



## Financial Policies & Procedures

### Internal Controls for Investments

Effective October 27, 2015

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#### 1.0 Purpose

To establish a system of internal controls relating to investment of funds in accordance with the Investment Policy adopted by the Port Commission as governing body of the Port of Houston Authority of Harris County, Texas (the "Authority").

All investment activities and internal controls of the Authority shall comply with provisions of Texas law, including Chapter 2256 of the Texas Government Code, as amended (the "Public Funds Investment Act").

#### 2.0 Scope

The Investment Policy and the internal controls outlined herein shall apply to all departments within the Authority.

#### 3.0 Guidelines

##### 3.1.0 Investment Objectives and Categories

- 3.1.1 As specified in Section 4.2 of the Investment Policy, the main objectives of investing the Authority's funds, in order of importance, are (1) safety of principal, (2) suitability of investment, (3) liquidity, (4) marketability, (5) diversification, and (6) yield.
- 3.1.2 The Investment Officer(s) and Authority Designee(s), as defined in the Investment Policy, may designate different investment strategies for various categories of investments, which categories may include but are not limited to the following:
  - (a) **Current or General Funds** are unrestricted funds received from operating revenues.
  - (b) **Debt Service Funds** are (1) with respect to tax-supported obligations, property tax revenues received from Harris County taxpayers designated for debt service and related payments on general obligation ad valorem tax bonds (also referred to as Interest and Redemption Funds or "I&R"), or (2) with respect to obligations or financings supported by operating revenues, funds designated for payment of principal, interest, and related payments on such obligations and financings.
  - (c) **Construction Funds or Capital Improvement Funds** are funds specifically designated for capital infrastructure projects and construction costs.
  - (d) **Bond Funds** are proceeds received from the sale of bonds, commercial paper, or other financings, which may be designated for capital infrastructure projects,

construction costs, or other purposes as approved under the applicable bond indenture or financing documents.

- (e) **Reserve Funds** are funds set aside to meet any reserve requirements, and payments of principal and interest as may be specified in a bond indenture or other financing documents.

### **3.2.0 Mitigating Risk**

- 3.2.1 Internal controls shall be designed to ensure secure and prudent management of Authority funds. This includes mitigating risk of losses arising from fraud, employee error, misrepresentation by third parties, unanticipated changes in financial markets, and imprudent actions by employees and officials of the Authority.
- 3.2.2 Controls deemed most important include control of collusion, segregation of duties, segregation of transaction authority from accounting and record keeping, custodial safekeeping, avoidance of bearer-form securities, clear delegation of authority, specific limitations regarding securities losses and remedial action, approved written confirmation of telephone transactions, minimizing the number of authorized investment personnel, documentation of transactions and strategies, and compliance with codes of ethics.

### **3.3.0 Responsibilities**

- 3.3.1 It is the responsibility of the Port Commission to review on an annual basis, and adopt, the Investment Policy for the Authority. The Investment Policy specifies that a system of internal accounting controls for investments shall periodically and at least annually be prepared and submitted to the Port Commission for approval.
- 3.3.2 The Chief Financial Officer is charged with oversight of all financial matters of the Authority, including implementation of funds management, accounting and internal controls for investments. It is also his responsibility to report and address any violations of company policy or code of ethics (e.g., fraud, embezzlement, conflicts of interest, etc.) relating to investment activities.
- 3.3.3 Under the direction of the Chief Financial Officer, the Senior Director, Treasury or other designee shall serve as **Investment Officer** with primary responsibility to handle the investment of Authority funds as specified in the Investment Policy. The Authority's Controller and the Chief Financial Officer are each authorized to act as Investment Officer for the Authority in the absence of the Investment Officer or when the Investment Officer is unavailable.
- 3.3.4 **Authority Designees** may be appointed to handle various aspects of the investment management process (a) as may be recommended by the Chief Financial Officer or the Investment Officer, (b) as approved by the Port Commission or the Executive Director of the Authority, and (c) as listed on Exhibit "A" to the Investment Policy. The Chief

Financial Officer and the Investment Officer are considered Authority Designees with regard to the internal controls outlined herein as well as the Investment Policy.

