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State Auditor

A Review of

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

March 2006

Report No. 06-026



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Overall Conclusion

Overall, state agencies, universities, and community college districts fully or substantially complied with the Public Funds Investment Act (Act). In general, universities and community college districts also fully or substantially complied with higher education investment reporting requirements mandated by Rider 5 (General Appropriations Act, 79th Legislature, page III-243). With \$42 billion in investments as of August 31, 2005, it is important that these entities comply with statutes and investment reporting requirements designed to help the Legislature, the entities' boards, and the general public ensure that entities manage and disclose their investments appropriately. The following describes compliance by type of entity for fiscal year 2005:

- **Agencies.** The 12 state agencies subject to the Act reported full or substantial compliance with the Act.
- **Universities.** Of the 15 universities subject to the Act, 14 reported full or substantial compliance with the Act. Sul Ross State University was noncompliant because it did not obtain a compliance audit. Twelve of the 15 universities were in either full or substantial compliance with higher education investment reporting requirements.
- **Community college districts.** All of the 50 community college districts subject to the Act reported they either fully or substantially complied with the Act. Thirty-eight of the 50 community college districts were in full or substantial compliance with higher education investment reporting requirements. One community college district, Coastal Bend College, did not post its investment reports, policy, and other required disclosures on its Web site and, therefore, was noncompliant; 11 other community college districts were minimally compliant with the reporting requirements.

Background Information

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

In addition, Rider 5 of the General Appropriations Act (79th Legislature, page III-243) requires universities and community college districts to produce quarterly investment reports, as well as an annual investment report prepared in a method prescribed by the State Auditor's Office. That method was outlined in *A Review of Higher Education Investment Reporting Requirements* (SAO Report No. 02-058, July 2002).

This review was conducted in accordance with Texas Government Code, Chapter 2256, and Rider 5, page III-243, the General Appropriations Act (79th Legislature).

For more information regarding this report, contact Verma Elliott, Audit Manager, or John Keel, State Auditor, at (512) 936-9500.

- **Universities subject to Rider 5 but exempt from the Act.** All of the 23 universities subject to Rider 5 reporting requirements set forth in *A Review of Higher Education Investment Reporting Requirements* (SAO Report No. 02-058, July 2002) but exempt from the Act had fully or substantially complied with higher education investment reporting requirements.

As the Act requires, state agencies, universities, and community college districts reported that they had not purchased certain high-risk investments (specific types of derivatives) and that they had invested their funds only in authorized investment asset classes. They reported having \$170,627 in derivatives as of August 31, 2005, compared with \$91,000 in derivatives as of August 31, 2003 (the last reporting date). The increase in derivatives occurred because Angelo State University reported amounts as derivatives this year that should have been reported as derivatives in the prior reporting period and derivative market values increased since the last reporting date.

Community college districts and some universities experienced difficulties in meeting the higher education investment reporting requirements, particularly the requirements to post information on their Web sites. However, after we contacted them, community college districts posted most of the required information on their Web sites. Universities also posted most of their remaining investment information on their Web sites after we contacted them.

Summary of Objectives, Scope, and Methodology

The objectives of this review were to report whether:

- State agencies and most universities complied with the Public Funds Investment Act requirement to submit a compliance report to the State Auditor's Office by January 1 of each even-numbered year.
- Universities complied with the Rider 5 (General Appropriations Act, 79th Legislature, page III-243) reporting requirements as prescribed by the State Auditor's Office in *A Review of Higher Education Investment Reporting Requirements* (SAO Report No. 02-058, July 2002).

The scope of this review covered investment disclosures and reports from September 1, 2004, through February 9, 2006, the deadline we established for entities to achieve full compliance after recognizing that some of them had not fully complied and needed more guidance. We also reviewed results of the entities' most recent audits regarding compliance with the Act.

