



John Keel, CPA  
State Auditor

An Audit Report on

# Certification of the Permanent School Fund's Bond Guarantee Program for Fiscal Year 2014

March 10, 2015

Members of the Legislative Audit Committee:

The State Auditor's Office certifies that, for the fiscal year ended August 31, 2014, the amount of school district bonds guaranteed by the Permanent School Fund's (Fund) Bond Guarantee Program (Program) was within the limits applicable to the Program. In addition, the Fund had sufficient reserves to meet the State Board of Education's (Board) reserve requirements for the same time period.

As of August 31, 2014, the total principal of the 2,879 outstanding bond issues guaranteed by the Program was \$58.4 billion (see Section 1 of the attachment to this letter for a summary of the Program's activity during fiscal year 2014). In addition, as of that date, the bond guarantee capacity of the Program under the Board limit was \$82.8 billion. The Board held in reserve \$4.1 billion (5 percent) of that capacity.

The Board's rules in the Texas Administrative Code set a limit on the Program's bond guarantee capacity of three times the cost value of the Fund, as permitted by Texas Education Code, Section 45.053(d). The Board's rules also require the Board to hold guarantee capacity in reserve of no less than 5 percent of the Fund's capacity, as permitted by Texas Education Code, Section 45.0531(a). The Board may use the reserve to award guarantees to school districts with unforeseen catastrophes or emergencies that require renovation or replacement of school facilities, as described in Title 19, Texas Administrative Code, Section 33.65(e)(2).

Furthermore, on September 16, 2013, the U.S. Treasury and the Internal Revenue Service (IRS) published proposed rules in the *Federal Register*<sup>1</sup> (IRS proposed rules) that established another limit on the bond guarantee capacity of no more than 500 percent of the total cost of the assets held by the Fund as of December 16, 2009. That federal limit is intended to provide flexibility to state and local governments to obtain credit enhancement for tax-exempt bonds. The bond guarantee capacity under that limit was \$117.3 billion.

## Objective, Scope, and Methodology

The objective of this audit was to determine whether the total amount of school district bonds the Permanent School Fund's (Fund) Bond Guarantee Program (Program) guarantees is within the limits established by state statute.

The scope of this audit covered the Fund's valuation and all bonds guaranteed by the Fund at the end of fiscal year 2014.

Auditors obtained most of the audit evidence needed to complete this audit's objective from audit work performed for *A Report on the Audit of the Permanent School Fund's Fiscal Year 2014 Financial Statements* (State Auditor's Office Report No. 15-016, January 2015). This audit work included reviewing the State Board of Education's bond guarantee limit and reserve calculations for accuracy and determining the Fund's total cost value as of the end of fiscal year 2014.

Auditors also assessed the design and operation of applicable internal controls. That assessment included observing key controls relevant to the Program.

Audit fieldwork was conducted from January 2015 through February 2015. We conducted this performance audit in accordance with generally accepted governmental auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. The following staff of the State Auditor's Office performed the audit:

- Gregory Scott Adams, CPA, MPA, CGFM (Project Manager)
- Robert G. Kiker, CGAP (Assistant Project Manager)
- Charles P. Dunlap, Jr., CPA (Quality Control Reviewer)
- Brianna C. Lehman, CPA (Audit Manager)

<sup>1</sup> See *Federal Register*, Volume 78, page 56842.

