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A Report on

**Agencies', Higher Education  
Institutions', and Community Colleges'  
Compliance with Public Funds  
Investment Act and Rider 5, General  
Appropriations Act, Reporting  
Requirements**

June 2021  
Report No. 21-023

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*A Report on*

# **Agencies', Higher Education Institutions', and Community Colleges' Compliance with Public Funds Investment Act and Rider 5, General Appropriations Act, Reporting Requirements**

SAO Report No. 21-023  
June 2021

## **Overall Conclusion**

All agencies, higher education institutions, and community colleges subject to Texas Government Code, Chapter 2256, the Public Funds Investment Act (Act), reported that they complied with the Act for the reporting period ending August 31, 2019<sup>1</sup>. Additionally, higher education institutions, including universities, university systems, and community colleges<sup>2</sup>, are subject to the reporting requirements of Special Provisions Relating Only to State Agencies of Higher Education (Rider 5), page III-261, General Appropriations Act (86th Legislature), and prescribed by the State Auditor's Office. All of those institutions complied with Rider 5. Entities subject to the requirements of the Act, Rider 5, or both reported total investment holdings of \$118.5 billion<sup>3</sup> as of August 31, 2020.

It is important to note that the entities provided the information in this report and that the State Auditor's Office did not independently verify this information.

### **Background Information**

The Legislature enacted the Public Funds Investment Act (Act) in 1995 to improve the transparency and management of investments by state agencies, higher education institutions, community colleges, and local governments. The Act requires certain state agencies, higher education institutions, and community colleges to implement controls in the form of investment policies, contracting, training, reporting, and reviewing, as well as to obtain audits of those controls at least once every two years and provide those audits to the State Auditor's Office by January 1 of every even numbered year.

In addition, Rider 5, the General Appropriations Act (86th Legislature), requires higher education institutions and community colleges to file an annual investment report prepared in a method prescribed by the State Auditor's Office. The State Auditor's Office prescribed that method and additional reporting requirements at

<http://www.sao.texas.gov/InternalAudit/PublicFunds/>. Additionally, the higher education institutions and community colleges are required to publish quarterly investment reports on their websites.

Sources: The Act, the General Appropriations Act (86th Legislature), and the State Auditor's Office website.

<sup>1</sup> The Act requires compliance reporting once every two years. As a result, this report reviewed compliance reports as of August 31, 2019, two years after the previous report. Rider 5 compliance requires information posted by the higher education institutions for the previous two years. Rider 5 compliance testing is for the two years ended August 31, 2020, and investment balances are as of August 31, 2020.

<sup>2</sup> For the purposes of this report, if a community college is within a community college district (with multiple community colleges), the phrase "community college" refers to the community college district.

<sup>3</sup> Total investment holdings is the sum of investments of the agencies, higher education institutions, and community colleges that are subject to the Act, as well as investments of the higher education institutions that are not subject to the Act. The total excludes those entities' investments in the Texas Local Government Pool (TexPool) and Texas Local Government Investment Pool Prime (TexPool Prime) to prevent counting those holdings twice. The sources for the investment amounts are the entities' annual investment reports and annual financial statements.

*This project was conducted in accordance with Texas Government Code, Section 2256.005(n), and Rider 5, page III-261, General Appropriations Act (86th Legislature).*

*For more information regarding this report, please contact James Timberlake, Audit Manager, or Lisa Collier, First Assistant State Auditor, at (512) 936-9500.*

## Summary of Compliance

The following describes compliance by the type of entity.

- **Agencies.** All 13<sup>4</sup> agencies subject to the Act submitted compliance audit reports that indicated full or substantial compliance with the Act.
- **Higher Education Institutions.**
  - **Compliance with the Act.** All four higher education institutions subject to the Act submitted compliance reports that indicated substantial or minimal compliance with the Act. Midwestern State University and Texas Southern University provided compliance audits that indicated multiple or significant instances of noncompliance.
  - **Compliance with the Higher Education Investment Reporting Requirements.** All of the higher education institutions, including three universities and one system subject to the Act and one university and six university systems not subject to the Act, complied with the reporting requirements of Rider 5, page III-261, General Appropriations Act (86th Legislature).
- **Community Colleges.**
  - **Compliance with the Act.** All 50 community colleges subject to the Act submitted compliance audit reports that indicated full or substantial compliance with the Act. Amarillo College, Clarendon College, and San Jacinto College provided compliance audits with minor instances of noncompliance.
  - **Compliance with the Higher Education Investment Reporting Requirements.** All 50 community colleges complied with the reporting requirements of Rider 5. Southwest Texas Junior College was determined to be substantially compliant due to one instance of noncompliance.

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<sup>4</sup> The 13 agencies include agencies of the state, self-directed semi-independent agencies, and nonprofit corporations established by and for the benefit of the state agency.

Some entities did not submit compliance reports by the statutorily required due date of January 1, 2020. In addition, a number of institutions using external auditors submitted reports limited to material noncompliance. Further, a number of higher education institutions did not fully comply with the higher education reporting requirements by the due date of December 31, 2020. However, the entities or auditors were able to provide the missing information or verify that the reporting requirements were met prior to completion of this report.

## ***Audit Objectives and Scope***

The objectives of this project were to:

- Determine whether state agencies and higher education institutions complied with the Act requirement to submit a compliance report to the State Auditor's Office by January 1, 2020.
- Determine whether higher education institutions complied with Special Provisions Relating Only to State Agencies of Higher Education, page III-261, the General Appropriations Act (86th Legislature), and reporting requirements as prescribed by the State Auditor's Office on its website.

The scope of this project covered compliance audit reports with due dates of January 1, 2020, and Rider 5 investment disclosures with due dates of December 31, 2019, and December 31, 2020. State auditors performed reviews of the reports from February 2021 through April 2021.

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# Detailed Results

Chapter 1

## **All Agencies Subject to the Act Submitted Compliance Reports That Indicated They Were Fully or Substantially Compliant**

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The Public Funds Investment Act (Act) in Texas Government Code, Chapter 2256, requires that the governing bodies of state agencies with authority to invest public funds implement investment-related controls in the following areas: policies, contracting, training, reporting, reviewing, and auditing. The Act contains multiple requirements for each of those areas, and the agencies' internal or external auditors must test compliance with those policies every two years. The Act requires the agencies to submit those audit results to the State Auditor's Office.

For the compliance reporting period ended August 31, 2019, all entities subject to the Act submitted the required compliance audit reports.

The State Auditor's Office reviewed those reports and defined levels of compliance (see text box).

### Definitions of Compliance with the Act

-  **Fully Compliant:** No findings were reported.
-  **Substantially Compliant:** Few findings were reported that may include a significant finding related to policies, contracting, training, reporting, reviewing, or auditing.
-  **Minimally Compliant:** Some findings were reported that were significant to policies, contracting, training, reporting, reviewing, or auditing.
-  **Noncompliant:** The required compliance report was not provided or contained many findings that were significant to policies, contracting, training, reporting, reviewing, or auditing.

**Agencies' Compliance with the Act.** Of the 13 agencies subject to the Act, 11 agencies submitted reports that indicated full compliance with the Act. Two agencies submitted reports that indicated they were substantially compliant with the Act. Instances of noncompliance are noted in Appendix 2.

Table 1 on the next page shows ratings for compliance by agencies subject to the Act.

Table 1

Agencies' Compliance with the Act	
Rating	Agency
●	Board of Law Examiners
●	Department of Criminal Justice
●	Department of Housing and Community Affairs
●	Department of Transportation
●	Office of the Consumer Credit Commissioner
●	Real Estate Commission
●	School for the Blind and Visually Impaired
●	State Bar of Texas
●	Texas Access to Justice Foundation
●	Texas State Affordable Housing Corporation
●	Texas Treasury Safekeeping Trust Company (TexPool and TexPool Prime)
●	Trusted Programs within the Office of the Governor
●	Water Development Board

## **Higher Education Institutions Subject to the Act Were Determined to Be Substantially or Minimally Compliant with the Act and Fully Compliant with Investment Reporting Requirements of Rider 5**

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The State Auditor’s Office reviewed the compliance audit reports submitted, and based on the results of those reports, determined the level of compliance with the Act (see text box for definitions of compliance with the Act).