The methodology consisted of (1) collecting evidence of compliance and noncompliance with the Act reported in audits and (2) reviewing investment reports and comparing those reports with investments reported in entities' annual financial reports. In addition, we reviewed entities' Web sites for the required investment disclosures, and we communicated with state entities and community

college districts to ensure that disclosures were completed by February 9, 2006. We did subsequent review of the agency and university Web sites for any entity that was determined to be non-compliant or minimally compliant related to the required Web disclosures on February 22, 2006, and reported the entities that subsequently fully complied.

Recent SAO Work		
Number	Product Name	Release Date
04-033	A Review of State Entity and Community College District Compliance with the Public Funds Investment Act and Investment Reporting Requirements	May 2004
02-058	A Review of Higher Education Investment Reporting Requirements	July 2002
02-039	A Review of State Entity Compliance with the Public Funds Investment Act	May 2002

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Detailed Results

Chapter 1

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

All state agencies that were subject to the Public Funds Investment Act (Act) reported they were in full or substantial compliance with the Act. These agencies reported investments totaling more than \$14.6 billion as of August 31, 2005.

We assessed compliance with the Act after reviewing the audit reports issued by agencies' external and internal auditors. Table 1 denotes instances of noncompliance for the agency that was assessed as being in substantial compliance; all other agencies were in full compliance (see Appendix 2 for a list of those in full compliance).

Table 1

Agency that Substantially Complied with the Act		
Agency	Areas of Noncompliance	Comments
Texas Equal Access to Justice Foundation	Investment Policy	Investments were purchased with a maturity longer than allowed by the investment policy.
	Investment Policy	Investment policies had not been reviewed and approved by the board in the last year.

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

Most universities that were subject to the Act reported they were in full or substantial compliance with the Act. These universities reported investments totaling \$1.1 billion as of August 31, 2005.

We assessed compliance with the Act after reviewing the audit reports issued by the universities' auditors. Table 2 denotes instances of noncompliance for universities that were assessed as being in substantial compliance; one university, Sul Ross State University, was noncompliant because it did not obtain a compliance audit. The universities in full compliance are noted in Appendix 2.

Table 2

Universities that Substantially Complied with the Act		
University	Areas of Noncompliance	Comments
Stephen F. Austin State University	Reporting	May 2005 investment report was not completed within the prescribed time frame.
	Reporting	This university does not reconcile general ledger balances with the amounts reported on its investment summary report.
	Collateral	Collateralized investments held by custodians were not always held in this university's name, as required by its investment policy.
Texas Southern University	Recordkeeping/Documentation	University officials did not file required annual conflict-of-interest statements with the president's office as required.
Texas Woman's University	Reporting	May 2005 investment report was not submitted to the board until December 9, 2005.
	Investment Policy	This university invested a greater percentage of assets in investment pools than its investment policy allows.

In addition to complying with the Act, universities are required to follow higher education investment reporting requirements, which became effective September 1, 2002 (the beginning of fiscal year 2003). In reviewing universities for compliance with these requirements, auditors assessed seven universities as fully compliant, five as substantially compliant, two as minimally compliant, and one as noncompliant with the requirements (see Table 3 for details).

Table 3

Universities that Did Not Fully Comply with Higher Education Investment Reporting Requirements		
University	Area(s) of Noncompliance	Comments
Noncompliance		
Lamar State College-Port Arthur	Disclosure	None of the required disclosures were posted on this university's Web site.
Minimal Compliance		
Angelo State University	Disclosure	Outside investment managers, soft dollar arrangements, ^a and foundation affiliations were not posted on this university's Web site, and the investment policy posted on the Web site was not current.
Lamar Institute of Technology	Disclosure	Foundation affiliations, investment reports, and the investment policy posted on this university's Web site were not current.
Substantial Compliance		
Midwestern State University	Disclosure	This university's quarterly investment reports and foundation affiliation were not current.
Stephen F. Austin State University	Disclosure	This university's foundation affiliations and investment policy were not current.
Texas State University-San Marcos	Disclosure	This university's investment policy was not current.
Texas Woman's University	Disclosure	This university's foundation affiliation Web disclosure was not current.
Sul Ross State University	Disclosure	This university did not disclose its outside investment managers on its Web site.
^a Soft dollar arrangements are a means of paying for services through brokerage commission revenue rather than through direct payments.		

