
**Public Funds Investment Act Compliance Audits
and
Higher Education Institution Investment Reporting Requirements in
Accordance with Article III, "Rider 5"**

Introduction

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Each biennium, the State Auditor's Office (SAO) reviews (if warranted by a risk assessment and approved by the Legislative Audit Committee) state agency, community college, and university compliance with the Public Funds Investment Act ("PFIA," Texas Government Code, Section 2256.005(n)).

As part of that review, the SAO also typically reviews compliance by institutions of higher education with the investment reporting requirements in the current General Appropriations Act. For the 2012-2013 biennium, those reporting requirements were listed in the General Appropriations Act (82nd Legislature), Article III, Rider 5–Investment Reports (hereinafter referred to as "Rider 5").

The information below addresses information that the SAO requires (I) [all state agencies, community colleges, and universities that are subject to the PFIA](#) to provide to the SAO in accordance with Texas Government Code, Section 2256.005(n), and (II) [all higher education institutions](#) to provide to the SAO in accordance with Rider 5.

I. PUBLIC FUNDS INVESTMENT ACT COMPLIANCE AUDITS

The Public Funds Investment Act (PFIA), Texas Government Code, Section 2256.005(n), requires every state agency to obtain a compliance audit for its investments that are not invested by the State Comptroller of Public Accounts under Texas Government Code, Section 404.024.

Entities Subject to the Compliance Audit Requirements of the PFIA

The PFIA's definition of "state agency" includes:

- All offices, departments, commissions, or other agencies that are part of any branch of state government.
- Institutions of higher education (which include state universities and community colleges).
- Nonprofit corporations acting on behalf of any of these entities.

Certain entities or investments are exempted from the requirements in Subchapter A of the PFIA. This includes the requirement for obtaining compliance audits. The PFIA, at Texas Government Code, Section 2256.004, states the following:

APPLICABILITY. (a) This subchapter does not apply to:

- (1) a public retirement system as defined by Section 802.001 [Texas Government Code];
 - (2) state funds invested as authorized by Section 404.024 [Texas Government Code];
 - (3) an institution of higher education having total endowments of at least \$95 million in book value on May 1, 1995;
 - (4) funds invested by the Veterans' Land Board as authorized by Chapter 161, 162, or 164, Natural Resources Code;
 - (5) registry funds deposited with the county or district clerk under Chapter 117, Local Government Code; or
 - (6) a deferred compensation plan that qualifies under either Section 401(k) or 457 of the Internal Revenue Code of 1986 (26 U.S.C. Section 1 et seq.), as amended.
- (b) This subchapter does not apply to an investment donated to an investing entity for a particular purpose or under terms of use specified by the donor.

Compliance Audit Requirements in the PFIA

The PFIA (Texas Government Code, Section 2256.005(n)) states:

"[A]t least once every two years a state agency shall arrange for a compliance audit of management controls on investments and adherence to the agency's established investment policies. The compliance audit shall be performed by the agency's internal auditor or by a private auditor employed in the manner provided by Section 321.020 [Texas Government Code]. Not later than January 1 of each even-numbered year a state agency shall report the results of the most recent audit performed under this subsection to the state auditor."

The same section of the PFIA also gives the State Auditor's Office (SAO) the authority, in connection with its review of these compliance audits, to *"require a state agency to also report to the state auditor other information the state auditor determines necessary to assess compliance with laws and policies applicable to state agency investments. A report under this subsection shall be prepared in a manner the state auditor prescribes."*

Compliance Audit Information Required by the SAO

The SAO requires that every state agency subject to the compliance audit provisions of the PFIA provide to the SAO by January 1 of each even-numbered year the following information about its most recent compliance audit:

- A detailed description of all instances of noncompliance that were identified as a result of the compliance audit procedures performed, regardless of the assessed materiality of any such noncompliance, and, if available, all responses to any audit findings that agency management provided to its auditor.
 - **NOTE:** It is **not** acceptable to limit this communication to only those instances of noncompliance (1) for which noncompliance could have a direct and material effect on the determination of financial statement amounts or (2) that auditors are required to report under *Government Auditing Standards* for financial statement audits.
- A copy of the report issued by the independent auditor or the entity's internal auditor that results from the auditor's performance of the required compliance audit defined in the PFIA.

- **NOTE:** The PFIA does not specify the applicable professional standards under which private auditors or an entity's internal auditors must perform the required compliance audit. Therefore, each entity and its compliance auditor should agree on suitable standards under which the audit will be performed. The auditor's report should clearly state the standards (for example, attestation standards issued by the AICPA or internal auditing standards issued by the Institute of Internal Auditors) under which the audit has been performed.

II. HIGHER EDUCATION INSTITUTION INVESTMENT REPORTING REQUIREMENTS IN ACCORDANCE WITH ARTICLE III, RIDER 5

The General Appropriations Act (82nd Legislature), Article III, Rider 5–Investment Reports (hereinafter referred to as “Rider 5”) states the following:

5. Investment Reports.

a. The governing board of each of the educational institutions named in this Article shall file with the State Auditor, Comptroller of Public Accounts, Legislative Budget Board, and the Governor an annual report of all investment transactions involving endowment funds, short-term and long-term investment funds, and all other securities transactions, in a method prescribed by the State Auditor's Office. Copies of such reports shall be available for public inspection. In addition to the annual report, each institution shall publish on its website quarterly investment reports in any format it deems appropriate.

b. The governing boards of each educational institution named in this Article must adopt formal investment policies. Each governing board shall submit to the Legislative Budget Board and State Auditor's Office a copy of their investment policy by December 31 of each year.