The Act defines state agencies to include higher education institutions with authority to invest public funds. However, higher education institutions with total endowments of \$150 million in book value as of September 1, 2017, are exempt from the Act. Requirements for compliance with the Act are discussed in Chapter 1. Also, see Chapter 4 for more information on the university and university systems determined to be exempt from the Act.

### Definitions of Compliance with the Act

-  **Fully Compliant:** No findings were reported.
-  **Substantially Compliant:** Few findings were reported that may include a significant finding related to policies, contracting, training, reporting, reviewing, or auditing.
-  **Minimally Compliant:** Some findings were reported that were significant to policies, contracting, training, reporting, reviewing, or auditing.
-  **Noncompliant:** The required compliance report was not provided or contained many findings that were significant to policies, contracting, training, reporting, reviewing, or auditing.

In addition, the State Auditor’s Office reviewed the investment reports and disclosures on the institutions’ websites to determine compliance with Rider 5, page III-261, General Appropriations Act (86th Legislature), and as prescribed by the State Auditor’s Office requirements.

**Higher Education Institutions’ Compliance with the Act.** All four higher education institutions provided compliance audit reports for the compliance period ending August 31, 2019. Two institutions provided reports from which auditors determined that they were substantially compliant with the Act. Two institutions provided reports from which auditors determined that they were minimally compliant with the Act. Instances of noncompliance with the Act are noted in Appendix 2.

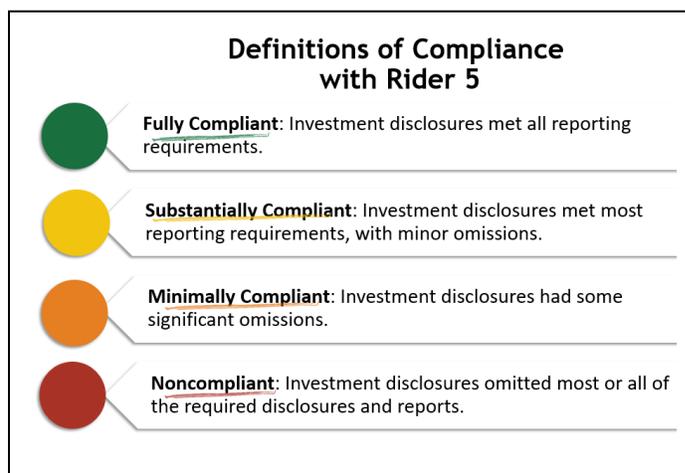
**Higher Education Institutions’ Compliance with Investment Reporting Requirements of Rider 5.** Rider 5 requires all higher education institutions to provide an annual report of investment transactions, in a manner prescribed by the State Auditor’s Office.

Those requirements include the following:

- Submitting an annual investment report to the State Auditor’s Office, the Office of the Comptroller of Public Accounts, the Office of the Governor, and the Legislative Budget Board, using the format prescribed by the State Auditor’s Office.
- Disclosing the following information on the higher education institution’s website:
  - ♦ Quarterly investment reports.
  - ♦ The use of outside investment advisors or managers.
  - ♦ The use of soft dollar agreements, directed brokerage or directed commission, commission recapture, or similar arrangements.<sup>5</sup>
  - ♦ Associations with independent endowments or foundations.
  - ♦ Current investment policies.

All four institutions provided reports from which auditors determined that they were fully compliant with Rider 5 (see text box for definitions of the levels of compliance with Rider 5).

Table 2 on the next page shows ratings for compliance by higher education institutions subject to the Act and Rider 5.



<sup>5</sup> Those arrangements typically involve using brokerage commissions as a means of paying for other related investment services through credits of a portion of brokerage commissions paid, rather than through direct payments or using selected brokers who rebate a portion of the commission they receive on trades for the investor.

Table 2

Higher Education Institutions' Compliance		
Act	Rider 5	Higher Education Institution
		Midwestern State University
		Stephen F. Austin State University
		Texas Southern University
		Texas State Technical College System

## ***Community Colleges Submitted Compliance Audit Reports Indicating That They Were Fully or Substantially Compliant with the Act, and Most Were Compliant with the Reporting Requirements of Rider 5***

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The Act requires that the governing bodies of higher education institutions, including community colleges with authority to invest funds, implement investment-related controls in the following areas: policies, contracting, training, reporting, reviewing, and auditing. The Act contains multiple requirements for each of those areas, and the community colleges' internal or external auditors must test compliance with those policies every two years. The Act also requires the community colleges to submit those audit results to the State Auditor's Office.

Of the 50 community colleges in Texas, all 50 provided compliance audit reports for the reporting period ending August 31, 2019. The State Auditor's Office reviewed those reports and established definitions of compliance with the Act (see text box).

### Definitions of Compliance with the Act

-  **Fully Compliant:** No findings were reported.
-  **Substantially Compliant:** Few findings were reported that may include a significant finding related to policies, contracting, training, reporting, reviewing, or auditing.
-  **Minimally Compliant:** Some findings were reported that were significant to policies, contracting, training, reporting, reviewing, or auditing.
-  **Noncompliant:** The required compliance report was not provided or contained many findings that were significant to policies, contracting, training, reporting, reviewing, or auditing.

Additionally, community colleges are subject to the investment reporting requirements of Rider 5, page III-261, General Appropriations Act (86th Legislature).

**Community Colleges' Compliance with the Act and Rider 5.** Of the 50 community colleges, 47 fully complied and 3 substantially complied with the Act. Instances of noncompliance are listed in Appendix 2.

In reviewing the community colleges' websites, 49 fully complied with the reporting requirements of Rider 5 (see text box for definitions of compliance with Rider 5). One community college, Southwest Texas Junior College, was determined to be substantially compliant because of a minor omission related to the review, approval, and publication of its investment policies.

**Definitions of Compliance with Rider 5**

-  **Fully Compliant:** Investment disclosures met all reporting requirements.
-  **Substantially Compliant:** Investment disclosures met most reporting requirements, with minor omissions.
-  **Minimally Compliant:** Investment disclosures had some significant omissions.
-  **Noncompliant:** Investment disclosures omitted most or all of the required disclosures and reports.

Table 3 provides additional details of community colleges' compliance with the Act and reporting requirements of Rider 5.

Table 3

Community College Compliance		
Act	Rider 5	Community College
		Alamo Community College
		Alvin Community College
		Amarillo College
		Angelina College
		Austin Community College
		Blinn College
		Brazosport College
		Central Texas College
		Cisco Junior College
		Clarendon College
		Coastal Bend College
		College of the Mainland
		Collin County Community College
		Dallas County Community College
		Del Mar College
		El Paso Community College
		Frank Phillips College (Borger Junior College District)
		Galveston College
		Grayson County College

Community College Compliance		
Act	Rider 5	Community College
●	●	Hill College
●	●	Houston Community College
●	●	Howard College
●	●	Kilgore College
●	●	Laredo Community College
●	●	Lee College
●	●	Lone Star College System
●	●	McLennan Community College
●	●	Midland College
●	●	Navarro College
●	●	North Central Texas College
●	●	Northeast Texas Community College
●	●	Odessa College
●	●	Panola College
●	●	Paris Junior College
●	●	Ranger College
●	●	San Jacinto College
●	●	South Plains College
●	●	South Texas College
●	●	Southwest Texas Junior College
●	●	Tarrant County College
●	●	Temple College
●	●	Texarkana College
●	●	Texas Southmost College
●	●	Trinity Valley Community College
●	●	Tyler Junior College
●	●	Vernon College
●	●	Victoria College
●	●	Weatherford College
●	●	Western Texas College
●	●	Wharton County Junior College

## ***The University and the University Systems Subject to Rider 5 But Not Subject to the Act Complied with Reporting Requirements***

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The seven higher education institutions (one university and six university systems) that were subject to Rider 5, page III-261, General Appropriations Act (86th Legislature), and prescribed by the State Auditor's Office at <http://www.sao.texas.gov/internalaudit/publicfunds/> but exempt from the Act complied with the reporting requirements of Rider 5. Those higher education institutions are:

- Texas A&M University System.
- Texas State University System.
- Texas Tech University System.
- Texas Woman's University.
- The University of Texas System.
- University of Houston System.
- University of North Texas System.

