timing of audit activities will vary as a result of differences in the nature of operations, organizational structure, competing resource priorities and management style as well as by the competence, employee capabilities, and concepts of operational control.

The IAD will also provide any assistance to the Audit Committee and Executive Director when they request special projects (assuming the available resources exist, and depending on the context and priority of the assignment as it relates to risk, exposure, fraud, waste and/or abuse). These special projects will normally be performed in addition to planned audit work. If the assistance requires the use of external consultants, additional funds may need to be provided by the appropriate departments and/or the Audit Committee. Executing the Audit Plan involves an update and status process that is performed regularly between the IAD and the Audit Committee. Additionally, the IAD will provide periodic status reports to the Port Authority's management, as necessary.



## ANTICIPATED BENEFITS OF AUDIT ACTIVITIES

- Compliance
- Improved Accountability
- Improved Risk Management and Internal Controls
- Improved Financial Reporting
- Improved Efficiency
- Cost Savings

## FISCAL YEAR 2017 PLANNED ACTIVITIES (PROJECTS)

The following is a probable list of projects for the FY 2017 Annual Audit Plan which is subject to modification based on the needs of the organization. The Audit Process, while often tracked in a linear fashion, is truly dynamic and reacts to evidence, impact, and magnitude of discovery occurring during the entire engagement process. As such, the following planned projects are considered a starting point from which to execute the Audit Plan and will provide a level of transparency and accountability for meeting goals and objectives.

### COMPLIANCE AND/OR CONTRACT AUDITS

A compliance audit is a comprehensive review of an organization's adherence to regulatory guidelines. Independent accounting, security or IT consultants evaluate the strength and thoroughness of compliance preparations. Auditors may review policies, user access controls and risk management procedures over the course of a compliance audit.

#### PLANNED AUDIT PROJECTS

##### PERFORMANCE AUDIT/CONTRACT COMPLIANCE – TENANT LEASES

**DESCRIPTION:** As of October 31, 2016, the Port Authority had approximately 147 active leases and recognized approximately \$37 million in lease revenue on a year-to-date basis. Lease revenue accounts for approximately 15% of total operating revenue.

##### COMPLIANCE AUDIT- U.S. FOREIGN TRADE ZONE (“FTZ”)

**DESCRIPTION:** FTZs are designated areas where the U.S. government considers foreign merchandise trade outside U.S. Customs territory. Merchandise may be transported into an FTZ without formal customs entry, import quotas and other import restrictions. Duties and excise taxes are not assessed until the merchandise enters U.S. commerce. Currently the Port Authority manages FTZ #84, which includes many privately owned and port-owned sites located throughout Houston and Harris County, Texas. For the calendar years 2014 and 2015, the Port Authority collected FTZ related revenues totaling \$244 thousand and \$318 thousand, respectively. As of September 2016, the Port Authority has collected \$296 thousand in FTZ related revenues. The IAD will review compliance with the U.S. Department of Commerce requirements for managing a FTZ.

##### COMPLIANCE AUDIT- FOREIGN CORRUPT PRACTICE ACT (“FCPA”)

**DESCRIPTION:** Currently the Port Authority retains three consultants based in foreign countries to act as agents. The Authority also does business with foreign companies. Therefore, the Authority must comply with the Foreign Corrupt Practice Act (“FCPA”) of 1977 as required by federal law. The IAD will continue to coordinate with the Legal and Commercial Divisions to monitor the Authority's compliance with the Port Authority's FCPA Compliance Policy, which was approved by the Port Commission on February 25, 2014. Worth noting is that this policy is under review by management, and revisions are anticipated during the upcoming fiscal year.



## COMPLIANCE AUDIT- CONSTRUCTION

**DESCRIPTION:** For the calendar years 2014 and 2015 the Port Authority has invested approximately \$100 million and \$84 million, respectively, in construction projects. Expenditures in this category represented approximately 67% and 62% of net cash used in capital financing activities during 2014 and 2015, respectively. As of October 31, 2016, the Port Authority has expended approximately \$123 million on construction projects. IAD will review, these expenditures, on a test basis, for compliance with the Port Authority's agreements and established procedures.

## COMPLIANCE AUDIT- CONTRACTS OTHER THAN CONSTRUCTION

**DESCRIPTION:** The Port Authority routinely engages third parties to perform a variety of services. As this area has not received a detailed process review or audit in recent years, IAD will review, these expenditures, on a test basis, for compliance with the Port Authority's agreements and established procedures.

