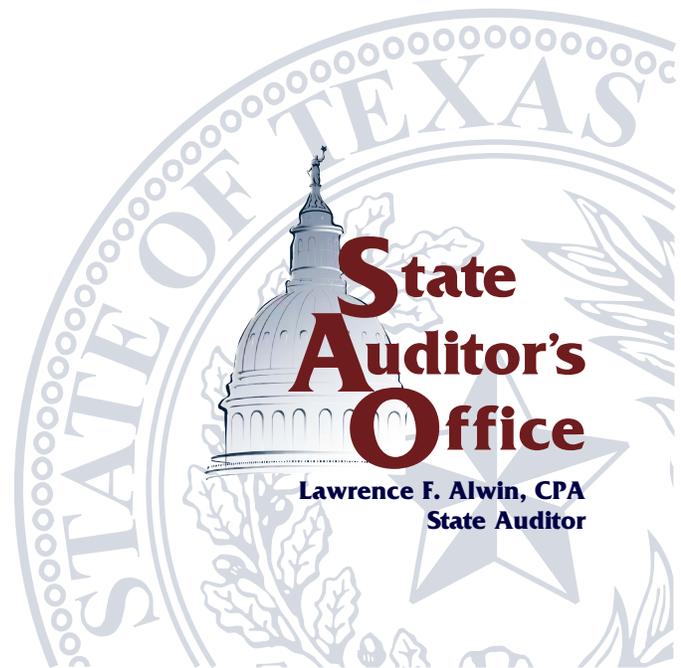


A Review of

State Entity and Community College District Compliance with the Public Funds Investment Act and Investment Reporting Requirements

May 2004

Report No. 04-033



State Entity and Community College District Compliance with the Public Funds Investment Act and Investment Reporting Requirements

Overall Conclusion

Overall, state agencies, universities, and community college districts fully or substantially complied with the Public Funds Investment Act (Act). In addition, universities and community college districts fully or substantially complied with higher education investment reporting requirements mandated by Rider 5 in the General Appropriations Act (78th Legislature, page III-257). With \$16.5 billion in investments as of August 31, 2003, it is important that these entities comply with statutes and investment reporting requirements designed to help the Legislature, the entities' boards, and the general public ensure that entities manage and disclose their investments appropriately. The following describes compliance by type of entity for fiscal year 2003.

- **Agencies.** The 10 state agencies subject to the Act continued to report full or substantial compliance with the Act.
- **Universities.** The 15 universities subject to the Act continued to report full or substantial compliance with the Act and with higher education investment reporting requirements.
- **Community college districts.** All 50 community college districts reported full or substantial compliance with the Act. In addition, 49 of them were in full or substantial compliance with higher education investment reporting requirements. One community college district, Coastal Bend College, failed to post its investment reports, policy, and other required disclosures on its Web site.

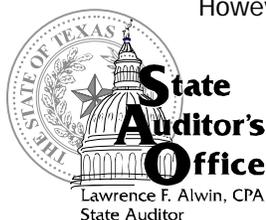
As the Act requires, state agencies, universities, and community college districts reported that they had not purchased certain high-risk investments (specific types of derivatives) and that they had invested their funds only in authorized investment asset classes. They reported having only \$91,000 in derivatives as of August 31, 2003, compared with more than \$9 million in derivatives as of August 31, 2001 (the last reporting date).

Community college districts and some universities experienced difficulties in meeting the higher education investment reporting requirements, particularly the requirements to post information on their Web sites. Community college districts also had difficulties obtaining from their auditors the required assurances regarding their compliance with the Act. However, after we contacted them, community college districts obtained the appropriate

Background Information

The Public Funds Investment Act (Act) was enacted in 1995 to improve the management of investments by state entities and local governments. The Act requires certain state agencies, universities, and community college districts to implement controls in the form of investment policies, training, and reporting, as well as to obtain audits of those controls at least once every two years.

