



John Keel, CPA
State Auditor

A Review of

**State Agency, University, and
Community College District
Compliance with the Public
Funds Investment Act and
Investment Reporting
Requirements**

March 2008

Report No. 08-023



A Review of

State Agency, University, and Community College District Compliance with the Public Funds Investment Act and Investment Reporting Requirements

SAO Report No. 08-023
March 2008

Overall Conclusion

Most state agencies, universities, and community college districts fully or substantially complied with the Public Funds Investment Act (Act) in fiscal year 2007. Most universities and community college districts also fully or substantially complied with higher education investment reporting requirements mandated by the General Appropriations Act (80th Legislature, Rider 5, page III-224) in fiscal year 2007.

With \$56 billion in investments as of August 31, 2007, it is important that these organizations comply with statutes and investment reporting requirements designed to help the Legislature, the organizations' boards, and the general public ensure that these organizations manage and disclose their investments appropriately. The following describes compliance by type of organization for fiscal year 2007:

Background Information

The Public Funds Investment Act (Act) was enacted in 1995 to improve the management of investments by state agencies, universities, 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 (80th Legislature, page III-224) 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* (State Auditor's Office Report No. 02-058, July 2002).

- **Agencies.** The 12 state agencies subject to the Act were in full or substantial compliance with the Act.
- **Universities.** Of the 15 universities subject to the Act, 13 were in full or substantial compliance with the Act. Two universities—Texas Southern University and Texas Woman's University—were in minimal compliance with the Act. All of the universities were in full or substantial compliance with the higher education investment reporting requirements.
- **Community college districts.** Of the 50 community college districts subject to the Act, 46 were in full or substantial compliance with the Act. One community college district—Alamo Community College District—was in minimal compliance with the Act. Three community college districts—Brazosport College District, Clarendon College, and Ranger College—did not comply with the Act because they did not provide acceptable compliance audits.

This review was conducted in accordance with Texas Government Code, Section 2256.005, and Rider 5, page III-224, the General Appropriations Act (80th Legislature).

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

Forty-three of the 50 community college districts were in full or substantial compliance with the higher education investment reporting requirements. Two community college districts—Austin Community College District and Ranger College—did not post their investment reports, current investment policies, and other required disclosures on their Web sites and, therefore, were non-compliant. Five community college districts—McLennan County Junior College, Navarro College, Panola College, Texarkana College, and Wharton County Junior College District—were minimally compliant with the higher education investment reporting requirements.

- **Universities exempt from the Act but still subject to the higher education investment reporting requirements.** Four university systems¹ are exempt from the Act but are still subject to the higher education investment reporting requirements. Those four university systems fully complied with the higher education investment reporting requirements.

State agencies, universities, and community college districts that are subject to the Act reported total investments of \$24 billion in fiscal year 2007. That total included \$8,031 in derivatives as of August 31, 2007, compared with \$170,627 in derivatives as of August 31, 2005 (the last reporting date).

In reviewing universities and community college districts for compliance with the higher education investment reporting requirements, auditors determined that the majority of these organizations had not fully complied by the initial due date of January 1, 2008. However, after auditors contacted them and established a new due date of January 23, 2008, to allow them to achieve compliance, these organizations posted most of the required information on their Web sites.

Summary of Objectives, Scope, and Methodology

The objectives of this review were to:

- Ensure that state agencies and most higher education institutions complied with the Act's requirement to submit a compliance report to the State Auditor's Office by January 1, 2008.
- Determine whether higher education institutions complied with Rider 5 (General Appropriations Act, 80th Legislature, page III-224) reporting requirements as prescribed by the State Auditor's Office in *A Review of Higher Education Investment Reporting Requirements* (State Auditor's Office Report No. 02-058, July 2002).

The scope of this review covered investment disclosures and reports from September 1, 2005, through January 23, 2008, the due date auditors established

¹ Those university systems include the Texas A&M University System, the Texas Tech University System, the University of Houston System, and the University of Texas System.

for organizations to achieve full compliance after determining that some of them had not fully complied and needed more guidance. Auditors also reviewed results of the organizations' most recent audits regarding compliance with the Act.

The methodology for this review consisted of (1) collecting evidence regarding compliance with the Act included in organizations' audit reports and (2) reviewing investment reports and comparing those reports with investments reported in organizations' annual financial reports. In addition, auditors reviewed organizations' Web sites for the required investment disclosures and communicated with state agencies, universities, and community college districts to ensure that disclosures were completed by January 23, 2008.

Contents

Detailed Results

| | |
|--|----|
| Chapter 1 | |
| All State Agencies Fully or Substantially Complied with the Public Funds Investment Act..... | 1 |
| Chapter 2 | |
| Most Universities Fully or Substantially Complied with the Public Funds Investment Act and Higher Education Investment Reporting Requirements | 3 |
| Chapter 3 | |
| Most Community College Districts Fully or Substantially Complied with the Public Funds Investment Act and Higher Education Investment Reporting Requirements | 8 |
| Chapter 4 | |
| All Universities Subject to the Higher Education Investment Reporting Requirements but Exempt from the Act Fully Complied with the Requirements | 13 |
| Chapter 5 | |
| Agencies, Universities, and Community College Districts Invest in Authorized Investments | 14 |
| Chapter 6 | |
| Enhancements to the Higher Education Investment Reporting Requirements and Other Recommendations | 25 |

Appendices

| | |
|---|----|
| Appendix 1 | |
| Objectives, Scope, and Methodology..... | 26 |
| Appendix 2 | |
| Definitions of Asset Classes | 28 |
| Appendix 3 | |
| Related State Auditor’s Office Work | 30 |

Detailed Results

Chapter 1

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

The Public Funds Investment Act (Act) requires certain state agencies, universities, and community college districts to implement controls in the following areas: policies, contracting, training, reporting, and reviewing. The Act contains multiple requirements for each of these areas, and compliance with these requirements must be tested by the organizations' internal or external auditors at least every two years.

All 12 state agencies that were subject to the Act were in full or substantial compliance with the Act in fiscal year 2007. These agencies reported investments totaling more than \$19.9 billion as of August 31, 2007.

| Definitions of Compliance |
|---|
| <p>Public Funds Investment Act Compliance:</p> <ul style="list-style-type: none"> ▪ Fully Compliant: No findings were reported. ▪ Substantially Compliant: Few findings were reported that were not significant to policies, contracting, training, reporting, or reviewing. ▪ Minimally Compliant: Some findings were reported that were significant to policies, contracting, training, reporting, or reviewing. ▪ Non-compliant: The required compliance report was not provided or was not acceptable. |

Auditors assessed compliance with the Act after reviewing the audit reports issued by agencies' external or internal auditors. Table 1 summarizes the findings reported for the agencies that were assessed as being in substantial compliance.

