



Lawrence F. Alwin, CPA

Robert E. Johnson Building
1501 North Congress Avenue
Suite 4.224
Austin, Texas 78701

Phone: (512) 936-9500
Fax: (512) 936-9400

A Report on State Entities Compliance With the Public Funds Investment Act

July 10, 2000

Members of the Legislative Audit Committee:

For fiscal year 1999, state entities subject to the Public Funds Investment Act (Act) continued to report substantial compliance with the Act's requirements. Compliance is important to protect the \$11.7 billion (up from \$9.2 billion in 1998) the entities invest. These entities individually manage relatively small funds and therefore may not have access to investment expertise. Since fiscal year 1996 when entities began submitting audit reports, we have noted steady improvement in compliance.

Results of audits submitted by state agencies, universities, and community college districts disclose:

- Twenty-eight of 29 state agencies and universities subject to the Act reported general compliance with the Act. As in prior years, the remaining entity, Texas Southern University (TSU), reported compliance. However, TSU identified significant deficiencies in five of the six compliance areas. TSU Internal Audit also reported that new management implemented control procedures during fiscal year 2000 to ensure compliance. The attachment lists specific instances of noncompliance for each entity. The market value of these entities' investments was approximately \$10.7 billion as of August 31, 1999.
- Of 50 community college districts, 48 reported compliance with the Act. Reports from the remaining two districts did not include statements on compliance. The market value of all the districts' investments was \$1.0 billion as of August 31, 1999.

State entities invested most of their funds in investment classes authorized under the Act. Only \$12.7 million (0.1 percent) of state entity funds is currently invested in derivatives. Section 2 of the attachment provides information on the state entities' investment portfolio.

We appreciate the cooperation of the state agencies, universities, and community college districts. Please contact Carol Noble, Audit Manager, (512) 936-9500, with any questions.

Sincerely,

Lawrence F. Alwin, CPA
State Auditor

tgc/Attachment

cc: All Executive Directors, Presidents, and Chancellors
of the State Entities Included in This Report

Objective, Scope, and Methodology

This review reports on state entities' compliance with the Public Funds Investment Act (Government Code, Chapter 2256). Investing state entities must satisfy requirements regarding: (1) investment policies, (2) management controls, (3) quarterly investment reports, (4) ethics and conflict of interest disclosures, (5) training of Board members and investment officers, and (6) broker/dealer acknowledgments of investment policies. State entities consist of state agencies, universities, and community college districts.

State entities subject to the Act must submit a compliance audit report to the State Auditor annually. We collected and analyzed: (1) internal audit reports, (2) external audit reports, and (3) investment portfolio compositions. The entities self-reported this information; we did not audit the reports or investment data.

SAO Report No. 00-033

Section 1:

State Entities Complied With Requirements of the Public Funds Investment Act

In fiscal year 1999, state entities subject to the Public Funds Investment Act (Act) continued to report substantial compliance with the Act's requirements.

Section 1-A:

Compliance Status of State Agencies and Universities

Twenty-eight of 29 state agencies and universities subject to the Act reported overall compliance with the Act. As in prior years, the remaining entity, Texas Southern University (TSU), reported compliance with the exception of several reportable conditions. However, TSU Internal Audit also reported that new management implemented control procedures during fiscal year 2000 to ensure compliance. Table 1 details the specific instances of noncompliance for each entity. The market value of these entities' investments was approximately \$10.7 billion as of August 31, 1999.