After the reporting deadline, auditors reassessed compliance for universities that were initially assessed as being minimally compliant or noncompliant. Lamar State College–Port Arthur and the Lamar Institute of Technology were then assessed as being fully compliant. Most of the remaining instances of noncompliance involved universities' not posting current investment disclosures on their Web sites.

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

Independent audits of the 50 community college districts identified overall compliance with the Act. Forty-eight of the districts were in full compliance. Table 4 shows the two districts that were in substantial compliance. The districts in full compliance are noted in Appendix 2.

Table 4

Community College Districts that Substantially Complied with the Act		
Community College District	Area(s) of Noncompliance	Comments
Cisco Junior College District	Collateral	This district had minor insufficient collateralization of deposits.
Texarkana College	Investment Policy	This district's investment policy was not reviewed in fiscal year 2005.
	Training	This district's investment officer did not attend the required 10 hours of investment training.

Districts are also required to follow higher education investment reporting requirements, which became effective September 1, 2002 (the beginning of fiscal year 2003). In reviewing districts for compliance with these requirements, auditors recognized that the majority of the districts had not fully complied. Most of the instances of noncompliance involved districts' not posting current investment disclosures on their Web sites. Auditors provided more guidance to each district and set a new deadline of February 9, 2006, to allow them to achieve compliance. Auditors reassessed compliance after that deadline, and identified 12 districts that did not fully or substantially comply (see Table 5 for details).

Table 5

Community College Districts that Did Not Fully or Substantially Comply with Higher Education Investment Reporting Requirements		
Community College District	Area(s) of Noncompliance	Comments
Not in Compliance		
Coastal Bend College	Disclosure	None of the required disclosures were posted on this district's Web site.
In Minimal Compliance		
College of the Mainland	Disclosure	Quarterly investment reports were not posted on this district's Web site, and this district's investment policy was not current.
Grayson County College	Disclosure	This district's quarterly investment reports and investment policy were not current.
Hill College District	Disclosure	This district's quarterly investment reports and investment policy were not current.
Laredo Community College	Disclosure	This district's outside advisors, soft dollar arrangements, ^a and foundations were not posted on its Web site, and its investment policy was not current.
Lee College District	Disclosure	This district's quarterly investment reports and investment policy were not current.
Navarro College	Disclosure	This district's outside advisors, soft dollar arrangements, ^a and foundations were not posted on Web site.
Northeast Texas Community College	Disclosure	This district's annual investment summary was not posted on its Web site, its quarterly investment reports were not current, and its investment policy was not posted on its Web site.
Ranger College	Disclosure	This district's quarterly investment reports and investment policy were not current.
Southwest Texas Junior College	Disclosure	This district's quarterly investment reports and investment policy were not current.
Texarkana College	Disclosure	This district's quarterly investment reports and investment policy were not current.
Texas Southmost College	Disclosure	This district's quarterly investment reports and investment policy were not current.
^a Soft dollar arrangements are a means of paying for services through brokerage commission revenue rather than through direct payments.		

Upon subsequent review, auditors assessed the following community college districts as fully compliant with the reporting requirements as of February 22, 2006: Grayson County Junior College, Laredo Community College, Texarkana College, and Texas Southmost College.

All Universities Subject to Rider 5 and State Auditor’s Office Reporting Requirements but Exempt from the Act Fully or Substantially Complied with the Requirements

Some universities are required to follow higher education investment reporting requirements, which became effective September 1, 2002 (the beginning of fiscal year 2003) but are exempt from the Act. Any university that had total endowments of at least \$95 million as of May 1, 1995, is exempt from the Act. This exemption includes any universities that are part of the Texas A&M University System, the Texas Tech University System, the University of Houston System, or the University of Texas System. The universities in these systems reported they were in full or substantial compliance with Rider 5 reporting requirements set forth in *A Review of Higher Education Investment Reporting Requirements* (SAO Report No. 02-058, July 2002). The university systems reported for all of the universities within their systems. Table 6 shows the university that was in substantial compliance with the reporting requirements. The entities in full compliance are noted in Appendix 2.

