



John Keel, CPA  
State Auditor

An Audit Report on

# Certification of the Permanent School Fund's Bond Guarantee Program for Fiscal Year 2006

March 23, 2007

Members of the Legislative Audit Committee:

The State Auditor's Office certifies that, for the fiscal year ended August 31, 2006, the amount of school district bonds guaranteed by the Permanent School Fund's (Fund) Bond Guarantee Program (Program) was within the two limits applicable to the Program. One limit, prescribed by Section 45.053(a) of the Texas Education Code, protects the Fund by minimizing the risk of loss to the Fund. The other limit, which was established by an Internal Revenue Service (IRS) letter ruling, is intended to prevent reductions in federal tax receipts due to bond arbitrage (issuing tax-exempt bonds for the purpose of investing the proceeds at higher rates than the tax-exempt bonds).

As of August 31, 2006, the bond guarantee capacity of the Fund was \$48.3 billion. The total principal debt guaranteed by the Program on 2,265 outstanding bond issues was \$37.8 billion. The guarantee saves school districts money by enhancing their bond ratings to the highest possible rating. Without the guarantee of this Program, school districts would need to (1) purchase private bond insurance or (2) pay higher interest rates on the bonds they sell.

## The Guarantee Approval Process Complies with State Laws

The bond guarantee approval process is adequately designed and operating effectively to comply with state laws and regulations. Before a guarantee application is recommended for approval, Program personnel review several sources to determine if the school district is financially sound. The Program then uses a Microsoft Access database to verify guarantee eligibility and prioritize applications according to rules in Title 19, Texas Administrative Code, Section 33.65 (19 TAC 33.65).

Each month, the Fund calculates the remaining capacity of the Program. Program personnel then ensure that applications recommended for approval will not cause the Program to exceed the amount of available capacity. To help ensure that the Fund accurately reports the amount of guaranteed bonds outstanding, the Fund semiannually reconciles Program records to the Municipal Advisory Council's records of guaranteed bonds.

## Objectives, Scope, and Methodology

The objectives of the audit were to:

- Determine whether the Texas Education Agency and the Bond Guarantee Program (Program) are in compliance with the requirements of Texas Education Code, Section 45.053 (a), which specifies that "The Commissioner may not approve bonds for guarantee if the approval would result in the total amount of outstanding guaranteed bonds exceeding an amount equal to 2-1/2 times the cost value or market value, whichever is less, of the permanent school fund, as estimated by the board and certified by the state auditor."
- Determine whether the Program is within the limitations set forth in the Internal Revenue Service letter ruling.

The scope of this audit covered the Permanent School Fund's (Fund) valuation, all bonds guaranteed by the Fund during fiscal year 2006, and the controls related to the guarantee and recording processes.

The audit methodology included analyzing investment data obtained from the Texas Education Agency and data originating at the Municipal Advisory Council, as well as information gathered during interviews. This audit was conducted in accordance with generally accepted government auditing standards.

The following staff of the State Auditor's Office performed the audit:

- Kristin Alexander, CIA (Project Manager)
- Brian Jones
- Dennis Ray Bushnell, CPA (Quality Control Reviewer)
- Michael C. Apperley, CPA (Assistant State Auditor)