The Act does not apply to any institution of higher education with total endowments of at least \$150 million in book value as of September 1, 2017. However, all institutions of higher education are subject to the investment reporting requirements of Rider 5.

## **Summary of Investments for Agencies, Higher Education Institutions, and Community Colleges**

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The agencies, higher education institutions, and community colleges reviewed reported total investment holdings of \$118.5 billion as of August 31, 2020. Specifically:

- The 13 agencies **subject to the Act** reported investments of \$38.6 billion as of August 31, 2020.
- The four higher education institutions **subject to the Act** reported total investments of \$402.5 million as of August 31, 2020.
- The 50 community colleges **subject to the Act** reported total investments of \$3.8 billion as of August 31, 2020.
- The seven higher education institutions that are **not subject to the Act** reported investments of \$75.7 billion as of August 31, 2020.

### **Investments at Agencies Subject to the Act**

Table 4 on the next page lists the total investments for agencies subject to the Act as of August 31, 2020. To avoid double counting, these amounts do not include TexPool and TexPool Prime investments of \$1.3 billion held by certain agencies and included with Texas Treasury Safekeeping and Trust Company investments.

Table 4

Total Investments for Agencies Subject to the Act <sup>a</sup>	
Agency	Market Value of Investments as of August 31, 2020
Board of Law Examiners	\$ 4,245,420
Department of Criminal Justice	54,405,252
Department of Housing and Community Affairs	1,640,636,617
Department of Transportation	1,193,613,000
Office of the Consumer Credit Commissioner	8,466,107
Real Estate Commission	28,564,840
School for the Blind and Visually Impaired	984,516
State Bar of Texas <sup>b</sup>	51,492,815
Texas Access to Justice Foundation	42,269,785
Texas State Affordable Housing Corporation	98,197,426
Texas Treasury Safekeeping Trust Company	32,778,368,268
Trusted Programs within the Office of the Governor	11,428,877
Water Development Board	2,713,229,771
<b>Total</b>	<b>\$ 38,625,902,694</b>

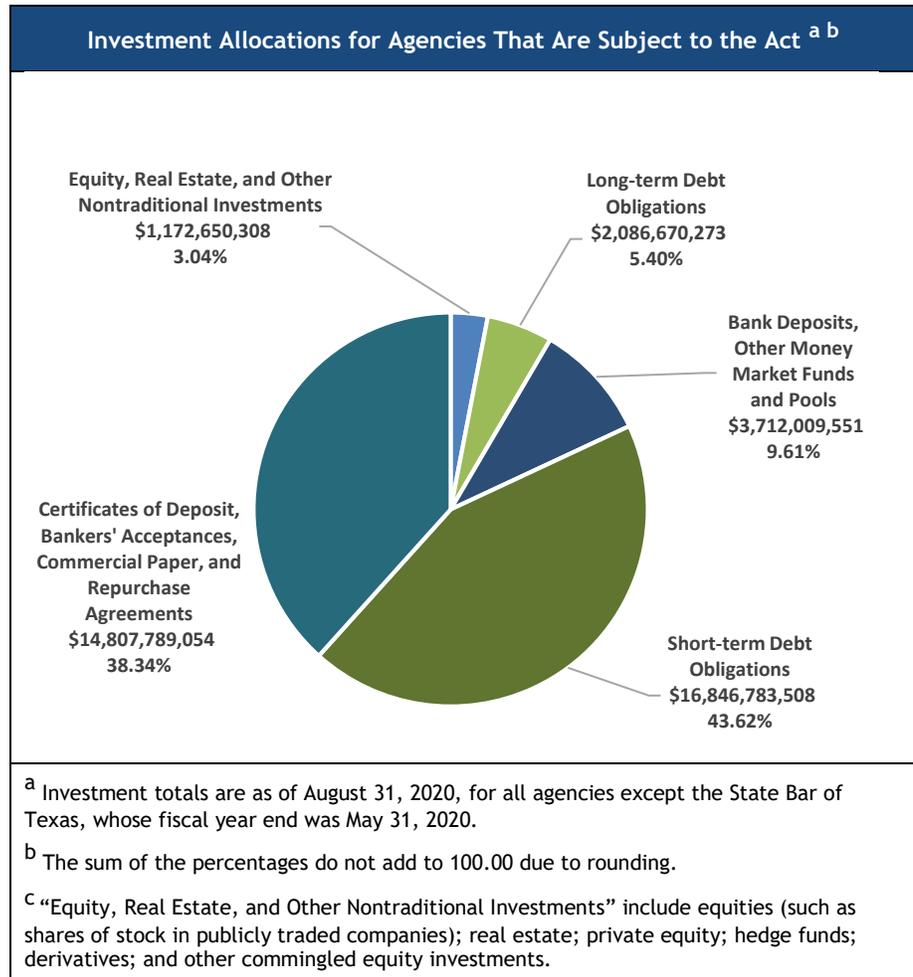
<sup>a</sup> This table includes investment information only for agencies subject to the Act. The amounts in this table are based on information the agencies provided. Auditors did not perform tests or other procedures to verify the accuracy of the reported amounts. These amounts include agency investments that are subject to the Act but exclude agencies' investments in the Texas Treasury Safekeeping Trust Company (TexPool and TexPool Prime) to prevent counting those holdings twice.

<sup>b</sup> Data is as of the agency's fiscal year end, May 31, 2020.

Sources: **Unaudited annual financial reports:** Department of Criminal Justice, Department of Housing and Community Affairs, Office of the Consumer Credit Commissioner, Real Estate Commission, School for the Blind and Visually Impaired, Trusted Programs within the Office of the Governor, and Water Development Board. **Annual investment report:** Texas Access to Justice Foundation. **Audited annual financial reports:** Board of Law Examiners, Department of Transportation, State Bar of Texas, Texas State Affordable Housing Corporation, and Texas Treasury Safekeeping Trust Company.

Figure 1 on the next page shows the allocation of investments held by agencies subject to the Act as of August 31, 2020. See Appendix 3 for definitions of asset classes.

Figure 1



Sources: **Unaudited annual financial reports:** Department of Criminal Justice, Department of Housing and Community Affairs, Office of the Consumer Credit Commissioner, Real Estate Commission, School for the Blind and Visually Impaired, Trusteed Programs within the Office of the Governor, and Water Development Board. **Annual investment report:** Texas Access to Justice Foundation. **Audited annual financial reports:** Board of Law Examiners, Department of Transportation, State Bar of Texas, Texas State Affordable Housing Corporation, and Texas Treasury Safekeeping Trust Company.

## Investments at Higher Education Institutions Subject to the Act

Table 5 lists the total investments as of August 31, 2020, reported by higher education institutions that are subject to the Act and subject to the reporting requirements of Rider 5. These amounts do not include TexPool and TexPool Prime investments of \$124.4 million held by multiple institutions and included with Texas Treasury Safekeeping and Trust Company investments.