In addition, Rider 5 of the General Appropriations Act (78th Legislature, page III-257) requires universities and community college districts to produce annual and quarterly investment reports in a method prescribed by the State Auditor's Office. That method was outlined in *A Review of Higher Education Investment Reporting Requirements* (SAO Report No. 02-058, July 2002).



assurances and posted most of the required information on their Web sites. Universities also posted most of their remaining investment information after we contacted them.

We appreciate the cooperation of the state agencies, universities, and community college districts during this review.

Summary of Objectives, Scope, and Methodology

The objectives of this review were to report on:

- State agency, university, and community college district compliance with the Act.
- University and community college district compliance with higher education investment reporting requirements.
- The types of investments state entities and community college districts held as of August 31, 2003.

The scope of our review covered investment disclosures and reports from September 1, 2002, through April 2, 2004, the deadline we established for entities to achieve full compliance after recognizing that some of them had not fully complied and needed more guidance. We also reviewed results of the entities' most recent audits regarding compliance with the Act.

Our methodology consisted of collecting evidence of compliance and noncompliance with the Act reported in audits and of reviewing investment reports and comparing them with investments reported in entities' annual financial reports. In addition, we reviewed entities' Web sites for the required investment disclosures, and we communicated with state entities and community college districts to ensure that disclosures were completed by April 2, 2004.

Prior Related SAO Work		
Number	Product Name	Release Date
02-058	A Review of Higher Education Investment Reporting Requirements	July 2002
02-039	A Review of State Entity Compliance with the Public Funds Investment Act	May 2002

Contents

Detailed Results

Chapter 1	
All State Agencies Fully or Substantially Complied with the Public Funds Investment Act.....	1
Chapter 2	
All Universities Fully or Substantially Complied with the Public Funds Investment Act and Higher Education Reporting Requirements	2
Chapter 3	
Most Community College Districts Fully Complied with the Public Funds Investment Act and Higher Education Investment Reporting Requirements	3
Chapter 4	
Agencies, Universities, and Community College Districts Invest Most of Their Funds in Authorized Investments	5
Chapter 5	
Enhancements to the Higher Education Investment Reporting Requirements and Other Recommendations	10

Appendix

Objectives, Scope, and Methodology.....	11
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Detailed Results

Chapter 1

All State Agencies Fully or Substantially Complied with the Public Funds Investment Act

All state agencies that were subject to the Public Funds Investment Act (Act) were in full or substantial compliance with the Act. These agencies reported investments totaling more than \$14 billion as of August 31, 2003.

We assessed compliance with the Act after reviewing the audit reports issued by agencies' external and internal auditors. Table 1 denotes instances of noncompliance for agencies that were assessed as being in substantial compliance; all other agencies were in full compliance.

Table 1

Agencies that Substantially Complied with the Act		
Agency	Areas of Noncompliance	Comments
State Bar of Texas	Investment Policy	Investment policies did not include some of the required components.
Water Development Board	Investment Policy	Investment policy did not allow for certain investments purchased before the policy was written.

All Universities Fully or Substantially Complied with the Public Funds Investment Act and Higher Education Reporting Requirements

All universities that were subject to the Act were in full or substantial compliance with the Act. These entities reported investments totaling \$967 million as of August 31, 2003.

We assessed compliance with the Act after reviewing the audit reports issued by the universities' internal auditors. Table 2 denotes instances of noncompliance for universities that were assessed as being in substantial compliance; all other universities were in full compliance.

Table 2

Universities that Substantially Complied with the Act		
University	Areas of Noncompliance	Comments
Sul Ross State University	Investment Policy	University departed from the endowment investment strategy.
	Training Requirements	Investment officer training report was not submitted to board.
Texas Southern University	Investment Policy	Investment policy did not include all investment types. Management could not provide evidence that external investment managers received the university's investment policy.
	Recordkeeping/Documentation	Management was unable to locate investment transaction documentation.
Texas State University—San Marcos	Reporting	Investment reporting accuracy should be improved.
	Investment Policy	Quarterly investment reports were not submitted to the president and system vice chancellor in a timely manner.
Texas Woman's University	Investment Policy	Investment policies were not reviewed and approved within the past year.