Table 6

University that Substantially Complied with Reporting Requirements		
University	Areas of Noncompliance	Comments
Texas Tech University	Disclosure	This university’s foundation Web disclosure and quarterly reports were not current.

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

As the Act requires, state agencies, universities, and community college districts reported that they had not purchased certain high-risk investments (specific types of derivatives) and that they had invested their funds only in authorized investment asset classes. They self-reported having \$170,627 in derivatives as of August 31, 2005, compared with \$91,000 in derivatives as of August 31, 2003 (the last reporting date). The increase in derivatives occurred because Angelo State University reported amounts as derivatives this year that should have been reported as derivatives in the prior reporting period and derivative market values increased since the last reporting date. Derivatives are financial instruments (securities or contracts) with values that link to, or “derive” from, changes in interest rates, currency rates, and stock and commodity rates.

State agencies subject to the Act, universities subject to the Act, universities exempt from the Act, and community college districts reported different types of investments as of August 31, 2005. Universities and community college districts had more than \$976 million invested in the Texas Local Government Investment Pool (TexPool), while agencies had \$9 billion invested in repurchase agreements. Universities exempt from the Act invest very differently from the remaining entities. Exempt universities had more than \$3.4 billion invested in hedge funds.

Agencies and universities also invested more than \$3.4 billion in short-term U.S. government agency obligations, while community college districts reported significant investments in long-term U.S. government and U.S. government agency obligations. Universities not subject to the Act invested more than \$4.6 billion in equity securities.

Total investments reported by state agencies subject to the Act are presented in Table 7.

Table 7

Total Agency Investments ^a	
Agency	Market Value of Investments as of August 31, 2005
Board of Law Examiners	\$ 2,253,573
Department of Criminal Justice	19,701,839
Department of Housing and Community Affairs	1,405,018,582
Texas Local Government Investment Pool (TexPool) ^b	9,833,932,557
Texas Local Government Investment Pool Prime (TexPool Prime)	764,699,731
Real Estate Commission	2,226,263
School for the Blind and Visually Impaired	246,484
State Bar of Texas	30,907,910
Texas Equal Access to Justice Foundation	5,351,881
Texas Youth Commission	891,000
Water Development Board	656,055,952
Total	\$ 12,721,285,772

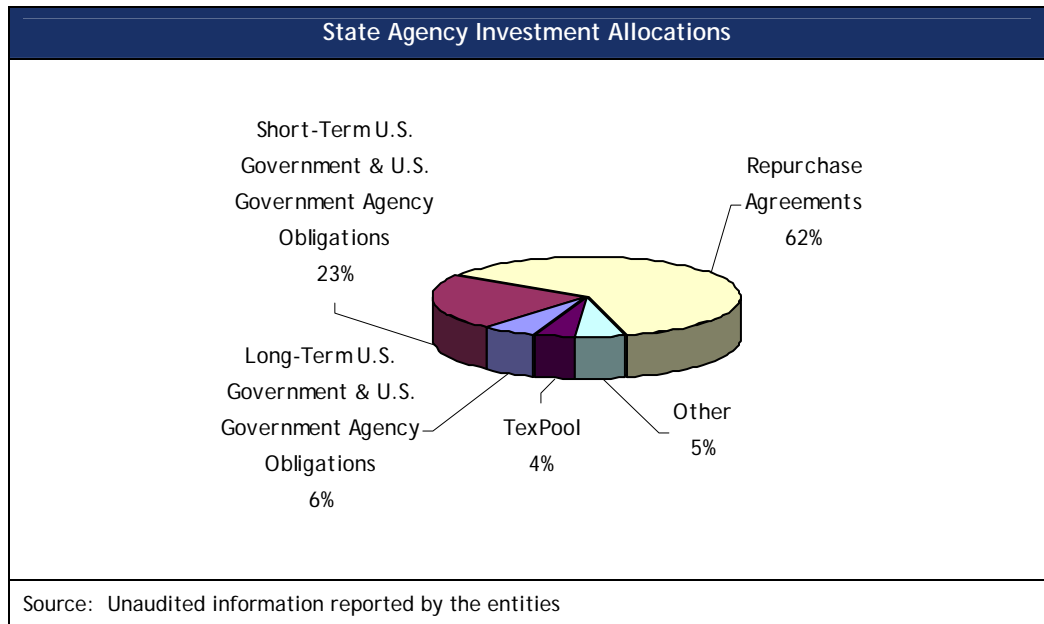
^a This table includes investment information only for agencies that are subject to the Act.