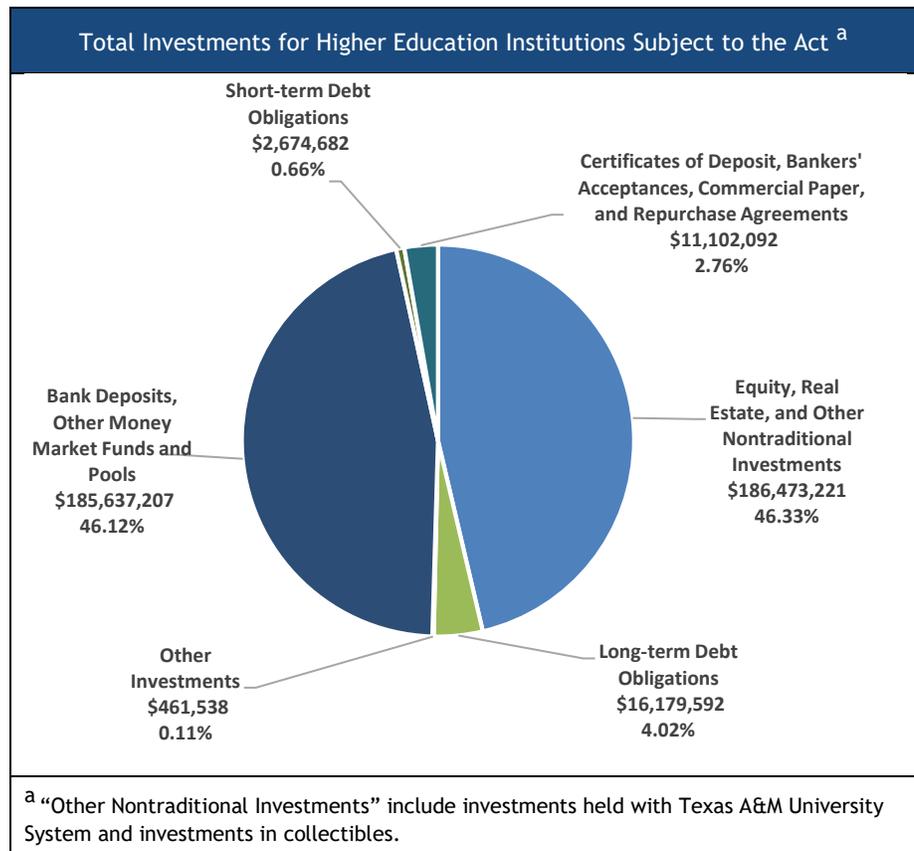
Table 5

Total Investments for Higher Education Institutions Subject to the Act <sup>a</sup>	
University or System	Market Value of Investments as of August 31, 2020
Midwestern State University	\$ 74,883,842
Stephen F. Austin State University	205,632,395
Texas Southern University	67,022,818
Texas State Technical College System	54,989,277
<b>Total</b>	<b>\$ 402,528,332</b>
<sup>a</sup> This table includes investment information only for higher education entities subject to the Act and does not include cash. The amounts in this table are based on self-reported information. Auditors did not perform tests or other procedures to verify the accuracy of the reported amounts. These amounts include higher education institutions' investments that are subject to the Act but exclude higher education institutions' investments in the Texas Treasury Safekeeping Trust Company (TexPool and TexPool Prime) to prevent counting those holdings twice.	

Sources: Annual investment reports as of August 31, 2020, provided by the universities and system.

Figure 2 on the next page shows the investment allocations as of August 31, 2020, for higher education institutions subject to the Act.

Figure 2



Sources: Annual investment reports as of August 31, 2020, provided by the universities and system.

### Investments at Community Colleges Subject to the Act

Table 6 on the next page lists the total investments at community colleges subject to the Act as of August 31, 2020, and subject to the reporting requirements of Rider 5. These amounts do not include TexPool and TexPool Prime investments of \$1.3 billion held by certain institutions and included with Texas Treasury Safekeeping and Trust Company investments.

Table 6

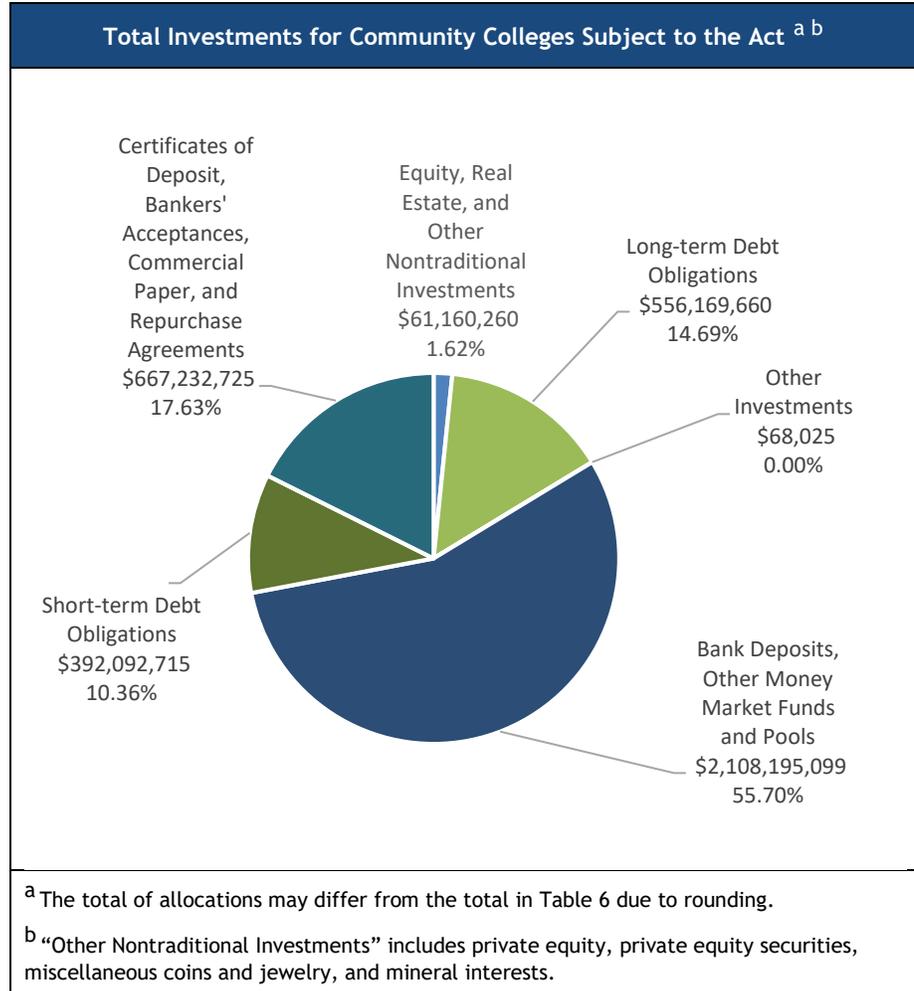
Total Investments for Community Colleges Subject to the Act <sup>a</sup>	
Community College	Market Value of Investments as of August 31, 2020
Alamo Community College	\$ 168,428,585
Alvin Community College	15,242,361
Amarillo College	26,483,133
Angelina College	24,319,056
Austin Community College	109,667,524
Blinn College	120,412,889
Brazosport College	13,207,978
Central Texas College	104,899,555
Cisco Junior College	6,140,860
Clarendon College	4,536,687
Coastal Bend College	7,403,464
College of the Mainland	106,283,851
Collin County Community College	140,871,177
Dallas County Community College	423,977,421
Del Mar College	250,649,996
El Paso Community College	153,191,370
Frank Phillips College (Borger Junior College District) <sup>b</sup>	-
Galveston College	15,682,324
Grayson County College	34,100,677
Hill College	19,393,110
Houston Community College	156,203,857
Howard College	26,403,869
Kilgore College	22,990,579
Laredo Community College	94,763,430
Lee College	33,013,029
Lone Star College System	193,736,407
McLennan Community College	15,526,746
Midland College	53,688,647
Navarro College	27,343,248
North Central Texas College	7,220,961
Northeast Texas Community College	6,319,011
Odessa College	36,869,927
Panola College	36,745,243

