

Schedule of Expenditures of Federal Awards and  
Report of Independent Certified Public  
Accountants

**Port of Houston Authority of Harris County,  
Texas**

Year ended December 31, 2012

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## Part I - Financial

**Port of Houston Authority of Harris County, Texas**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
Year ended December 31, 2012

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA number	Pass-through entity identifying number	Expenditures
Expenditures of Federal Awards:			
U.S. Department of Homeland Security			
Direct program			
Port Security Grant Program	97.056	N/A	\$ 3,937,049
Pass Through: Harris County			
Port Security Grant Program	97.056	746011946	<u>5,398,177</u>
Total U.S. Department of Homeland Security			9,335,226
U.S. Department of Defense			
Direct Program			
Project Cooperation Agreement	12.XXX	N/A	<u>1,152,874</u>
Total U.S. Department of Defense			<u>1,152,874</u>
Total			<u>\$ 10,488,100</u>

The accompanying notes are an integral part of this schedule.

**Port of Houston Authority of Harris County, Texas**

**NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

Year ended December 31, 2012

1. The accompanying Schedule of Expenditures of Federal Awards is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in or used in the preparation of the basic financial statements.
2. The expenditures of federal awards reported for the Project Cooperation Agreement (PCA), CFDA 12.XXX, reflect design and engineering costs incurred by the Authority which will be submitted to the U.S. Army Corps of Engineers for credit under the PCA. The Corps of Engineers has preapproved the projects for which such costs can be incurred, but retains the right to deny credit for costs submitted.

Part II - Internal Controls  
and Compliance Reports



**REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS  
ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND  
ON COMPLIANCE AND OTHER MATTERS REQUIRED BY  
GOVERNMENT AUDITING STANDARDS**

To the Port Commission  
Port of Houston Authority of Harris County, Texas

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We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Port of Houston Authority of Harris County, Texas (the “Authority”) as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the Authority’s basic financial statements, and have issued our report thereon dated April 16, 2013. Our report was modified to include an explanatory paragraph related to the adoption of new accounting standards. As discussed in Note 1 to the financial statements, the Authority adopted new accounting guidance in 2012 related to the accounting for bond issuance costs as current period expenditures and deferred gains and losses on refunding of debt as deferred inflows and deferred outflows of resources. This new accounting guidance required retrospective application to prior periods and therefore, the 2011 amounts previously reported have been adjusted to reflect the impact of the application of this guidance as if it were in effect as of January 1, 2011. Our opinion is not modified with respect to this matter.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the Authority’s internal control over financial reporting (“internal control”) to design audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of internal control. Accordingly, we do not express an opinion on the effectiveness of the Authority’s internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Authority’s financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control was also not designed to identify all deficiencies in internal control that might be significant deficiencies. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We identified certain deficiencies in internal control, described in the accompanying schedule of findings and questioned costs as items 2012-01 and 2012-02 that we consider to be significant deficiencies in the Authority's internal control.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

#### Intended purpose

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Authority's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control and compliance. Accordingly, this report is not suitable for any other purpose.

*Grant Thornton LLP*

Houston, Texas  
April 16, 2013





**REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS  
ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM AND  
ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY  
OMB CIRCULAR A-133**

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To the Port Commission  
Port of Houston Authority of Harris County

**Report on compliance for each major federal program**

We have audited the compliance of the Port of Houston Authority of Harris County, Texas (the "Authority") with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that could have a direct and material effect on its major federal program for the year ended December 31, 2012. The Authority's major federal program is identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs.

**Management's responsibility**

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to the Authority's federal programs.

**Auditor's responsibility**

Our responsibility is to express an opinion on compliance for each of the Authority's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

The above-mentioned standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Authority's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the Authority's compliance.

**Opinion on each major federal program**

In our opinion, the Authority complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended December 31, 2012.