Table 1

| Summary of Agency Compliance with the Public Funds Investment Act For Agencies That Were Substantially Compliant with the Act | | |
|---|-------------------------|--|
| Agency | Areas of Non-compliance | Findings |
| Water Development Board | Reporting | The agency's investment officer did not sign two quarterly investment transaction reports. |
| | Reporting | The agency did not reconcile investment report data with financial report data for the first two quarters of fiscal year 2007 (reported and actual amounts differed by 1 percent or less). |
| Texas Equal Access to Justice Foundation ^a | Contracting | The foundation's contract with its investment management firm did not specify a contract termination date. |
| | Reporting | The foundation's investment management firm did not submit a required document stating that it had implemented reasonable procedures and controls in an effort to preclude investment transactions that were not authorized by the foundation's investment policy. |

**Summary of Agency Compliance with the Public Funds Investment Act
For Agencies That Were Substantially Compliant with the Act**

| Agency | Areas of Non-compliance | Findings |
|--|-------------------------|---|
| | Training | The foundation's investment officer did not prepare a report on investment training requirements or deliver that report to the Board as required. |
| | Investment Policy | Based on the investment policy, during the year the foundation held on average five unallowable investments in its portfolio. The investments were unallowable due to the length of their maturities. |
| ^a The Texas Equal Access to Justice Foundation is a quasi-agency. | | |

Table 2 lists the agencies that were fully compliant with the Act.

Table 2

| Agencies in Full Compliance with the Act |
|---|
| Board of Law Examiners |
| Department of Criminal Justice |
| Department of Housing and Community Affairs |
| Parks and Wildlife Department |
| Real Estate Commission |
| School for the Blind and Visually Impaired |
| State Bar of Texas |
| Texas Youth Commission |
| Texas Local Government Investment Pool (TexPool) |
| Texas Local Government Investment Pool (TexPrime) |

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

Most of the 15 universities that were subject to the Act were in full or substantial compliance with the Act in fiscal year 2007. These universities reported investments totaling nearly \$1.3 billion as of August 31, 2007.

Auditors assessed compliance with the Act after reviewing the audit reports issued by the universities' auditors. Table 3 summarizes findings for universities that were minimally compliant and substantially compliant. Texas

Southern University and Texas Woman's University were minimally compliant because each of their audit reports contained findings that would significantly affect contracting with investment advisors and reporting to their boards, other agencies, or the public. Additionally, Texas Southern University's audit report contained a significant finding regarding the fact that its investment policy did not include required guidance on investments. Individual audit reports issued by those universities' auditors also contained management comments and action plans regarding the findings noted.

| Definitions of Compliance |
|---|
| <p>Public Funds Investment Act Compliance:</p> <ul style="list-style-type: none"> ▪ Fully Compliant: No findings were reported. ▪ Substantially Compliant: Few findings were reported that were not significant to policies, contracting, training, reporting, or reviewing. ▪ Minimally Compliant: Some findings were reported that were significant to policies, contracting, training, reporting, or reviewing. ▪ Non-compliant: The required compliance report was not provided or was not acceptable. |

Table 3

| Summary of University Compliance with the Public Funds Investment Act | | |
|---|-------------------------|---|
| University | Areas of Non-compliance | Findings |
| Universities That Were Minimally Compliant with the Act | | |
| Texas Southern University | Investment Policy | The university's investment policy did not contain required guidance on investing funds. |
| | Reporting | The university did not submit its investment reports to the Board on a quarterly basis, and the reports did not contain required information. |
| | Reporting | The university did not post its investment reports, investment policy, and 2007 disclosures on its Web site. |
| | Reporting | The university did not obtain written acknowledgements from persons or firms offering to engage in investment transactions with the university. |
| | Reviewing | The university did not maintain and make available confirmations of investment transactions. |
| | Contracting | The university did not have current executed agreements with two of four investment advisors. |
| | Reporting | Three of four investment advisors did not file disclosure statements in a timely manner. |

Summary of University Compliance with the Public Funds Investment Act

| University | Areas of Non-compliance | Findings |
|--|-------------------------|---|
| Texas Woman's University | Reporting | The university did not update its investment Web page with the most recent audit report of investments. |
| | Reporting | The university did not submit its approved investment policy to the Legislative Budget Board and State Auditor by December 31. |
| | Contracting | The university's board did not formally approve a contract extension with an investment management firm. In addition, that contract had exceeded the two-year limitation. |
| | Reviewing | The university did not ensure that an independent auditor performed a formal, annual review of reports prepared by the investment officer. |
| Universities That Were Substantially Compliant with the Act | | |
| Midwestern State University | Reporting | The university did not submit investment reports in a timely manner. |
| | Investment policy | The university's investment policy does not address performance measures. |
| | Training | The university did not provide investment training to board members in a timely manner. |
| Sam Houston State University | Training | The university's investment officer did not complete required continuing professional education. |
| Stephen F. Austin State University | Investment Policy | The university had uninsured and uncollateralized balances held at a local financial institution. |
| | Reporting | The university's financial advisor completed the disclosure form but did not submit it to the State Auditor's Office as required. |
| Sul Ross State University | Reporting | The university did not submit its third quarter investment report to the board in a timely manner. |
| | Investment Policy | Because of the retirement of an employee, the university had only one investment officer. This was a violation of the university's administrative procedures. |
| | Reporting | The university did not post its quarterly investment reports for the second and third quarter on its Web site until October 2007. |
| Texas State Technical College System | Reviewing | The college should enhance its approval and monitoring of access to demand deposit accounts. |
| | Training | The college should expand training to new regents and investment decision makers. |
| Texas State University-San Marcos | Reporting | The university's investment reports did not comply with State Auditor's Office's reporting format. |
| | Reviewing | The university did not perform required annual reviews of investment reports. |
| | Controls | The university should implement segregation of duties for stronger controls over investment activity. |

Universities' Compliance with Higher Education Investment Reporting Requirements

The higher education investment reporting requirements, as outlined in *A Review of Higher Education Investment Reporting Requirements* (SAO Report No. 02-058, July 2002), are as follows:

- Submit the annual investment report to the State Auditor's Office, the Comptroller of Public Accounts, the Governor's Office, and the Legislative Budget Board.
- Disclose the following information on the organization's Web site:
 - ♦ Quarterly investment reports.
 - ♦ Outside investment managers disclosure.
 - ♦ Soft dollar agreements disclosure.²
 - ♦ Foundation disclosure.
 - ♦ Current investment policies.

² Soft dollar arrangements are a means of paying commissions and other services through fee agreements rather than through direct per transaction payments.

| Definitions of Compliance |
|--|
| <p>Higher Education Investment Reporting Requirements:</p> <ul style="list-style-type: none"> ▪ Fully Compliant: The organization met all reporting requirements. ▪ Substantially Compliant: The organization met reporting requirements, with minor omissions. ▪ Minimally Compliant: The organization's achievement of the reporting requirements was incomplete, and there were significant omissions. ▪ Non-compliant: The organization's achievement of the reporting requirements was incomplete, and most or all of the required disclosures and reports were omitted. |

In reviewing universities for compliance with the higher education investment reporting requirements, auditors determined that, of the 15 universities, 7 were substantially compliant and 8 were fully compliant (see Table 4 for details).