In addition to complying with the Act, universities are required to follow higher education investment reporting requirements, which became effective September 1, 2002 (the beginning of fiscal year 2003). In reviewing for compliance with these requirements, we recognized that some of the universities had not fully complied with them. We provided more guidance to each university and set a deadline of April 2, 2004, to allow them to achieve compliance. After the deadline, we reassessed compliance, and all universities had achieved full or substantial compliance. Most of the remaining instances of noncompliance we identified pertained to investment disclosures not being posted on universities' Web sites.

Most Community College Districts Fully Complied with the Public Funds Investment Act and Higher Education Investment Reporting Requirements

Independent audits of the 50 community college districts reported overall compliance with the Act. Forty-six of the districts were in full compliance. Table 3 shows the four districts that were assessed as being in substantial compliance.

Table 3

Community College Districts that Substantially Complied with the Act		
Community College District	Areas of Noncompliance	Comments
Brazosport College District	Investment Policy	Policy not reviewed in fiscal year 2003
Galveston Community College District	Investment Policy	Policy not reviewed in fiscal year 2003
Laredo Community College	Reporting	Inaccuracies in quarterly reports
	Collateral	Insufficient collateralization of deposits
Navarro College	Collateral	Insufficient collateralization of certificates of deposit

In addition to the noncompliance noted above, most community college districts did not initially obtain the appropriate assurances from their independent auditors regarding compliance with the Act. We communicated with managers at the community college districts, as well as some of their independent auditors, and secured the appropriate assurances.

Community college districts are also required to follow higher education investment reporting requirements, which became effective September 1, 2002 (the beginning of fiscal year 2003). In reviewing for compliance with these requirements, we recognized that the majority of the community college districts had not fully complied with them. Many of the instances of noncompliance we identified pertained to investment disclosures not being posted on community colleges' Web sites. We provided more guidance to each district and set a deadline of April 2, 2004, to allow them to achieve compliance. After the deadline, we reassessed compliance, and only one community college district—Coastal Bend College—was assessed as not in compliance with the higher education investment reporting requirements. Table 4 lists the community college districts that did not fully comply.

Table 4

Community College Districts that Did Not Fully Comply with Higher Education Investment Reporting Requirements		
Community College Districts	Areas of Noncompliance	Comments
Not in Compliance		
Coastal Bend College	Disclosure	Failed to post investment reports, policy, and other disclosures on Web site
In Substantial Compliance		
Borger Junior College District	Disclosure	Quarterly investment reports not posted on Web site
Clarendon College	Disclosure	Quarterly investment reports not posted on Web site
El Paso Community College District	Disclosure	Soft dollar ^a information not posted on Web site
Kilgore College	Disclosure	One quarterly report and foundation information not posted on Web site
North Harris Montgomery Community College District	Disclosure	Quarterly investment reports not posted on Web site
Paris Junior College	Disclosure	No quarterly investment reports posted on Web site
Ranger College	Disclosure	Quarterly investment reports not posted on Web site
Southwest Texas Junior College	Disclosure	Quarterly investment reports not posted on Web site
Temple College	Disclosure	Quarterly investment reports not posted on Web site
Weatherford College of the Parker County Junior College District	Disclosure	Quarterly investment reports and information on outside advisors, soft dollar arrangements ^a , and foundations not posted on Web site
^a Soft dollar arrangements are a means of paying for services through brokerage commission revenue rather than through direct payments.		

Agencies, Universities, and Community College Districts Invest Most of Their Funds in Authorized Investments

As the Act requires, state agencies, universities, and community college districts reported that they had not purchased certain high-risk investments (specific types of derivatives) and that they had invested their funds only in authorized investment asset classes. They reported having only \$91,000 in derivatives as of August 31, 2003, compared with more than \$9 million in derivatives as of August 31, 2001 (the last reporting date). 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.

State agencies subject to the Act, universities subject to the Act, and community college districts reported different types of investments as of August 31, 2003. Universities and community college districts had more than \$1 billion invested in the Texas Local Government Investment Pool (TexPool), while agencies had \$7.5 billion invested in repurchase agreements.