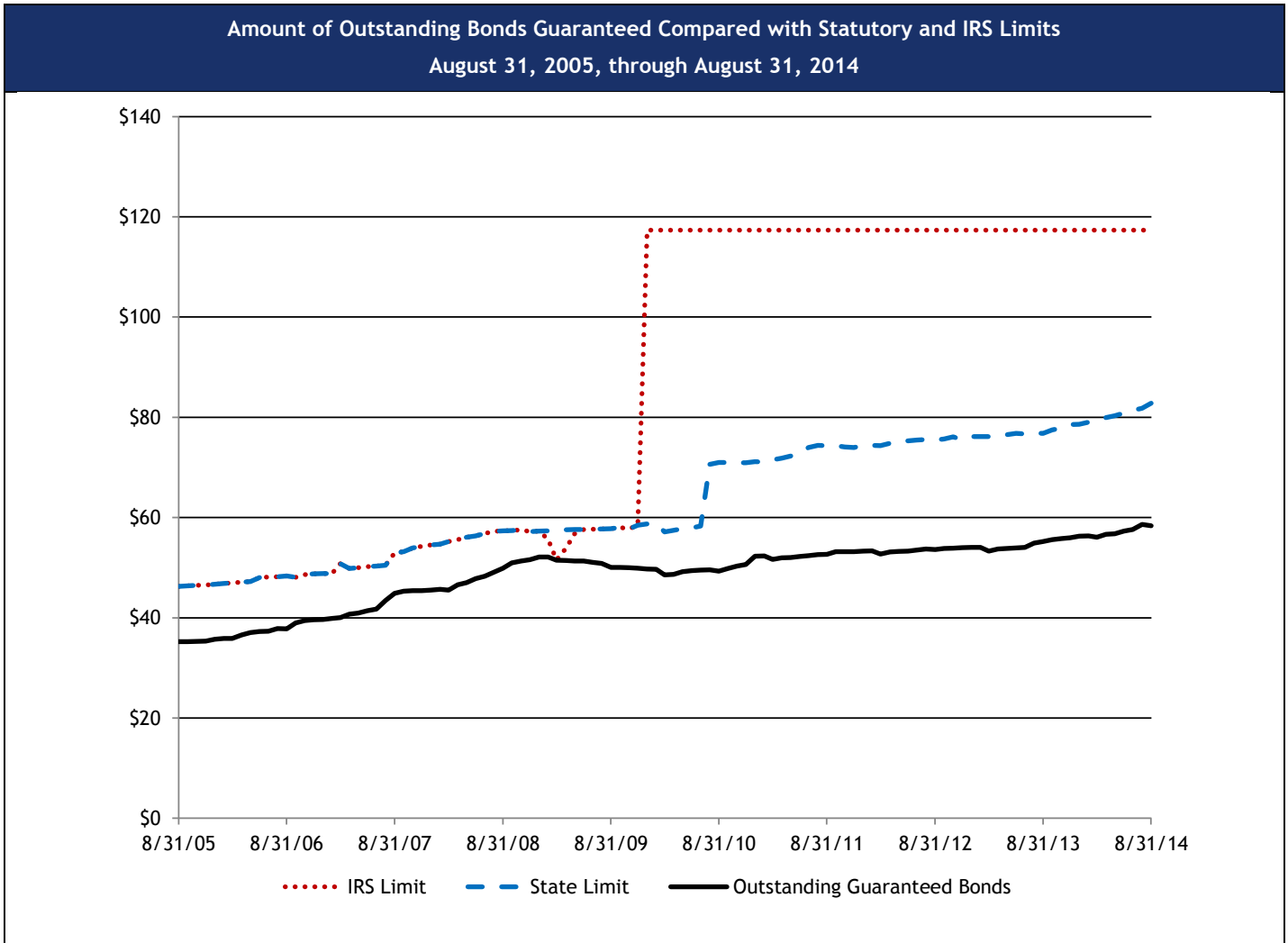
The guarantee saves school districts money by enhancing their bond ratings to the highest possible rating. Without the Program’s guarantee, school districts would need to (1) purchase private bond insurance or (2) pay higher interest rates on the bonds they sell.

**The Program’s remaining statutory capacity, net of the Board’s \$4.1 billion reserve, was \$20.3 billion at the end of fiscal year 2014.**

The attachment to this letter provides additional information on the Program’s fiscal year 2014 activity. As of August 31, 2014, the Program could guarantee an additional \$20.3 billion in bonds before reaching the limit imposed by the Board, net of its \$4.1 billion reserve. The remaining capacity is equal to 24.5 percent of the Program’s statutory capacity.

Figure 1 shows the amounts of outstanding bonds guaranteed and the statutory and IRS guarantee limits from August 31, 2005, through August 31, 2014. The Board’s additional reserve is not presented in the graph.

Figure 1



Sources: Supplementary information in the *Texas Permanent School Fund Comprehensive Annual Financial Report for the Fiscal Year Ending August 31, 2014*; auditors calculated the capacity based on the Permanent School Fund’s Bond Guarantee Program summary data.

**The Program began to award guarantees to charter district bonds in May 2014.**

The Board guaranteed \$302.5 million in bonds for six charter districts during fiscal year 2014. That amount is included in the bond amounts discussed on the previous pages and in the attachment. Of the \$302.5 million in bonds issued to charter districts, \$152.5 million were refunding bonds and \$150.0 million were non-refunding bonds. All of those amounts were lower than the guarantee limits for charter districts set in Texas Education Code, Section 45.0532. The Texas Education Code limits the available bond capacity for charter districts based on the percentage of the number of students enrolled in open-enrollment charter districts compared to the total number of students enrolled in all Texas public schools. As of August 31, 2014, the Fund's capacity used to guarantee charter district bonds was 3.95 percent of the Fund's capacity, or \$801.3 million, of which no more than half can be used for refunding bonds.