- 3.3.5 The Port Commission has adopted standard banking resolutions designating various individuals as **Authorized Agents**. In order to minimize the risk of fraudulent accounts and embezzlement of funds or assets, two Authorized Agents, acting together, are required (a) to sign agreements relating to cash, investments and safekeeping of securities, (b) to open and close accounts, including investment brokerage and custody accounts, and (c) to designate and change **Authorized Signatories** for such accounts.
- 3.3.6 As an added measure, the Authority shall provide certificates of resolutions and certificates of signatories to financial institutions, signed by the Secretary or an Assistant Secretary of the Authority, certifying the signatures of those Authorized Agents and/or Authorized Signatories authorized for specific accounts.
- 3.3.7 Pursuant to a Financial Advisor Agreement effective December 16, 2002, as may be amended from time to time, the Authority has engaged First Southwest Company and its affiliate First Southwest Asset Management, Inc. (collectively, "***Financial Advisor***") for the performance of various investment advisory services, including but not limited to assistance with development of the Authority's investment policy, consultation on proposed investment strategies, and preparation of quarterly investment reports.

#### **3.4.0 Executing Investment Transactions**

- 3.4.1 Authority Designees are authorized to pursue relationships with broker-dealers and financial institutions (a) as may be recommended by the Chief Financial Officer or the Investment Officer, (b) as approved by the Port Commission or the Executive Director of the Authority, and (c) as listed on Exhibit "C" to the Investment Policy.
- 3.4.2 The Investment Officer shall ensure that an approved financial institution completes a certificate in substantially the form of Exhibit "B" to the Investment Policy, to document such seller's receipt, review and understanding of the Investment Policy, prior to entering into any investment transaction with such institution. In order to help provide assurance regarding counterparty risk, the Investment Officer shall ensure that broker-dealers are properly registered with the Texas State Securities Board, the Securities Exchange Commission ("SEC"), or the Financial Industry Regulatory Authority ("FINRA"), and shall conduct such due diligence as necessary, which may include a review by the Investment Officer or the Authority's financial advisors of a broker-dealer's financial position and reputation in the marketplace. Such due diligence shall be documented and those records shall be maintained in the Authority's files. The Investment Officer may recommend termination of a relationship with a broker-dealer in case of serious violations or sanctions imposed by a regulatory agency or governmental entity.
- 3.4.3 Authority Designees may explore various investment opportunities and alternatives with approved banks and broker-dealers, including soliciting and obtaining proposals for purchase and/or sale of securities.

- 3.4.4 The Investment Officer shall consider all such proposals vis-à-vis the Authority's Investment Policy, strategies and objectives. Upon deciding to proceed with a proposed transaction, the Investment Officer shall ensure that clear instructions are provided to execute or document such investment transaction on behalf of the Authority (e.g., amount to invest, desired maturity, pricing, etc.). Oral instructions shall be followed up with a confirmation via email or fax.
- 3.4.5 An Authority Designee shall prepare a "Purchase of Security Form" or "Sale of Security Form" for any investment transactions that are executed, and shall obtain all necessary approvals in accordance with the Authority's policies and procedures.
- 3.4.6 The Investment Officer shall maintain files and backup documentation for all investment transactions. Such records may include information on the yield curve, bids from other broker-dealers, indicative pricing of similar securities, etc.