The SAO adopted new procedures in 2012 for higher education institutions to address Rider 5's requirements to report information to the SAO. These include:

- Implementing an [Annual Tracking Report for Investment Reporting by Higher Education Institutions](#) that every higher education institution should submit to the SAO by December 31 of each year to satisfy its Rider 5 reporting requirements to the SAO.
- Revising the format of the [Annual Investment Report \(Including Deposits\)](#) and the examples and descriptions of potential investment and deposit types that might be included on that report. The revisions are discussed further in [Annual Investment Reporting Required by the SAO](#).
- Revising and clarifying the first two of the [three investment-related questions](#) to which the SAO requires all higher education institutions to post responses on their Web site.

To be considered by the SAO to be in compliance with Rider 5, institutions of higher education should:

- **Post on their Web site** all information required by Rider 5, including:
 - [Annual investment reporting requirements prescribed by the SAO](#).
 - [Quarterly investment reports prescribed by Rider 5](#).
 - [Current investment policy](#).
- Disclose to the SAO on the annual tracking report the Web address of that information

- Submit the annual tracking report to the SAO by December 31 of each year

The tracking report also requests information from all higher education institutions that are subject to Subchapter A of the PFIA demonstrating that the institution's governing board has performed an annual review of its investment policy required by Texas Government Code, Section 2256.005(e).

Annual Investment Reporting Required by the SAO

In accordance with Rider 5's requirement that the SAO prescribe the manner of reporting annual investment information, the SAO requires institutions to annually report (**by posting the required information on the institution's Web site**):

1. Investment balances as of August 31, by investment type, on the [Annual Investment Report \(Including Deposits\)](#) form prescribed by the SAO.
2. Responses to [three questions](#) and applicable explanatory details (**institutions may present this information on the same Web page as the Annual Investment Report form or on a separate Web page**).

1. Annual Investment Report (Including Deposits):

In 2012, the SAO revised the contents and format of the required Annual Investment Report (Including Deposits). The new format is effective for institutions of higher education reporting fiscal year 2012 investment information. Major changes to the content and format include:

- New or clarified categories for investment and deposit types (however, institutions may choose to include **more** detailed categories than requested provided they are presented in the appropriate major investment or deposit type category).
- New or revised definitions of the listed investment or deposit types.
- Elimination of the requirement to disclose to the SAO the August 31 "book value" of investments. (The SAO now requires only "**market**" or "**fair**" value information; however, institutions of higher education that choose to continue to report book value information on their Web site should reformat the SAO's template for the annual report as needed to present that additional data.)

To the greatest extent practical, the overall market value of investments and deposits reported in the Annual Investment Report (Including Deposits) should agree with the amounts reported in the institution's final financial statements for the fiscal year.

2. Three investment-related questions to which institutions should respond annually: Beginning in 2002, the SAO required all higher education institutions to answer questions about their (1) use of external investment advisors or managers, (2) use of "soft dollar" arrangements, and (3) association with an independent endowment or foundation. In 2012, the SAO revised or clarified the first two of those three questions.

The SAO requires institutions to post on their Web site their responses to the following three questions:

1. Does the institution employ outside investment advisors or managers and, if so, who are they (provide individual or firm name and address)? Do the outside investment advisors or managers have the authority to make investment decisions without obtaining prior approval?

- **NOTE:** Institutions should include all consultants and “separately managed account” portfolio managers (in which the underlying investments are wholly owned by the institution) in this disclosure.

Institutions that, in addition, choose to disclose information about their participation in various forms of “commingled funds” should distinguish that information from the required listing of “separately managed” investment accounts. In general, commingled funds represent pooled investments in which multiple investors contribute money to the fund and own a share of the pool but do not own the individual investments. This structure could include the various pooled investment funds managed by Commonfund, as well as “alternative investments” such as hedge funds and limited partnerships that invest in private equity, real estate, or other assets.

2. Does the institution use soft dollar, directed brokerage or directed commission, commission recapture, or similar arrangements (these 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 will rebate a portion of commissions they receive on trades for the investor)? If the answer to this question is yes, the institution must summarize briefly the guidelines that govern the use of such arrangements.
3. Is the institution associated with an independent endowment or foundation? If the answer to this question is yes, the institution must provide contact information (name and address) for the individual(s) who manage the independent endowment or foundation. The institution must also provide, if available, the market value of the endowment’s or foundation’s investments.

Annual Posting of Investment Policy

The SAO requires institutions to post on their Web site by December 31 of each year the institution’s most current investment policies in order to satisfy the Rider 5 investment policy submission requirement to the SAO.

Institutions should be aware that the PFIA, (Texas Government Code, Section 2256.005(e)) requires the institution’s governing body to review its investment policy and investment strategies at least annually. The SAO’s [Annual Tracking Report](#) form requires that each institution list the date of the last policy update or provide the Web site location that documents when the last policy update occurred.