^b The amount reported for TexPool is reported net of the \$1,883,082,782 that other entities report as being invested in TexPool. This is to prevent the duplication of the TexPool amount. The actual TexPool investment total is \$11,717,015,339.

Source: Unaudited information reported by the entities

State agency investment allocations as of August 31, 2005, are depicted in Figure 1.

Figure 1



Source: Unaudited information reported by the entities

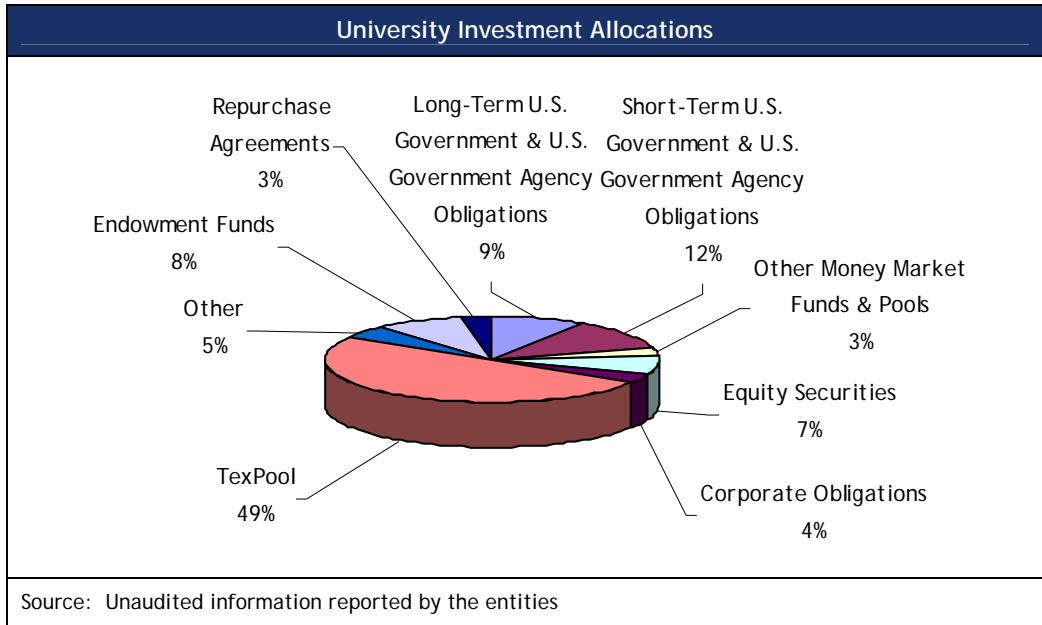
Total investments reported by universities subject to the Act are presented in Table 8.

Table 8

Total University Investments ^a	
University	Market Value of Investments as of August 31, 2005
Angelo State University	\$ 106,280,542
Lamar Institute of Technology	1,888,983
Lamar State College - Orange	6,690,095
Lamar State College - Port Arthur	2,102,438
Lamar University	67,842,562
Midwestern State University	38,460,888
Sam Houston State University	97,887,022
Stephen F. Austin State University	75,492,065
Sul Ross State University	43,475,241
Texas Southern University	72,919,180
Texas State Technical College System	9,789,444
Texas State University - San Marcos	174,631,910
Texas Woman's University	109,720,012
University of North Texas	211,893,100
University of North Texas Health Science Center at Fort Worth	53,483,654
Total	\$ 1,072,557,136
^a This table includes investment information only for universities that are subject to the Act and higher education reporting requirements. Source: Unaudited information reported by the entities	

University investment allocations as of August 31, 2005, are depicted in Figure 2.