Table 4

| Summary of Universities' Compliance with Higher Education Investment Reporting Requirements | |
|---|---|
| University | Requirements in Non-compliance |
| Universities That Were Substantially Compliant with Higher Education Investment Reporting Requirements | |
| Lamar State College - Orange | <ul style="list-style-type: none"> • The investment policies the university posted on its Web site were not current or did not disclose the date of the most recent annual reaffirmation. |
| Lamar State College - Port Arthur | <ul style="list-style-type: none"> • The investment policy the university posted on its Web site did not note the date of the board's last annual reaffirmation of that policy. |
| Sul Ross State University | <ul style="list-style-type: none"> • The university did not post outside investment managers on its Web site. • The university did not post foundation affiliations on its Web site. |
| Texas Southern University | <ul style="list-style-type: none"> • The university did not post its investment policy on its Web site. |
| Texas State University - San Marcos | <ul style="list-style-type: none"> • The university did not post foundation affiliations on its Web site. • The investment policies the university posted on its Web site were not current. |
| University of North Texas | <ul style="list-style-type: none"> • The investment policies the university posted on its Web site were not current or did not disclose the date of the most recent annual reaffirmation. |
| University of North Texas Health Sciences Center at Fort Worth | <ul style="list-style-type: none"> • The investment policies the university posted on its Web site were not current or did not disclose the date of the most recent annual reaffirmation. |

Table 5 lists the universities that were fully compliant with both the Act and the higher education investment reporting requirements.

Table 5

| Universities in Full Compliance with the Act and Higher Education Investment Reporting Requirements |
|--|
| Angelo State University |
| Lamar Institute of Technology |
| Lamar University - Beaumont |

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

Independent audits provided by the community college districts identified overall compliance with the Act in fiscal year 2007. These community college districts reported investments totaling \$2.8 billion as of August 31, 2007.

Definitions of Compliance

Public Funds Investment Act Compliance:

- Fully Compliant: No findings reported.
- Substantially Compliant: Few findings were reported that are not significant to policies, contracting, training, reporting, reviewing, or auditing.
- Minimally Compliant: Some findings reported that are significant to policies, contracting, training, reporting, reviewing, or auditing.
- Non-compliant: The required compliance report was not provided or was not acceptable.

Forty-four of the districts were in full compliance. Table 6 shows the three districts (Brazosport College District, Clarendon College, and Ranger College) that were non-compliant because they did not submit acceptable compliance reports. One district—Alamo Community College District—was minimally compliant because it reported significant findings related to its investment policy and reporting. Two districts—Temple College and Texarkana College—were substantially compliant.

Table 6

| Community College Districts' Compliance with the Act | | |
|---|----------------------------------|---|
| Community College District | Area(s) of Non-compliance | Comments |
| Community College Districts That Were Non-compliant with the Act | | |
| Brazosport College District | Reporting | The district did not submit the required audit report on compliance with the Act. |
| Clarendon College | Reporting | The district did not submit the required audit report on compliance with the Act. |
| Ranger College | Reporting | The district did not submit the required audit report on compliance with the Act. |
| Community College Districts That Were Minimally Compliant with the Act | | |
| Alamo Community College District | Investment Policy | The district's board did not review the investment policy and strategies during the year ended August 31, 2007. |
| | Reporting | One of the district's investment dealers, which was responsible for originating transactions, did not complete the required acknowledgement and certifications. |
| | Reporting | The district's board did not approve a list of qualified brokers during the year ended August 31, 2007. |
| Community College Districts That Were Substantially Compliant with the Act | | |
| Temple College | Reporting | The district did not present quarterly investment report in a timely manner. |
| Texarkana College | Investment Policy | The district's governing body did not review its investment policy during the year ended August 31, 2007. |

Community College Districts' Compliance with Higher Education Investment Reporting Requirements

In reviewing community college districts for compliance with the higher education investment reporting requirements, auditors identified 2 districts that were non-compliant, 5 districts that were minimally compliant, and 19 districts that were substantially compliant (see Table 7 for details).

Definitions of Compliance

Higher Education Investment Reporting Requirements:

- **Fully Compliant:** The organization met all reporting requirements.
- **Substantially Compliant:** The organization met reporting requirements, with minor omissions.
- **Minimally Compliant:** The organization's achievement of the reporting requirements was incomplete, and there were significant omissions.
- **Non-compliant:** The organization's achievement of the reporting requirements was incomplete, and most or all of the required disclosures and reports were omitted.

The two districts that were non-compliant—Austin Community College District and Ranger College—did not disclose any of the required information on their Web sites.

The minimally compliant districts—McLennan County Junior College, Navarro College, Panola College, Texarkana College, and Wharton County Junior College District—did not comply with several disclosure requirements, including at least one of the following: not complying with the requirement to post current investment policies on their Web sites, not complying with the requirement to disclose the most current annual reaffirmation date of the investment policies, or not complying with the requirement to post quarterly reports on their Web sites.

Table 7

| Community College Districts' Compliance with Higher Education Investment Reporting Requirements | |
|--|---|
| Community College District | Requirements in Non-Compliance |
| Community College Districts That Were Non-compliant with Higher Education Investment Reporting Requirements | |
| Austin Community College District | <p>The district did not post the following items on its Web site:</p> <ul style="list-style-type: none"> • Quarterly investment reports. • Outside advisors. • Soft dollar arrangements.^a • Foundations. • Annual investment summary. <p>The investment policy the district posted on its Web site was not current.</p> |
| Ranger College | <p>The district did not post the following items on its Web site:</p> <ul style="list-style-type: none"> • Quarterly investment reports. • Outside advisors. • Soft dollar arrangements.^a • Foundations. • Annual investment summary. <p>The investment policy the district posted on its Web site was not current.</p> |

**Community College Districts' Compliance with
Higher Education Investment Reporting Requirements**

| Community College District | Requirements in Non-Compliance |
|--|---|
| Community College Districts That Were Minimally Compliant with Higher Education Investment Reporting Requirements | |
| McLennan County Junior College District | <p>The district did not submit or post on its Web site the following items:</p> <ul style="list-style-type: none"> • Annual investment summary. • Quarterly investment reports. <p>The investment policies the district posted on its Web site were not current or did not disclose the date of the most recent annual reaffirmation.</p> |
| Navarro College | <p>The district did not post the following items on its Web site:</p> <ul style="list-style-type: none"> • Outside advisors. • Soft dollar arrangements.^a • Foundation disclosures. <p>The investment policies the district posted on its Web site were not current or did not disclose the date of the most recent annual reaffirmation.</p> |
| Panola College | <p>The district did not submit or post on its Web site the following items:</p> <ul style="list-style-type: none"> • Annual investment summary. • Quarterly investment reports. <p>The investment policy the district posted on its Web site did not disclose the date of the board's most recent reaffirmation of that policy.</p> |
| Texarkana College | <p>The district did not submit or post on its Web site its quarterly investment reports.</p> <p>The investment policies the district posted on its Web site were not current or did not disclose the date of the most recent annual reaffirmation.</p> |
| Wharton County Junior College District | <p>The district did not post the following items on its Web site:</p> <ul style="list-style-type: none"> • Outside advisors. • Soft dollar arrangements.^a • Foundation disclosures. <p>The investment policies the district posted on its Web site were not current or did not disclose the date of the most recent annual reaffirmation.</p> |
| Community College Districts That Were Substantially Compliant with Higher Education Investment Reporting Requirements | |
| Amarillo College | The investment policy the district posted on its Web site did not disclose the date of the board's most recent reaffirmation of that policy. |
| Blinn College | The foundation disclosure the district posted on its Web site was not current. |
| Brazosport College District | The investment policies the district posted on its Web site were not current or did not disclose the date of the most recent annual reaffirmation. |
| Clarendon College | The district did not post all of the required quarterly investment reports on its Web site. |
| College of the Mainland | The investment policies the district posted on its Web site were not current or did not disclose the date of the most recent annual reaffirmation. |
| Dallas County Community College District | The foundation disclosure the district posted on its Web site was not current. |
| Del Mar College | The district did not post its investment policy on its Web site. |
| Frank Phillips College (Borger) | The investment policies the district posted on its Web site were not current or did not disclose the date of the most recent annual reaffirmation. |
| Grayson County College | The investment policies the district posted on its Web site were not current or did not disclose the date of the most recent annual reaffirmation. |
| Houston Community College System | The investment policies the district posted on its Web site were not current or did not disclose the date of the most recent annual reaffirmation. |

