

Table of Contents

A Report on State Agencies' and Universities' Compliance With the Texas Public Funds Investment Act

May 1997

Key Points of Report

Executive Summary	1
--------------------------------	---

Section 1:

Substantial Compliance With the Public Funds Investment Act Was Reported in the First Year of Implementation; However, Improvements Are Possible at Most of the Entities	4
---	---

New or Revised Investment Policies Are Now in Place at 30 Entities; However, 12 Entities Still Reported Some Noncompliance	6
--	---

Fifteen Entities Reported Weaknesses in Controls Over Investment Activity	8
---	---

Fifteen Entities Reported That Quarterly Investment Reports Did Not Always Contain the Information Required by the Act	9
--	---

Five Entities Reported Deficiencies Related to Ethics Policies and Conflict of Interest Documents	10
---	----

Eight Entities Reported That Board Members and/or Designated Investment Officers Did Not Meet the Minimum Training Requirements	10
---	----

Six Entities Reported Noncompliance With Requirements for Signed Broker/Dealer Acknowledgments, and Two Reported Noncompliance with Competitive Bid Requirements	11
--	----

Three Agencies Did Not Submit Audited Compliance Information	12
--	----

Section 2:

While Improvement Has Been Made, Certain Portfolios Continue to Hold Significant Concentrations of CMOs	13
--	----

Table of Contents, concluded

Most Universities That Had High Concentrations of Volatile Derivatives in July 1994 Continue to Have a High Percentage of Their Portfolio Invested in These Securities	14
--	----

Market Values, in Relation to the Corresponding Book Values, Have Slightly Improved Since July 1994	15
--	----

Section 3:

Some Enhancements to the Public Funds Investment Act Were Suggested by State Entities	16
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Appendices

1 - Objective, Scope, and Methodology	18
2 - Scope of the Public Funds Investment Act	19
3 - Summary of Audit Results and Investments From Entities Subject to the Act	22

Key Points of Report

A Report on State Agencies' and Universities' Compliance With the Texas Public Funds Investment Act

May 1997

Overall Conclusion

Based on our review of internal audit compliance reports submitted by 30 of 33 state entities subject to the Public Funds Investment Act (Act), it appears that substantial compliance was demonstrated in fiscal year 1996, the year of implementation. While 26 of these reports identified instances of noncompliance with at least one requirement of the Act, most of the entities had completed significant actions required to comply with the Act. (Figure 1 profiles the areas where noncompliance with provisions of the Act were reported.) The 33 entities held investments with a book value of nearly \$6.9 billion at August 31, 1996, or almost 7 percent of the State's total investments. This includes TexPool's \$4.4 billion investment portfolio.

Key Facts and Findings

- Investment policies have been improved at 30 entities as a result of the Act. Substantial compliance with the Act was reported by internal auditors. However, more improvements are needed. Revisions of investment policies are needed at 12 entities, while 15 entities need improvement in management controls over the investment function. Other compliance areas in need of improvement were also noted. Additionally, three agencies did not receive the required audit.
- The concentration of derivative investments in university portfolios appears to have decreased, and market values have improved slightly in relation to corresponding book values since the publication of a *Briefing Report on Derivative Investments by Texas State Entities* (SAO Report No. 95-035, December 1994). The decreases were due primarily to increases in total investment portfolio balances.
- Enhancements to the Public Funds Investment Act were suggested by various state entities. These included establishing minimum portfolio criteria for applicability of the Act and clarifying other issues.

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This compliance audit was conducted in accordance with the Public Funds Investment Act, Government Code, Chapter 2256.005 (m).

Executive Summary

Fiscal year 1996 appeared to be a year of transition as most investing entities prepared or revised investment policies to comply with the Public Funds Investment Act (Act). By the close of calendar year 1996, 15 agencies and 15 universities had prepared or revised investment policies and procedures. However, 26 state agency and university internal audit reports identified improvements needed to strengthen controls over the investment function. Effective controls are essential in managing the investment of public funds as market conditions change and demands on state resources increase.

The 74th Legislature amended the Public Funds Investment Act (Chapter 2256, Government Code) to ensure that entities establish these management controls for the protection of public funds. These steps were taken after some entities reported high concentrations of collateralized mortgage obligations (CMOs) in their investment portfolios. These CMOs experienced dramatic decreases in market value, which significantly impacted various portfolios after interest rates rose several times in calendar year 1994.

An annual compliance audit of management controls and adherence to established investment policies is now required by the Act. These internal audit results are required to be reported to the State Auditor's Office. In most cases, internal auditors conducted the fieldwork to assess compliance with the Act.

Substantial Compliance With the Public Funds Investment Act Was Reported in the First Year of Implementation

The State Auditor's Office received reports from 30 of 33 state investing entities subject to the Act. Three agencies did not receive the required audit (see Section 1-G). The Hospital Equipment Financing Council and the Board

of Law Examiners had extenuating circumstances for not submitting an audit. The Parks and Wildlife Department did not perform the audit because the legislation was unclear as to whose responsibility it was.

These 33 entities represent \$6.9 billion, or almost 7 percent, of the State's total investments. Entities which hold over 90 percent of the State's investments are specifically exempted from the Act. Additionally, entities which represent approximately 2 percent of the State's investments indicated their funds were not covered by the Act (see Appendix 2).

Opportunities to Improve Still Exist

The internal audit reports indicated that several noncompliance and control weakness issues still exist at most state investing entities. The reports also indicated that significant concentrations of CMOs in certain investment portfolios continue to impact investment management decisions. Management responses contained in the audit reports indicate a willingness to take corrective action in order to comply with the Act and to support prudent investment activity.

Some Enhancements to the Act Were Suggested by State Entities

Suggestions to enhance the Public Funds Investment Act included:

- Establishing minimum portfolio criteria so that entities with less than a specified amount of investments would not be subject to the Act
- Specifically identifying the investing entity's responsibility regarding the annual compliance audit

Executive Summary

- Clarifying investments authorized by the Act as compared with those investments authorized by the Education Code
- Addressing questions arising from donated investments, which may be unauthorized investments under the Act
- Defining the term “public funds” as it applies to those funds subject to the Act, specifically trust funds held for the benefit of individuals

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Substantial Compliance With the Public Funds Investment Act Was Reported in the First Year of Implementation; However, Improvements are Possible at Most of the Entities

Based on our review of internal audit compliance reports submitted by 30 of 33 state agencies and universities subject to the Act, it appears that substantial compliance was demonstrated in fiscal year 1996, the year of implementation. While 26 of these reports identified instances of noncompliance with at least one requirement of the Act, most of the entities had completed significant actions required to comply with the Act. (Figure 1 profiles the areas where noncompliance with provisions of the Act were reported.) Additionally, 30 entities now have new or revised investment policies in place as a result of the Act. Three entities did not submit audited information needed to determine compliance with the Act. Therefore, no information on noncompliance with significant requirements of the Act is included for those entities.

The 33 entities held investments with a book value of nearly \$6.9 billion at August 31, 1996, or almost 7 percent of the State's total investments. One portfolio, TexPool, with \$4.4 billion in investments, composes 4 percent of the State's total investments.

The Act requires investing agencies and universities to maintain and adhere to written investment policies which set forth specific requirements regarding:

- Internal Controls
- Quarterly investment reports
- Ethics policies and documentation of conflicts of interest
- Training of Investment Officers
- Signed broker/dealer acknowledgments and competitive bidding

Figure 1

Investing Entity	Market Value of Portfolio at August 31, 1996	Investment Policies in Noncompliance	Control Weaknesses	Quarterly Reports in Noncompliance	Ethics Policies and Conflict of Interest Documents Not Complete	Training Requirements for Board Members and Investment Officers Not Met	Broker/Dealer Documents and Competitive Bidding Requirements Not Met
Texas Local Government Investment Pool (TexPool)	\$ 4,402,631,000						
Texas Department of Housing and Community Affairs	\$ 747,940,419	X		X		X	
Texas Turnpike Authority	\$ 616,994,027		X			X	
Texas Water Development Board	\$ 460,067,361	X		X			
University of North Texas	\$ 94,088,949		X				
Department of Commerce	\$ 79,507,733			X			

Investing Entity	Market Value of Portfolio at August 31, 1996	Investment Policies in Noncompliance	Control Weaknesses	Quarterly Reports in Noncompliance	Ethics Policies and Conflict of Interest Documents Not Complete	Training Requirements for Board Members and Investment Officers Not Met	Broker/Dealer Documents and Competitive Bidding Requirements Not Met
Southwest Texas State University	\$ 70,578,003		X	X			X
Angelo State University	\$ 69,963,109		X				
Texas Woman's University	\$ 53,392,699		X			X	
Department of Criminal Justice	\$ 50,399,525		X		X		X
Sam Houston State University	\$ 43,525,389	X	X	X			
Stephen F. Austin State University	\$ 21,613,091	X	X	X			X
State Bar of Texas	\$ 21,126,393			X		X	
Lamar University- Beaumont	\$ 19,650,936		X	X	X		X
Midwestern State University	\$ 19,439,119						
East Texas State University	\$ 18,320,654						
Texas Southern University	\$ 12,950,439	X	X	X	X	X	X
University of North Texas Health Science Center	\$ 11,038,046					X	
Texas Hospital Equipment Financing Council	\$ 9,590,621	No Audit Performed					
Sul Ross State University	\$ 8,520,476		X				
Texas National Guard Armory Board	\$ 7,844,219			X	X	X	X
Texas Parks and Wildlife	\$ 6,624,163	No Audit Performed					
Texas National Research Laboratory Commission	\$ 6,064,320	X	X				
Department of Banking	\$ 5,734,133	X	X	X			X
Texas State Technical College	\$ 4,086,393						
Texas Real Estate Commission	\$ 2,512,875	X					
Texas Board of Law Examiners	\$ 1,855,278	No Audit Performed					
Lamar University - Orange	\$ 1,620,342		X	X			
Lamar University - Port Arthur	\$ 1,609,872		X	X			
Texas Youth Commission ^A	\$ 617,146	X				X	
Texas School for the Blind and Visually Impaired	\$ 210,700	X		X	X		X
Office of the Attorney General	\$ 193,477	X					

Investing Entity	Market Value of Portfolio at August 31, 1996	Investment Policies in Noncompliance	Control Weaknesses	Quarterly Reports in Noncompliance	Ethics Policies and Conflict of Interest Documents Not Complete	Training Requirements for Board Members and Investment Officers Not Met	Broker/Dealer Documents and Competitive Bidding Requirements Not Met
Texas School for the Deaf	\$ 10,582	X		X			
^A The Texas Youth Commission reports that its funds are not subject to the Public Funds Investment Act, but the agency has chosen to comply with the law voluntarily. The Commission indicated that the funds it maintains are trusts held for the benefit of orphaned children, not for the benefit of the State or the state agency. Therefore, the Commission interprets these investments to be non-public funds. Because the Commission submitted its internal audit, the results are included in this report.							