Figure 2



Total investments reported by community college districts are presented below in Table 9.

Table 9

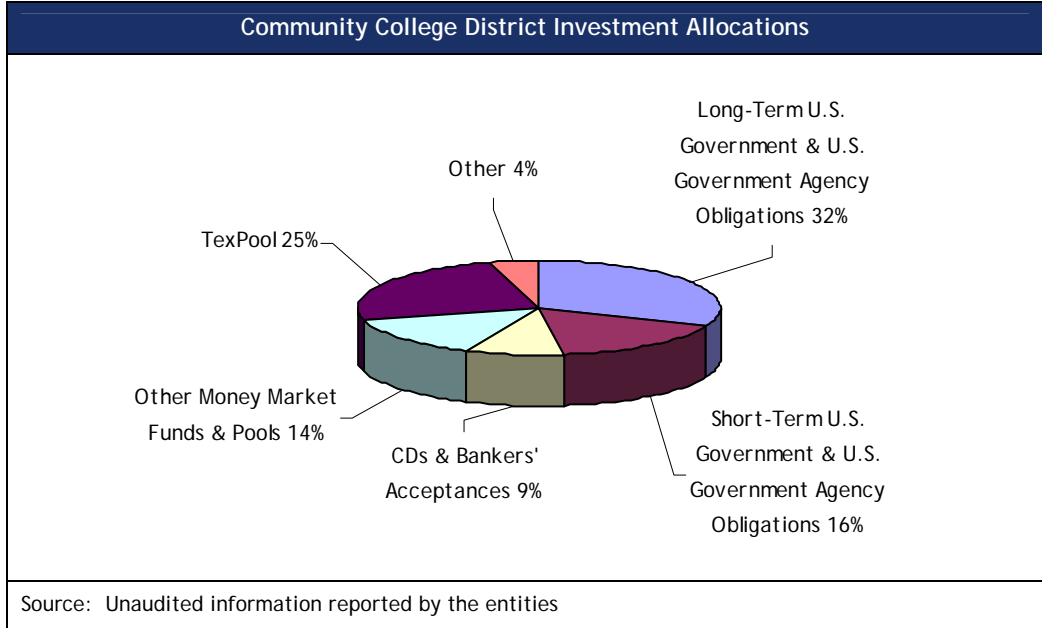
Total Community College District Investments	
Community College District	Market Value of Investments as of August 31, 2005
Alamo Community College District	\$ 113,989,639
Alvin Community College	26,717,767
Amarillo College	27,687,889
Angelina County Junior College District	8,026,890
Austin Community College District	100,372,640
Blinn College	19,788,931
Brazosport College District	11,687,584
Central Texas College District	65,577,813
Cisco Junior College District	4,567,359
Clarendon College	2,146,119
Coastal Bend College	5,071,032
College of the Mainland	10,135,657
Collin County Community College District	123,774,274
Dallas County Community College District	233,485,893
Del Mar College	53,099,680
El Paso County Community College District	52,655,399

Table 9

Total Community College District Investments	
Community College District	Market Value of Investments as of August 31, 2005
Frank Phillips College (Borger)	\$ 2,236,012
Galveston Community College District	8,273,437
Grayson County College	23,065,194
Hill College District	1,379,987
Houston Community College System	231,477,351
Howard County Junior College District	11,435,988
Kilgore Junior College District	8,099,365
Laredo Community College	10,294,729
Lee College District	11,275,244
McLennan County Junior College District	9,379,383
Midland Community College District	46,578,901
Navarro College	4,825,894
North Central Texas College	9,910,218
North Harris Montgomery Community College District	39,195,054
Northeast Texas Community College	966,676
Odessa Junior College District	25,050,026
Panola College	7,584,702
Paris Junior College	6,842,506
Ranger College	299,210
San Jacinto College District	64,326,722
South Plains College	8,705,141
South Texas College	51,728,998
Southwest Texas Junior College	3,098,989
Tarrant County College District	267,807,924
Temple College	13,211,432
Texarkana College	20,990,341
Texas Southmost College	56,113
Trinity Valley Community College	6,551,392
Tyler Junior College District	12,305,480
Vernon College	17,198
Victoria County Junior College District	5,961,048
Weatherford College of the Parker County Junior College District	10,175,571
Western Texas College	4,998,821
Wharton County Junior College District	21,925,697
Total Investments	\$ 1,808,815,310
Source: Unaudited information reported by the entities	

Community college district investment allocations as of August 31, 2005, are depicted in Figure 3.