**Community College Districts' Compliance with
Higher Education Investment Reporting Requirements**

| Community College District | Requirements in Non-Compliance |
|--|--|
| Laredo Community College | The investment policies the district posted on its Web site were not current or did not disclose the date of the most recent annual reaffirmation. |
| North Harris Montgomery Community College District (Lone Star College System) | The investment policies the district posted on its Web site were not current or did not disclose the date of the most recent annual reaffirmation. |
| Paris Junior College | The district did not post its investment policy on its Web site. |
| San Jacinto College District | The district did not post its foundation disclosure on its Web site. |
| South Plains College | The foundation disclosure the district posted on its Web site was not current. The investment policy the district posted on its Web site did not disclose the date of the board's most recent reaffirmation of that policy. |
| South Texas College | The district did not post its investment policy on its Web site. |
| Tarrant County College District | The investment policy the district posted on its Web site did not disclose the date of the board's most recent reaffirmation of that policy. |
| Temple College | The investment policies the district posted on its Web site were not current or did not disclose the date of the most recent annual reaffirmation. |
| Trinity Valley Community College | The investment policies the district posted on its Web site were not current or did not disclose the date of the most recent annual reaffirmation. |
| ^a Soft dollar arrangements are a means of paying commissions and other services through fee agreements rather than through direct per transaction payments. | |

Table 8 lists the community college districts that were fully compliant with both the Act and higher education investment reporting requirements.

Table 8

| Community College Districts That Were Fully Compliant with The Act and Higher Education Investment Reporting Requirements |
|---|
| Alvin Community College |
| Angelina County Junior College District |
| Central Texas College District |
| Cisco Junior College District |
| Coastal Bend College |
| Collin County Community College District |
| El Paso County Community College District |
| Galveston County College |
| Hill College District |
| Howard County Junior College District |
| Kilgore Junior College District |
| Lee College District |
| Midland Community College District |
| North Central Texas College |
| Northeast Texas Community College |
| Odessa Junior College District |
| Southwest Texas Junior College |
| Texas Southmost College |
| Tyler Junior College District |
| Vernon College |
| Victoria County Junior College District |
| Weatherford College of the Parker Junior College District |
| Western Texas College |

All Universities Subject to the Higher Education Investment Reporting Requirements but Exempt from the Act Fully Complied with the Requirements

Certain universities are required to follow the higher education investment reporting requirements but they are exempt from the Act. Specifically, any university that had total endowments of at least \$95 million as of May 1, 1995, is exempt from complying with 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.

These university systems were in full compliance with higher education investment reporting requirements. (The university systems reported for all of the universities within their systems.) Table 9 shows the university systems that were in full compliance with the higher education investment reporting requirements.

Table 9

| University Systems that Fully Complied with Higher Education Investment Reporting Requirements |
|--|
| Texas A&M University System |
| Texas Tech University System |
| University of Houston System |
| The University of Texas System |

Agencies, Universities, and Community College Districts Invest in Authorized Investments

State agencies, universities, and community college districts that were subject to the Act reported they had a total of \$8,031 in derivatives as of August 31, 2007, compared with \$170,627 in derivatives as of August 31, 2005 (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. Although the Act lists derivatives as a prohibited investment, organizations may continue to hold derivatives they owned as of the date of the Act’s enactment.

The state agencies, universities, and community college districts auditors reviewed reported different types of investments as of August 31, 2007. Universities and community college districts had more than \$1.9 billion invested in the Texas Local Government Investment Pool (TexPool), which had \$14 billion invested in repurchase agreements.

Universities that were exempt from the Act invested very differently from the other types of organizations. For example:

- Universities that were exempt from the Act had more than 40 percent of their portfolios invested in “other investments,” including real estate, private equity, and hedge funds.
- Universities that were subject to the Act had 9.3 percent of the portfolio invested in “other investments.”
- Community college districts that were subject to the Act held 0.2 percent of their portfolios in “other investments.”
- State agencies that were subject to the Act held less than 0.1 percent of their portfolios in “other investments.”

Agencies, universities, and community college districts that were subject to the Act also invested up to 16.9 percent of their portfolios in short-term U.S. government and agency obligations, but Universities that were exempt from the Act invested only 0.5 percent of their portfolios in that category.

Total investments reported by state agencies subject to the Act are presented in Table 10.