Source: Internal Audit Reports

Section 1-A:

New or Revised Investment Policies Are Now in Place at 30 Entities; However, 12 Entities Still Reported Some Noncompliance

New or revised investment policies were reported to be in place at 30 of the agencies that submitted information:

- 16 governing boards adopted new or revised investment policies in fiscal year 1995 or the first quarter of fiscal year 1996.
- 13 governing boards adopted new or revised investment policies in the three remaining quarters of the fiscal year.
- 1 entity, the Texas National Guard Armory Board, adopted its investment policy in the first quarter of fiscal year 1997, more than one year after the effective date of the Act.

Some of the 16 entities adopted their policies within one quarter after the required implementation date. This short delay in reviewing, preparing, revising, and adopting investment policies seems reasonable given the magnitude of the revisions and the detailed information mandated for investment policies.

The remaining 14 entities' untimely adoption of investment policies represented noncompliance with the requirements of the Act. The Act required implementation to be effective September 1, 1995. Explanations for the lack of timeliness in adopting these policies were not documented in the internal audit reports. (Figure 2 provides more information as to the dates on which these 14 entities adopted their new or revised investment policy.)

In addition, 12 entities reported some noncompliance related to the policies adopted.

Two agencies had inadequate or no formal investment policies. These agencies had extenuating circumstances as noted below:

- **Texas National Research Laboratory Commission (Commission)** - The Commission's investment policy did not comply with significant provisions of the Act. However, the internal audit report on the Commission does not recommend action to amend the policy, unless the Commission obtains significant investments in the future. The Commission does not anticipate additional funds for investments since the Superconducting Supercollider Project was canceled by the Federal Government. The internal audit report also notes that the Commission will liquidate most of its investments in final settlement of certain debts in the near future.
- **Office of the Attorney General (Office)** - In the normal course of operations, the Office would not be an investing entity. However, the Office oversees investments as a result of maintaining an account established to invest the State's share of retainage from a contractor due for the development of a new automated child support system.

While the Office has not adopted an investment policy because of this special circumstance, it did submit an internal audit report stating that the controls for the investments are contained in the State's contract with the vendor. Funds are deposited in the Texas Treasury Safekeeping Trust Company, and controls have been established in the Office's Accounting Division to manage the investment account.

Two entities reported holding investments which violated provisions of investment policies required by the Act. In each instance, the entity cites extenuating circumstances for the noncompliance:

- **Texas School for the Deaf** - Its investment portfolio holds investments that are not authorized; however, these investments were donated.
- **Texas Department of Banking** - Holds deposit accounts (time accounts and certificates of deposits) that were issued by financial institutions domiciled in other states, which are not authorized investments under the Act. However, these investments were obtained in a trust company failure in 1994, under the liquidation of a court-appointed receiver.

Less significant instances of noncompliance with the Act's provisions, specifically the maintenance of or adherence to investment policies, were reported at eight other investing entities. Further details regarding noncompliance at individual investing entities are reported in Appendix 3.

Figure 2

Entities with Investment Policies Adopted After November 1995			
Investing Entity	Policy Adopted	Investing Entity	Policy Adopted
Midwestern State University	revised August 1996	Department of Criminal Justice	March 1996
Stephen F. Austin State University	April 1996	National Guard Armory Board	November 1996
Texas State Technical College	revised April 1996	Texas National Research Laboratory Commission	revised June 1996
Department of Banking	June 1996	Texas Real Estate Commission	revised November 1996
State Bar of Texas	revised January 1996	Texas School for the Deaf	July 1996
Texas Board of Law Examiners	July 1996	Texas Water Development Board	revised May 1996
Department of Commerce	August 1996, revised November 1996	Texas Youth Commission	May 1996

Source: Internal Audit Reports

Section 1-B:

Fifteen Entities Reported Weaknesses in Controls Over Investment Activity

Management controls over the investment function require improvement at 15 state agencies and universities. These entities are identified in Figure 1. (Specific control weaknesses are identified by individual state agency and university at Appendix 3 of this report.)

The compliance reports identified weaknesses related to the lack of:

- Written procedures
- Segregated job duties
- Monthly investment reconciliations
- Formal and/or meaningful cash flow projections
- Documented investment monitoring processes

These controls, in conjunction with those mandated by the Act, would provide assurances that state agencies and universities are managing the investment of public funds in the best interest of the State's taxpayers. Given the changing environment of the investments industry, it is imperative that managers of public funds maintain strong internal controls and adhere to the requirements set forth in the Act.

Section 1-C:

Fifteen Entities Reported That Quarterly Investment Reports Did Not Always Contain the Information Required by the Act

Fifteen entities reported instances of noncompliance with the Act's reporting requirements. The Act requires quarterly reports to provide necessary information to governing boards and senior management for their monitoring and oversight of investment activity. Without these required quarterly reports, governing boards may not be fully informed when making decisions regarding the investment of public funds.

In fiscal year 1996, quarterly reports were not prepared by:

- Texas Southern University
- Texas Department of Commerce
- Texas School for the Deaf

Six entities reported untimely submission of quarterly reports to the governing boards:

- Lamar University - Beaumont
- Lamar University - Orange
- Stephen F. Austin State University
- Texas Department of Banking
- Texas Department of Housing and Community Affairs
- Texas School for the Blind and Visually Impaired

Insufficient disclosure and/or omission of required information, such as weighted average maturity of the portfolio, the maturity dates, book values and market values, and signature(s) of the investment officer(s) were noted at 11 entities:

- Lamar University - Beaumont
- Lamar University - Orange
- Lamar University - Port Arthur
- Sam Houston State University
- Southwest Texas State University
- Stephen F. Austin State University
- State Bar of Texas
- Texas Department of Housing and Community Affairs
- Texas National Guard Armory Board
- Texas School for the Blind and Visually Impaired
- Texas Water Development Board

Section 1-D:

Five Entities Reported Deficiencies Related to Ethics Policies and Conflict of Interest Documents

One investing entity had not established an ethics policy. Four entities reported that disclosures regarding the existence or nonexistence of personal business relationships were not filed by investment officers as required by the Act and/or each entities' individual investment policies. However, no issues related to inappropriate behavior or personal business relationships were reported.

The five entities and the reported weaknesses were:

- **Texas School for the Blind and Visually Impaired** - Neither an ethics policy nor references to ethical behavior are in the investment policy.
- **Lamar University - Beaumont** - Disclosures were not filed with the Texas Ethics Commission or the Texas State University System office.
- **Texas Southern University** - Officials with investment responsibility did not have disclosure statements on file.
- **Texas Department of Criminal Justice** - Signed statements on ethical standards or disclosure of conflicts of interest with respect to the three portfolios managed by the Texas Department of Criminal Justice are not required.
- **Texas National Guard Armory Board** - The Investment Officer did not sign an ethics or conflict of interest statement.

Section 1-E:

Eight Entities Reported That Board Members and/or Designated Investment Officers Did Not Meet the Minimum Training Requirements

Eight investing entities reported noncompliance with the minimum training requirements stipulated in the Act. Each member of the governing board of a state agency or university and its investment officer are required to attend at least one training session relating to the person's responsibilities under the Act.

Training must include education in investment controls, security risks, strategy risks, market risks, and compliance with the Act. This requirement was intended to provide governing boards with information regarding their roles and responsibilities with respect to the prudent investment of public funds and compliance with applicable state laws.

The eight entities and personnel that did not meet training requirements were:

- **University of North Texas Health Science Center** - Investment Officer
- **Texas Southern University** - De facto Investment Officer and six of nine Board Members
- **Texas Woman's University** - Board Members (internal audit report did not provide number)
- **State Bar of Texas** - Board Members (internal audit report did not provide number)
- **Texas Department of Housing and Community Affairs** - Three of nine Board Members and two of three Investment Officers
- **Texas National Guard Armory Board** - Investment Officer and one Board Member
- **Texas Turnpike Authority** - 5 of 12 Board Members
- **Texas Youth Commission** - 2 of 6 Board Members

Section 1-F:

Six Entities Reported Noncompliance With Requirements for Signed Broker/Dealer Acknowledgments, and Two Reported Noncompliance With Competitive Bidding Requirements

Six investing entities did not obtain signed acknowledgments from brokers or dealers seeking to sell investments to the entities, and exceptions to competitive bidding requirements were noted at two universities. The six entities were:

- Stephen F. Austin State University
- Texas Southern University
- Texas Department of Banking
- Texas Department of Criminal Justice
- Texas National Guard Armory Board
- Texas School for the Blind and Visually Impaired

The Act requires that a written copy of the investment policy be presented to any person or business seeking to sell investments to the entity. An investment officer may not buy securities from a person or organization that has not signed a statement acknowledging:

- “receipt and thorough review of the entity’s investment policy”
- Implementation of “reasonable procedures and controls in an effort to preclude imprudent investment activities arising from investment transactions conducted between the entity and the organization”

In addition, exceptions to competitive bidding requirements, established by governing boards, were noted at two universities:

- **Lamar University - Beaumont** - Two competitive bids were sought in July 1996. The internal audit report indicates that, although the investment policy requires written justification and Board approval when at least three competitive bids are not obtained, this policy was not followed.
- **Southwest Texas State University** - On two separate occasions (November 1995 and February 1996), the University obtained bids for the sale of CMOs from brokers/dealers that had not been approved by the Texas State University System Board of Regents. On both occasions, the sales were awarded to the high bidder, who was also the dealer that originally sold the CMOs to the University. The dealer was approved by the Board of Regents about three weeks after the second sales transaction took place.