<b>Total Investments for Community Colleges Subject to the Act <sup>a</sup></b>	
<b>Community College</b>	<b>Market Value of Investments as of August 31, 2020</b>
Paris Junior College	27,609,212
Ranger College	2,955,355
San Jacinto College	34,284,819
South Plains College	29,725,295
South Texas College	277,285,094
Southwest Texas Junior College	10,704,069
Tarrant County College	642,928,649
Temple College	24,619,031
Texarkana College	26,762,173
Texas Southmost College	70,491,673
Trinity Valley Community College	21,429,736
Tyler Junior College	31,799,472
Vernon College	7,398,745
Victoria College	14,096,057
Weatherford College	55,023,746
Western Texas College	27,723,648
Wharton County Junior College	24,364,739
<b>Total</b>	<b>\$ 3,784,918,485</b>
<p><sup>a</sup> The amounts in this table are based on information the community colleges provided. Auditors did not perform tests or other procedures to verify the accuracy of the reported amounts. This table includes investment information only for community colleges subject to the Act. These amounts include investments that are not subject to the Act and exclude community colleges' investments in the Texas Treasury Safekeeping Trust Company (TexPool and TexPool Prime) to prevent counting those holdings twice.</p> <p><sup>b</sup> Frank Phillips College investments included \$3,615 invested in TexPool. TexPool and TexPool Prime are not reflected in the investment totals above.</p>	

Sources: Annual investment reports as of August 31, 2020, provided by the community colleges.

Figure 3 shows the allocation of investments held by community colleges as of August 31, 2020.

Figure 3



Sources: Annual investment reports as of August 31, 2020, provided by the community colleges.

### Investments at Higher Education Institutions Not Subject to the Act

Table 7 on the next page lists the total investments reported by higher education institutions that are not subject to the Act but are subject to the higher education reporting requirements of Rider 5. These amounts do not include TexPool and TexPool Prime investments of \$902.5 million held by certain institutions and included with Texas Treasury Safekeeping and Trust Company investments.

Table 7

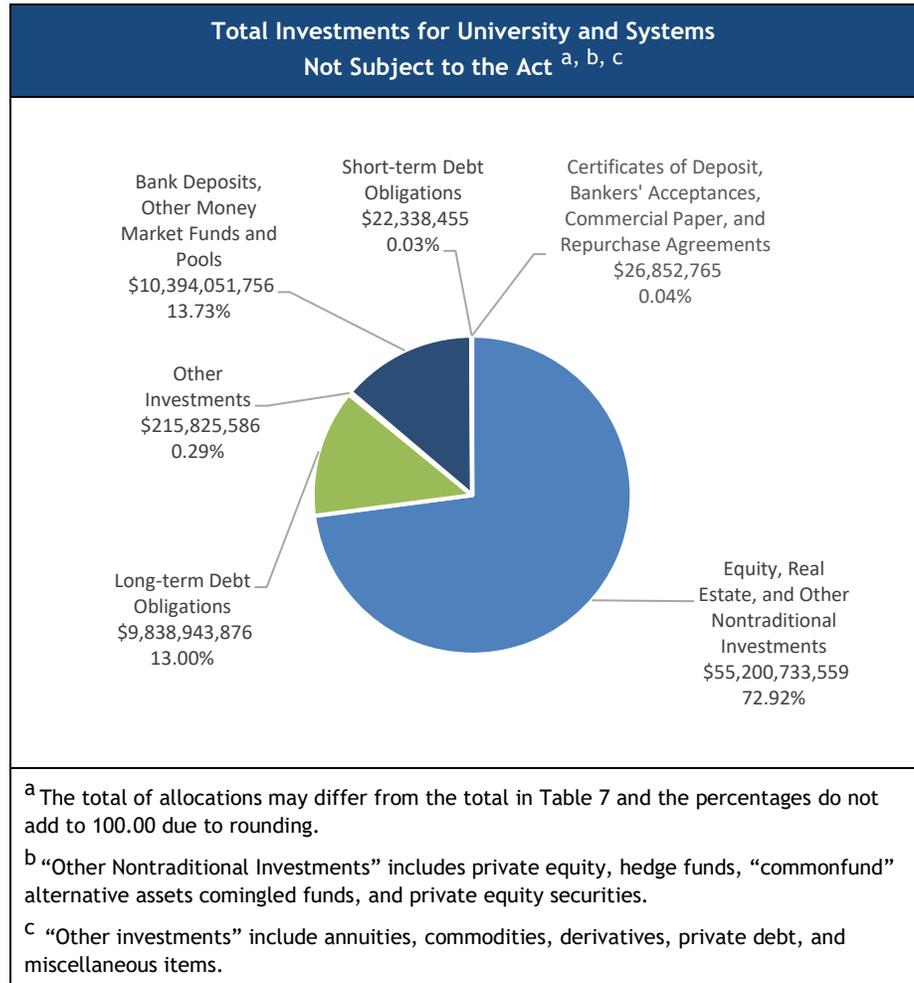
Total Investments for University and Systems Not Subject to the Act <sup>a</sup>	
University or System	Market Value of Investments as of August 31, 2020
Texas A&M University System	\$ 6,613,186,012
Texas State University System	680,072,978
Texas Tech University System	2,977,715,832
Texas Woman's University	273,506,285
The University of Texas System	62,925,256,526
University of Houston System	1,596,860,625
University of North Texas System	632,147,740
<b>Total</b>	<b>\$ 75,698,745,998</b>

<sup>a</sup> This table includes investment information only for the university and the university systems exempt from the Act in Texas Government Code, Section 2256.004. The amounts do not include cash or TexPool and TexPool Prime. Investments in the Texas Treasury Safekeeping Trust Company (TexPool and TexPool Prime) are not included to prevent counting those holdings twice. The amounts in this table are based on self-reported information, and auditors did not perform tests or other procedures to verify the accuracy of the reported amounts.

Sources: Annual investment reports as of August 31, 2020, provided by the university and university systems.

Figure 4 on the next page shows the investment allocations as of August 31, 2020, for higher education institutions that are not subject to the Act but are subject to the investment reporting requirements of Rider 5.

Figure 4



Sources: Annual investment reports as of August 31, 2020, provided by the university and university systems.

# Appendices

Appendix 1

## **Objectives, Scope, and Methodology**

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### **Objectives**

The objectives of this project were to:

- Determine whether state agencies and 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, 2020.
- Determine whether higher education institutions complied with Special Provisions Relating Only to State Agencies of Higher Education, page III-261, the General Appropriations Act (86th Legislature), and reporting requirements as prescribed by the State Auditor’s Office on its website.

### **Scope**

The scope of this project covered compliance audit reports with due dates of January 1, 2020, and Rider 5 investment disclosures with due dates of December 31, 2019, and December 31, 2020. State auditors performed reviews of the reports from February 2021 through April 2021.

Auditors considered information provided through March 19, 2021, for agencies, higher education institutions, and community colleges when determining their level of compliance with the Act and higher education investment requirements.

## Methodology

The project methodology included (1) collecting and evaluating evidence regarding compliance with the Act included in entities' most recent compliance audit reports, (2) reviewing higher education institutions' and community colleges' websites and the documents that they submitted to the State Auditor's Office for the required investment disclosures, and (3) compiling entities' investment balances individually and by type of entity. In addition, auditors communicated with agencies, higher education institutions, and community colleges in an effort to clarify the relevant requirements. Auditors did not perform any information technology work. It is important to note that the entities provided the information in this report and that the State Auditor's Office did not independently verify that information.