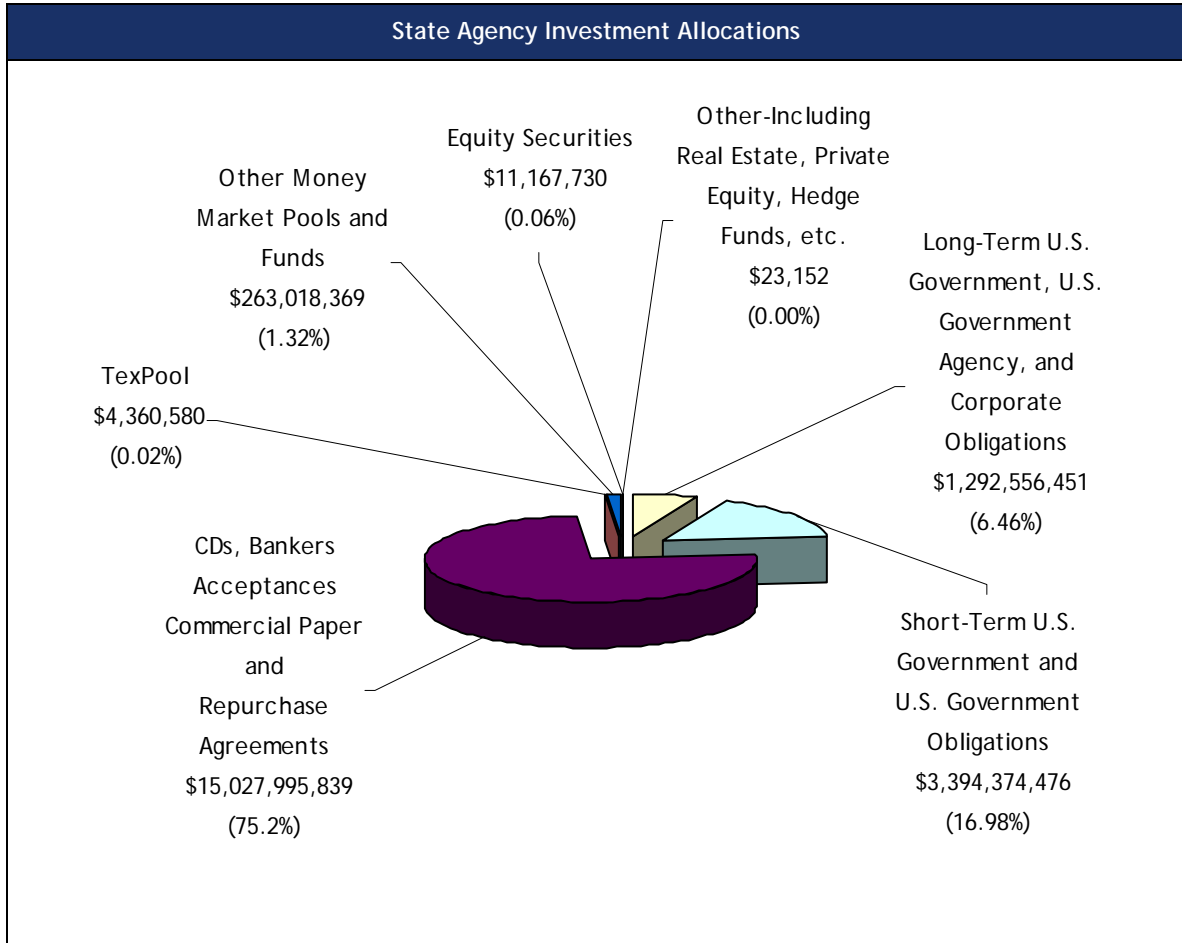
Table 10

| Total Agency Investments ^a | |
|--|---|
| Agency | Market Value of Investments as of August 31, 2007 |
| Board of Law Examiners | \$ 2,376,018 |
| Department of Criminal Justice | 21,633,790 |
| Department of Housing and Community Affairs | 1,628,052,828 |
| Texas Local Government Investment Pool (TexPool) ^b | 16,429,628,693 |
| Texas Local Government Investment Pool Prime (TexPool Prime) | 1,213,065,982 |
| Texas Parks and Wildlife Department | 11,518,625 |
| Real Estate Commission | 2,102,294 |
| School for the Blind and Visually Impaired | 550,657 |
| State Bar of Texas | 33,082,334 |
| Texas Equal Access to Justice Foundation | Not reported |
| Texas Youth Commission | Not reported |
| Water Development Board | 651,485,375 |
| Total | \$ 19,993,496,596 |
| ^a This table includes investment information only for agencies that are subject to the Act. ^b The amount reported for TexPool includes \$1.9 billion that other agencies report as being invested in TexPool. To avoid duplication, this amount should be deducted from the overall total of available investments. | |

Source: Unaudited information reported by the agencies.

State agency investment allocations as of August 31, 2007, are depicted in Figure 1 (see Appendix 2 for definitions of specific asset classes).

Figure 1



Source: Unaudited information reported by the agencies.

Total investments reported by universities that were subject to the Act are presented in Table 11.

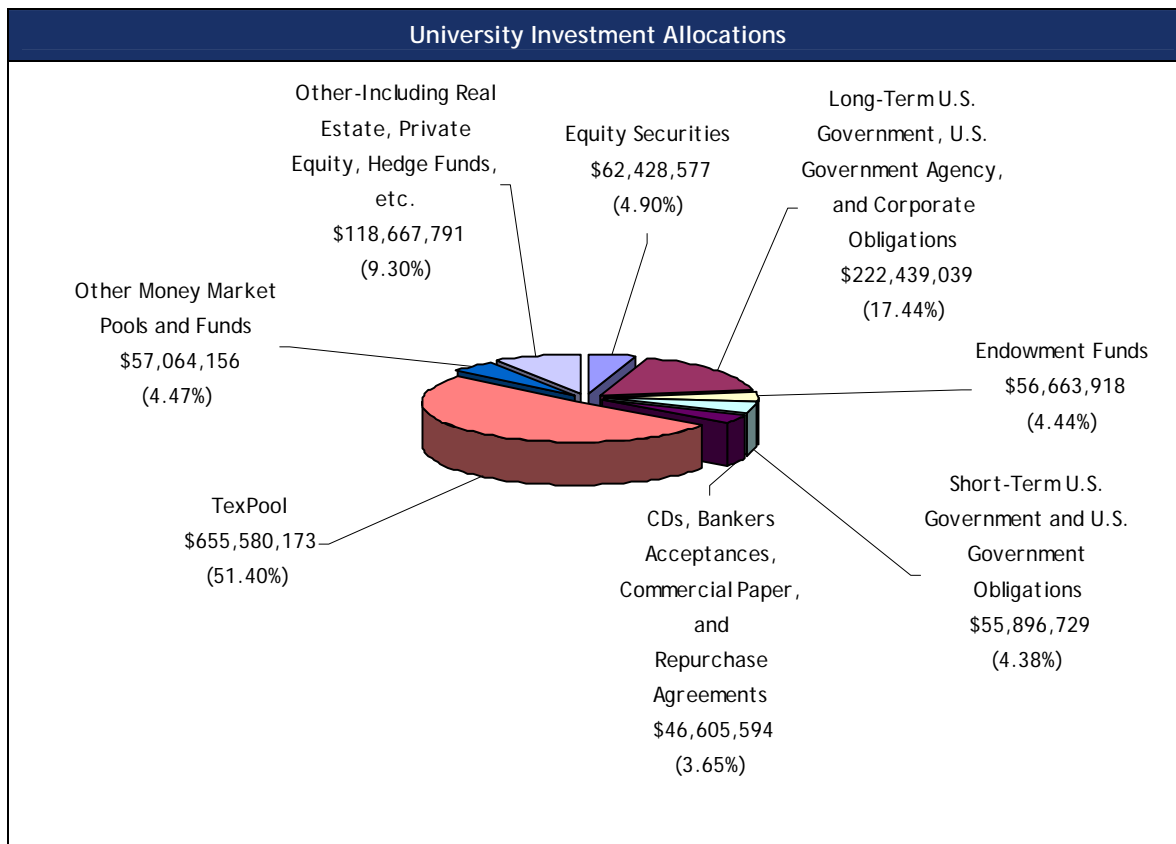
Table 11

| Total University Investments ^a | |
|--|---|
| University | Market Value of Investments as of August 31, 2007 |
| Angelo State University | \$ 124,659,150 |
| Lamar Institute of Technology | 2,327,003 |
| Lamar State College - Orange | 7,685,266 |
| Lamar State College - Port Arthur | 4,062,704 |
| Lamar University | 59,214,500 |
| Midwestern State University | 52,074,279 |
| Sam Houston State University | 128,917,397 |
| Stephen F. Austin State University | 38,473,688 |
| Sul Ross State University | 25,006,076 |
| Texas Southern University | 46,651,592 |
| Texas State Technical College System | 17,528,086 |
| Texas State University - San Marcos | 254,730,972 |
| Texas Woman's University | 134,770,880 |
| University of North Texas | 294,708,203 |
| University of North Texas Health Science Center at Fort Worth | 84,536,181 |
| Total | \$ 1,275,345,977 |
| ^a This table includes investment information only for universities that are subject to both the Act and higher education investment reporting requirements. | |

Source: Unaudited information reported by the universities.

University investment allocations as of August 31, 2007, are depicted in Figure 2.