Section 1-G:

Three Agencies Did Not Submit Audited Compliance Information

The three entities are:

- **Texas Parks and Wildlife Department** - An audit of compliance with the Act was not performed. The Texas Parks and Wildlife Department did respond with information on its portfolio composition. Its investment in equities raises questions regarding compliance, because equity securities are not authorized investments for state agencies.

The Texas Parks and Wildlife Department should place emphasis on ensuring that policies and procedures are in place to implement state laws in a timely manner.

- **Texas Board of Law Examiners** - The Texas Board of Law Examiners did not conduct a review of compliance with the Act in the manner required. The Texas Board of Law Examiners, which does not have an internal audit function, interpreted the compliance audit requirement to mean the review of compliance could be conducted internally. The Executive Director and Chief Accountant submitted a letter indicating that no areas of noncompliance were noted during their internal review and identified the date the investment policy was adopted.
- **Texas Hospital Equipment Financing Council** - The risks resulting from noncompliance with the Act were sufficiently low and, thus, no audit was performed. The invested funds, according to the Texas Hospital Equipment Financing Council's documents, are subject to a trustee's investment agreement and are guaranteed by an independent third party guarantor. The State Auditor's Office determined that the risk to the State was minimal if no audit was performed.

While Improvement Has Been Made, Certain Portfolios Continue to Hold Significant Concentrations of CMOs

Derivatives are financial instruments (security or contract) whose value is linked to, or "derived from," changes in interest rates, currency rates, and stock and commodity prices.

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
- The current economic climate
- The geographic makeup of the underlying mortgage loans

Currently, CMO maturities are still extended and market values continue to remain below book values. Monitoring of these portfolios is necessary to continuously determine the impact of these investments on the total portfolio and implement changes in investment strategies as interest rates change.

The 74th Legislature passed the Public Funds Investment Act subsequent to the identification of problems associated with derivative investments held by public entities. Since the publication of a *Briefing Report on Derivative Investments by Texas State Entities* (SAO Report No. 95-035, December 1994) on derivative investments held by Texas state universities, the concentration of derivative investments in university portfolios appears to have decreased, and market values have improved slightly in relation to corresponding book values as a result of the increase in overall investment portfolio balances.

In December 1994, the State Auditor's Office reported that investment portfolios at eight universities indicated more than 25 percent of their investments were in highly volatile collateralized mortgage obligations (CMOs). Five of these eight universities still have more than 25 percent of their total investment portfolios in derivatives. While the concentration of derivatives at all eight universities has decreased, the declines were primarily due to increases in total investment portfolio balances.

Some entities holding these investments have developed divestment plans to help them make decisions regarding the sale of these investments prior to maturity. This requires frequent monitoring of market values so that windows of opportunity are not missed if market conditions appear conducive for the sale of these investments.

Those entities that have not prepared investment strategies or divestment plans for their CMO portfolios should consider this option to prevent liquidity problems. Unfavorable investment yields could also result if short-term investments are the only options available to entities due to the concentration of CMOs in the overall portfolio.

Section 2-A:

Most Universities That Had High Concentrations of Volatile Derivatives in July 1994 Continue to Have a High Percentage of Their Portfolios in These Securities

Mortgage Derivatives are subject to "extension risk," which causes the maturity of the investment to extend as interest rates rise. In a period of low interest rates, many people refinance mortgage loans, thereby paying off the outstanding balance and shortening the period to maturity. High interest rates, however, lead more people to forego refinancing, thus extending the period to maturity.

Five of the eight universities that previously held more than 25 percent of their total investment portfolios in highly volatile derivatives at July 31, 1994, continue to do so. However, the percentage of the portfolio invested in derivatives at these universities has declined, resulting from both an increase in overall investment balances and a reduction in the derivatives held. Most institutions sold a portion of the CMOs they previously held and some of these investments matured, contributing to the decrease of CMOs in these portfolios.

Angelo State University reported an increase in the concentration of derivatives in its portfolio since July 31, 1994. However, Angelo State University reported that a gift, not a purchase, caused the increase of CMOs in its portfolio.

Figure 3 identifies the values and percentages of the portfolios of the nine universities that reported significant concentrations of CMOs in their portfolio balances.

Figure 3

Comparison of CMOs to Total Portfolio Balances								
Institution	Book Value at July 31, 1994			CMO Market Value July 31, 1994	Book Value at August 31, 1996			CMO Market Value August 31, 1996
	Total Portfolio	CMOs	% of CMOs		Total Portfolio	CMOs	% of CMOs	
University of North Texas Health Science Center	\$11,995,747	\$10,360,366	86.4%	\$6,143,749	\$15,017,803	\$10,284,695	68.5%	\$6,304,938
Midwestern State University	\$12,220,853	\$10,302,680	84.3%	\$6,303,393	\$22,221,297	\$8,887,983 ^A	40.0 %	\$6,137,248
East Texas State University	\$21,162,214	\$16,728,021	79.0%	\$9,093,754	\$23,961,243	\$13,825,825	57.7%	\$8,202,357
Southwest Texas State University	\$54,707,901	\$34,154,321	62.4%	\$21,553,596	\$76,853,021	\$29,209,757	38.0%	\$21,262,008
Sul Ross State University	\$9,416,280	\$4,113,575	43.7%	\$2,696,820	\$9,383,389	\$3,691,484	39.3%	\$2,825,728

Comparison of CMOs to Total Portfolio Balances								
Institution	Book Value at July 31, 1994			CMO Market Value July 31, 1994	Book Value at August 31, 1996			CMO Market Value August 31, 1996
	Total Portfolio	CMOs	% of CMOs		Total Portfolio	CMOs	% of CMOs	
Texas Woman's University	\$29,659,592	\$10,321,222	34.8%	\$6,610,357	\$55,081,230	\$8,036,361	14.6%	\$6,075,559
University of North Texas	\$67,955,537	\$19,597,481	28.8%	\$19,227,781	\$93,786,985	\$8,915,411	9.5%	\$8,810,008
Stephen F. Austin State University	\$10,600,000	\$2,867,522	27.0%	\$2,808,320	\$21,112,721	\$87,266 ^A (MBSs only)	0.4%	\$88,068
Angelo State University	\$70,189,303	\$6,487,295	9.2%	\$4,304,175	\$71,580,433	\$9,077,922 ^A	12.67%	\$7,465,163

Source: SAO Report No. 95-035; Portfolio composition forms submitted by each institution as of August 31, 1996 (unaudited)

^A For the purposes of this report, Collateralized Mortgage Obligations and Mortgage Backed Securities are combined under the category "CMOs". Mortgage Backed Securities (MBSs), created by pooling together individual borrowers' mortgage loans, are generally securitized through a federal government agency and do not carry the risk associated with CMOs. In 1996, three universities reported investments in Mortgage Backed Securities.

- Midwestern State University CMOs, as listed above, include \$175,903 in Mortgage Backed Securities.
- Stephen F. Austin State University reported Mortgage Backed Securities only.
- Angelo State University CMOs, as listed above, include \$2,677,322 in Mortgage Backed Securities.

Section 2-B:

Market Values, in Relation to the Corresponding Book Values, Have Slightly Improved Since July 1994

Among the nine universities mentioned in Section 2-A, the market values of the derivative investments have improved slightly in relation to corresponding book values. As of July 31, 1994, the market values of the CMOs ranged from a low of 54 percent of the book values at East Texas State University to a high of over 98 percent of the book values at the University of North Texas. Based on August 31, 1996, reported information, market values as a percentage of book values were between 59 percent at East Texas State University and 101 percent at Stephen F. Austin State University.

At August 31, 1996, CMOs held by these institutions totaled more than \$92 million. The majority of these CMOs are invested in inverse

floaters (\$68.9 million), CMOs with stated maturities greater than 10 years (\$10.6 million), and principal-only strips (\$5.5 million).

East Texas State University reported the highest amounts of unrealized losses (book value minus market value) on its CMOs for both July 1994 and August 1996. The CMOs held by East Texas State University were sold in October 1996 for an actual

Inverse floaters are CMOs whose coupon adjusts opposite to the changes in a market index.

Principal-only strips represent the principal stream of cash flow from the underlying mortgage-backed collateral and bear no interest rate.

loss of almost \$5.2 million. These investments were sold after East Texas State University merged with the Texas A&M System on September 1, 1996.

CMO Type	Book Value
Mortgage Backed Securities	\$2,922,492
Principal-Only Strips	\$5,514,311
Inverse Floaters	\$68,989,035
CMOs (Stated maturities > 10 years)	\$10,620,404
Other CMOs	\$3,970,461
TOTAL	\$92,016,704

Source: Portfolio composition forms as of August 31, 1996

The University of North Texas reported the lowest amount of unrealized losses among the eight institutions with more than 25 percent of their total investment portfolio concentrated in highly volatile derivatives. The market values of its derivatives were 98 percent and 99 percent of the book values at July 31, 1994, and August 31, 1996, respectively.

Stephen F. Austin State University reported market value greater than book value for the CMOs held at August 31, 1996. However, it had reduced its investment in derivatives from approximately \$2.8 million to approximately \$87,000.

Since the effective date of the Public Funds Investment Act (September 1, 1995), institutions are now prohibited from purchasing these investments. Entities that acquired these types of

CMOs prior to September 1, 1995, are not required to liquidate them before the final stated maturity of the investment.