**Report on internal control over compliance**

Management of the Authority is responsible for designing, implementing, and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Authority's internal control over compliance with the types of compliance requirements that could have a direct and material effect on each major federal program to design audit procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in the Authority's internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this Report on Internal Control Over Compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

*Grant Thornton LLP*

Houston, Texas  
April 16, 2013



**REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS  
ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
REQUIRED BY OMB CIRCULAR A-133**

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To the Port Commission  
Port of Houston Authority of Harris County, Texas

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the basic financial statements of the Port of Houston Authority of Harris County, Texas (the Authority) as of and for the year ended December 31, 2012 and 2011 and our report thereon dated April 16, 2013 expressed an unmodified opinion on those financial statements. Our report was modified to include an explanatory paragraph related to the adoption of new accounting standards. As discussed in Note 1 to the financial statements, the Authority adopted new accounting guidance in 2012 related to the accounting for bond issuance costs as current period expenditures and deferred gains and losses on refunding of debt as deferred inflows and deferred outflows of resources. This new accounting guidance required retrospective application to prior periods and therefore, the 2011 amounts previously reported have been adjusted to reflect the impact of the application of this guidance as if it were in effect as of January 1, 2011. Our opinion is not modified with respect to this matter. Our audit was performed for the purpose of forming an opinion on these basic financial statements as a whole.

The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures. These additional procedures included comparing and reconciling the information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

*Grant Thornton LLP*

Houston, Texas  
April 16, 2013

Part III - Schedule of Findings  
and Questioned Costs

**Port of Houston Authority of Harris County**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
Year ended December 31, 2012

**SECTION I – SUMMARY OF AUDITOR’S RESULTS**

Financial Statements

Type of auditor’s report issued:	Unqualified
Internal control over financial reporting:	
• Material weakness identified?	No
• Significant deficiencies identified that are not considered to be material weaknesses?	Yes
Noncompliance material to financial statements noted?	No

Federal Awards

Internal control over major programs:	
• Material weakness identified?	No
• Significant deficiencies identified that are not considered to be material weaknesses?	None Reported
Type of auditor’s report issued on compliance for major programs:	Unqualified
Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of OMB Circular A-133?	No

Identification of major federal program:

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
97.056	Port Security Grant Program

Dollar threshold used to distinguish between Type A and Type B federal programs:	\$300,000
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Auditee qualified as low-risk auditee?	No
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Port of Houston Authority of Harris County, Texas

SCHEDULE OF FINDINGS AND QUESTIONED COSTS – CONTINUED

**SECTION II – FINANCIAL STATEMENT FINDINGS**

**Finding #: 2012-01**

**Misapplication of GAAP**

**Type of Finding: Significant Deficiency**

**Criteria:**

Generally accepted accounting principles (GAAP) require financial statements or disclosures to be presented on an accrual basis of accounting. Accrual basis accounting is the method of accounting where revenues are recognized when earned, and expenses are recognized when incurred.

**Condition and Context:**

It was noted that revenue and unearned revenue for pipeline leases was not being properly recorded when earned. In addition it was noted that unearned revenue associated with pipeline leases was not properly categorized between short term and long term. Revenue was recorded based on the communication from the Channel Development Department and no formal process to ensure proper revenue recognition for pipeline leases was in place.

**Recommendation:**

We recommend the Authority ensure revenue is properly recognized based on the earnings process. This can be facilitated by establishing a process by which the Channel Development Department communicates to the Revenue Department the execution and approval of new leases in a timely manner. Further, we recommend the Authority perform a review to ensure unearned revenue is properly categorized between short-term and long-term.

***View of Responsible Officials***

The Authority recognizes revenue when the conditions for revenue recognition are met, in this case the receipt of a fully executed pipeline license agreement. Until the fully executed agreement is received by the Billing department, the Authority does not believe it would be appropriate to recognize the revenue. The issue is timeliness of obtaining the executed agreement from the pipeline customer; in some cases this could be a period of several years. When the executed agreement is received, the customer is billed for all prior periods in which their pipelines were operating without an executed agreement. Thus, though it was earned in a prior period it was not recognized until the agreement was concluded.

Management is considering incremental business processes that would expedite obtaining the executed pipeline license agreements from customers which would further minimize the value of the unrecognized pipeline lease revenue.

The Authority will ensure that a final review of the categorization of revenue between short-term and long-term is performed on a quarterly basis.

**Port of Houston Authority of Harris County, Texas**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS – CONTINUED**

**Finding #: 2012-02**

**Establishing Proper Schedule of Expenditures of Federal Awards Preparation**

**Type of Finding: Significant Deficiency**

**Criteria:**

In accordance with OMB Circular A-133 the auditee is required for Federal awards received as a subrecipient to list the name of the pass-through entity and identifying number assigned by the pass-through entity. In addition, all funds expended in the current year are required to be included within the Schedule of Expenditures of Federal Awards (SEFA).