### **3.5.0 Safekeeping of Securities**

- 3.5.1 With the exception of investments in certificates of deposit, bank deposits, investment pools, and money market funds, all securities transactions shall be settled on a "delivery versus payment" or "DVP" basis through the Authority's custody account at JPMorgan Chase Bank, or another custodian selected by the Investment Officer from the list of institutions approved by the Port Commission or the Executive Director. Under DVP processing, the custodian makes payment on behalf of the Authority to the broker-dealer or seller, only upon receipt of the securities into the Authority's custody account, thereby helping mitigate counterparty risk.
- 3.5.2 The Investment Officer or an Authority Designee shall be responsible for providing instructions to the custodian for settlement of investment transactions, and for ensuring that there are sufficient funds on deposit at the custodian to cover such settlement. Instructions sent to the custodian in writing or via fax shall be executed by two Authority Designees. Instructions submitted to the custodian via the custodian's electronic banking system shall require action by two Authority Designees, one to input and another to approve the instruction.
- 3.5.3 Securities purchased for different funds (e.g., General Fund, Debt Service Fund, Construction Bond Fund, etc.) may be held in the same custody account, provided that the Authority's Financial Accounting department shall track and record the investments belonging to each fund.
- 3.5.4 Securities shall normally be maintained in electronic book-entry form. All transactions with respect to securities to be held in physical form and any unregistered bearer bonds shall require the written approval of two Authority Designees, and such documentation shall be maintained in the Authority's investment files.

### **3.6.0 Competitive Bidding Process**

- 3.6.1 On occasion, it may be prudent to sell a security prior to its maturity (e.g., selling a security at a premium prior to the call date vs. receiving par value at the call date). It may also be advantageous to consider a swap transaction, in which a security is sold and another is purchased to replace it. The Investment Officer shall approve such sale or swap of securities. Any analyses performed showing the economics or expected gain from such sale and swap transactions shall be maintained in the investment files.
- 3.6.2 For purchase or sale transactions, the Treasury Manager, who is designated as an Authority Designee, or another Authority Designee, shall attempt to obtain at least three competitive bids, in order to achieve the best value for the Authority. Competitive bids are not required (a) in cases where an agreement is reached with a particular issuer to sell back a security and purchase a similar instrument from the same issuer (e.g., swapping a commercial paper investment with the issuer to extend the maturity), (b) for investments in money market mutual funds, investment pools, and regular cash deposits at the Authority's depository banks, and (c) for U.S. Treasury and agency securities purchased as new issues.
- 3.6.3 Bids may be solicited and received orally, in writing, electronically, or in any combination of those methods. In situations where the exact security is not offered by other broker-dealers, offers on the closest comparable investment may be used to establish a fair market price for the security. In the case of a certificate of deposit purchase, at least two other offers should be solicited to provide a comparison. If fewer institutions participate in such competitive bids, then the Authority Designees may use another authorized investment of similar maturity for evaluation purposes. The Investment Officer may approve exceptions to this process on a case by case basis, and shall document such exceptions in writing.

### **3.7.0 Accounting**

- 3.7.1 The Authority's Financial Accounting department is responsible for booking all investment transactions to the general ledger, including all customary journal entries (e.g., accruals of investment income, valuation of investments, gain or loss on sale of securities, etc.), in accordance with generally accepted accounting principles and established departmental approval procedures.
- 3.7.2 The Financial Accounting department shall review all investment transactions, and calculate the appropriate cash amounts to be transferred to and from the Authority's bank, custody and/or other accounts on the settlement date. Such transfers of funds shall be documented and executed pursuant to established approval procedures.
- 3.7.3 The Financial Accounting department shall maintain a spreadsheet, that may be referred to as the "Securities Schedule," showing details of all security holdings (e.g., CUSIP, interest rate, yield, par amount, maturity date, etc.), and shall reconcile such information on a monthly basis against safekeeping statements and confirmations received from the custodian.

- 3.7.4 Investments in certificates of deposit, bank deposits, local government investment pools, and money market funds are not required to be held in safekeeping at the custodian. Such investments shall be reconciled against the monthly statements provided by the appropriate financial institution, and recorded in a spreadsheet maintained by the Financial Accounting department that may be referred to as the “Cash Activity Report.”
- 3.7.5 The Securities Schedule and Cash Activity Report are prepared by an accountant in the Financial Accounting department, and reviewed on a monthly basis by the Financial Accounting Manager, the Assistant Controller (if any), or the Controller.

