



Lawrence F. Alwin, CPA
State Auditor

An Audit Report on State-Issued Bonds for Fiscal Year 2001

April 8, 2002

Members of the Legislative Audit Committee:

The bond-issuing state agencies and higher education institutions we audited complied with all significant bond covenants, laws, and regulations regarding bonded debt during the fiscal year ending August 31, 2001. In addition, these entities reported accurate information for the supplementary bond schedules included in the *Texas 2001 Comprehensive Annual Financial Report (CAFR)*. We did not audit the bonds issued by the Department of Housing and Community Affairs or the Texas State Affordable Housing Corporation because these entities received external audits (see Audit Scope in text box).

The bond covenants we tested included requirements regarding the payment of principal and interest and the maintenance of required reserve funds. Our opinion on compliance with covenants is provided in Section 2 of the attachment to this letter. We believe the assurance our opinion provides could be useful to bond-rating agencies.

The supplementary bond schedules in the CAFR include information such as debt service requirements, reserve fund requirements, and sources and uses of funds for debt service. Texas is one of the few states to provide this level of information and audit assurance in its CAFR.

Bond rating agencies meet annually with the Bond Review Board, the Comptroller of Public Accounts, and the State Auditor's Office to review the bond schedules and related information. Section 1 of the attachment includes trend information on the State's bonded debt summarized from these schedules for fiscal years 1987 through 2001.

As of August 31, 2001, the State had more than \$12.5 billion in outstanding bonded debt. Bonds are used to fund programs such as those related to building construction, loans for tuition and housing, and grants for state resource development. The *Texas Bond Review Board 2001 Annual Report (November 2001)* provides additional information on the State's bonded debt.

Audit Scope

We audited all of the State's bond-issuing entities except for the Department of Housing and Community Affairs (Department) and the Texas State Affordable Housing Corporation. These entities received external audits.

The external auditors found the financial statements and schedules to be fairly stated.

The external auditors' work was limited only to audit procedures required to issue an opinion on these entities' financial statements and, in the case of the Department, the related supplementary bond schedules. The objective of the external audit was not to provide an opinion on overall compliance with bond-related covenants, laws, and regulations. Therefore, the assurances on compliance with bond covenants provided in our report do not extend to these entities.

We are working with the Department to be able to provide assurances on compliance in fiscal year 2002.

Members of the Legislative Audit Committee
April 8, 2002
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We thank the management and staff of the entities involved for their assistance during the audit. If you have any questions, please contact Susan Riley, Audit Manager, at (512) 936-9500.

Sincerely,

Lawrence F. Alwin, CPA
State Auditor

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Attachment

cc: Members of the governing boards of the audited entities
Chancellors and Presidents of the audited higher education institutions
Executive Directors of the audited entities
Office of the Comptroller of Public Accounts
 The Honorable Carole Keeton Rylander, Comptroller
 Mr. Billy Hamilton, Deputy Comptroller
Bond Review Board
 Mr. Jim Buie, Executive Director