Contents	
State Entities Complied With Requirements of the Public Funds Investment Act	1
State Entities Investment Portfolio Information	6
Amendments Made to the Act by the 76 th Legislature	7

Table 1

Compliance Status of State Agencies and Universities				
Agency/University	Market Value of Investments at August 31, 1999	Compliance Reported by Entity	Instances of Noncompliance	Comments From Entity's Audit Report
Angelo State University	\$110,185,989	Yes		
Board of Law Examiners	\$2,093,969	Yes		
Department of Economic Development	\$77,306,044	Yes	Training Requirements	One of the governing board members did not attend a training session within six months after taking office, as required by the Act. The Investment Officer did not attend at least 10 hours of continuing education courses, as required by the Department's investment policy.
Lamar University-Beaumont	\$35,418,050	Yes		
Lamar Institute of Technology	\$3,210,810	Yes		
Lamar State College-Orange	\$7,210,226	Yes		
Lamar State College-Port Arthur	\$4,544,473	Yes		

Table 1 (continued)

Compliance Status of State Agencies and Universities				
Agency/University	Market Value of Investments at August 31, 1999	Compliance Reported by Entity	Instances of Noncompliance	Comments From Entity's Audit Report
Local Government Investment Pool (TexPool) ¹	\$8,237,706,000	Yes	Investment Policies Training Requirements	The investment policy does not address expected rates of return and does not include a requirement for settlement of all transactions, except investment pool funds and mutual funds, on a delivery versus payment basis. TexPool was unable to provide support for its assertion that members of its governing body attend at least one training session relating to the person's responsibilities under this Act within the designated time period after taking office or assuming duties.
Midwestern State University	\$26,926,446	Yes		
Sam Houston State University	\$59,121,624	Yes		
Southwest Texas State University	\$148,628,616	Yes		
State Bar of Texas	\$23,389,047	Yes	Investment Policies	The current investment policy was not reviewed during fiscal year 1999. Certain items required by the Act are not presently incorporated into the investment policy, including a) methods to monitor the market price of investments acquired with public funds, and b) a requirement for settlement of all transactions, except investment pools and mutual funds, on a delivery versus payment basis.
Stephen F. Austin State University	\$7,978,141	Yes		
Sul Ross State University	\$26,515,598	Yes		
Department of Housing and Community Affairs	\$960,956,594	Yes		
Department of Banking	\$1,205,235	Yes		
Department of Criminal Justice	\$11,460,843	Yes		
Texas Military Facilities Commission	\$6,235,097	Yes		
Parks and Wildlife Department	\$16,454	Yes		

¹ TexPool is a public funds investment pool created to invest funds on behalf of local governments such as cities, counties, and school districts. The Comptroller of Public Accounts and the TexPool Advisory Board have oversight responsibility over the assets of TexPool.

Table 1 (continued)

Compliance Status of State Agencies and Universities				
Agency/University	Market Value of Investments at August 31, 1999	Compliance Reported by Entity	Instances of Noncompliance	Comments From Entity's Audit Report
Real Estate Commission	\$1,915,000	Yes		
School for the Blind and Visually Impaired	\$700,000	Yes		
Texas School for the Deaf	\$9,559	Yes		
Texas Southern University	\$53,217,858	Compliance except for the reportable conditions identified. See Comments.	<p>Management Controls</p> <p>Quarterly Reports</p> <p>Ethics Policies and Conflicts of Interest</p> <p>Training Requirements</p> <p>Broker/Dealer Acknowledgements</p>	<p>Investment transactions were not reconciled and recorded on a monthly basis; auditors were unable to locate investment transaction summaries to facilitate the testing of investment transactions.</p> <p>Quarterly reports of investment activity were not presented to the Board of Regents.</p> <p>University officials did not file the required Disclosure of Conflict of Interest Statement for Senior Officials with the President's Office for fiscal year 1999.</p> <p>The training required for investment officers under the Act was not satisfied by the former investment officer as of his resignation in February 1999.</p> <p>Auditors were unable to locate external investment managers' signed statements acknowledging receipt of the University's investment policies under which they are required to operate.</p>
Texas State Technical College System	\$7,574,813	Yes		
Water Development Board	\$636,002,322	Yes		
Texas Woman's University	\$57,988,688	Yes		
Texas Youth Commission	\$588,000	Yes		
University of North Texas	\$135,222,186	Yes		
University of North Texas Health Science Center at Fort Worth	\$48,264,168	Yes		
Total Investments of Agencies and Universities			\$ 10,691,591,850	

ATTACHMENT

Section 1-B:

Compliance Status of Community College Districts

Independent audits of 50 community college districts reported that 48 districts were in overall compliance with the Act. The State Auditor's Office could not determine the compliance of North Central Texas College and Texarkana College because their auditors' reports did not include statements on compliance. Odessa Junior College District reported one instance of noncompliance—the District's investment policy does not include the acceptable method of soliciting bids for certificates of deposit.