Agencies also invested more than \$4.5 billion in short-term U.S. government agency obligations, while universities and community college districts reported significant investments in long-term U.S. government and U.S. government agency obligations.

Total investments reported by state agencies subject to the Act are presented in Table 5.

Table 5

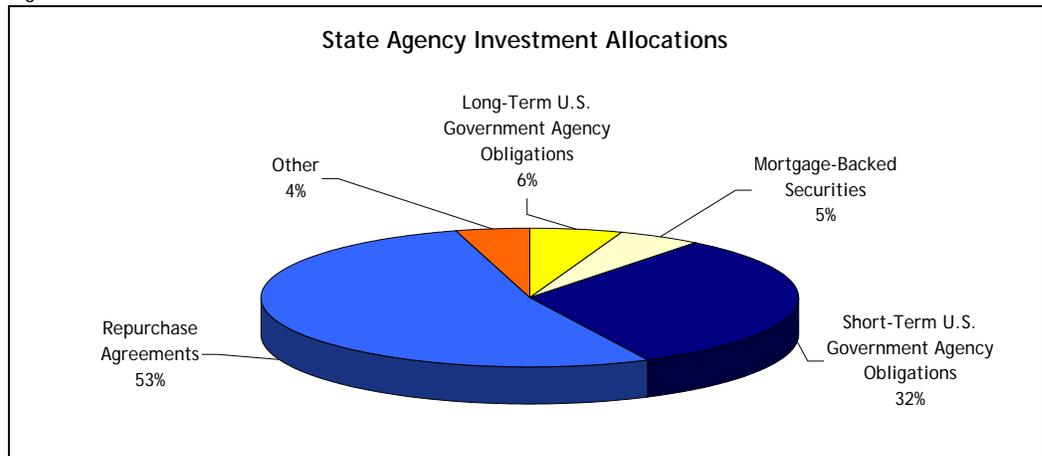
Total Agency Investments ^a	
Agency	Market Value of Investments as of August 31, 2003
Board of Law Examiners	\$ 1,992,412
Department of Criminal Justice	14,571,584
Department of Housing and Community Affairs	1,317,170,321
Texas Local Government Investment Pool (TexPool)	11,742,114,592
Texas Local Government Investment Pool Prime (TexPool Prime)	247,557,510
Real Estate Commission	2,099,506
School for the Blind and Visually Impaired	215,607
State Bar of Texas	28,809,423
Texas Military Facilities Commission	5,877,960
Texas Youth Commission	683,000
Water Development Board	756,517,529
Total	\$ 14,117,609,444

^a This table includes investment information only for agencies that are subject to the Act.

Source: Entity-reported, unaudited information

State agency investment allocations as of August 31, 2003, are depicted in Figure 1.

Figure 1



Source: Entity-reported, unaudited information

Total investments reported by universities subject to the Act are presented in Table 6.

Table 6

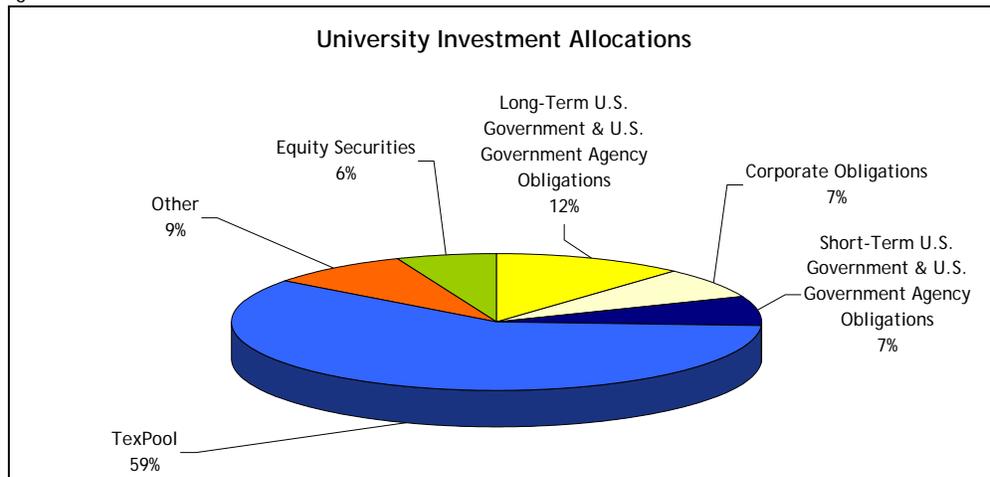
Total University Investments ^a	
University	Market Value of Investments as of August 31, 2003
Angelo State University	\$ 112,695,387
Lamar Institute of Technology	7,774,136
Lamar State College - Orange	6,008,007
Lamar State College - Port Arthur	8,175,839
Lamar University	52,938,352
Midwestern State University	24,966,116
Sam Houston State University	102,149,066
Stephen F. Austin State University	39,154,141
Sul Ross State University	28,045,423
Texas Southern University	74,454,378
Texas State Technical College	10,865,885
Texas State University - San Marcos	163,723,835
Texas Woman's University	89,394,224
University of North Texas	209,065,584
University of North Texas Health Science Center at Fort Worth	37,538,236
Total	\$ 966,948,609