**Condition and Context:**

Per review of the Schedule of Expenditures of Federal Awards, the Authority did not list funds received for the Port Security Grant that were provided by Harris County as a pass through entity. In addition, funding associated with the Port Security Grant was not included on the SEFA in the appropriate fiscal year. Although a system is set up to account for expenses by various grants, this information is not reconciled to the overall trial balance, thus causing the potential for expenses to be incomplete.

**Recommendation:**

We recommend that the Authority further enhance its system of reviewing grant origination and gathering the information to prepare the SEFA.

***Views of Responsible Officials***

The Authority agrees with these recommendations and will establish processes to ensure accuracy in the preparation of the Schedule.

**SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

The results of our audit procedures disclosed no findings to be reported for the year ended December 31, 2012.

**SECTION V – SUMMARY OF PRIOR AUDIT FINDINGS**

**Finding #: 2011-1**

**Program Title:** National Clean Diesel Funding Assistance Program

**CFDA Number:** 66.039

**Federal Award Number:** 2A-96695001 and 2A-96695101

**Federal Award Year:** 2011

**Federal Agency:** U.S. Environmental Protection Agency

**Type of Finding:** Significant Deficiency and Noncompliance

**Matching**

**Condition:**

As of the end of the budget period, the Port of Houston Authority (PHA) did not meet the matching requirements as outlined in the respective grant agreements.

**Port of Houston Authority of Harris County, Texas**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS – CONTINUED**

**Recommendation:**

We recommend PHA establish a tracking mechanism to ensure that matching requirements are met for each grant. This tracking mechanism should be designed such that risk of noncompliance with the match requirement is identified early in the process to allow for the PHA to make modifications as deemed necessary prior to conclusion of the grant.

**Status**

***Completed***

A mechanism is now in place to track (EPA) funding and PHA matching costs though this will be modified to highlight the resulting matching percentage for the federal and local share amounts. If it appears there may be difficulty in meeting the match requirements, PHA will work with the EPA to issue an amendment that will have updated budget and matching requirements.

**Finding #: 2010-03**

**Misapplication of GAAP**

**Type of Finding – Significant Deficiency**

**Condition:**

It was noted that interest and penalties for property taxes were recorded on a cash basis rather than an accrual basis. It was also noted that revenue and deferred revenue for pipeline leases was not being properly recorded when earned as well as not properly categorizing the deferred revenue associated with the pipeline lease activity between short term and long term. Revenue was recorded based on when the communication came from the Channel Development Department. In addition, it was noted that construction in process invoices were not accrued in the proper period.

**Recommendation:**

We recommend that interest and penalties be maintained using the accrual basis of accounting. We further recommend the Port ensure revenue is properly recognized based on the earnings process. This can be facilitated by establishing a process by which the Channel Development Department communicates to the Revenue Department the approval and execution of new leases in a timely manner. We recommend the Port ensure deferred revenue is categorized between short term and long term. We also recommend the Port ensure expenses are recorded when incurred.

**Status:**

***In Progress***

The Revenue Department will work with the Channel Development Department to establish a formal process to ensure pipeline lease revenue is recognized in the proper period. The Financial Accounting Department will ensure that deferred revenue is categorized correctly between short-term and long-term.

See Finding 2012-01 for further information.



**Port of Houston Authority of Harris County, Texas**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS – CONTINUED**

**Finding #: 2010-04**

**Lack of Formalized Policies and Procedures**

**Type of Finding – Significant Deficiency**

**Condition:**

It was noted that over the past few years, the Authority has experienced a high turnover in its upper management positions. As a result, well-defined accounting policies and procedures have not been established and many review and reconciliation policies and procedures have not been consistently or continuously maintained. A well-structured accounting policies and procedures manual can be very helpful in ensuring that proper procedures and related internal controls are in place and consistently followed.

**Recommendation:**

We recommend that a formal accounting policies and procedures manual be developed, documented, and distributed to all employees. At a minimum, the Authority should develop, enhance or finalize policies and procedures for the following:

- Capital Assets
  - Capitalization criteria
  - Establishment of time frame when a capital project that is substantially complete is transferred to in-service
  - Maintenance of support for capital asset categories Land and Channel Site Land and Improvements.
- Property Tax Allowance
- Journal Entry

**Status:**

***In Progress***

The Financial Accounting Department has completed the specific policies and procedures regarding the capitalization criteria, substantial completion, property tax and journal entries and is working on the full Capital Assets policy & procedure document.