The 50 districts reported \$1.0 billion in investments as of August 31, 1999. Table 2 shows the market value of investments for each community college district.

Table 2

Market Value of Investments for Community College Districts as of August 31, 1999	
Community College District	Investments
Alamo Community College District	\$76,745,876
Alvin Community College	1,352,000
Amarillo College	72,987,335
Angelina County Junior College District	9,240,301
Austin Community College District	29,648,345
Blinn College	16,052,224
Borger Junior College District	4,158,329
Brazosport Junior College District	13,528,971
Central Texas College District	50,456,062
Cisco Junior College District	2,825,830
Clarendon College	4,100,894
Coastal Bend College	6,805,565
Collin County Community College District	24,575,958
Dallas County Community College District	145,005,523
Del Mar College	17,325,495
El Paso County Community College District	51,925,176
Galveston Community College District	5,694,930
Grayson County College	7,776,418
Hill College	3,663,024
Houston Community College System	103,463,808
Howard County Junior College District	4,915,744

ATTACHMENT

Table 2 (continued)

Market Value of Investments for Community College Districts as of August 31, 1999	
Community College District	Investments
Kilgore Junior College District	12,635,703
Laredo Community College	1,297,291
Lee College	10,740,896
College of the Mainland	4,085,563
McLennan Community College	5,007,276
Midland Community College District	8,502,415
Navarro College	6,253,400
North Central Texas College	5,637,871
North Harris Montgomery Community College District	41,244,910
Northeast Texas Community College	1,622,597
Odessa Junior College District	28,982,767
Panola College	4,470,297
Paris Junior College	1,576,087
Ranger College	264,588
San Jacinto College District	34,439,829
South Plains College	10,224,999
South Texas Community College	20,628,908
Southwest Texas Junior College	3,684,873
Tarrant County College District	63,539,230
Temple College	10,234,307
Texarkana College	18,022,683
Texas Southmost College	6,711,458
Trinity Valley Community College	6,118,796
Tyler Junior College District	7,598,173
Vernon Regional Junior College	1,744,977
Victoria County Junior College District	10,353,457
Weatherford College of the Parker County	5,415,162
Western Texas College	3,104,280
Wharton County Junior College District	13,835,223
Total Investments	\$1,000,225,824

ATTACHMENT

State Entities Investment Portfolio Information

State entities invested most of their available funds in investment classes authorized under the Act. Over 90 percent of total investment assets were allocated into less risky investments such as short-term investments, U.S. government and agency securities, and investment pools. The majority of the remaining assets were invested in fixed income securities, guaranteed investment contracts, equities, and collateralized mortgage obligations (CMOs).