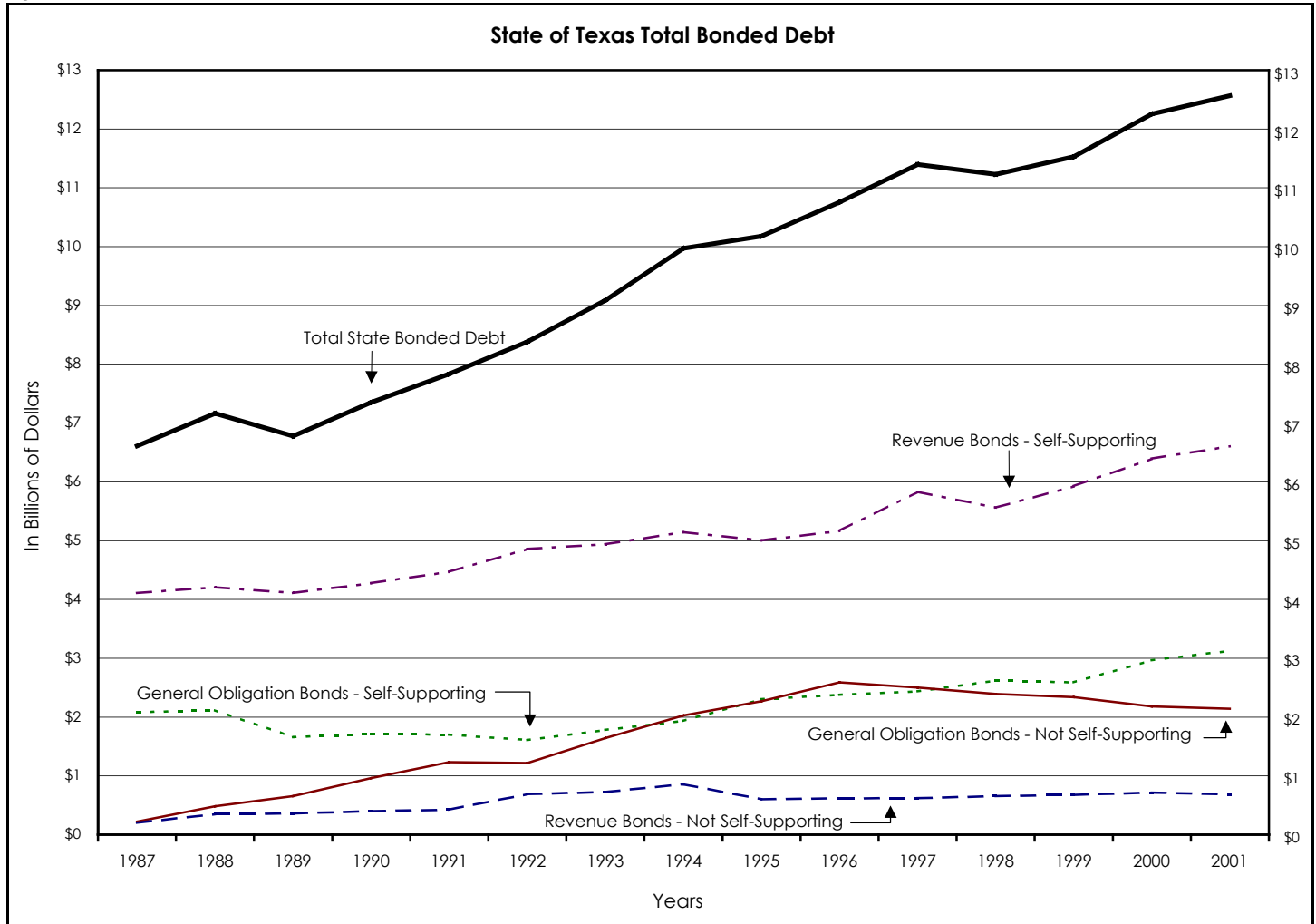
Trends in Bonded Debt and Related Debt Service Costs

The State of Texas has issued a *Comprehensive Annual Financial Report* (CAFR) each fiscal year since 1987. Although the supplementary bond schedules in the CAFR are not required by the Governmental Accounting Standards Board, the Comptroller of Public Accounts and the State Auditor’s Office determined that this information would be useful to the users of the financial statements.

The following trend information was summarized from the supplementary bond schedules presented in the *Comprehensive Annual Financial Reports*.

Total bonded debt for the State has almost doubled (from \$6.6 billion to more than \$12.5 billion) since 1987. The largest dollar increase was in Revenue Bonds - Self-Supporting, which increased from \$4.1 billion to \$6.6 billion. However, the largest percentage increase was in General Obligation Bonds - Not Self-Supporting, which increased from \$220 million to \$2.1 billion at August 31, 2001—an increase of 874 percent. In November 2001 Texas voters approved the issuance of an additional \$1 billion in general obligation debt (see page 2 for more information).