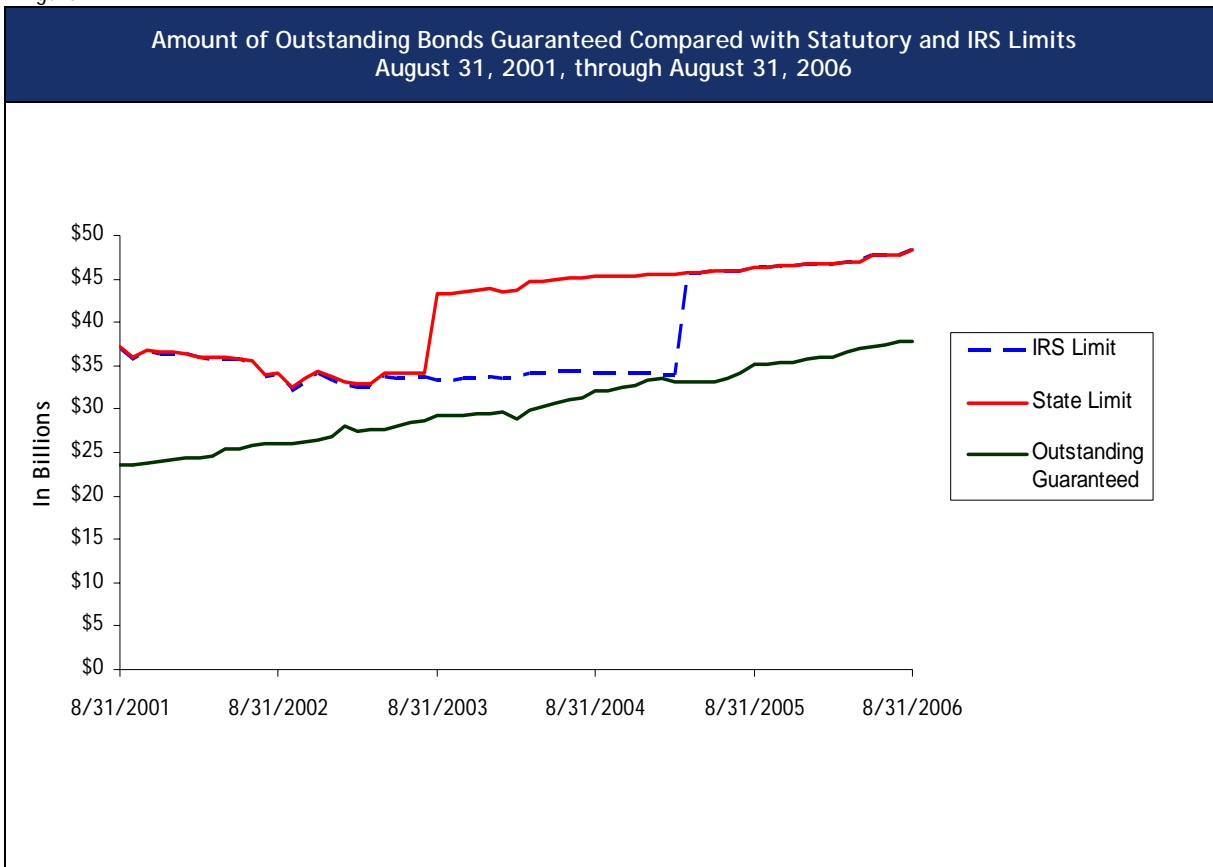
SAO Report No. 07-024

**Recent Changes to Program Rules**

In recent years, application prioritization requirements and eligibility restrictions have been added to the Program to extend its ability to guarantee bonds. Guarantees now are limited to school districts with less than \$1,250 of annual debt service per student in average daily attendance at the time of the guarantee application. This limitation does not apply to school districts that have enrollments that are 25 percent higher than their enrollments reported five years earlier or to bonds for which the election authorizing the issuance of bonds was called before July 15, 2004.

In December 2005, 19 TAC 33.65 was revised to clarify the types of new and refunded bond issues eligible for a guarantee. The revisions also required that no less than 5 percent of the Fund’s guarantee capacity be held in reserve. This reserve helps ensure that the Fund does not exceed its guarantee capacity and that additional capacity is available for an emergency situation. Figure 1 shows the amounts of outstanding bonds guaranteed and the two guarantee limits from August 31, 2001, through August 31, 2006.

Figure 1



Source: Texas Education Agency data used to calculate available bond guarantee capacity.