Figure 2



Source: Unaudited information reported by the universities.

Total investments reported by community college districts are presented below in Table 12.

Table 12

| Total Community College District Investments | |
|--|---|
| Community College District | Market Value of Investments as of August 31, 2007 |
| Alamo Community College District | \$ 575,123,813 |
| Alvin Community College | 11,801,888 |
| Amarillo College | 33,429,957 |
| Angelina County Junior College District | 8,402,357 |
| Austin Community College District | 90,266,512 |
| Blinn College | 27,436,297 |

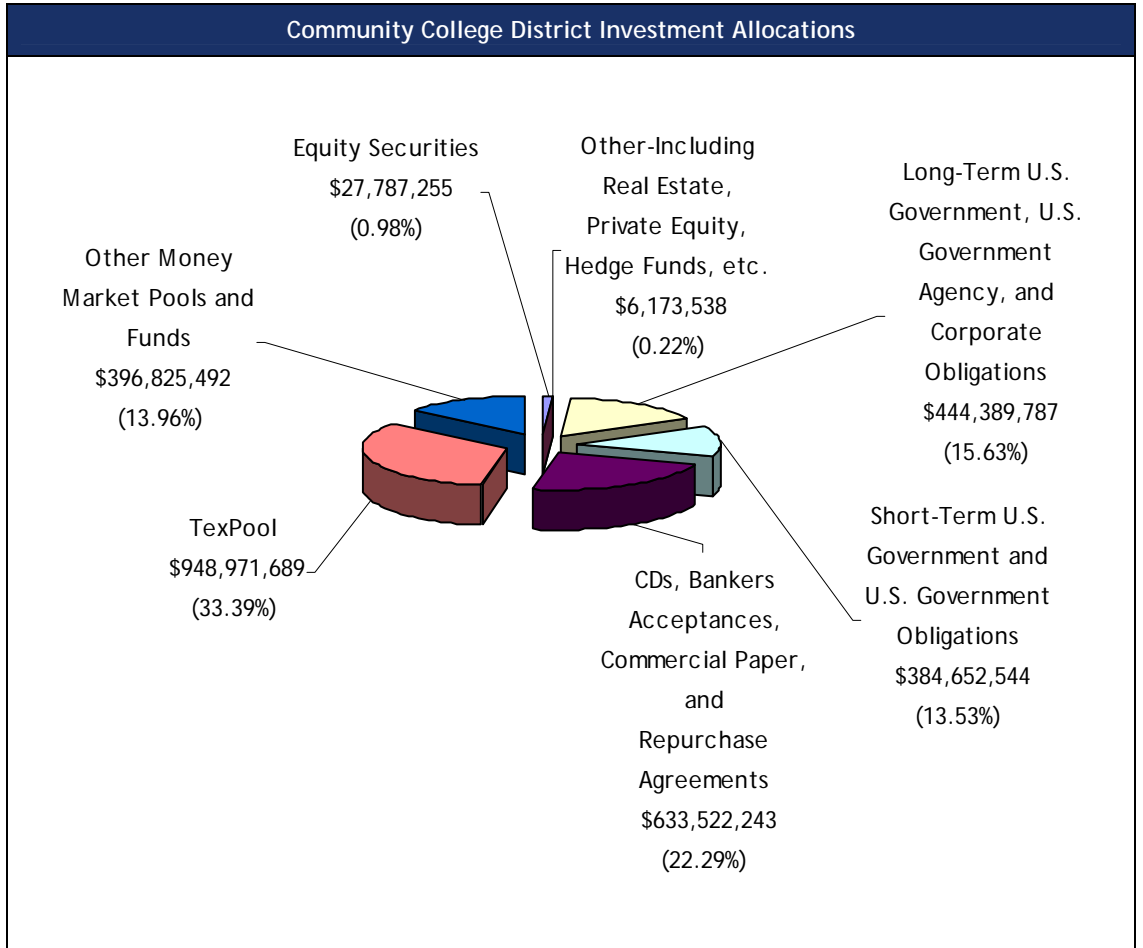
| Total Community College District Investments | |
|--|--|
| Community College District | Market Value of Investments as of August 31, 2007 |
| Brazosport College District | 10,829,327 |
| Central Texas College District | 88,937,568 |
| Cisco Junior College District | 4,445,966 |
| Clarendon College | 2,705,602 |
| Coastal Bend College | 4,930,088 |
| College of the Mainland | 12,385,316 |
| Collin County Community College District | 195,931,014 |
| Dallas County Community College District | 208,042,003 |
| Del Mar College | 61,548,168 |
| El Paso County Community College District | 87,738,171 |
| Frank Phillips College (Borger) | 2,669,841 |
| Galveston Community College District | 10,720,129 |
| Grayson County College | 12,653,182 |
| Hill College District | 2,671,702 |
| Houston Community College System | 289,483,110 |
| Howard County Junior College District | 33,165,959 |
| Kilgore Junior College District | 8,198,505 |
| Laredo Community College | 4,670,895 |
| Lee College District | 23,984,099 |
| McLennan County Junior College District | 48,074,150 |
| Midland Community College District | 50,066,879 |
| Navarro College | 5,509,046 |
| North Central Texas College | 17,845,809 |
| North Harris Montgomery Community College District | 100,824,866 |
| Northeast Texas Community College | 5,496,886 |
| Odessa Junior College District | 27,653,681 |
| Panola College | 7,805,846 |
| Paris Junior College | 17,784,392 |
| Ranger College | 437,857 |
| San Jacinto College District | 56,045,966 |
| South Plains College | 7,932,356 |
| South Texas College | 78,265,578 |
| Southwest Texas Junior College | 7,710,364 |
| Tarrant County College District | 394,628,355 |
| Temple College | 23,864,844 |
| Texarkana College | 21,771,897 |
| Texas Southmost College | 54,824,633 |

| Total Community College District Investments | |
|--|--|
| Community College District | Market Value of Investments as of August 31, 2007 |
| Trinity Valley Community College | 10,105,560 |
| Tyler Junior College District | 40,858,195 |
| Vernon College | 4,098,958 |
| Victoria County Junior College District | 4,161,363 |
| Weatherford College of the Parker County Junior College District | 13,687,810 |
| Western Texas College | 3,145,486 |
| Wharton County Junior College District | 27,550,302 |
| Total | \$ 2,842,322,548 |

Source: Unaudited information reported by the community college districts.

Community college district investment allocations as of August 31, 2007, are depicted in Figure 3.

Figure 3



Source: Unaudited information reported by the community college districts.

Total investments reported by university systems that are not subject to the Act but that are subject to higher education investment reporting requirements are presented in Table 13.