Section 3:

Some Enhancements to the Public Funds Investment Act Were Suggested by State Entities

Suggestions to enhance the Public Funds Investment Act were obtained from investing entities subject to the Act as well as the State Auditor's Office. These changes or clarifications to the Act were the in following areas:

- Establish minimum portfolio criteria, so that entities with less than a specified amount of investments would not be subject to the Act. Some entities with smaller amounts of investments are concerned that the benefits of complying with the Act do not outweigh the costs associated with compliance and conducting the internal audit. This concern was noted primarily among entities with investments in certificates of deposit, interest-bearing checking accounts, and demand accounts.
- Specifically identify the investing entity's responsibility regarding the annual compliance audit requirement. Some entities did not conduct an audit for this project either because they did not interpret the Act to mean they were responsible for the audit, or because the entity did not have the staff to conduct the audit.

- Clarify the investments authorized by the Act as compared to the investment authority provided by Section 51.003 of the Education Code. The Act exempts endowment funds greater than \$95 million at May 31, 1995, whereas the Education Code appears to exempt entities whose endowment funds exceed \$25 million.
- Address questions arising from donated investments (such as certain CMOs) which are unauthorized investments under the Act. Several agencies and universities maintain unauthorized investments that were donated. The Act, however, does not address whether the entity must liquidate these assets or whether they may hold them until maturity.
- Define the term “public funds” as it applies to those funds subject to the Public Funds Investment Act. The definition of “public funds” has been interpreted not to include individuals’ trust funds, such as those held by:
 - Texas Youth Commission
 - Texas Department of Criminal Justice
 - Texas Department of Mental Health and Mental Retardation

Although the Texas Youth Commission and the Texas Department of Criminal Justice submitted internal audit reports, their reports did not include their trust fund investments. In addition, the Texas Youth Commission indicated that it was exempt from the Act, but had chosen to comply voluntarily. The legal counsel at the Texas Department of Mental Health and Mental Retardation indicated it is exempt from the Act, because its client trust funds were not public funds and all its other funds were held at the Treasury.

Objective, Scope, and Methodology

Objective

The objective of this project was to assess compliance with the Public Funds Investment Act among the 33 state agencies and universities subject to the Act.

Scope

The initial scope of this project included consideration of:

- Public Funds Investment Act (Government Code, Chapter 2256)
- Internal audit compliance reports submitted by state agencies and universities subject to the Act
- Investment policies of state agencies and universities subject to the Act
- Investment portfolio compositions for state agencies and universities subject to the Act

Methodology

Information was collected and analyzed, including:

- Internal audit compliance reports
- Portfolio compositions

Other Information

Fieldwork was conducted between October 1996 and February 1997. This project was conducted to satisfy the requirements set forth in the Public Funds Investment Act (Government Code, Chapter 2256.055, Section 9).

The project was performed by the following members of the State Auditor's staff:

- Dianne M. Oldroyd, CPA (Project Manager)
- Stanley W. Brumfield, Jr., CPA, MBA
- Debra K. Weyer, CGFM
- Denise F. Wieler, MPA
- Worth S. Ferguson, CPA (Quality Control Reviewer)
- Carol A. Smith, CPA (Audit Manager)
- Craig D. Kinton, CPA (Audit Director)

Scope of the Public Funds Investment Act

The Public Funds Investment Act requires state and local government investing entities to satisfy requirements regarding:

- Internal controls
- Quarterly reports
- Ethics and conflict of interest disclosures
- Training of investment officers
- Broker/dealer and competitive bidding arrangements

The statute requires agencies subject to the Act to submit an annual audit report on compliance: 14 agencies and 15 universities and TexPool submitted these reports. These entities hold nearly \$6.9 billion in investments, or almost 7 percent of the State's total investments (\$104.5 billion). TexPool's portfolio, which equals \$4.4 billion, composes 4 percent of the State's total investments.

Eleven state agencies and universities, with investments totaling almost \$95 billion (book value) at August 31, 1996, are exempt from the Act by reference in the statutes or the Texas Constitution. (These agencies and universities are listed in Figure 4.) These entities, which hold over 90 percent of the State's total investments, manage primarily pension funds, university endowment funds, and/or significant amounts of state funds.

The complexity involved with managing long-term portfolios, such as pension and endowment funds, creates the need to diversify investments to achieve desired goals and protect funds from significant market fluctuations. The significant amount of money held in the State's Treasury requires greater flexibility in the diversification of investments than is allowed in the Act. As a result, exemption from the Act is necessary to ensure these funds are managed prudently.

Figure 4

Entities Exempted From the Public Funds Investment Act by the Legislature				
Agency Number	Name of Investing Entity	Statutory Reference	Investments as of August 31, 1996	
			Book Value	Market Value
323	Teacher Retirement System ^A	2256.004(1)	\$ 49,876,257,324	\$ 49,876,257,324
310	State Treasury ^B	2256.004(2)		
	• Custodial Operations ^C		9,734,701,751	9,683,373,809
	• Departmental Operations ^D		1,211,521,312	1,258,841,855
	TOTAL - State Treasury		10,946,223,063	10,942,215,664
327	Employees Retirement System ^A	2256.004(1)	13,591,328,011	13,591,328,011
701	Texas Education Agency (Permanent School Fund)	Texas. Const. Article VII	9,985,111,542	12,842,908,102
799	The University of Texas System	2256.004(3)	8,389,977,158	9,192,467,990
798	Texas A&M University System	2256.004(3)	838,142,461	865,433,601

Entities Exempted From the Public Funds Investment Act by the Legislature				
Agency Number	Name of Investing Entity	Statutory Reference	Investments as of August 31, 1996	
			Book Value	Market Value
305	General Land Office	2256.004(4)	508,249,812	497,220,873
733/739	Texas Tech Texas Tech Health Sciences Center	2256.004(3)	\$289,649,273 \$170,250,891	\$288,980,561 \$168,452,904
783	University of Houston System	2256.004(3)	343,384,158	419,731,097
325	Fire Fighters' Pension Commissioner	2256.004(1)	17,265,185	19,431,448
TOTAL			\$ 94,955,838,878	\$ 98,704,427,575
<p>^A Pension Trust Funds, which compose most of the investment balances, are reported at market value on the financial statements of these entities. Book values were not reported.</p> <p>^B State Treasury merged with the Comptroller of Public Accounts on September 1, 1996.</p> <p>^C Custodial Operations includes the internal pool of investments managed by the Treasury and the investments made on behalf of the Lottery, which total more than \$1.1 billion.</p> <p>^D Departmental Operations consists of TexPool, Cigarette Stamp Tax Recovery Trust Fund, Texas Treasury Safekeeping Company Trust Fund, and the escrowed funds from defeased bonds of Texas Public Finance Authority, all of which are managed by the Treasury. TexPool, however, is subject to the Act. Therefore the figure listed here for Departmental Operations does not include TexPool.</p>				

Source: Fiscal year 1996 annual financial reports (unaudited)

Internal auditors and/or the legal counsels of 11 state investing entities indicated that their funds or a portion of their investments were not subject to the Act, although not specifically exempted by provisions of the Act or the Texas Constitution. These 11 entities held investments totaling more than \$2.7 billion (book value), or over 2 percent of the State's total investments. (Figure 5 lists the entities and a brief description of the basis of their exemption.)

Interpreting these additional exemptions was beyond the scope of this project, and may require a legal opinion or legislative clarification.

Figure 5

State Agencies Indicating They Were Exempt From the Public Funds Investment Act			
Agency	Portfolio		Reason Provided for Exemption
	Book Value	Market Value	
Texas Workers' Compensation Insurance Fund ^A	\$ 1,040,862,992	\$ 1,000,501,377	Enabling statutes provide that the Fund is not a state agency unless specifically mentioned in a statute.
Texas Department of Insurance (includes component unit reported in the annual financial report)	807,649,843	815,529,494	The Department has no statutory authority to invest the funds it report as investments. These investments represent statutory deposits from licensed companies and corporate agencies which are maintained to protect policyholders and other funds in the Catastrophic Reserve Trust Fund.
Texas Workforce Commission	774,661,302	774,661,302	These funds are deposited in the State's Treasury and the Federal Treasury and the Commission has no authority to invest them.

State Agencies Indicating They Were Exempt From the Public Funds Investment Act			
Agency	Portfolio		Reason Provided for Exemption
	Book Value	Market Value	
Texas Guaranteed Student Loan Corporation	73,447,665	73,280,776	The Corporation is not a state agency, holds no state or local funds, and has never received appropriation of funds from the State.
Texas Public Finance Authority	37,462,170	37,462,170	The State's Treasury has the authority to invest these funds.
Texas Department of Mental Health and Mental Retardation	6,808,687	6,808,687	Management indicated it did not perform an audit because its funds are maintained for patients and therefore are exempted from the Act as non-public funds accounts. The financial statements indicate that the funds are invested in certificates of deposits.
Texas Youth Commission	256,013	256,013	The Texas Youth Commission has similar client trust funds maintained for its clients. Texas Youth Commission submitted audit results, but the audits did not include these trust funds. The financial statements indicate that the funds are in demand deposit accounts.
Texas Department of Criminal Justice	8,620,227	8,620,227	Texas Department of Criminal Justice has trust funds for its inmates. These funds were excluded from the audit report the Department submitted for its investments. The financial statements indicate that these funds are in demand deposits and certificate of deposits.
Texas Higher Education Coordinating Board	8,982,454	8,982,454	These funds are deposited in the Treasury and the Texas Treasury Safekeeping Trust Company. Since these funds are managed by the Treasury, the Coordinating Board indicates it has no funds subject to the Act. However, the Trust Company does provide agencies the ability to direct investment decisions through the funds management agreement.
Texas Commission on the Arts	3,468,363	3,468,363	The enabling statutes grant the Commission more investment authority than that provided by the Act.
State Preservation Board	2,108,313	2,108,313	Although the Board has the authority to direct investments, it has not exercised this authority. The Board has explicitly or implicitly agreed with investment decisions made at the Texas Treasury Safekeeping Trust Company, where the funds are held.
TOTAL	\$2,764,328,029	\$2,731,679,176	

Source: Fiscal year 1996 annual financial reports and documentation provided by the state agencies listed above (unaudited).