Figure 1

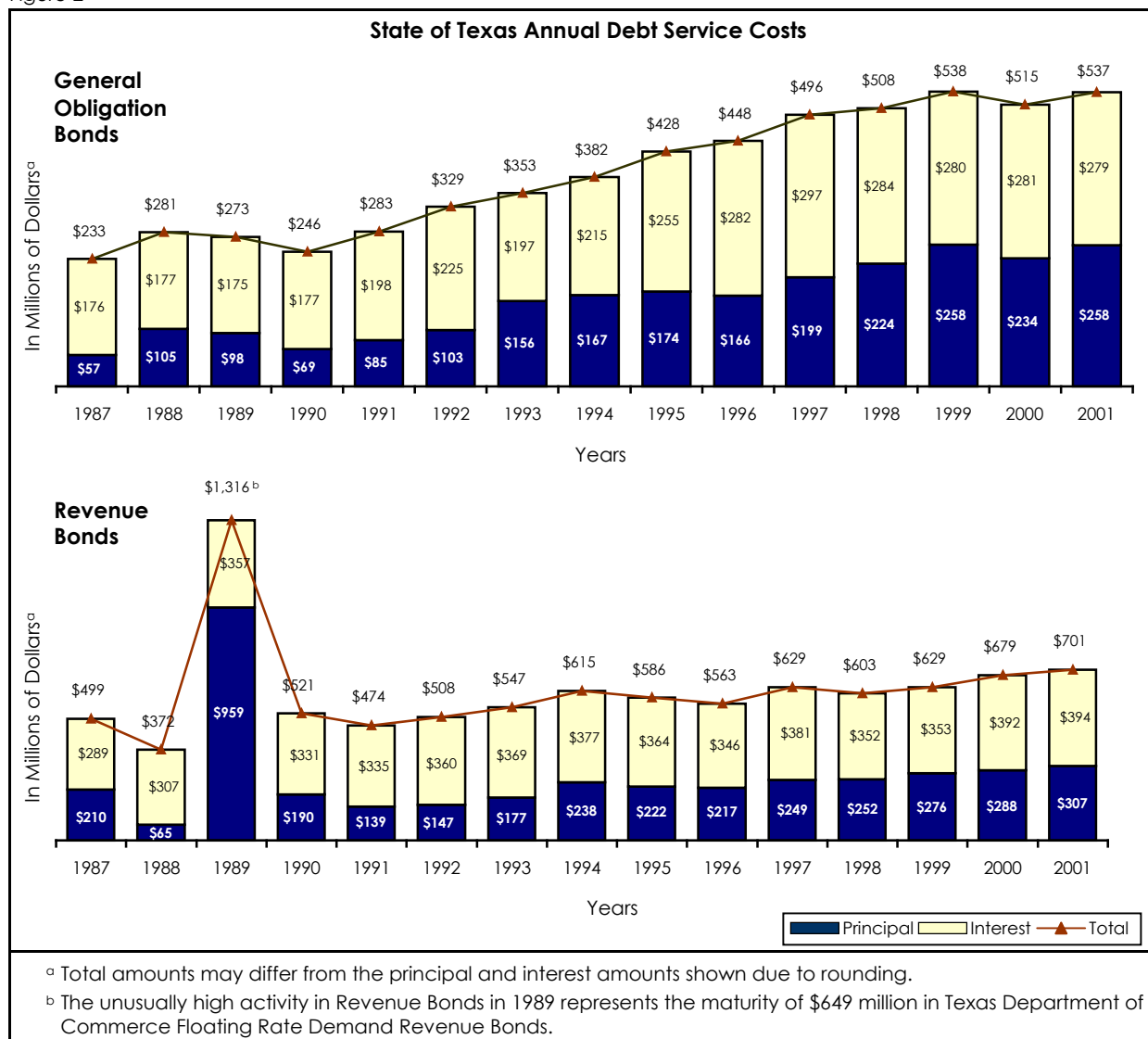


Source: State of Texas *Comprehensive Annual Financial Report*, fiscal years 1987 - 2001

Annual debt service payments are a combination of interest on bonds and payment of principal. Since 1987, the annual debt service for General Obligation Bonds has increased at the same rate as the increase in outstanding General Obligation debt. Over time, the percentage of General Obligation principal payments compared to total debt service has nearly doubled from almost 25 percent in 1987 to over 48 percent in 2001. In comparison, the percentage of principal payments to total debt service for Revenue Bonds has remained fairly constant. Currently, total interest on all bonds (General Obligation and Revenue bonds) represents about 54 percent of the State's total annual debt service requirements.