Figure 3



Total investments reported by agencies and universities that are not subject to the Act but that are subject to Rider 5 are presented below in Table 10.

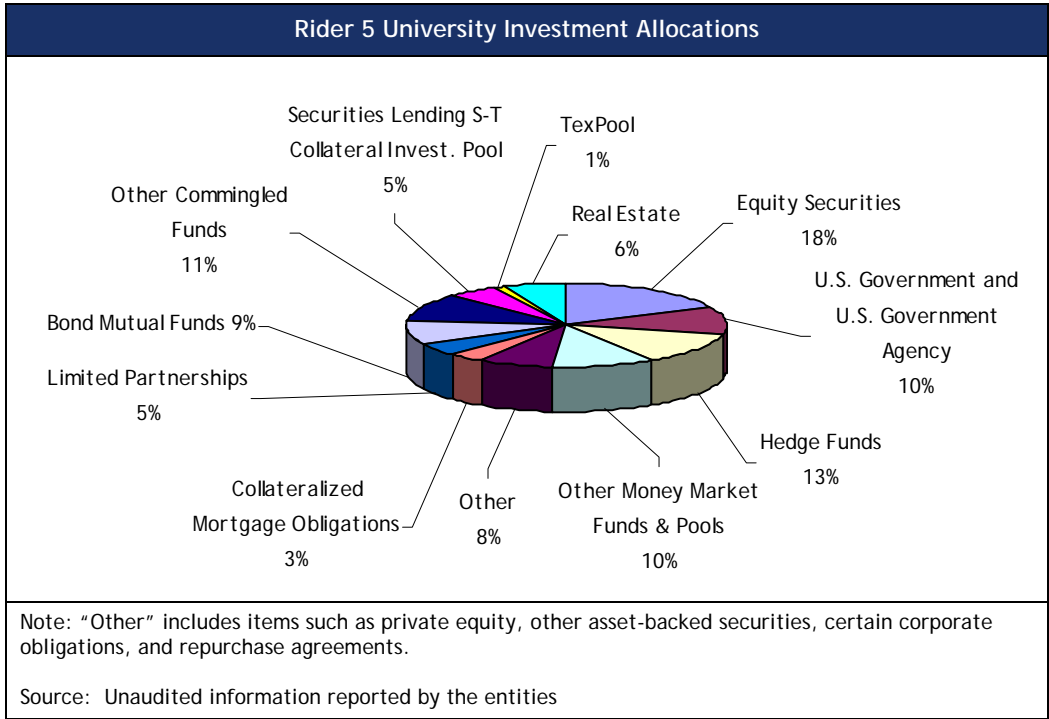
Table 10

Total Entity Investments ^a	
Entity	Market Value of Investments as of August 31, 2005
Texas A&M University System	\$ 2,130,637,916
Texas Tech University System	1,001,319,627
University of Houston System	720,937,284
The University of Texas System	22,498,384,887
Total	\$ 26,351,279,714

^a This table includes investment information for entities that are not subject to the Act but that are subject to Rider 5.
Source: Unaudited information reported by the entities

Investment allocations as of August 31, 2005, for agencies and universities that are not subject to the Act but that are subject to Rider 5 are depicted in Figure 4.