^Information for Texas Workers' Compensation Fund is as of December 31, 1994.

Summary of Audit Results and Investments From Entities Subject to the Act

Angelo State University

Angelo State University's investments total almost \$71.6 million, including the \$44.9 million that is managed by the Carr Foundation. Investments for Angelo State University are listed by category in the following table:

Angelo State University Portfolio Composition		
Investment Type	August 31, 1996	
	Book Value	Market Value
Certificates of Deposit	\$ 198,000	\$ 198,000
Investment Pools	\$17,520,314	\$17,518,465
U.S. Government Agencies	5,790,263	5,701,231
U.S. Government Securities	11,425,735	11,031,342
Collateralized Mortgage Obligations ^A	9,077,922	7,465,163
No-Load Mutual Fund	8,416,432	7,734,539
Equities	3,926,103	5,174,476
Corporate Bonds/Debt Obligations	14,499,537	14,138,144
Other Investments	726,127	731,749
TOTAL	\$ 71,580,433	\$ 69,693,109

Source: Angelo State University

^A For the purposes of this report, Collateralized Mortgage Obligations and Mortgage Backed Securities are combined under the category "CMOs". Mortgage Backed Securities (MBSs), created by pooling together individual borrowers' mortgage loans, are generally securitized through a federal government agency and do not carry the risk associated with CMOs. Angelo State University CMOs, as listed above, include \$2,677,322 in Mortgage Backed Securities.

The internal audit report concludes that Angelo State University's investment activities appear to comply with the investment policy and other relevant documents. It does note, however, that improvements are needed to enhance the controls over the safety deposit box where donated stocks and bonds are kept. Internal auditors recommend that a record of the safety deposit box's contents be maintained and that two employees be present when the box is opened.

East Texas State University

The East Texas State University campuses at Commerce and Texarkana reported investments totaling \$23.9 million at August 31, 1996. More than \$13 million of these funds were invested in inverse floaters, a type of collateralized mortgage obligation. As of September 1, 1996, management and responsibility for the investments of East Texas State University were transferred to the Texas A&M University System. In October 1995, the Texas A&M University System sold these inverse floaters, which resulted in a loss of almost \$5.2 million to East Texas State University.

East Texas State University's portfolio composition is shown in the following table:

East Texas State University Portfolio Composition		
Investment Type	August 31, 1996	
	Book Value	Market Value
Investment Pools (TexPool)	\$ 7,224,548	\$ 7,224,548
U.S. Government Securities	424,625	407,504
Collateralized Mortgage Obligations	13,825,825	8,202,357
Other Investments	2,486,245	2,486,245
TOTAL	\$ 23,961,243	\$ 18,320,654

Source: East Texas State University

The internal audit report states that no evidence of material noncompliance with the Public Funds Investment Act was found at East Texas State University.

Lamar University - Beaumont

Lamar University - Beaumont reported investments of almost \$19.2 million as of August 31, 1996, the majority of which is invested in TexPool and U.S. Government agencies. Lamar University - Beaumont's investment portfolio is reflected in the following table:

Lamar University - Beaumont Portfolio Composition		
Investment Type	August 31, 1996	
	Book Value	Market Value
Certificates of Deposit	\$ 491	\$ 495
Investment Pool (TexPool)	10,506,530	10,506,530
U.S. Government Agencies	6,410,165	6,461,358
Equities (Common Fund)	2,282,234	2,682,553
TOTAL	\$ 19,199,420	\$ 19,650,936

Source: Lamar University - Beaumont

Key findings resulting from the audit required under the Act were identified in the internal audit report. These issues were reported as follows:

- The investment monitoring process is not documented.
- Quarterly investment reports do not disclose compliance with the Texas State University System policy or the weighted average maturity of the portfolio.
- There is a lack of meaningful cash flow projections.
- Investment transactions are not recorded in a timely manner.

- Review of the reconciliations of the investment subsidiary ledger are not documented.

Lamar University - Orange

Lamar University - Orange reported total investments of about \$1.6 million, all of which is invested in TexPool.

Lamar University - Orange Portfolio Composition		
Investment Type	August 31, 1996	
	Book Value	Market Value
Investment Pool (TexPool)	\$ 1,620,342	\$ 1,620,342
TOTAL	\$ 1,620,342	\$ 1,620,342

Source: Lamar University - Orange

The internal audit report noted the following conditions with respect to Lamar University - Orange's investments function:

- Quarterly investment reports did not disclose compliance with Texas State University System policy or the weighted average maturity of the portfolio. In addition, these reports were not submitted in a timely manner.
- Formal cash flow projections were not prepared and submitted to the President and the Texas State University System office as required by policy.
- The portfolio's weighted average rate of return (4.81 percent) was lower than the benchmark (5.25 percent) established by the Lamar University - Orange.

Lamar University - Port Arthur

The investment portfolio for Lamar University - Port Arthur had a book value of almost \$1.6 million at August 31, 1996. The composition of the portfolio is reflected in the following table:

Lamar University - Port Arthur Portfolio Composition		
Investment Type	August 31, 1996	
	Book Value	Market Value
Investment Pool (TexPool)	\$ 625,462	\$ 625,462
U.S. Government Securities	\$ 973,654	\$ 984,410
TOTAL	\$ 1,599,116	\$ 1,609,872

Source: Lamar University - Port Arthur

The following issues related to the investments function at Lamar University - Port Arthur were identified in the internal audit report:

- Compliance with the Texas State University System investment policy and the Public Funds Investment Act was not disclosed on the quarterly investments reports. In addition, the quarterly investment reports did not include the weighted average maturity of the portfolio.
- Formal cash flow projections were not prepared and submitted to the President and the Texas State University System office, as required by policy.
- Reviews of monthly reconciliations of the investment subsidiary ledger were not documented.

Midwestern State University

Midwestern State University reports a total portfolio of more than \$22.2 million as of August 31, 1996. The University's investment in collateralized mortgage obligations decreased from \$10.3 million as of July 31, 1994, to \$8.9 million at August 31, 1996. In addition, the total balance of the portfolio increased from \$12.2 million to \$22.2 million during the same time period. The total portfolio composition is shown in the following table:

Midwestern State University Portfolio Composition		
Investment Type	August 31, 1996	
	Book Value	Market Value
Investment Pools - TexPool and LOGIC	\$ 3,637,974	\$ 3,637,636
U.S. Government Securities	4,113,402	4,113,430
U.S. Government Agencies	5,581,938	5,550,805
Collateralized Mortgage Obligations ^A	8,887,983	6,137,248
TOTAL	\$ 22,221,297	\$ 19,439,119

Source: Midwestern State University

^A For the purposes of this report, Collateralized Mortgage Obligations and Mortgage Backed Securities are combined under the category "CMOs". Mortgage Backed Securities (MBSs), created by pooling together individual borrowers' mortgage loans, are generally securitized through a federal government agency and do not carry the risk associated with CMOs. Midwestern State University CMOs, as listed above, include \$175,903 in Mortgage Backed Securities.

The internal audit report of Midwestern State University's investment function reported that it is in compliance with the Public Funds Investment Act, the investment policy is appropriate and being followed, and the controls over investment activities are adequate.

Sam Houston State University

Sam Houston State University (University) reported a total portfolio of \$43.8 million as of August 31, 1996. Of that amount, \$15.1 million was invested in TexPool and almost \$23.9 million was invested in long-term U.S. Government Agencies, exceeding

the University's concentration target for these investments. The University's portfolio composition is shown in the following table:

Sam Houston State University Portfolio Composition		
Investment Type	August 31, 1996	
	Book Value	Market Value
No-Load Mutual Fund	\$ 10,000	\$ 28,759
Investment Pool (TexPool)	15,140,880	15,139,820
U.S. Government Securities	927,291	857,313
U.S. Government Agencies	27,205,623	26,963,817
Equities	45,097	45,221
Other Investments	492,720	490,459
TOTAL	\$ 43,821,611	\$ 43,525,389

Source: Sam Houston State University

The following issues related to the University's investments function were identified in the internal audit report:

- The weighted average maturity of the portfolio was not disclosed in the quarterly investment reports.
- Formal cash flow projections were not prepared and submitted to the President or the Texas State University System office on a quarterly basis. The University does monitor cash information daily.
- On at least three occasions, securities were not released from safekeeping in accordance with policy. Although the investment policy requires two signatures to release securities from safekeeping, only one signature was obtained in three instances.
- During fiscal year 1996, the University maintained a higher concentration of U.S. Government Agency securities in its portfolio than is allowed in the University and the Texas State University System investment policies. Although the University's investment policy allows no more than 50 percent of the portfolio to consist of U.S. Government Agency securities, these securities represented between 62 percent and 65 percent of the portfolio during the fiscal year.
- Monthly reconciliations of the investment subsidiary ledger were not reviewed periodically by the University's Internal Auditor, as required by the investment policy.