**Remaining Capacity Was \$10.55 Billion at the End of Fiscal Year 2006**

The attachment to this letter provides additional information on the Program’s fiscal year 2006 activity. As of August 31, 2006, the Program could guarantee an additional \$10.55 billion in bonds before reaching the Texas Education Code and IRS capacity limits. If there is no change to current Program rules, the Fund’s

management estimates that the Program's ability to guarantee school district bonds will be exhausted during fiscal year 2010.

The Fund's management estimates that if the State and IRS limits were increased to 3.5 times the cost or market value of the Fund, the guarantee capacity would be extended through 2018. If the limit were increased to 5 times the cost or market value of the Fund, capacity would be extended beyond 2030.

We appreciate the Texas Education Agency's cooperation during this audit. If you have any questions, please contact Michael C. Apperley, CPA, Assistant State Auditor, or me at (512) 936-9500.

Sincerely,

John Keel, CPA  
State Auditor

Attachment

cc: Members of the State Board of Education:

- Ms. Geraldine Miller, Chair
- Mr. David Bradley, Vice Chair
- Mr. Rick Agosto, Secretary
- Mr. Laurence A. Allen Jr.
- Mrs. Mary Helen Berlanga
- Mrs. Barbara Cargill
- Mr. Bob Craig
- Ms. Cynthia Dunbar
- Mrs. Terri Leo
- Mrs. Gail Lowe
- Ms. Patricia Hardy
- Mrs. Mavis B. Knight
- Dr. Don McLeroy
- Mr. Ken Mercer
- Mr. Rene Nunez
- Dr. Shirley J. Neeley, Commissioner of Education, Texas Education Agency
- Mr. Holland Timmins, CFA, Executive Administrator and Chief Investment Officer, Texas Permanent School Fund
- Ms. Catherine A. Civiletto, CPA, Deputy Executive Administrator, Texas Permanent School Fund



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# Attachment

## Bond Guarantee Program Summary

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The following tables provide a summary of fiscal year 2006 activity for the Permanent School Fund's Bond Guarantee Program (Program). Tables 1 and 2 show the changes in the number and amount of outstanding bonds guaranteed by the Program.

Table 1

Number of Guaranteed Bonds Outstanding	
Category	Number of Issues
Balance on September 1, 2005	2,189
Issued during fiscal year 2006	219
Refunded or matured during fiscal year 2006	<u>(143)</u>
<b>Balance on August 31, 2006</b>	<b>2,265</b>

Source: Permanent School Fund's Bond Guarantee Program Fiscal Year-End Summary.

Table 2

Amount of Guaranteed Bonds Outstanding	
Category	Amount of Issues
Balance on September 1, 2005	\$ 35,230,425,201
Issued during fiscal year 2006	6,442,863,008
Issues that matured during fiscal year 2006	(1,188,170,540)
Issues refunded during fiscal year 2006	(2,681,298,018)
Issues with sinking payments during fiscal year 2006	( 10,390,347)
Other adjustments	<u>\$ 24</u>
<b>Balance on August 31, 2006</b>	<b>\$ 37,793,429,328</b>

Source: Permanent School Fund's Bond Guarantee Program Fiscal Year-End Summary.

Table 3 lists the school districts whose fiscal year 2006 applications for bond guarantees were denied.

Table 3

School Districts Whose Fiscal Year 2006 Bond Guarantee Applications Were Denied	
District	Reason Application Denied
Andrews Independent School District	Not eligible <sup>a</sup>
Coppell Independent School District	Not eligible <sup>a</sup>
Evadale Independent School District	Not eligible <sup>a</sup>
Grapevine-Colleyville Independent School District	Not eligible <sup>a</sup>
La Porte Independent School District	Not eligible <sup>a</sup>
Tolar Independent School District	Not considered financially sound

<sup>a</sup> These school districts were not eligible for the guarantee because their annual debt service per student in average daily attendance exceeded \$1,250.

Source: Data provided by the Texas Education Agency.