The unusually high activity in Revenue Bonds in 1989 represents the maturity of \$649 million in Texas Department of Commerce Floating Rate Demand Revenue Bonds.

Figure 2



Source: State of Texas Comprehensive Annual Financial Report, fiscal years 1987 - 2001

Table 1

State of Texas Bond-Issuing Entities' Outstanding Bond Indebtedness - Fiscal Year 2001	
Agency or Higher Education Institution	Total Amount of Outstanding Bond Issues as of August 31, 2001
Audited by State Auditor's Office	
Economic Development, Department of	\$ 99,335,000
General Land Office and Veterans' Land Board	1,892,781,983
Higher Education Coordinating Board	627,157,312
Midwestern State University	13,310,000
Military Facilities Commission	15,725,000
Public Finance Authority	2,720,258,868
Southwest Texas State University	32,165,000
Stephen F. Austin State University	27,140,000
Texas A&M University System	950,615,866
Texas Southern University	58,130,000
Texas State Technical College	5,740,000
Texas State University System	197,100,000
Texas Tech University System	150,790,000
Texas Woman's University	30,620,000
The University of Texas System	1,412,255,000
University of Houston System	177,400,000
University of North Texas System	76,064,016
Water Development Board	2,639,755,000
Audited by External Auditors	
Housing and Community Affairs, Department of ^{a b}	1,438,397,321
Texas State Affordable Housing Corporation ^c	0
Total	\$ 12,564,740,366 ^d
<p>^a External auditors performed the bond audit for the Department of Housing and Community Affairs as authorized by Texas Government Code, Sections 2113.102 and 2306.074.</p> <p>^b Total includes \$399,751,009 in conduit debt. The Department, the State, and any political subdivisions thereof are not obligated in any manner for repayment of the bonds.</p> <p>^c External auditors performed the audit for the aggregate principal of \$33,032,000 in conduit debt issued by Texas State Affordable Housing Corporation, as required by Texas Government Code, Section 2306.560. The Corporation, the State, and any political subdivisions thereof are not obligated in any manner for repayment of the bonds.</p> <p>^d Reported totals may not tie to totals reported in the <i>Texas 2001 Comprehensive Annual Financial Report (CAFR)</i> because CAFR totals are rounded and reported in thousands.</p>	

Source: Entity fiscal year 2001 annual financial reports

Bonded Debt Activity Subsequent to August 31, 2001

State agencies and higher education institutions have issued, or have been authorized to issue, over \$755 million in new bonds and commercial paper and over \$558 million in refunding bonds since August 31, 2001.

In November 2001 voters approved a constitutional amendment giving the Legislature the authority to authorize the Texas Public Finance Authority to issue \$1.025 billion in General Obligation bonds to finance state facilities and colonia roadway projects. The Texas Public Finance Authority expects to issue bonds amounting to \$40,985,000 in fiscal year 2002 with the remaining amount to be issued in fiscal years 2003-2007.

The Texas State Affordable Housing Corporation (Corporation) has been authorized to issue over \$241 million in new bonds since August 31, 2001, part of which have already been issued. These bonds are conduit debt. The Corporation, the State, and any political subdivisions thereof are not obligated in any manner for repayment of the bonds.

Section 2:

Report on Compliance with Requirements in Significant Bond Covenants and Applicable Laws and Regulations Related to Bonded Debt for the Fiscal Year Ending August 31, 2001

We audited bond-issuing agencies and higher education institutions for compliance with requirements in significant bond covenants and applicable laws and regulations for the fiscal year ending August 31, 2001. We also reviewed these entities' procedures for complying with Internal Revenue Service arbitrage rebate requirements and Securities and Exchange Commission disclosure requirements. Our audit scope did not include the Department of Housing and Community Affairs (Department) and the Texas State Affordable Housing Corporation because these entities received external audits. (See Table 1 in Section 1 for a complete list of the State's bond-issuing entities.)