Southwest Texas State University

Southwest Texas State University reported a total portfolio of about \$76.8 million as of August 31, 1996. The major portion of the portfolio consists of investments in TexPool (\$40 million) and collateralized mortgage obligations (\$29.2 million). The book value of the collateralized mortgage obligations shows some decrease from \$34.1 million as of July 31, 1994, to \$29.2 million at August 31, 1996. However, very little difference in market value occurred as these investments were valued at \$21.5 million as of July 31, 1994, and almost \$21.3 million on August 31, 1996. The total portfolio for Southwest Texas State University is reflected in the following table:

Southwest Texas State University Portfolio Composition		
Investment Type	August 31, 1996	
	Book Value	Market Value
Investment Pools - TexPool	\$ 40,003,185	\$ 40,000,550
U.S. Government Securities	4,771,566	4,796,635
Collateralized Mortgage Obligations	29,209,757	21,262,008
Equities	131,285	159,904
The Common Fund	2,695,571	4,317,023
Other Investments	41,657	41,883
TOTAL	\$ 76,853,021	\$ 70,578,003

Source: Southwest Texas State University

The following conditions related to controls and noncompliance with the Public Funds Investment Act were identified in the internal audit report:

- The University does not have meaningful cash flow projections. The projections are not considered high priority since the University's available cash is currently deposited in TexPool.
- On two separate occasions (November 1995 and February 1996), the University obtained bids for the sale of CMOs from brokers/dealers that had not been approved by the Texas State University System Board of Regents. Both times, the sales were awarded to the high bidder, who was also the dealer that originally sold the CMOs to the University. The dealer was approved by the Board of Regents nearly three weeks after the second sales transactions took place.
- Two signatures were not always obtained, as required by policy, when the University transferred funds to or from TexPool.
- Appropriate signatures were not always obtained when the University released investments that were sold from safekeeping.
- The quarterly investment reports did not include the weighted average maturity of the portfolio. In fact, the University does not presently know the

weighted average maturity of the portfolio, according to the internal audit report.

- Reconciliations of the investment subsidiary ledger were not reviewed, as required by policy.

Stephen F. Austin State University

A total portfolio balance of \$21.1 million was reported by Stephen F. Austin State University (University) as of August 31, 1996. Most of the balance consisted of investments in no-load money market mutual funds and U.S. Government Securities, as indicated in the following table:

Stephen F. Austin State University Portfolio Composition		
Investment Type	August 31, 1996	
	Book Value	Market Value
Certificates of Deposit	\$ 459,600	\$ 459,600
No-Load Money Market Mutual Fund	7,952,083	7,952,083
Investment Pool (TexPool)	77,352	77,352
U.S. Government Securities	10,643,609	10,444,126
Collateralized Mortgage Obligations ^A	87,266	88,068
Equities	1,833,605	2,532,656
Other Investments	59,206	59,206
TOTAL	\$ 21,112,721	\$ 21,613,091

Source: Stephen F. Austin State University

^A For the purposes of this report, Collateralized Mortgage Obligations and Mortgage Backed Securities are combined under the category "CMOs". Mortgage Backed Securities (MBSs), created by pooling together individual borrowers' mortgage loans, are generally securitized through a federal government agency and do not carry the risk associated with CMOs. Stephen F. Austin State University reported Mortgage Backed Securities only.

Stephen F. Austin State University's internal audit reports noted the following issues of noncompliance:

- The University's policy does not adequately address the maximum average dollar-weighted maturity for pooled fund groups. The policy also does not meet the diversification limit stated in the Act for mutual funds.
- Signed broker/dealer acknowledgments were not filed.
- Quarterly reports, as required by the University's policy and the Act, were not submitted to the Board in a timely manner, and did not include the weighted average maturity for the portfolio.
- Board approval for investments with maturities in excess of five years was not always obtained, as required by the University's policy.

- Pledged securities have not been maintained in accordance with the University's investment policy.
- Monthly reconciliations and cash flow projections were not performed in accordance with the University's policy.
- TexPool transactions were not always authorized with the two signatures required by the University's policy.

Sul Ross State University

Sul Ross State University (University) reported a portfolio balance of more than \$9.3 million as of August 31, 1996.

Sul Ross State University Portfolio Composition		
Investment Type	August 31, 1996	
	Book Value	Market Value
Certificates of Deposit	\$ 396,000	\$ 396,000
Investment Pool (TexPool)	4,900,313	4,899,990
U.S. Government Securities	296,735	300,363
Collateralized Mortgage Obligations	3,691,484	2,825,728
Other Investments	98,857	98,395
TOTAL	\$ 9,383,389	\$ 8,520,476

Source: Sul Ross State University

The internal audit report indicated that while Sul Ross State University was in compliance with all investment-related requirements of the Act; however, the following control weakness were noted:

- The limited access to current market value information in relation to the University's holdings in CMOs limits the University's ability to respond to "windows of opportunity."
- Mortgage-backed securities concentrations exceeded portfolio diversification guidelines established by the University and the Texas State University System policies.
- The University liquidation plan does not provide a decision-point, or stop-loss, provision to limit potential losses from sudden significant downturns.
- The allocation of TexPool interest is based on month-end balances, which may not be as accurate as calculating the average investment balance (average of beginning and ending balances).

Texas Southern University

Texas Southern University's investments total more than \$12.3 million. Investments are listed by category in the following table:

Texas Southern University Portfolio Composition		
Investment Types	August 31, 1996	
	Book Value	Market Value
Commercial Paper	\$ 5,358,999	\$ 5,404,586
No-Load Money Market Mutual Fund	1,484,232	1,484,232
U.S. Government Securities	933,660	924,731
U.S. Government Agencies	868,985	869,030
Cash Management Fixed Income Funds	1,050,662	1,050,662
Corporate Bonds, Debentures, or Debt Obligations	290,646	283,490
Equities	2,363,484	2,933,708
TOTAL	\$ 12,350,668	\$ 12,950,439

Source: Texas Southern University

The following issues related to Texas Southern University's investment function were identified in the internal audit report:

- The Board of Regents had not designated an investment officer, as required by the Act.
- Minimum training requirements set forth in the Act were not met by the de facto Investment Officer, or by six of the nine Board Members.
- University officials responsible for investment activity do not appear to have disclosure statements on file.
- Requirements for signed broker/dealer acknowledgments were not met by two of three external investment managers.
- Quarterly investment reports were not presented to the Board of Regents, as required by the Act.
- Investment transactions were not recorded by Texas Southern University in a timely manner.

Texas State Technical College System

Texas State Technical College System's (System) investments total more than \$4 million. Investments are listed by category in the following table:

Texas State Technical College System Portfolio Composition		
Investment Types	August 31, 1996	
	Book Value	Market Value
Savings Accounts in Financial Institutions	\$ 26,757	\$ 26,757
Certificates of Deposits	3,303,017	3,303,017
U.S. Government Securities	751,029	756,619
TOTAL	\$ 4,080,803	\$ 4,086,393

Source: Texas State Technical College System

The internal audit report for the System states no areas of non compliance were found. The System has established an adequate system of internal management controls over the investments process and the system is functioning as designed, according to the internal audit report.

Texas Woman's University

The investments of Texas Woman's University total more than \$55 million. Investments are listed by category in the following table:

Texas Woman's University Portfolio Composition		
Investment Types	August 31, 1996	
	Book Value	Market Value
Investment Pool (LGIP)	\$ 43,568,286	\$ 43,565,236
U.S. Government Securities	3,277,017	3,249,566
Collateralized Mortgage Obligations	8,036,361	6,075,559
Equities	82,766	502,338
Other Investments	116,800	n/a
TOTAL	\$ 55,081,230	\$ 53,392,699

Source: Texas Woman's University

The internal audit report notes that Texas Woman's University is in compliance with the Act, controls are adequate, and the investment policy is proper; however, some members of the Board of Regents had not received the investment training as required by the Act. In addition, the internal audit report recommends that Texas Woman's University enhance reconciliation procedures.

University of North Texas

The University of North Texas' investments total nearly \$93.8 million. Investments are listed by category in the following table:

University of North Texas Portfolio Composition		
Investment Types	August 31, 1996	
	Book Value	Market Value
Investment Pool (Tex Pool)	\$ 17,975,000	\$ 17,975,000
U.S. Government Securities	40,788,295	40,380,344
U.S. Government Agencies	22,049,676	22,112,278
Collateralized Mortgage Obligations	8,915,411	8,810,008
Equities (Common Fund)	4,058,603	4,811,319
TOTAL	\$ 93,786,985	\$ 94,088,949

Source: University of North Texas

The University of North Texas' internal audit report states that the investment policy is in compliance with the Act and that internal controls are strong and being followed. However, the audit reported concerns regarding the current method of amortizing and accumulating premium (discount) on investments.

University of North Texas Health Science Center at Fort Worth

The University of North Texas Health Science Center's (Center) investments total more than \$15 million. Investments are listed by category in the following table:

University of North Texas Health Science Center Portfolio Composition		
Investment Types	August 31, 1996	
	Book Value	Market Value
Investment Pool (Tex Pool)	\$ 4,733,108	\$ 4,733,108
Collateralized Mortgage Obligations	\$ 10,284,695	\$ 6,304,938
TOTAL	\$ 15,017,803	\$ 11,038,046

Source: University of North Texas Health Science Center at Fort Worth

The Center's internal audit report states that the investment policy is in compliance with the Act and that internal controls are in place and adequate. However, the investment policy states that only 10 percent of a portfolio can be in derivatives; the current derivative investment is approximately 59 percent. The 59 percent results from the Center holding the derivatives it currently maintains, since the sale of these derivatives would result in a loss due to their decline in market value. The Center's investment policy states that the current derivatives will be allowed to mature and no further purchase of derivatives will be made until the 10 percent restriction on such investments has been met.

In addition, the internal audit report recommended that the Director of Accounting receive the training which the Act requires of the Investment Officer. Although the Director is not technically the Investment Officer, the Director conducted significant investment transactions under the supervision of the Investment Officer (Controller).

Office of the Attorney General

The Office of Attorney General's records reflect a total investment balance of \$193,477 as of August 31, 1996. These funds are maintained in an account at the Texas Treasury Safekeeping Trust Company (Trust Company) and have been invested solely in overnight repurchase agreements, according to the internal audit report.

Office of the Attorney General Portfolio Composition		
Investment Types	August 31, 1996	
	Book Value	Market Value
Texas Treasury Safekeeping Trust Co.	\$ 193,477	\$ 193,477
TOTAL	\$ 193,477	\$ 193,477

Source: Office of the Attorney General

The Office of the Attorney General does not have an investment policy for the funds deposited in the Trust Company. However, the internal audit report notes that controls are written into the investment agreement. In addition, adequate controls have been established in the Office of the Attorney General's Accounting Division to manage the investment account, according to the internal audit report. This account was established to invest the State's share of retainage from a contractor for the development of the new automated child support system.