We appreciate the Texas Education Agency's cooperation during this audit, particularly the cooperation of staff of the Permanent School Fund. If you have any questions, please contact Brianna Lehman, Audit Manager, or me at (512) 936-9500.

Sincerely,

John Keel, CPA  
State Auditor

Attachment

cc: The Honorable Greg Abbott, Governor  
Members of the State Board of Education  
Mrs. Barbara Cargill, Chair  
Mr. Thomas Ratliff, Vice Chair  
Mr. Lawrence A. Allen, Jr.  
Mrs. Donna Bahorich  
Ms. Erika Beltran  
Mr. David Bradley  
Mr. Ruben Cortez, Jr.  
Dr. Martha M. Dominguez  
Ms. Patricia Hardy  
Mr. Tom Maynard  
Ms. Sue Melton-Malone  
Mr. Ken Mercer  
Mrs. Geraldine "Tincy" Miller  
Ms. Marisa B. Perez  
Mr. Marty Rowley  
Texas Education Agency  
Mr. Michael Williams, Commissioner of Education  
Mr. Holland Timmins, CFA, Executive Administrator and Chief Investment Officer, Permanent School Fund



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# Attachment

Section 1

## Bond Guarantee Program Summary

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Table 1 provides a summary of fiscal year 2014 activity for the Permanent School Fund's Bond Guarantee Program (Program) and shows the changes in the number and dollar amount of outstanding bonds guaranteed by the Program.

Table 1

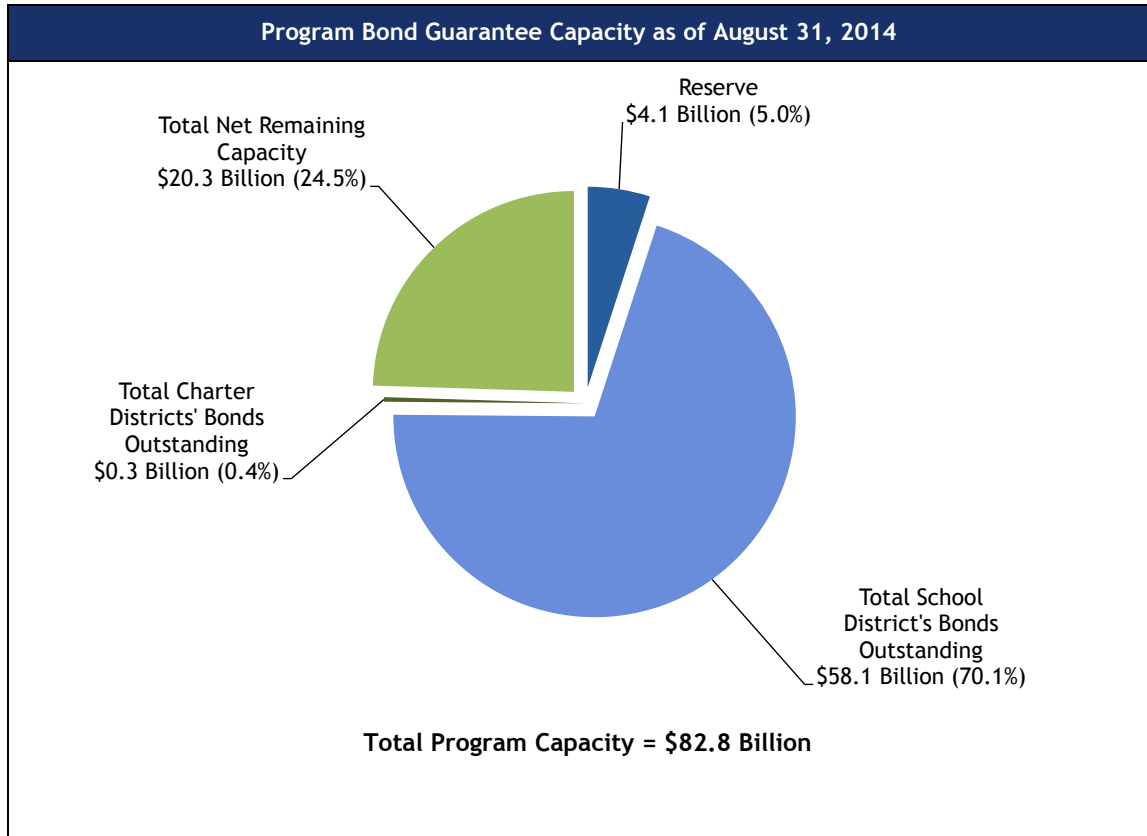
Number of Guaranteed Bonds Outstanding		
Category	Number of Issues	Dollar Amount of Issues
Balance on August 31, 2013	2,789	\$55,218,889,156
Issued during fiscal year 2014	323	8,745,481,511
Issues that matured during fiscal year 2014	(184)	(2,065,610,524)
Issues that refunded during fiscal year 2014	(49)	(3,516,482,338)
Other Adjustments	Not Applicable	(17,927,022)
<b>Balance on August 31, 2014</b>	<b>2,879</b>	<b>\$58,364,350,783</b>