Information collected and reviewed included the following:

- Compliance audit reports issued by entities' internal or external auditors.
- Annual investment reports of higher education entities and community colleges.
- Investment policies of higher education institutions and community colleges.
- Investment disclosures on higher education institutions' and community colleges' websites.
- Audited and unaudited annual financial reports.

Procedures and tests conducted included the following:

- Reviewing compliance audit reports and summarizing any findings reported.
- Determining whether each higher education institution and community college submitted an annual investment report to the State Auditor's Office and posted the following on its website:
  - ♦ Investment policy reviewed and approved by its board within the previous two years.
  - ♦ Quarterly and annual investment reports for the previous two years.
  - ♦ Answers to the State Auditor's Office questions regarding outside investment managers, soft-dollar arrangements, and foundations.

- Determining whether the annual investment report for each higher education institution and community college used the format prescribed by the State Auditor’s Office.
- Compiling investment balances for each entity individually and by type of entity.

Criteria used included the following:

- The Public Funds Investment Act (Texas Government Code, Chapter 2256).
- Higher education investment reporting requirements mandated by Rider 5, page III-261, General Appropriations Act (86th Legislature), and prescribed by the State Auditor’s Office on its website at <http://www.sao.texas.gov/InternalAudit/PublicFunds/>.

### **Project Information**

Project fieldwork was conducted from February 2021 through April 2021. This project was not an audit, and the information in this report was not subjected to all the tests and confirmations that would be performed in an audit. However, the information in this report was subjected to certain quality control procedures to ensure accuracy.

The following members of the State Auditor’s staff performed the project:

- Jules V. Hunter, CPA, CIA (Project Manager)
- Kristin Auriel René Pope, MSA
- Michelle Ann Duncan Feller, CPA, CIA (Quality Control Reviewer)
- James Timberlake, CIA, CFE (Audit Manager)



Table 9

Higher Education Institutions That Were Not Fully Compliant with the Act (From Compliance Audit Reports for the Reporting Period Ending August 31, 2019)		
Higher Education Institution	Area of Noncompliance	Internal or External Auditor Compliance Audit Findings <sup>a</sup>
<b>Higher Education Institutions That Were Substantially Compliant with the Act</b>		
Stephen F. Austin State University (University)	Reporting	<i>The University has historically included interest-bearing bank deposits on the annual investment report; however, the accounts have not been included in the quarterly investment reports. With the 2017 change to the Act, the accounts should be reflected on the quarterly investment reports.</i>
Texas State Technical College System (System)	Policies	<i>Employees who work with System investments are required to submit an Employee Independence - Deposits and Investment form by October 1 of each year. While all employees either submitted forms by the due date or within 30 days of it, 6 of 12 the forms were dated after October 1. There were no conflicts reported on any form.</i>  <i>Regents are required to submit a Board Member Independence - Deposits and Investment form by November 1 of each year. Of the 20 forms [Internal Audit] tested, 3 were submitted after the due date and 4 of the forms were not dated. There were no conflicts reported on any form.</i>
	Reporting	<i>A report on investment officer training was not presented to the Board of Regents in November 2017. Nevertheless, all training was completed.</i>  <i>[Internal Audit] identified a Quarterly Investment report presented to the Board of Regents that was signed by only 1 of the investment officers. The report was accurate, nevertheless.</i>



**Higher Education Institutions That Were Not Fully Compliant with the Act  
(From Compliance Audit Reports for the Reporting Period Ending August 31, 2019)**

Higher Education Institution	Area of Noncompliance	Internal or External Auditor Compliance Audit Findings <sup>a</sup>
Texas Southern University (University)	Policies	<i>Management did not submit its Investment policies (both the Endowment and Non-Endowment Funds policies) to the Texas Southern University Governing Board during Fiscal Year 2019 to receive adoption by rule, order, ordinance, or resolution as written investment policies controlling the investment of funds under University's control as required by the Public Funds Investment Act (Texas Government Code Section 2256.005).</i>
	Reporting	<p><i>[Internal Audit] reviewed the University's website on November 22, 2019 to determine whether the University is complying with the investment reporting requirements for institutions of higher education specified in the Texas State Auditor's. [Internal Audit] observed that the University has posted some of the required information on the University's website:</i></p> <p><i>Management has posted current investment policies:</i>  <i>(Endowment Policy - February 2010)</i>  <i>(Non-Endowment Policy - February 2010)</i></p> <p><i>Management has not posted the following information for 2019:</i></p> <p><i>Quarterly Investment Reports as prescribed by Rider 5; Management has not posted the 4th Quarter Report for 2019 on University's Website. Quarterly Investment Reports for the first three quarters were posted on the University's website.</i></p> <p><i>Management has not posted 2019 Disclosure concerning:</i></p> <p><i>(a) Employment of investment advisor/manager (name and address);</i>  <i>(b) Use of soft dollar arrangements (brokerage commission or direct pmt.);</i>  <i>(c) Existence of associated endowments and foundations (e.g., component units)</i></p> <p><i>One of the University's investment advisors/managers, Consequent Capital, has not completed and submitted the Annual Disclosure Statement for FY2019.</i></p>
	Contracting	<i>The Consequent Capital contract should not exceed two years.</i>

<sup>a</sup> The findings presented are direct excerpts from the universities' audit reports.

Source: State Auditor's Office review of the compliance audit reports issued by the universities' auditors.

Table 10

Community Colleges That Were Not Fully Compliant with the Act (From Compliance Audit Reports for the Reporting Period Ending August 31, 2019)		
Community College	Area of Noncompliance	Internal or External Auditor Compliance Audit Findings <sup>a</sup>
<b>Community Colleges That Were Substantially Compliant with the Act</b>		
Amarillo College (College)	Policies	<i>The College did not obtain proper approval prior to the purchase of securities or reinvestment of funds for one investment. This was an isolated instance.</i>
Clarendon College (College)	Reporting	<i>The College did not post their February 2019 Investment report to the College's website during fiscal year 2018-2019. This has now been corrected by the College.</i>
San Jacinto College (College)	Training	<i>Texas Government Code Section 2256.007 requires that an investment officer attend at least one training session related to the person's responsibilities within six months after assuming duties. As a result of testing procedures performed, [auditors] noted that the College's investment officer assumed duties during the year ended August 31, 2018 and that a training session was not taken by the investment officer within six months after assuming duties.</i>
	Reporting	<i>Texas Government Code Section 2256.023 requires that not less than quarterly, the investment officer shall prepare and submit to the governing body of the entity a written report of the investment transactions for all funds covered by the PFIA for the preceding reporting period. As a result of testing procedures performed, [auditors] noted that the written investment report for the quarter ended May 31, 2019 was not presented to the governing board.</i>
<sup>a</sup> The findings presented are direct excerpts from the colleges' audit reports.		

Sources: State Auditor's Office review of the compliance audit reports issued by the colleges' auditors.

## Definitions of Asset Classes

Table 11 provides the definitions of investment and deposit types used in reports by higher education institutions to the State Auditor’s Office.