### **3.8.0 Reporting**

- 3.8.1 The Financial Advisor shall prepare monthly and quarterly reports showing details of security holdings, changes in market value, earned income and investment transactions for the period.
- 3.8.2 The Treasury Manager and the Investment Officer shall review the reports from the Financial Advisor, and resolve any discrepancies or issues with said reports.
- 3.8.3 The Investment Officer shall prepare and cause to be provided to the Port Commission a quarterly report including information on investment holdings, maturity dates, book and market values, and investment transactions during the period. Said report shall be signed by the Investment Officer, the Controller, and the Chief Financial Officer, and shall indicate whether such investment transactions are in compliance with the Investment Policy and the Public Funds Investment Act. A cover letter with a brief summary of quarterly economic issues impacting the investment portfolio may also be submitted with the quarterly report.
- 3.8.4 The quarterly investment reports shall also be provided to the Authority’s independent auditor at least annually. The latter should review these reports in connection with its annual examination of the Authority’s financial statements in accordance with generally accepted auditing standards.

### **3.9.0 Collateral**

- 3.9.1 In accordance with the Authority’s Investment Policy and Chapter 2257, Texas Government Code, as amended from time to time (“Public Funds Collateral Act”), any cash held in the Authority’s depository bank accounts must be collateralized, to the extent such funds are not insured by the U.S. or an instrumentality of the U.S. (e.g., Federal Deposit Insurance Corporation or “FDIC”).
- 3.9.2 The Investment Officer shall (a) select the custodian for any collateral pledged to secure Authority funds from the approved list of institutions attached as Exhibit “C” to the Investment Policy, (b) monitor the status of such collateral on a monthly basis to ensure compliance with the Public Funds Collateral Act, and (c) notify the depository

bank in the event the market value of the collateral is not sufficient to cover 102% of the Authority's exposure or reducing the cash balances accordingly.

3.9.3 The Authority currently maintains significant cash balances in interest-bearing accounts at a depository bank, which funds are not covered by FDIC insurance. In accordance with a Depository Banking Services and Security Pledge Contract, the depository bank has agreed to pledge and deposit sufficient securities in favor of the Authority at the Federal Reserve Bank to cover 102% of such cash balances.

3.9.4 The Financial Accounting department should conduct an additional review of the monthly collateral report received from the custodian, to help ensure that the Authority's cash balances at the bank are fully covered by the collateral deposited at the custodian.

## **4.0 Review and Adoption**

### **4.1.0 Periodic Review**

4.1.1 The Investment Officer, with the assistance of Authority Designees, the Financial Advisor, and such other parties as he may request, shall periodically and at least annually review this system of internal controls relating to investments and shall recommend to senior management and the Port Commission such changes as deemed necessary, in line with best practices for mitigating risks.

4.1.2 The Port Commission should consider such recommendations and approve such system of internal accounting controls relating to investments as it deems appropriate and necessary.

4.1.3 The Authority's independent auditor, in connection with the annual examination of the Authority's financial statements, should evaluate the system of internal controls relating to investment activities in accordance with generally accepted auditing standards.

### **4.2.0 Adoption at Open Meeting**

4.2.1 The Port Commission officially finds, determines and declares that this system of internal controls relating to investment of funds was reviewed, carefully considered, and adopted at a regular meeting of the Port Commission, and that a sufficient written notice of the date, hour, place and subject of this meeting was posted as required by the Open Meetings Act, Chapter 551, Texas Government Code, and that this meeting had been open to the public as required by law at all times during which this matter was discussed, considered and acted upon and is herewith adopted.

[Signature page follows]

Adopted on the 27th day of October, 2015.



Chairman, Port Commission  
Port of Houston Authority of  
Harris County, Texas

ATTEST:



Chief Legal Officer and  
Assistant Secretary  
Port of Houston Authority of  
Harris County, Texas

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