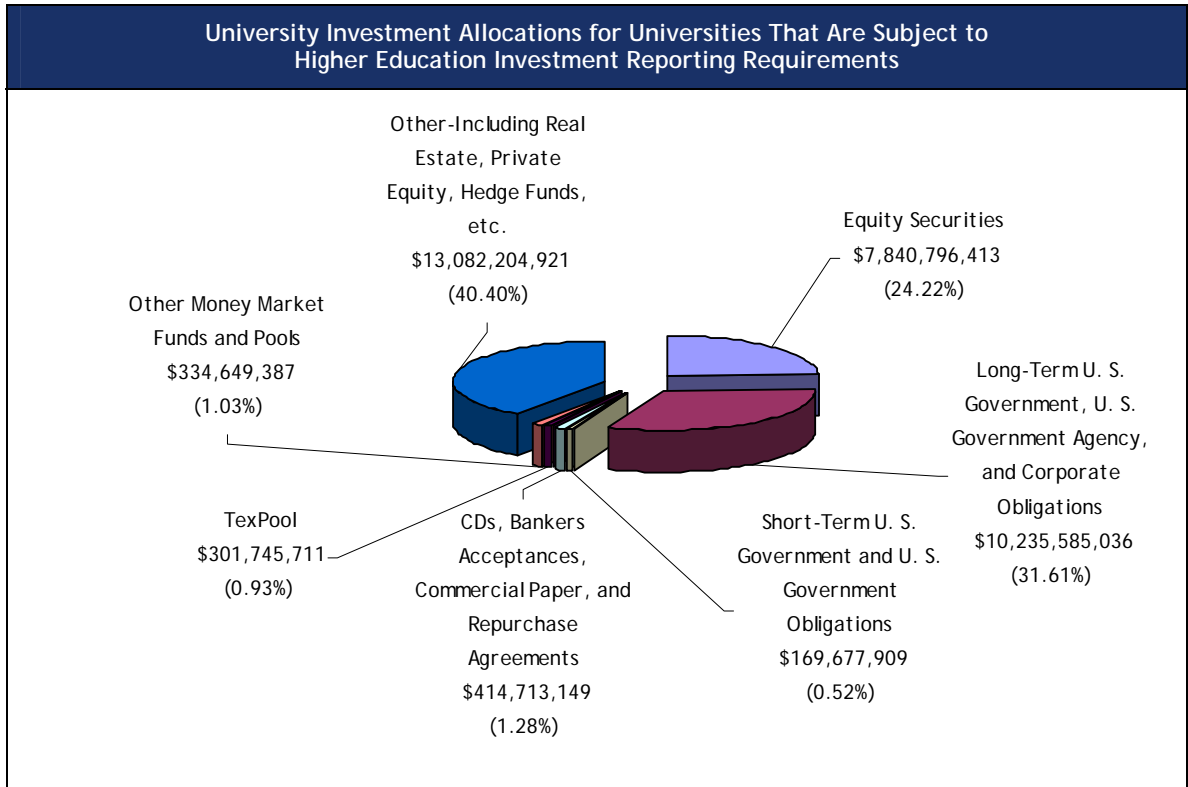
Table 13

| Total University System Investments ^a | |
|--|---|
| University System | Market Value of Investments as of August 31, 2007 |
| Texas A&M University System | \$ 2,813,202,904 |
| Texas Tech University System | 1,290,446,330 |
| University of Houston System | 844,010,279 |
| The University of Texas System | 27,431,713,012 |
| Total | \$ 32,379,372,525 |
| ^a This table includes investment information for university systems that are not subject to the Act but that are subject to higher education investment reporting requirements. | |

Source: Unaudited information reported by the university systems.

Investment allocations as of August 31, 2007, for university systems that are not subject to the Act but that are subject to higher education investment reporting requirements are depicted in Figure 4.

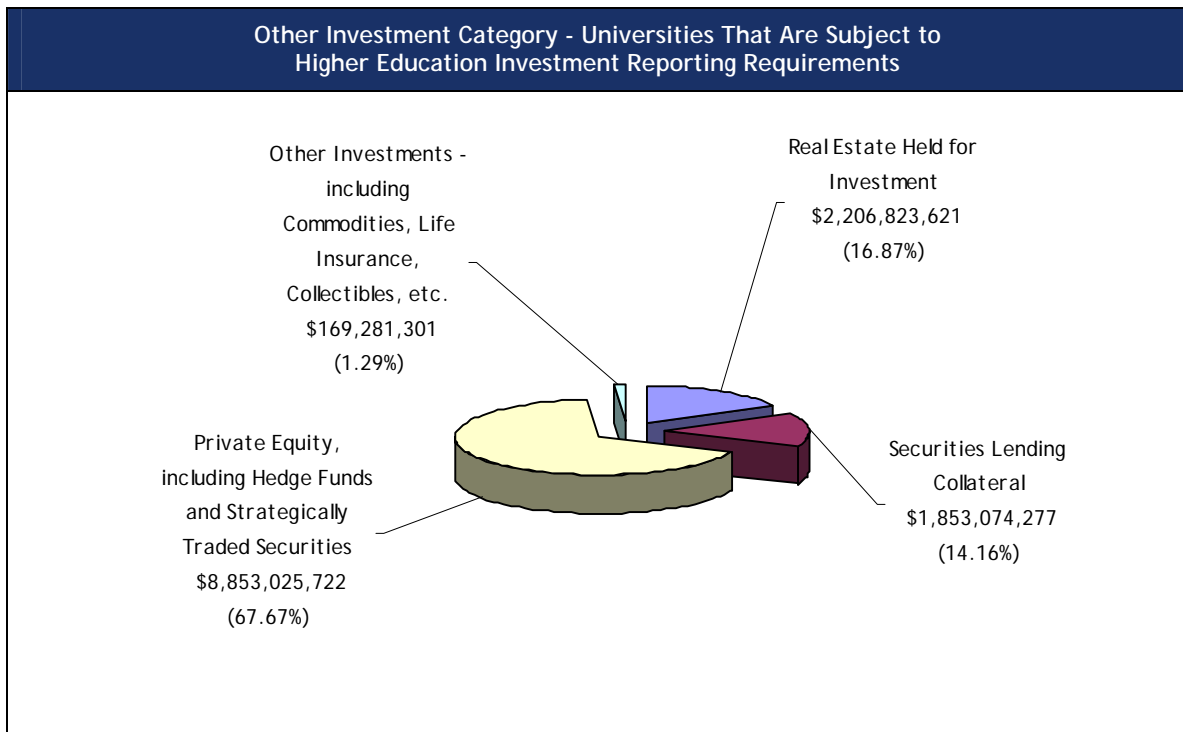
Figure 4



Source: Unaudited information reported by the university systems.

As shown in the figure above, “Other Investments” comprised approximately 40 percent of the overall portfolio for university systems that were exempt from the Act but that were subject to higher education investment reporting requirements. These other investments are detailed in Figure 5 below (see Appendix 2 for definitions of specific asset classes).

Figure 5



Source: Unaudited information reported by the university systems.

Enhancements to the Higher Education Investment Reporting Requirements and Other Recommendations

Auditors offer the following recommendations to enhance the consistency of investment reporting by organizations 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:

- We encourage management of these organizations 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 also should ensure that the required investment disclosures are posted on their Web sites in a timely manner.
- Management of these organizations should reconcile amounts reported in the *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:

- Ensure that state agencies and most higher education institutions complied with the Public Funds Investment Act (Act) requirement to submit a compliance report to the State Auditor's Office by January 1, 2008.
- Determine whether higher education institutions complied with Rider 5 (General Appropriations Act, 80th Legislature, page III-224) reporting requirements as prescribed by the State Auditor's Office in *A Review of Higher Education Investment Reporting Requirements* (State Auditor's Office Report No. 02-058, July 2002).