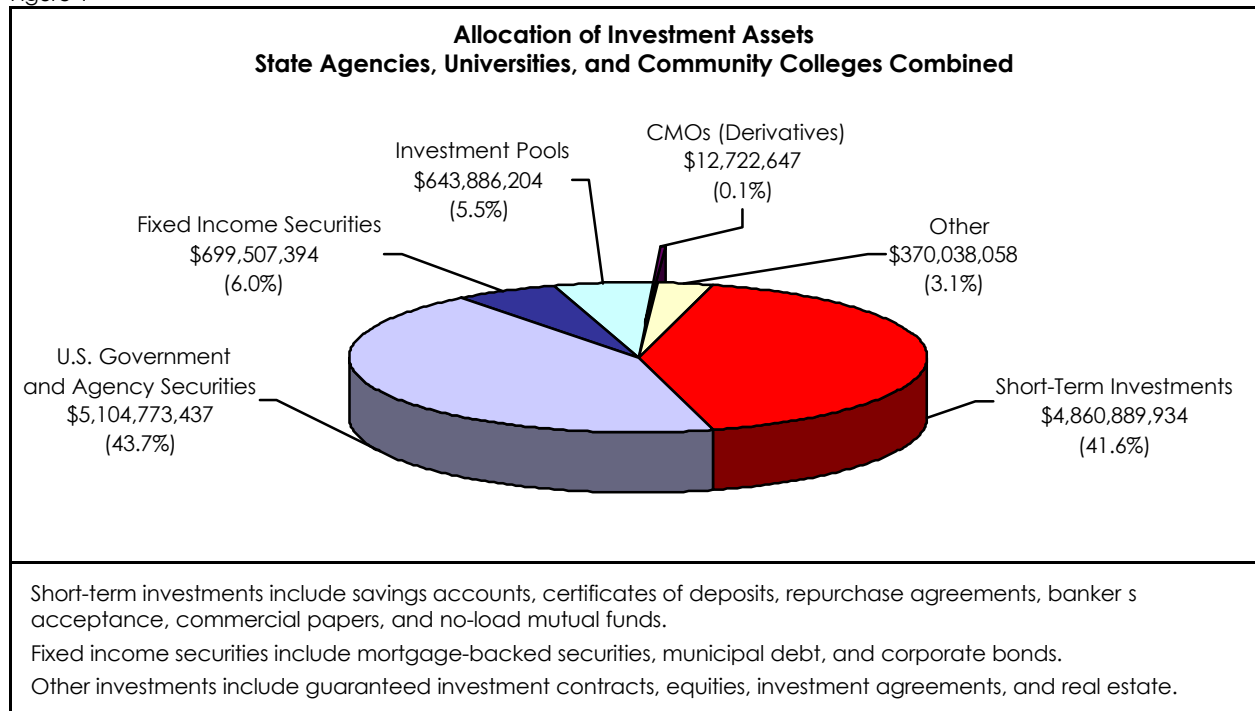
Derivatives are financial instruments (securities or contracts) with values that link to, or derive from, changes in interest rates, currency rates, and stock and commodity rates. Mortgage derivatives, or collateralized mortgage obligations, are securities created using the underlying cash flows from mortgage-backed securities (mortgage loan pools) as collateral. Uncertainty exists regarding the exact timing of principal return because the mortgage payments are influenced by:

- Changes in interest rates
- Current economic climate
- Geographic makeup of the underlying mortgage loans

The majority of the remaining assets were invested in fixed income securities, guaranteed investment contracts, equities, and collateralized mortgage obligations (CMOs).

The extent of state entities' investments in derivatives was very small (0.1 percent) as of August 31, 1999. State agencies, universities, and community college districts combined invested \$12.7 million in CMOs, which are types of derivatives. This is a decrease from fiscal year 1998, when state entities reported approximately \$65 million invested in derivatives. The Act prohibits most derivative investments. The following chart shows the allocation of state entities' investment assets by investment category as of August 31, 1999.

Figure 1



Sources: Investment portfolio compositions and audited financial reports

Amendments Made to the Act by the 76th Legislature

With the passage of House Bill 3009 in 1999, the Legislature adopted amendments to the Act, which took effect in fiscal year 2000 (September 1, 1999). The following amendments represent the significant changes made to the Act:

- The Act requires that every two years a compliance audit of management controls on investments and adherence to investment policies of state agencies be performed. The results of the audit must be reported to the State Auditor by January 1st of each even-numbered year. These audit requirements do not apply to state agency assets invested by the Comptroller of Public Accounts.
- The Act allows a governing body to contract with an investment management firm for the management of its funds. The firm must be registered under the Investment Advisers Act of 1940 or, if the firm is not subject to this law, registered with the State Securities Board.
- The Act does not apply to investments donated to the entity for a particular purpose or donated with specific terms.
- The Act adds guaranteed investment contracts to the list of eligible investments for the bond proceeds of all entities, if the contract has a defined termination date and is secured by obligations of the U.S. Government or its agencies or instrumentalities.
- The Act eliminates the percentage restriction on investments in no-load money market mutual funds.