State Bar of Texas

The State Bar of Texas reported a portfolio balance of over \$21 million as of August 31, 1996. Of that amount, more than \$19.1 million was invested in short-term U.S. Government securities and agencies. The portfolio composition is shown in the following table:

State Bar of Texas Portfolio Composition		
Investment Type	August 31, 1996	
	Book Value	Market Value
No-Load Money Market Mutual Fund	\$ 1,836,299	\$ 1,836,299
U.S. Government Securities	13,549,664	13,575,827
U.S. Government Agencies	5,648,478	5,714,267
TOTAL	\$ 21,034,441	\$ 21,126,393

Source: State Bar of Texas

According to the internal audit report, quarterly investments reports did not contain all information required by the Act, and all Board members did not meet the minimum training requirements. The number of Board members needing investments training was not provided. The quarterly investments reports did not contain the following information:

- A summary statement of each fund group that states the beginning market value for the reporting period, additions and changes to the market value during the period, and ending market value for the period
- The book value and market value of each separately invested asset at the beginning and end of the reporting period by type of security and fund group
- Signature of each investment officer of the entity
- A statement of compliance with the State Bar's investment policy and the Act

Texas Board of Law Examiners

At August 31, 1996, the investments managed by the Texas Board of Law Examiners consisted of short-term U.S. Government Securities with a book value of \$1,835,170 and a market value of \$1,855,278. The following table identifies the investments by category:

Texas Board of Law Examiners Portfolio Composition		
Investment Types	August 31, 1996	
	Book Value	Market Value
U. S. Government Securities	\$ 1,835,170	\$ 1,855,278
TOTAL	\$ 1,835,170	\$ 1,855,278

Source: Texas Board of Law Examiners

Since there is no internal audit function at the Texas Board of Law Examiners, the internal audit requirement in the Act was not met. However, a letter co-signed by the Executive Director and the Chief Accountant states that they reviewed the investment activity to determine the Texas Board of Law Examiners' adherence to its investment policy and compliance with the Act. According to the letter, no areas of noncompliance with the Act were noted and no internal control weaknesses or lack of adherence to the investment policy were identified.

Texas Department of Banking

At August 31, 1996, the investments managed by the Texas Department of Banking (Department) total more than \$5.7 million. The following table identifies the investments by category:

Texas Department of Banking Portfolio Composition		
Investment Types	August 31, 1996	
	Book Value	Market Value
Saving Accounts in Financial Institutions	\$ 2,731	\$ 2,731
Certificate of Deposit	452,486	452,486
Repurchase Agreements	4,229,590	4,229,590
No-Load Money Market Mutual Fund	246,064	246,064
No-Load Mutual Funds	369,611	369,611
Collateralized Mortgage Obligations	11,147	\$11,147
Other Investments	422,504	422,504
TOTAL	\$ 5,734,133	\$ 5,734,133

Source: Texas Department of Banking

The following issues related to the investments function at the Texas Department of Banking were identified in the internal audit report:

- The Department holds deposit accounts issued by financial institutions domiciled in other states. The Act only allows investments in financial institutions domiciled within Texas and insured by FDIC or secured by other allowable securities. The Department indicated that these funds were obtained in a trust company failure in 1994, under the liquidation of a court-appointed receiver.
- Signed acknowledgments were not maintained on all registered principals holding invested funds that are under the Department's control.
- Control weaknesses were noted regarding the signatures required for the transfer of the Department's investment funds.
- Expected rates of return and diversification objectives were not included in the investment policy.
- Quarterly reports did not coincide with the Department's fiscal year end.

Texas Department of Commerce

Investments managed by the Texas Department of Commerce total more than \$79.5 million, as identified in the following table:

Texas Department of Commerce Portfolio Composition		
Investment Types	August 31, 1996	
	Book Value	Market Value
Repurchase Agreements	\$ 79,507,733	\$ 79,507,733
TOTAL	\$ 79,507,733	\$ 79,507,733

Source: Texas Department of Commerce

The internal audit report indicated that the Department of Commerce did not prepare quarterly reports in fiscal year 1996. No other issues relating to compliance with the Act were identified by the internal audit report.

Texas Department of Criminal Justice

Investments in the three portfolios managed by the Texas Department of Criminal Justice (Department) total more than \$50.5 million. The following table identifies the investments by category:

Texas Department of Criminal Justice Portfolio Composition		
Investment Types	August 31, 1996	
	Book Value	Market Value
Department Fund for Lease Purchase Revenue Bonds		
Repurchase Agreements	\$ 5,815,328	\$ 5,815,328
No-Load Money Market Mutual Fund	2,423,348	2,423,348
U.S. Government Securities	8,014,763	7,913,078
U.S. Government Agencies	1,000,260	969,771
TOTAL	\$ 17,253,699	\$ 171,215,250
Department Fund for Education and Recreation (Enterprise Fund)		
Certificate of Deposit	\$ 2,850,000	\$ 2,850,000
U.S. Government Securities	20,171,358	20,185,590
TOTAL	\$ 23,021,358	\$ 23,035,590
Department Fund for Windham School District		
Investment Pool—TexPool	\$ 4,368,874	\$ 4,368,874
Other Investments Money Market Checking	5,873,991	5,873,991
TOTAL	\$ 10,242,865	\$ 10,242,865

Source: Texas Department of Criminal Justice

Internal audit reports identified the following instances of noncompliance and/or control weaknesses at the Department:

- Ethics disclosures and conflict of interest statements were not required by the Department.
- Signed broker/dealer acknowledgments were neither distributed nor maintained by the Department.
- The internal audit report noted a lack of written procedures for investment personnel.
- Job duties were not adequately segregated.

- The internal audit report recommended centralizing the investment function.

Texas Department of Housing and Community Affairs

The Texas Department of Housing and Community Affairs (Department) managed investments of over \$737 million as of August 31, 1996. Funds invested by the Department include bond proceeds, which are used to assist persons and families of very low and low to moderate incomes with their housing needs. The following table reflects the composition of the Department's investment portfolio:

Texas Department of Housing and Community Affairs Portfolio Composition		
Investment Types	August 31, 1996	
	Book Value	Market Value
Repurchase Agreements	\$ 86,755,002	\$ 86,755,002
Commercial Paper	90,897	90,897
No-Load Money Market Mutual Fund	2,728,583	2,728,583
U.S. Government Securities	37,249,566	47,458,882
U.S. Government Agencies	1,960,169	1,963,369
Mortgage Backed Securities ^A	483,369,961	483,777,343
Guaranteed Investment Contracts	125,166,343	125,166,343
TOTAL	\$ 737,320,521	\$ 747,940,419

Source: Texas Department of Housing and Community Affairs

^A For the purposes of this report, Mortgage Backed Securities and Collateralized Mortgage Obligations are usually listed under the category Collateralized Mortgage Obligations. However, these Mortgage Backed Securities are security for bonds issued by the Department and not purchased as an investment.

According to the Department, these mortgage backed securities are generated as a function of its mortgage assistance program and are guaranteed by Federal National Mortgage Association and Government National Mortgage Association certificates, agencies of the U.S. Government. These mortgage backed securities are pledged as security for the housing bonds previously issued by the Department. The bondholders have the rights to any proceeds from them under the covenants of the Department's housing bonds. The Department does not hold these mortgage backed securities to produce investment return as would a normal investor.

Texas Department of Housing and Community Affairs was included in *A Review of Controls Over Investment Practices at Five State Investing Entities* (SAO Report No. 97-036, February 1997). The results of that audit indicate noncompliance and/or control weaknesses in the following areas:

- The investment policy did not address the quality and capability of the investment staff as required by the Act.
- Three of the nine Board members and two of three investment officers did not meet the minimum training requirements set forth in the Act.

- Quarterly reports were not presented to the Board in a timely manner. Reports were not submitted to the Board for between two to five months after the reporting period. In addition, all investment officers did not always sign the investment reports.
- The Department's Code of Ethics policy could be enhanced to include identifying those persons subject to the Code of Ethics, listing specific laws and regulations, and providing examples of unacceptable behavior.

Texas Hospital Equipment Financing Council

Reserve funds for bonds issued in 1985 represent the invested monies for the Texas Hospital Equipment Financing Council. Eligible investments and responsibility for managing the funds are stipulated in the bond documents, which were executed prior to the Act. Portfolio composition for these invested funds is as follows:

Texas Hospital Equipment Financing Council Portfolio Composition		
Investment Type	August 31, 1996	
	Book Value	Market Value
Guaranteed Investment Contracts	\$ 9,330,000	\$ 9,330,000
No-Load Mutual Fund	260,621	260,621
TOTAL	\$ 9,590,621	\$ 9,590,621

Source: Bank of New York, Trustee for the Texas Hospital Equipment Financing Council's investments

Texas Hospital Equipment Financing Council has no employees. Administrative duties are performed by the Treasury Operations Division of the Comptroller of Public Accounts. The funds are managed by a trustee and there is a guarantor of the investments, as required by the bond indentures.

An audit of the Texas Hospital Equipment Financing Council's adherence to its investment policy and compliance with the Act was not performed. Since the trustee is responsible for managing the investments in accordance with the bond indentures, the risk appears low that investments would not be managed appropriately.

Texas Local Government Investment Pool (TexPool)

Texas Local Government Investment Pool (TexPool) Portfolio Composition		
Investment Type	August 31, 1996	
	Book Value	Market Value
Repurchase Agreements	\$ 3,737,500,000	\$ 3,737,500,000
Money Market Mutual Funds	68,600,000	68,600,000
U.S. Government Securities	223,215,108	223,008,000
U.S. Government Agencies	373,645,540	373,523,000
TOTAL	\$ 4,402,960,648	\$ 4,402,631,000

Source: TexPool's audited financial statements

As part of the financial audit of TexPool, KPMG Peat Marwick LLP performed the annual compliance audit as required under the Act. KPMG Peat Marwick LLP stated that it did not find any instances of noncompliance with the Act.