We conducted our audit in accordance with auditing standards generally accepted in the United States and with *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform our audit to obtain reasonable assurance about whether the entities that issue bonds are in compliance with the requirements in significant bond covenants and applicable laws and regulations. An audit includes examining, on a test basis, evidence about the State's compliance with those requirements and performing other procedures we consider necessary for the circumstances. Our audit included testing of covenant requirements regarding principal and interest payments, transfers, reserve funds, interest and sinking funds, and insurance. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the State's compliance with applicable covenants, laws, and regulations regarding bonded debt. We chose not to comply with a reporting standard that specifies the wording used to discuss restrictions on the use of this report. We believe that use of such wording does not align with our role as a legislative audit function.

We did not conduct compliance testing of the Department of Housing and Community Affairs' (Department) bond issues. As permitted by Texas Government Code, Sections 2113.102 and 2306.074, the Department contracted with an external auditor to perform an audit of its bond schedules for the fiscal year ending August 31, 2001. The external auditor's work was limited only to audit procedures required to issue an opinion on the Department's financial statements and the related supplementary bond schedules. The objective of the external audit was not to provide an opinion on the Department's overall compliance with bond-related covenants, laws, and regulations. Therefore, the assurances provided in our report do not extend to the Department's compliance with bond covenants, laws, and regulations regarding bonded debt. The Department's supplementary bond schedules composed 11 percent of the State's outstanding bonded debt as of August 31, 2001.

We did not conduct compliance testing of the Texas State Affordable Housing Corporation's (Corporation) bond issues. As required by Texas Government Code, Section 2306.560, the Corporation contracted with an external auditor to perform an audit of its financial statements for the fiscal year ending August 31, 2001. The bond issues of the Corporation are classified as conduit debt and are disclosed in the notes to the financial statements, rather than in supplementary bond schedules. The external auditor's work was limited only to audit procedures required to issue an opinion on the Corporation's financial statements. The objective of the external audit was not to provide an opinion on the Corporation's overall compliance with bond-related covenants, laws, and regulations. Therefore, the assurances provided in our report do not extend to the Corporation's compliance with bond covenants, laws, and regulations regarding bonded debt. As of August 31, 2001, the Corporation had conduit debt of \$33,032,000.

In our opinion, except for the bond-issuing entities not included in our audit scope, the State complied, in all material respects, with the covenants, laws, and regulations applicable to bonded debt for the State of Texas. We noted only immaterial instances of noncompliance and worked with management of the applicable bond-issuing entities for resolution.

This report is intended for the use of the Governor, the Legislature, management of the State's bond-issuing entities, bond-rating agencies, investors, bond counsel, and other interested parties. However, this report is a matter of public record, and its distribution is not limited.

Objectives, Scope, and Methodology

Objectives

The objectives of this audit were to audit state bond-issuing entities to:

- Determine compliance with requirements in significant bond covenants and applicable laws and regulations.
- Verify the accuracy of information reported in the bond schedules in each entity's annual financial report.

- Compile the audited bond schedule data into the statewide bond schedules for inclusion in the *Texas 2001 Comprehensive Annual Financial Report*.

Scope

The scope of this audit included all bond issues for the entities listed in Section 1 of this report, except for the Department of Housing and Community Affairs and the Texas State Affordable Housing Corporation, for the fiscal year ending August 31, 2001. These two entities received external audits.

Methodology

We examined the state bond-issuing entities' bond schedules, reconciliations and supporting documentation for the bond schedules, bank or trust statements, and general ledger information. We confirmed principal and interest payments and transfers and reviewed entities' policies and procedures, Uniform Statewide Accounting System transaction history, and bond-related insurance documentation.

We tested the entities' bond issues for the following:

- Compliance with requirements in significant bond covenants and applicable laws and regulations regarding bonded debt.
- Accuracy of bond schedule information reported in the entities' annual financial reports.
- Accuracy of the information in the entities' notes to financial statements reported in their annual financial reports.
- Compliance with Internal Revenue Service arbitrage rebate requirements.
- Compliance with Securities and Exchange Commission disclosure requirements.

The criteria used included the bond covenants, relevant laws and regulations, the *Comptroller's Reporting Requirements for Annual Financial Reports*, and audit standards generally accepted in the United States of America. The guidelines for this audit were provided by Texas Government Code, Sections 321.0131 and 321.0132. This audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States.