Table 11

Definitions of Investment and Deposit Types	
Investment/Deposit Type	Definition
Annuity	A type of contract sold by insurance companies guaranteeing fixed or variable future payments.
Asset Backed Securities (ABS)	Securities backed by pools of assets such as credit card receivables, home equity loans, and auto loans, but typically excluding mortgages.
Balanced Mutual Funds	Mutual funds that expect to invest in a mix of equity and debt investments. (Categorize in the “Publicly Traded Equity and Similar” category if the fund’s target allocation is expected to exceed 50 percent equities. Otherwise, categorize in the “Publicly Traded Debt and Similar” category.) (See also Mutual Funds.)
Bank Deposits	Amounts reported in this category should include balances held in a financial institution such as a bank, savings bank, or credit union as “demand deposits” (which the customer can withdraw at any time without penalty) or “time deposits” (which might be subject to restrictions on immediate withdrawal). However, bank deposits do not include certificates of deposit. Although non-negotiable certificates of deposit are generally considered time deposits, these balances should be separately disclosed on the annual investment report. (See also Certificates of Deposit.)
Bankers’ Acceptance	A time draft drawn on a bank by a bank’s customer, ordering the bank to pay an amount at a future date, generally within a short time period. When accepted by the bank, it can be traded in secondary markets, usually as a money market instrument.
Cash Held at State Treasury	All deposit balances held by the Comptroller of Public Accounts in the State Treasury. Institutions should not include funds invested in TexPool or TexPool Prime. Amounts managed by the Texas State Treasury Safekeeping Trust Company should be reported in the appropriate investment categories, and any uninvested cash held by the Trust Company should be reported as bank deposits.
Certificates of Deposit (CD)	Time deposits with a financial institution that may not be withdrawn prior to maturity without a penalty. “Negotiable CDs” are issued in large dollar amounts and are traded in secondary markets. Although some entities might report nonnegotiable CDs in their financial statements under the “Investments” category, they are considered deposits, whereas negotiable CDs represent investment securities. CDs are insured by the Federal Deposit Insurance Corporation. (Categorize nonnegotiable CDs separately from negotiable CDs on the annual investment report.)
Collateralized Mortgage Obligations (CMOs) - Agency or Private Label	CMOs consist of pools of mortgage pass-through securities or mortgage loans for which the cash flows of principal and interest payments are directed in a prescribed manner to different underlying classes of the CMOs. The different classes are referred to as “tranches,” with each tranche structured to have different expected risk, return, and maturity characteristics. “Agency” CMOs are guaranteed, or issued and guaranteed, by U.S. government agencies. “Private Label” CMOs are issued by, and are the sole obligation of, the private issuers, which might be financial institutions, subsidiaries of investment banks, or home builders. Certain tranches are generally prohibited by the Public Funds Investment Act (PFIA), including “Interest Only Strips (IOs),” “Principal Only Strips (POs),” and “Inverse Floaters.” The PFIA also does not authorize most investing entities to acquire CMOs that have a final stated maturity exceeding 10 years.
Collectibles	Rare items collected by investors, such as art, stamps, coins, antiques, and memorabilia.
Commercial Paper - A1/P1 (or equivalent)	Commercial paper is a type of short-term, unsecured obligation issued by banks, corporations, or other borrowers, usually issued at a discount and with maturities of 270 days or fewer. A1 and P1 denote the highest short-term rating categories used by Standard and Poor’s and Moody’s, respectively. (Lower rated commercial paper should be listed under “Other Commercial Paper - Lower Rated.”)

## Definitions of Investment and Deposit Types

Investment/Deposit Type	Definition
Commingled Fund	An external manager pools and invests the funds of several institutional investors. Securities are owned by the overall fund, and each investor owns a pro rata share of the fund. The U.S. Securities and Exchange Commission (SEC) does not oversee commingled funds. (Classification on the annual investment report should be based on the underlying assets in which the fund primarily invests, for example, publicly traded equities, publicly traded debt, or “other” investments.)
Commodities	Includes investments in bulk goods such as grains, metals, and foods, and energy products such as crude oil, heating oil, gasoline, and natural gas. Commodities are often traded using futures contracts; however, investing can also involve spot market trades or taking physical possession of the commodities.
Commonfund	Also known as “The Common Fund for Nonprofit Organizations,” this is a private, nonprofit organization that is exempt from taxation under Section 501(f), U.S. Internal Revenue Code of 1986 (Title 26, United States Code, Section 501(f)). Commonfund offers participating clients the ability to invest in a wide range of commingled investment funds, including fixed income, equity, and alternative assets.
Common Stock (publicly traded)	Also referred to as equities, or equity securities, common stock represents units of ownership in a publicly held corporation. Shareholders typically have rights to vote and to receive dividends. Claims of common stock holders are subordinate to claims of creditors, bond holders, and preferred stock holders.
Corporate Obligations (U.S. or foreign corporations)	Debt securities issued by U.S. or foreign corporations. Excludes debt issued by governmental entities (see Sovereign Debt). (Group by credit rating category, or, if applicable, as “not rated.”)
Equity/Stock Mutual Funds	Mutual funds that invest primarily in stocks, although at times they might hold some fixed-income and money market securities. (See also Balanced Mutual Funds description.)
Equity Securities	Stock (as opposed to bonds). The term is often used to refer to “common stock” (see Common Stock definition); however “preferred stock” is also considered an equity security (see Preferred Stock definition).
Fixed Income/Bond Mutual Funds	Mutual funds that, by policy, invest in the fixed-income sector. (See also Mutual Funds.)
Guaranteed Investment Contracts (GICs)	GICs represent contracts issued by insurance companies that promise to pay a specified rate of interest on the invested capital over the life of the contract. GICs are sometimes referred to as “guaranteed insurance contracts.”
Hedge Funds	Hedge funds may be broadly defined as pooled funds that are not registered with the SEC; are typically available only to institutional investors or individuals with a high net worth; and use advanced trading strategies such as leverage, derivatives, short selling, and arbitrage.
Highly Rated Corporate Obligations	Based on the description in the PFI for “Authorized Investments: Institutions of Higher Education,” this category is limited to corporate debt obligations rated by a nationally recognized investment rating agency in one of its two highest long-term rating categories, without regard to gradations (e.g. + or -) within those categories. The two highest rating categories for Standard and Poor’s and Fitch Ratings are AAA and AA, while the two highest categories for Moody’s are Aaa and Aa.
High Yield Bonds	Corporate obligations that are considered below “investment grade” and are also referred to as “junk bonds” or “speculative grade.” Such corporate securities are rated BB or lower by Standard and Poor’s or Fitch Ratings and Ba or lower by Moody’s.
Market Value	In general, this equates to the “fair value” of an investment, as defined in Governmental Accounting Standards Board Statement No. 31 (GASB 31). A reporting entity that reports certain short-term, highly liquid debt instruments—such as commercial paper, bankers’ acceptances, and U.S. Treasury and agency obligations (“money market investments”)—on its balance sheet at “amortized cost” may report the same value on the annual investment report in the “Market Value” column for consistency.
Money Market Mutual Fund (or Money Market Fund)	An open-end mutual fund (registered with the SEC) that must comply with the SEC’s “Rule 2a-7,” which imposes certain restrictions, such as a requirement that the fund’s board must attempt to maintain a stable net asset value (NAV) per share or stable price per share, limits on the maximum maturity of any individual security in the fund’s portfolio, and limits on the maximum weighted average portfolio maturity and weighted average portfolio life. Money market funds typically attempt to maintain an NAV or a price of \$1.00 per share. (Institutions should report the “market value” of their money market fund investments based on the fund’s share price.)
Mortgage Pass-throughs - Agency	Mortgage pass-throughs are securities created by pooling mortgages, for which investors receive a pro-rata share of payments of principal and interest on the pool of mortgages. Agency mortgage pass-throughs are guaranteed by a U.S. government agency or government sponsored enterprise.