### PERFORMANCE/FINANCIAL AUDITS AND PROCESS REVIEWS

#### PROCESS REVIEW – INTERNATIONAL LONGSHOREMEN'S ASSOCIATION (“ILA”) PAYROLL

**DESCRIPTION:** The International Longshoremen's Association, the largest union of maritime workers in North America, currently provides the Port Authority with longshoremen, warehouse, clerks, and checkers as casual workers. The West Gulf Maritime Association (“WGMA”) processes the payroll and benefits activity for these workers pursuant to a contract with the Port Authority. As of September 30, 2016, the Port Authority expended approximately \$31 million in payroll and other payroll related services for ILA workers. This represents approximately 49% of total salaries and benefit expenses. As this is a significant expenditure area and this area has not received an audit in recent years, the IAD will review and document key business processes to evaluate contract compliance.

#### PROCESS REVIEW – NEW PROCUREMENT SYSTEM

**DESCRIPTION:** The Port Authority implemented a new procurement software system, Periscope's BuySpeed eProcurement Software, in of June 2016. IAD will work with the Procurement Department and Information Technology Department to review, document and walkthrough key processes, which include but are not limited to a review of the implemented functional design (including segregation of duties and application controls), system access and user access, system process flows, and proper security protocols for internal and external access.

#### PROCESS REVIEW – FRESH WATER BILLING

**DESCRIPTION:** During the recent risk assessment process management identified the process of allocating and billing of fresh water service to customers as a high risk. Occasionally fresh water usage by customers is not monitored, and the Port Authority relies on the customer to notify appropriate parties that the service was utilized. IAD will review this area for compliance with applicable tariffs and Port Authority procedures.

#### PROCESS REVIEW – WHARFAGE REVENUES

**DESCRIPTION:** As of September 30, 2016, the Port Authority Turning Basin Terminals wharfage revenues were approximately \$16 million, or 8% of total operating revenues. A significant number of these transactions rely on manual processes. IAD will review a selection of wharfage customers to identify key business processes, confirm/verify reported volumes, test for approvals, billing, payment and contract compliance (focus on “major customers” and “high risk customers”).



## PROCESS REVIEW – IT PROCUREMENTS

**DESCRIPTION:** During FY2015, the Port Authority expended approximately \$2.8 million in purchases associated with the acquisition of IT-related equipment, supplies and services. As of November 30, 2016, the Port Authority has expended approximately \$2.5 million in IT related equipment and supplies. The IAD will review, document and walkthrough several key business processes to evaluate compliance with procurement and other policies and assess tracking and control of high value items.

## SPECIAL PROJECTS & ON-GOING MONITORING PROCEDURES

### ENTERPRISE RISK ASSESSMENT (ERA)

**DESCRIPTION:** Each year the IAD develops the Audit Plan based upon risks (primarily business, financial and operational). Professional auditing standards (IIA and GAS) require that audit resources be allocated to projects based on a continuous risk assessment methodology. Risk assessments will be performed as needed on a recurring basis to ensure a systematic review of risks and potential risks to the Port Authority.

### RISK MANAGEMENT

**DESCRIPTION:** Risk management continues to be an area of focus for the Port Authority. During 2016, the Risk Management department engaged an external resource to review and evaluate the claims handling practices of the Port Authority's third-party administrator. In addition, an insurance coverage audit is planned to assist with identifying potential gaps in insurance coverage. It is anticipated that these or similar efforts will be utilized to optimize costs while mitigating risks to the Port Authority. IAD will continue to work in collaboration with Risk Management as needed.

### CYBER SECURITY

**DESCRIPTION:** Cyber security continues to be identified as a high risk area for the Port Authority. During 2016, the Information Technology department engaged an external resource to review and evaluate the Port Authority's cyber security environment. This cross-functional effort, led by IT, utilizes a phased approach to address known and evolving cyber risks. It is anticipated that this will be a multi-year project as recommendations and process improvements are identified and implemented. IAD will work in collaboration with the IT and other departments as needed to ensure that the Port Authority mitigates risks in this area.