^a This table includes investment information only for universities that are subject to the Act.

Source: Entity-reported, unaudited information

University investment allocations as of August 31, 2003, are depicted in Figure 2.

Figure 2



Source: Entity-reported, unaudited information

Total investments reported by community college districts are presented below in Table 7.

Table 7

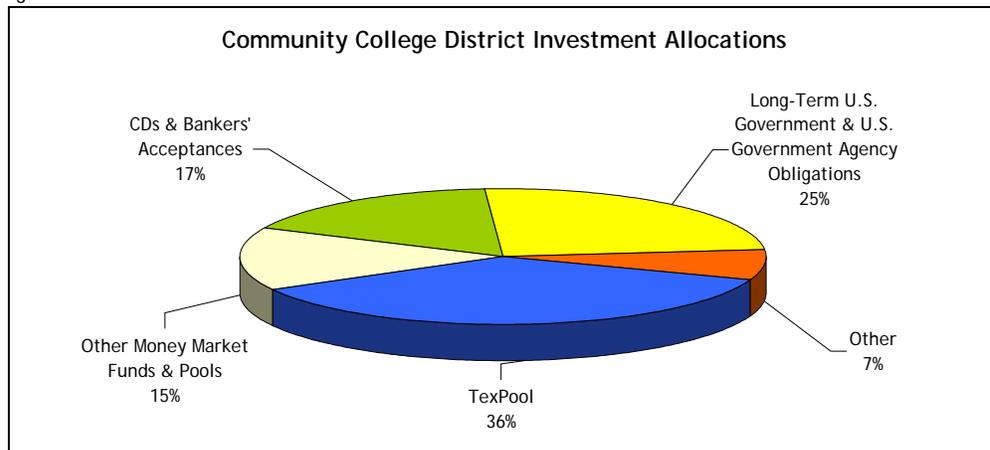
Total Community College Districts Investments	
Community College District	Market Value of Investments as of August 31, 2003
Alamo Community College District	\$ 108,007,467
Alvin Community College	3,460,067
Amarillo College	26,584,210
Angelina County Junior College District	6,064,551
Austin Community College District	101,582,779
Blinn College	18,525,647
Borger Junior College District	2,607,000
Brazosport College District	14,772,211
Central Texas College District	48,314,239
Cisco Junior College District	11,756,005
Clarendon College	3,143,572
Coastal Bend College	8,307,143
College of the Mainland	61,147
Collin County Community College District	90,413,144
Dallas County Community College District	171,432,334
Del Mar College	15,271,084
El Paso County Community College District	37,130,901
Galveston Community College District	3,218,794
Grayson County College	20,213,409
Hill College	1,331,318
Houston Community College System	99,511,891
Howard County Junior College District	11,605,984
Kilgore Junior College District	9,402,622
Laredo Community College	30,413,290
Lee College District	12,242,578
McLennan County Junior College District	2,771,830
Midland Community College District	13,842,053
Navarro College	17,424,023
North Central Texas College	7,670,777
North Harris Montgomery Community College District	55,618,085
Northeast Texas Community College	7,104,393
Odessa Junior College District	26,299,861
Panola College	5,090,445
Paris Junior College	3,842,506
Ranger College	232,415