Source: Supplementary information in the *Texas Permanent School Fund Comprehensive Annual Financial Report for the Fiscal Year Ending August 31, 2014*.

## Bond Capacity Summary

The following figures provide a summary of the Program's capacity as of August 31, 2014. Figure 2 shows the Program's status as of August 31, 2014, including the Program's bond guarantee reserve capacity and net remaining capacity.

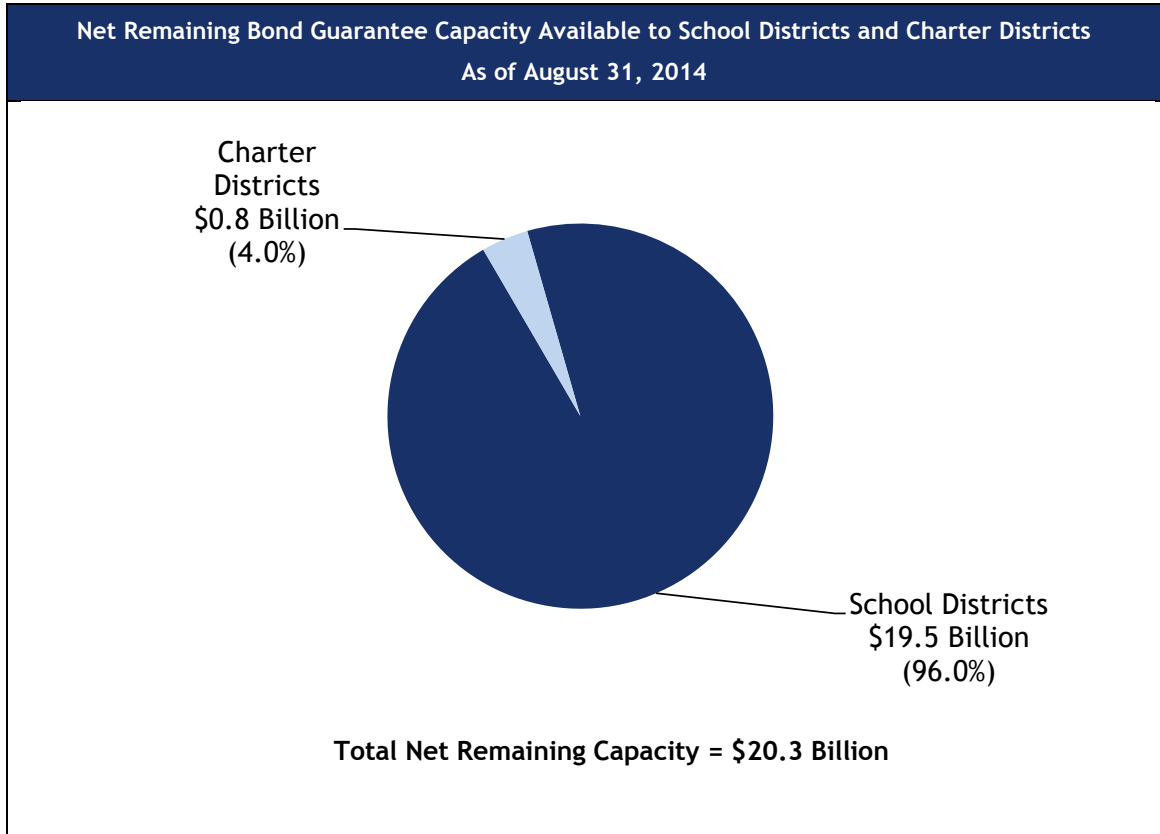
Figure 2



Source: Based on program data from the Texas Education Agency.

Figure 3 shows the net remaining capacity available to school districts and charter districts. Only half of the total net capacity (\$400.7 million of \$801.3 million) available to charter districts may be used to guarantee refunding bonds.

Figure 3



Source: Based on program data from the Texas Education Agency.