Scope

The scope of this review covered investment disclosures and reports from September 1, 2005, to January 23, 2008, the due date auditors established for completing disclosures. Auditors also reviewed results of organizations' most recent audits regarding compliance with the Act.

Methodology

The methodology consisted of (1) collecting evidence of compliance and non-compliance with the Act reported in audits and (2) reviewing investment reports and comparing those reports with investments reported in annual financial reports. In addition, auditors reviewed Web sites for the required investment disclosures and communicated with state agencies, universities, and community college districts in an effort to ensure that disclosures were complete by January 23, 2008, the due date auditors set after determining that some of the organizations had not fully complied with the requirements.

Other Information

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

- Hillary Eckford, CIA (Project Manager)
- Jules Hunter, CPA, CIA

- Leslie P. Ashton, CPA (Quality Control Reviewer)
- Verma Elliott, MBA, CIA, CGAP (Audit Manager)

Definitions of Asset Classes

Table 14 provides the definitions of different asset classes.

Table 14

| Definitions of Asset Classes |
|---|
| <u>A1/P1 Commercial Paper</u> : Commercial paper rated A1, P1, or F1 (or higher). Lower rated paper should be listed under "other" short-term investments. |
| <u>Annuities</u> : A type of investment sold by insurance companies; includes fixed and variable annuities. |
| <u>Bank Deposits</u> : Money held in bank, savings bank, or credit union accounts. |
| <u>Bond Mutual Funds</u> : Investment in debt securities with a net asset value per share that varies. |
| <u>Cash Held at State Treasury</u> : Includes all balances held in the State Treasury or the Texas Treasury Safekeeping Trust Company. |
| <u>CDs/BAs</u> : Certificates of Deposit and Bankers Acceptances with a maturity under one year. |
| <u>Collateralized Mortgage Obligations (CMO)</u> : Mortgage-backed securities that create separate pools of pass-through rates for different classes of bondholders and with varying maturities. (CMOs are not allowable investments under the Public Funds Investment Act. However, organizations may hold CMOs that they purchased prior to September 1, 1995.) |
| <u>Collectables</u> : Include items such as art, stamps, coins, historic documents, and memorabilia. |
| <u>Collective Endowment Funds</u> : Long-term endowment funds managed by a third party that combine investments from multiple investors (for example, the Common Fund or the Permanent Higher Education Fund). |
| <u>Commodities</u> : Include investments in areas such as oil and gas, timberland, and precious metals. |
| <u>Corporate Obligations</u> : Include all non-governmental debt issues classified by rating. For issues with split ratings, the lower ratings are reported. Equivalent ratings from rating agencies such as Fitch may be used. <ul style="list-style-type: none"> ▪ <u>Highly Rated Corporate Issues</u>: Issues rated AAA or AA by Standard and Poor's or AAA or Aa by Moody's. ▪ <u>Investment Grade Corporate Issues</u>: Issues rated A or BBB by Standard and Poor's or A or Baa by Moody's. ▪ <u>NR/High Yield Issues</u>: Include non-rated issues and those rated BB or lower by Standard and Poor's or Ba or lower by Moody's. |
| <u>Equity Mutual Funds</u> : These funds invest in stocks and also include balanced funds that include a mix of stocks and bonds. |
| <u>Equity Securities</u> : Include U. S. common stocks, equity mutual funds, and other equity securities. |
| <u>Foreign Issued Obligations</u> : Securities issued outside of the U.S. by non-U.S. issuers (in U.S. dollars or foreign currency). Also includes U.S.-issued securities denominated in foreign currencies. |
| <u>Guaranteed Investment Contracts (GIC)</u> : Contracts issued by insurance companies. |
| <u>Mortgage Pass-throughs</u> : Residential mortgage securities pooled together and marketed by governmental agency issuers as the Government National Mortgage Association (GNMA or Ginnie Mae), FNMA (Fannie Mae), and Freddie Mac; includes private issues with CMOs. |
| <u>Municipal Obligations</u> : Include all state, county, municipality, or public authority issues. |
| <u>Other Asset Backed Bonds</u> : Securities backed by pools of assets such as credit card loans, commercial real estate loans, and auto loans. |
| <u>Other Equity Securities</u> : Include preferred stocks, foreign stocks, and non-publicly traded stocks. |
| <u>Other Money Market Funds</u> : Money funds with a constant \$1.00 per share net asset value objective. |
| <u>Private Equity</u> : Includes investments in things such as venture capital, hedge funds, leveraged buyout, mezzanine, and strategically traded securities that are held directly or through investment vehicles such as limited partnerships. |
| <u>Real Estate</u> : Includes real estate held for investment either directly or through investment vehicles such as limited partnerships. |

Definitions of Asset Classes

Securities Lending Collateral: Collateral given to an investor in return for the loan of securities to a broker to cover a short sale.

Short-Term Investments: Include all debt investments with a maturity as of purchase date of less than one year. May also include cash and bank deposits not otherwise classified.

TexPool and TexPool Prime: Investments in TexPool; includes other Texas pool investments.

U.S. Common Stocks: Include only publicly traded stocks.

U.S. Government Agency Securities: Securities issued by U.S. government-sponsored agencies or corporations such as FNMA (Fannie Mae) or FHLB(Federal Home Loan Bank) that do not have full faith and credit guarantees from the U.S. government.

U.S. Government Securities: Include treasuries and any other investments with an affirmative full faith and credit guarantee of the U.S. government.

Source: *A Review of Higher Education Investment Reporting Requirements* (State Auditor's Office Report No. 02-058, July 2002).

Related State Auditor's Office Work

| Related SAO Work | | |
|------------------|---|--------------|
| Number | Product Name | Release Date |
| 06-026 | A Review of State Entity and Community College District Compliance with the Public Funds Investment Act and Investment Reporting Requirements | March 2006 |
| 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 |

Copies of this report have been distributed to the following:

Legislative Audit Committee

The Honorable David Dewhurst, Lieutenant Governor, Joint Chair
The Honorable Tom Craddick, Speaker of the House, Joint Chair
The Honorable Steve Ogden, Senate Finance Committee
The Honorable Thomas “Tommy” Williams, Member, Texas Senate
The Honorable Warren Chisum, House Appropriations Committee
The Honorable Jim Keffer, House Ways and Means Committee

Office of the Governor

The Honorable Rick Perry, Governor

All Organizations Listed in This Report

This report was distributed to the boards, presidents, and executive directors of the agencies, universities, and community college districts listed in this report.



This document is not copyrighted. Readers may make additional copies of this report as needed. In addition, most State Auditor's Office reports may be downloaded from our Web site: www.sao.state.tx.us.

In compliance with the Americans with Disabilities Act, this document may also be requested in alternative formats. To do so, contact our report request line at (512) 936-9880 (Voice), (512) 936-9400 (FAX), 1-800-RELAY-TX (TDD), or visit the Robert E. Johnson Building, 1501 North Congress Avenue, Suite 4.224, Austin, Texas 78701.

The State Auditor's Office is an equal opportunity employer and does not discriminate on the basis of race, color, religion, sex, national origin, age, or disability in employment or in the provision of services, programs, or activities.

To report waste, fraud, or abuse in state government call the SAO Hotline: 1-800-TX-AUDIT.