Total Community College Districts Investments	
Community College District	Market Value of Investments as of August 31, 2003
San Jacinto College District	\$ 34,413,024
South Plains College	7,410,895
South Texas Community College	115,069,981
Southwest Texas Junior College	3,076,460
Tarrant County College District	166,952,314
Temple College	12,295,534
Texarkana College	19,691,957
Texas Southmost College	45,298
Trinity Valley Community College	7,947,299
Tyler Junior College District	9,224,456
Vernon College	16,594
Victoria County Junior College District	6,294,504
Weatherford College of the Parker County Junior College District	4,717,496
Western Texas College	2,819,587
Wharton County Junior College District	11,062,571
Total Investments	\$ 1,396,307,745

Source: Entity-reported unaudited information.

Community college district investment allocations as of August 31, 2003, are depicted in Figure 3.

Figure 3



Source: Entity-reported, unaudited information

Enhancements to the Higher Education Investment Reporting Requirements and Other Recommendations

We offer the following recommendations to enhance the consistency of investment reporting by state entities subject to the Act and to encourage universities and community college districts to ensure that they maintain compliance with the Act and higher education investment reporting requirements.

- Investments with the Texas Treasury Safekeeping Trust Company should be reported by investment type rather than reported as Cash in State Treasury. Instructions regarding Annual Investment Reports on the State Auditor's Office Web site now reflect this change.
- As mentioned earlier in this report, universities and community college districts were initially slow in meeting the higher education investment reporting requirements, particularly the requirements to post information on their Web sites. Community college districts also had difficulties obtaining the required assurances regarding compliance with the Act from their independent auditors. After we contacted them, management at most of the universities and community college districts corrected all instances of noncompliance by April 2, 2004, the deadline we set after recognizing that some of the entities had not fully complied with the requirements.

We encourage management of these entities to remain in compliance with the higher education investment reporting requirements. Management should ensure that their auditors understand the requirements, including the required assurances on compliance with the Act. Management of universities and community college districts should also ensure that the required investment disclosures are posted on their Web sites in a timely manner.

Appendix

Objectives, Scope, and Methodology

Objectives

The objectives of this review were to report on:

- State agency, university, and community college district compliance with the Public Funds Investment Act (Act).
- University and community college district compliance with higher education investment reporting requirements.
- The types of investments state entities and community college districts held as of August 31, 2003.

Scope

The scope of our review covered investment disclosures and reports from September 1, 2002, to April 2, 2004, the deadline we established for completing disclosures. We also reviewed results of the entities' most recent audits regarding compliance with the Act.

Methodology

Our methodology consisted of collecting evidence of compliance and noncompliance with the Act reported in audits and of reviewing investment reports and comparing those reports with investments reported in annual financial reports. In addition, we reviewed Web sites for the required investment disclosures, and communicated with state entity and community college managers in efforts to ensure that disclosures were complete by April 2, 2004, the deadline we set after recognizing that some of the entities had not fully complied with the requirements.

Other Information

This project was a review and, therefore, the information in this report was not subjected to the tests and confirmations that would be performed in an audit. We conducted fieldwork from January 2004 through April 2004. The following members of the State Auditor's staff performed this review:

- Kelton M. Green, CPA, CFE (Project Manager)
- Jodi L. Edgar
- Barbara A. Lamberson
- J. Scott Killingsworth, CIA (Quality Control Reviewer)
- Carol Smith, CPA (Audit Manager)
- Frank Vito, CPA (Audit Director)

Copies of this report have been distributed to the following:

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The Honorable Talmadge Heflin, House Appropriations Committee
The Honorable Brian McCall, House Ways and Means Committee

Office of the Governor

The Honorable Rick Perry, Governor

Entities Mentioned in this Report

Chancellors, Members of the Boards, Presidents, and Executive Directors
of all agencies, universities, and community college districts



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