### SAFETY AND SECURITY

**DESCRIPTION:** The Port Authority owns and operates public facilities in the Houston Ship Channel region. The safety and security of Port Authority people and assets is an important mission for the Port Authority. Port police, fire and safety personnel continually execute strict processes and procedures in compliance with a facility security plan ("FSP") filed with the US Coast Guard ("USCG") to mitigate these risks, including engagement of 24-hour security details provided by Allied Universal. A number of external audits conducted by the USCG, US Customs and Border Protection and professional consultants, as well as internal audits lead by Port Authority facility security officers are performed to ensure compliance with the FSP. The IAD receives routine updates related to safety and security audit activities, and will work in collaboration with safety, security and other departments as needed to ensure that the Port Authority mitigates risks in this area.

### REGULATORY COMPLIANCE

**DESCRIPTION:** The Port Authority is subject to a number of regulatory requirements. During 2016, the Legal department engaged an external resource to review and inventory the multitude of regulatory





requirements to which the Port Authority must comply with. IAD will continue to work in collaboration with Legal as needed to ensure potential compliance gaps are identified and appropriately addressed.

## **MAJOR SYSTEM APPLICATIONS REVIEWS/MONITORING**

**DESCRIPTION:** IAD will perform user access reviews of the Port Authority's major system applications. Monitoring consists of procedures such as ensuring proper IT internal controls are properly implemented, proper segregation of duties, system access and user access is appropriate for employees and compatible with their job duties. Application performance accuracy testing and any other procedure considered necessary to improve efficiency of the Port Authority's system applications may also be performed.

### **FOLLOW-UP PROCEDURES**

**DESCRIPTION:** As issues are identified during the course of conducting audits/engagements, they are documented and reported accordingly. In order to help initiate change and continued improvement, our follow-up procedures will effectively monitor progress on implementation of management responses to our recommendations. IAD will communicate with responsible management at regular intervals to monitor progress on implementation of corrective actions. These communications will be documented and published accordingly. Additionally, a sample of items will be tested on a periodic basis, depending on the magnitude, impact, and estimated cost-benefit.

### **QUALITY ASSURANCE PROCEDURES**

**DESCRIPTION:** Professional standards require that the audit function have a system of quality control/assurance in place to ensure all necessary elements are in place and operating effectively. Each audit is reviewed by a professional staff member not directly assigned to the audit. The goal is to verify that sufficient, appropriate evidence is gathered and documented to adequately support conclusions based on procedures that are designed to test relevant audit objectives (this includes consideration of fraud, professional judgment, competency and supervision).

### **FRAUD HOTLINE/REPORTING**

**DESCRIPTION:** The IAD provides two primary vehicles for reporting fraud, waste and/or abuse: (1) A Fraud Hotline answered by Navex Global (formerly TheNetwork), a third-party hired by the Authority to independently gather and report fraud and/or misconduct to the IAD and (2) links to report fraud available from both the Port Authority SharePoint Homepage and Navex Global's website. Additionally, the IAD provides auditing support based on requests from the Port Security and/or other authorities. Each reported concern must be addressed. This may require performing substantive procedures, such as an audit, or may be referred to an outside agency or department for follow-up. The initial contact, work performed, conclusions and/or referral are documented to support their disposition. In some instances, this may also require subsequent follow-up or monitoring to adequately resolve.

## **DATA ANALYTICS AND CONTINUOUS MONITORING**

### **PROCESS REVIEW – Promotion & Development (“P&D”) Fund**

**DESCRIPTION:** During FY2015, the Port Authority spent approximately \$5.5 million, or 1.9% of gross operating revenues, on P&D activities. As of September 30, 2016, the Port Authority incurred approximately \$3.7 million, or 1.7% of gross operating revenues, in P&D activities. The IAD shall monitor the authority's compliance with statutory requirements governing use of the P&D fund, as defined by Section 5007.219(a), Texas Special District Laws Code.

### **PROCESS REVIEW – Travel & Business Entertainment Expenses**



**DESCRIPTION:** During 2014 and 2015, the Port Authority spent approximately \$586 thousand and \$730 thousand, respectively in travel and business entertainment expenses. As of September 30, 2016, the Port Authority spent approximately \$445 thousand in travel and business entertainment expenses. The IAD will monitor the authority's compliance with the Port Authority's Travel & Business Entertainment Expense Policy and Standards, effective date December 2014. Worth noting is that this policy is under review by management, and revisions are anticipated during the upcoming fiscal year.

#### UNANNOUNCED AUDITS

**DESCRIPTION:** The IAD may perform audits on an unannounced basis during the year. These may include:

- Payroll
- Purchase Orders
- Petty Cash