Texas National Guard Armory Board

The Texas National Guard Armory Board maintains investments of \$7.75 million as of August 31, 1996. The funds invested are the bond proceeds deposited in either the construction fund or the debt service fund. The portfolio composition for the Texas National Guard Armory Board is shown in the following table:

Texas National Guard Armory Board Portfolio Composition		
Investment Type	August 31, 1996	
	Book Value	Market Value
Certificates of Deposit	\$ 7,683	\$ 7,683
No-Load Money Market Mutual Fund	2,628,855	2,628,855
U.S. Government Securities	3,873,629	3,958,961
Interest-Bearing Checking Account	1,248,720	1,248,720
TOTAL	\$ 7,758,887	\$ 7,844,219

Source: Texas National Guard Armory Board

The internal audit report on the Texas National Guard Armory Board's investment activities identified the following conditions:

- The Investment Officer and one Board member did not meet the minimum training requirements stipulated in the Act.
- The Investment Officer did not sign an ethics statement or a conflict of interest statement.
- Acknowledgment letters were not sent to persons seeking to sell investments to the Texas National Guard Armory Board until November 1996.

- The quarterly investment report did not contain all investments held by the Texas National Guard Armory Board, or the maturity date of each invested asset.

Texas National Research Laboratory Commission

The Texas National Research Laboratory Commission (Commission) maintains investments of more than \$6 million as of August 31, 1996. The Commission’s funds were part of the Superconducting Supercollider Project canceled by the Federal Government. The portfolio composition for the Commission is shown in the following table:

Texas National Research Laboratory Commission Portfolio Composition		
Investment Type	August 31, 1996	
	Book Value	Market Value
Repurchase Agreement	\$ 6,064,972	\$ 6,064,320
TOTAL	\$ 6,064,972	\$ 6,064,320

Source: Texas National Research Laboratory Commission

Instances of noncompliance noted in the internal audit report submitted for the Commission included:

- The investment policy does not specifically address diversification policies, expected returns on investment, or the percentage of portfolio concentration within investment type as required by the Act.
- Letters of instruction documenting oral communications with the Texas Treasury Safekeeping Trust Company were not filed.
- The investment policy designates one investment officer, although a resolution adopted by the Commission certifies two individuals to act in this capacity.

The internal audit report on the Commission does not recommend action to amend the policy unless the Commission obtains significant investments in the future. The internal audit report also notes that the Commission will liquidate most of its investments in final settlement of certain debts in the near future.

Texas Parks and Wildlife Department

The Texas Parks and Wildlife Department (Department) reported investments of \$6.4 million as of August 31, 1996. These investments are managed by the Department and a nonprofit foundation operating on behalf of the Department. The Department’s portfolio composition is reflected in the following table:

Texas Parks and Wildlife Department Portfolio Composition		
Investment Type	August 31, 1996	
	Book Value	Market Value
Certificates of Deposit	\$ 225,000	\$ 225,000
Equities (stocks)	1,262,295	1,480,674
Corporate Bonds	1,197,068	1,169,170
U.S. Government Securities	25,391	24,504
Other (Fidelity 57 U.S. Government Fund)	3,724,815	3,724,815
TOTAL	\$ 6,434,569	\$ 6,624,163

Source: Texas Parks and Wildlife Department

Audit results concerning compliance with the Act are not available because an internal audit was not performed. The Department's investment in equities raises questions regarding compliance, since equity securities are not authorized investments under the Act. However, these equities could have been purchased prior to the Act or donated, as was the case with other investing entities.

According to the Internal Audit Director, the internal audit, as required by the Act, was not performed because:

- The Department was unaware of the compliance requirement until the State Auditor's Office sent a letter in April 1996.
- The Internal Audit Director interpreted the Act to mean the State Auditor's Office was responsible for conducting the audit.

Texas Real Estate Commission

Texas Real Estate Commission's \$2.5 million portfolio consists of long-term securities, as shown in the following table:

Texas Real Estate Commission Portfolio Composition		
Investment Type	August 31, 1996	
	Book Value	Market Value
U.S. Government Securities	\$ 2,200,000	\$ 2,210,813
U.S. Government Agencies	300,000	302,062
TOTAL	\$ 2,500,000	\$ 2,512,875

Source: Texas Real Estate Commission

The Texas Real Estate Commission invests the real estate recovery funds, which are used for reimbursing people who suffer actual damages committed by a real estate broker, salesman, (or their employee or agency) or by a duly licensed inspector. Fees collected at the time a broker or salesman passes the licensing examinations and prior to the submission of the license application by an inspector are used to fund the real estate recovery funds.

The internal audit report noted that there was no provision for the maximum allowable stated maturity of the investments in the Texas Real Estate Commission's investment policy, as required by the Act.

Texas School for the Blind and Visually Impaired

The investment portfolio at the Texas School for the Blind and Visually Impaired (School) consists of certificates of deposit and short-term U.S. Government Securities, as shown in the table below:

Texas School for the Blind and Visually Impaired Portfolio Composition		
Investment Type	August 31, 1996	
	Book Value	Market Value
Certificates of Deposit	\$ 99,000	\$ 99,000
U.S. Government Securities	111,700	111,700
TOTAL	\$ 210,700	\$ 210,700

Source: Texas School for the Blind and Visually Impaired

Instances of noncompliance with the Act were identified in the internal audit report for the Texas School for the Blind and Visually Impaired's investment function. The conditions noted relate to omissions in the investment policy, which are needed for compliance with the Act.

- A designated Investment Officer is not mentioned in the investment policy. The School did not designate an Investment Officer until July 1996.
- The investment policy does not require the Investment Officer to sign conflict of interest or financial disclosure statements.
- There is no requirement for person(s) seeking to sell investments to the School to sign acknowledgment letters.
- The investment strategy and definition of acceptable risk levels are difficult to identify in the investment policy.
- The School does not have an ethics or fraud policy.

The investment reports did not contain all required elements, and they were not signed by the investment officer until July 1996. Details regarding the specific information not included in the investment reports were not provided in the internal audit report.

Texas School for the Deaf

Texas School for the Deaf has a portfolio of more than \$10,000, which consists of donated stock and an annuity contract purchased in 1993. These investments are shown in the following table:

Texas School for the Deaf Portfolio Composition		
Investment Type	August 31, 1996	
	Book Value	Market Value
Equities	\$ 5,092	\$ 5,512
Annuity Contract	5,070	5,070
TOTAL	\$ 10,162	\$ 10,582

Source: Texas School for the Deaf

These investments are not authorized under the Public Funds Investment Act or the Texas School for the Deaf investment policy, according to the internal audit report. The report further states that the equities were donated to the Texas School for the Deaf in fiscal year 1996 and the annuity was purchased in 1993. Because the Act does not address donated investments, it is unclear whether or not state agencies are allowed to accept gifts of investments not authorized by the Act. However, the annuity was still not an authorized investment under the Public Funds Investment Act prior to its revision that became effective September 1, 1995.

The internal audit report also noted the following conditions with respect to the investments function at Texas School for the Deaf:

- The investment policy does not include the maximum allowable stated maturity of any individual investment owned by the entity.
- Texas School for the Deaf did not designate an Investment Officer, as required by the Act.
- Quarterly investment reports were not prepared and submitted to the Board in fiscal year 1996.

Texas Turnpike Authority

The Texas Turnpike Authority has a portfolio of more than \$616.8 million. These investments are identified by category in the following table:

Texas Turnpike Authority Portfolio Composition		
Investment Type	August 31, 1996	
	Book Value	Market Value
Repurchase Agreements	\$ 24,863,009	\$ 24,863,009
No-Load Money Market Mutual Fund	10,414,073	10,414,073
U.S. Government Securities	109,341,812	109,496,271
U.S. Government Agencies	4,995,881	4,997,850
Guaranteed Investment Contract	467,222,824	467,222,824
TOTAL	\$ 616,837,599	\$ 616,994,027

Source: Texas Turnpike Authority

The internal audit report indicated that 5 of 12 Board Members had not met the minimum training requirements for investment officers and board members, as set forth in the Act. In addition, procedures for the operation of the investment program, as required by Texas Turnpike Authority's investment policy, were not written until October 1996, after close of fiscal year 1996.

Texas Water Development Board

The Texas Water Development Board has a portfolio of more than \$533 million. These investments are identified by category in the following table:

Water Development Board Portfolio Composition		
Investment Type	August 31, 1996	
	Book Value	Market Value
U.S. Government Securities	\$ 446,019,962	\$ 446,178,905
U.S. Government Agencies	87,368,874	87,329,932
TOTAL	\$ 533,388,836	\$ 533,508,837

Source: Texas Water Development Board

Texas Water Development Board was included in *A Review of Controls Over Investment Practices at Five State Investing Entities* (SAO Report No. 97-036, February 1997). The results of that audit indicate noncompliance and or control weaknesses in the following areas:

- An investment policy was not approved until May 1996, more than eight months after the effective date of the Act.
- The investment policy does not clearly define the quality and capability of the investment staff, as required by the Act.
- Quarterly investment reports did not state the beginning book and market values of the Texas Water Development Board's investments.

Texas Youth Commission

The Texas Youth Commission has a portfolio of more than \$600,000. These investments are identified by category in the following table:

Texas Youth Commission Portfolio Composition		
Investment Type	August 31, 1996	
	Book Value	Market Value
Certificate of Deposit	\$ 538,000	\$ 538,000
Other Investments Interest Bearing Checking and Money Market Account	79,146	79,146
TOTAL	\$ 617,146	\$ 617,146

Source: Texas Youth Commission

The Texas Youth Commission indicated that its funds are not subject to the Act, but chose to comply voluntarily for its non-trust funds. Internal audit reports indicated the following instances of noncompliance with the Act:

- The investment policy and strategy were not adopted until May 1996, eight months after the effective date of the Act.
- Minimum training requirements for Board members, as set forth in the Act, were not met. Two of six Board members had not completed the required training within the six month period required by the Act.