## Definitions of Investment and Deposit Types

Investment/Deposit Type	Definition
Mortgage Pass-throughs - Private Label	Private label mortgage pass-throughs are issued by institutions such as subsidiaries of investment banks, financial institutions, and home builders. They are the obligation of the issuers and are not guaranteed by the U.S. government or any government sponsored enterprise.
Municipal Obligations	Debt (typically bonds) issued by states, cities, counties, or other government entities. Income on some municipal bonds is exempt from both federal and state income taxes, while, for other municipal bonds, the income is not exempt from federal taxation.
Mutual Funds	Similar to commingled funds, the funds of multiple investors are pooled by the external manager. The investors own shares of the fund but do not own the individual securities. The public, as well as institutional investors, can invest in mutual funds. In contrast to commingled funds, mutual funds are regulated by the SEC. (See also Money Market Funds, a subset of mutual funds that should be categorized separately.)
Not Rated (NR) Corporate Obligations	Issues that have not been rated by a major rating agency. Standard and Poor's uses NR to designate issues for which no rating was requested; there was insufficient information on which to assign a rating; or, by policy, it does not rate that particular obligation.
Other Commercial Paper - lower rated	Commercial paper rated below the highest short-term rating categories used by major rating agencies (that is, below A-1, P-1, or equivalent ratings).
Other Investment Grade Corporate Obligations	Corporate debt obligations that are not categorized as "Highly Rated Corporate Obligations" but, nevertheless, receive an "investment grade" rating from a nationally recognized investment rating agency. Ratings of A or BBB by Standard and Poor's or Fitch Ratings and A or Baa by Moody's are considered "investment grade."
Other Real Asset Investments	Real assets typically exist in physical form and are generally considered to include "hard assets" that are used to produce goods or services, in contrast to "financial assets," such as stocks and bonds, which represent a claim on the income provided by real assets. Examples of real assets include real estate, timber, commodities like oil and gas, and infrastructure. (Institutions should categorize investments in real estate separately from their investments in "other real assets" if managed as distinct portfolios. See also Real Estate.)
Preferred Stock	A class of capital stock in a corporation distinct from common stock. Preferred stock generally carries no voting rights, pays a specified dividend, and has preference over common stock in the payment of dividends or in the event that corporate assets are liquidated. Although preferred stock has some features similar to bonds, it is classified as an "equity" investment.
Private Equity	Private equity funds are privately managed investment pools, typically organized as limited partnerships. They are managed by the fund's general partners who typically make long-term investments in private companies and who may take a controlling interest with the aim of increasing the value of those companies, often by helping to manage the companies. Private equity fund strategies include venture capital investments and leveraged buyouts, among others. (Institutions that make direct investments in private companies, often as "co-investments" alongside a private equity fund in which they invest, also should categorize such investments as "Private Equity.")
Public Funds Investment Pool Created to Function as a Money Market Mutual Fund and Other Investment Pools	The PFIA describes the criteria for allowable investments in "investment pools," including those it describes as a "public funds investment pool created to function as a money market mutual fund." Those types of pools are typically also referred to as "local government investment pools" or "LGIPs." They often function like money market mutual funds (see discussions at "TexPool" and "Money Market Funds") and might be referred to as "2a7-like" pools, but they are not required to register with the SEC. Other investment pools might choose not to function like money market funds, and therefore might permit a floating NAV, longer overall or individual investment maturity, and higher potential investment risk and return. (Institutions should separately categorize investments in (1) TexPool, (2) Other Public Funds Investment Pools Functioning as Money Market Mutual Funds, and (3) Other Investment Pools that do not operate as money market funds.)
Real Estate	Includes real estate held for investment directly or through investment vehicles such as private investment funds, which are limited partnerships that invest in real estate. Such investments are designed to produce high current income and/or capital gains through appreciation in the underlying real estate. (Does not include real estate not held for investment, such as campus buildings.)

## Definitions of Investment and Deposit Types

Investment/Deposit Type	Definition
Real Estate Investment Trusts (REITs)	REITs are companies that invest in real estate by investing directly in portfolios of various types of real estate properties and/or by making loans to building developers. Although generally they are publicly traded on major exchanges and available to all investors, some REITs are established as private investments, which can reduce the liquidity of such investments. (Private REITs should be categorized on the annual investment report as Real Estate in "Other Investments.")
Repurchase Agreements (Repos)	Short-term investment agreements in which an investor buys securities, usually U.S. government securities, from a seller and the seller agrees to repurchase them at a later date for a slightly higher price that is negotiated between the parties. Such arrangements function as money market investments with either a fixed maturity date, often overnight, or an open term, in which they are callable at any time.
Securities Lending Collateral Reinvestments	Institutions that participate in securities lending programs often receive cash as collateral for their loaned investments. The cash is normally reinvested, typically by the entity's lending agent, in a separate account for the lender or as part of a collateral investment pool that commingles the cash collateral received by multiple lenders. The cash collateral is typically invested in investments having relatively low credit risk, and interest rate risk is reduced by maintaining a relatively short average portfolio maturity. (An institution involved with securities lending should report the value for its share of any reinvested cash collateral in the same amount on its annual investment report and on its financial statements.)
Separately Managed Account	Securities in the external manager's portfolio are owned directly by the investing entity and are held by each investing entity's custodian bank. The investing entity can require the external manager to adhere to specific investment guidelines.
Short-term Investments	Includes all debt investments maturing within one year of the purchase date.
Short-term Mutual Funds (other than Money Market funds)	Mutual funds that specialize in short-term debt instruments, but that do not meet the strict criteria required to be called "money market" mutual funds. (If not reported as fixed income mutual funds in the section for Debt and Similar Investments > 1 Year Maturity, institutions should report non-money market, short-term fixed income mutual funds in the section for Short-Term Investments and Deposits.)
Sovereign Debt (non-U.S.)	Debt securities issued or guaranteed by foreign governments.
TexPool (and TexPool Prime)	TexPool and TexPool Prime are local government investment pools administered by the Texas Treasury Safekeeping Trust Company at the Office of the Comptroller of Public Accounts. Both funds are operated according to the rules governing money market mutual funds (the SEC's "Rule 2a-7"), which require a policy to maintain a stable net asset value per share (both funds seek to maintain a \$1.00 NAV per share) and impose limitations on maximum maturities of the overall portfolio and any individual security. Unlike true mutual funds, local government investment pools (whether or not organized to operate as money market mutual funds) are not required to register with the SEC.
U.S. Government Agency Securities	Also called "Agency Securities" or "Agencies," they represent debt securities (1) issued or guaranteed by U.S. federal government agencies or (2) issued by government sponsored enterprises (GSEs). Debt securities issued or guaranteed by U.S. federal government agencies, like U.S. Treasury Securities, are backed by the full faith and credit of the U.S. government. However, debt securities issued by GSEs are not backed by similar U.S. government guarantees; therefore, they are considered to carry more credit risk than securities issued or guaranteed by federal government agencies.
U.S. Government Securities	Also called "U.S. Treasury Securities" or "Treasuries," U.S. government securities are negotiable debt obligations, such as treasury bills, treasury notes, and treasury bonds that are backed by the full faith and credit of the U.S. government.

Source: The explanation of terms used in the annual investment report (including deposits) by higher education institutions is available on the State Auditor's Office's website at <http://www.sao.texas.gov/Resources/HigherEducationInvestmentReporting/>.

**Related State Auditor's Office Reports**

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Table 12

Related State Auditor's Office Reports		
Number	Report Name	Release Date
18-029	<i>A Report on Agencies', Higher Education Institutions', and Community Colleges' Compliance with Public Investment Reporting Requirements</i>	May 2018
16-027	<i>A Report on Agencies', Higher Education Institutions', and Community Colleges' Compliance with Public Investment Reporting Requirements</i>	May 2016

Copies of this report have been distributed to the following:

### **Legislative Audit Committee**

The Honorable Dan Patrick, Lieutenant Governor, Joint Chair

The Honorable Dade Phelan, Speaker of the House, Joint Chair

The Honorable Jane Nelson, Senate Finance Committee

The Honorable Robert Nichols, Member, Texas Senate

The Honorable Greg Bonnen, House Appropriations Committee

The Honorable Morgan Meyer, House Ways and Means Committee

### **Office of the Governor**

The Honorable Greg Abbott, Governor

### **Entities Listed in Report**

This report was distributed to the boards, chancellors, presidents, and executive directors of the agencies, higher education institutions, and community colleges listed in this report.



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