Figure 4



Enhancements to the Higher Education Investment Reporting Requirements and Other Recommendations

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

- Entities' investments with the Texas Treasury Safekeeping Trust Company should be reported as investments in TexPool rather than reported as Cash in State Treasury.
- We encourage management of these entities to remain in compliance with the higher education investment reporting requirements. Management should ensure that their auditors understand the requirements, including the required assurances on compliance with the Act. Management of universities and community college districts should also ensure that the required investment disclosures are posted on their Web sites in a timely manner.
- Management of these entities should reconcile amounts reported in their Summary of Investment reports posted on their Web sites and submitted to the State Auditor's Office to the amounts reported in their annual financial reports.

Appendices

Appendix 1

Objectives, Scope, and Methodology

Objectives

The objectives of this review were to report whether:

- State agencies and most universities complied with the Public Funds Investment Act (Act) requirement to submit a compliance report to the State Auditor's Office by January 1 of each even-numbered year.
- Universities complied with the Rider 5 (General Appropriations Act, 79th Legislature, page III-243) reporting requirements as prescribed by the State Auditor's Office in *A Review of Higher Education Investment Reporting Requirements* (SAO Report No. 02-058, July 2002).

Scope

The scope of this review covered investment disclosures and reports from September 1, 2004, to February 9, 2006, the deadline we established for completing disclosures. We also reviewed results of entities' most recent audits regarding compliance with the Act.

Methodology

The methodology consisted of (1) collecting evidence of compliance and noncompliance with the Act reported in audits and (2) reviewing investment reports and comparing those reports with investments reported in annual financial reports. In addition, we reviewed Web sites for the required investment disclosures and communicated with state entity and community college district managers in an effort to ensure that disclosures were complete by February 9, 2006, the deadline we set after recognizing that some of the entities had not fully complied with the requirements. We did a subsequent review for any entity that was initially determined to be noncompliant or minimally compliant related with required Web disclosures on February 22, 2006, and reported the entities that subsequently fully complied.

Other Information

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

- Michael Clayton, CPA, CFE (Project Manager)

- Terry Nickel, CIA, CFE, CBA, CFSA, CBM (Assistant Project Manager)
- Jennifer Brantley
- Worth S. Ferguson, CPA (Quality Control Reviewer)
- Verma Elliott, MBA, CGAP (Audit Manager)
- Carol Smith, CPA, CIA (Assistant State Auditor)

Entities in Full Compliance

Entities that fully complied with all reporting requirements reviewed are noted in Table 11 below.

Table 11

Entities in Full Compliance with Reporting Requirements	
State Agencies	
Board of Law Examiners	State Bar of Texas
Department of Criminal Justice	Texas Youth Commission
Department of Housing and Community Affairs	Texas Local Government Investment Pool (TexPool)
Parks and Wildlife Department	Texas Local Government Investment Pool (TexPrime)
Real Estate Commission	Water Development Board
School for the Blind and Visually Impaired	
Community College Districts	
Alamo Community College District	Howard County Junior College District
Alvin Community College	McLennan County Junior College District
Blinn College	Odessa Junior College District
Central Texas College District	Panola College
Clarendon College	Tarrant County College District
Collin County Community College District	Victoria College
Houston Community College System	Wharton Junior College
Universities	
Lamar University	University of Houston - Victoria
Prairie View A&M University	University of North Texas
Sam Houston State University	University of North Texas Health Science Center at Fort Worth
Texas A&M University	The University of Texas at Arlington
Texas A&M University - Commerce	The University of Texas at Austin
Texas A&M University - Corpus Christi	The University of Texas at Brownsville
Texas A&M University - Galveston	The University of Texas at Dallas
Texas A&M University - Kingsville	The University of Texas at El Paso
Texas A&M University - Texarkana	The University of Texas-Pan American
Texas A&M International University	The University of Texas of the Permian Basin
Texas State Technical College System	The University of Texas at San Antonio
University of Houston	The University of Texas at Tyler
University of Houston - Clear Lake	West Texas A&M University
University of Houston - Downtown	

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The Honorable Thomas “Tommy” Williams, Member, Texas Senate
The Honorable Jim Pitts, House Appropriations Committee
The Honorable Jim Keffer, House Ways and Means Committee

Office of the Governor

The Honorable Rick Perry, Governor

Entities mentioned in this report

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



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