



STATE BAR OF TEXAS

Internal Audit Services

AN INTERNAL AUDIT OF

Public Funds Investment Act Compliance

Report No. 23-001

March 24, 2023

This report provides management with information about the condition of risks and internal controls as a specific point in time. Future changes in environmental factors and actions by personnel may impact these risks and internal controls in ways that this report cannot anticipate.



Report Highlights

Why Was This Review Conducted?

McConnell & Jones LLP (MJ) serving as the outsourced internal audit function (Internal Audit) for the State Bar of Texas (SBOT) performed this internal audit as part of the approved FY 2023 Annual Internal Audit Plan.

Audit Objectives and Scope

To assess management’s controls and processes in place to ensure investments are authorized, accurately recorded, and reported, and that the investments are in compliance with SBOT investment policies and the Public Funds Investment Act (PFIA).

The audit scope period was June 1, 2021 to May 31, 2022.

Audit Focus

1. Investment transactions.
2. Investment reconciliations.
3. Investment reporting.
4. Investment officer training.
5. Compliance with TREC investment policy and PFIA requirements.

We wish to thank all employees for their openness and cooperation. Without this, we would not have been able to complete our review.



Audit Conclusions

Our audit procedures applied to management’s controls and processes surrounding the SBOT’s investment transactions, investment reconciliations, investment reporting, investment officer training and investment policies indicate that internal controls and processes in place are effective. We noted that SBOT continues to deploy best practice processes in managing and reporting SBOT’s investments.

Internal Control Rating

Generally Effective with Best Practice Processes.

What Did We recommend?

No recommendations were made.

Number of Findings/ Opportunities by Risk Rating

| Category | High | Medium | Low | Total |
|---------------------------|------|--------|-----|-------|
| Findings | 0 | 0 | 0 | 0 |
| Improvement Opportunities | 0 | 0 | 0 | 0 |



Introduction

McConnell & Jones LLP (MJ), serving as the outsourced internal audit function (Internal Audit) for the State Bar of Texas (SBOT), performed an internal audit of SBOT’s compliance with SBOT’s investment policy and Texas Government Code Chapter 2256 Public Funds Investment, commonly referred to as the Public Funds Investment Act (PFIA).

Government Code Chapter 2256 Section 2256.005 Investment Policies, Investment Strategies; Investment Officer subsection (n) requires that at least once every two years a state agency arranges for a compliance audit of management controls on investments and adherence to the agency's established investment policies to be performed by their internal auditor or a private auditor. The resulting audit reports must be reported to the state auditor no later than January 1st of each even numbered year.

SBOT’s investment policy requires an annual audit of the investment funds’ records.

SBOT’s investment funds are invested through SBOT’s investment manager (PFM Asset Management LLC). SBOT’s investment manager was selected through a formal bid process.

We performed this audit as part of the approved FY 2023 Annual Internal Audit Plan. This audit was conducted in accordance with Generally Accepted Government Auditing Standards (GAGAS). 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 objectives. We believe that the evidence obtained accomplishes that requirement.

Pertinent information has not been omitted from this report. This report summarizes the audit objective and scope, our assessment based on our audit objectives and the audit approach.

SBOT’s Investment Standard

The State Bar shall invest its funds in a manner in which persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not for speculation, but to, in order of priority, preserve and safeguard the principal amount invested, provide liquidity to meet operating cash flow needs, and earn the highest yield possible considering the required safeguards.

SBOT’s Investment Principals

- ✓ Safety of Principal
- ✓ Diversification
- ✓ Yield

The Texas State Bar had a total of \$45.1 million in investment funds as of May 31, 2022. The following is each investment account’s ending market value as of May 31, 2022.

General Fund –

\$34,361,719

Texas Law Center –

\$4,294,379

Client Security Fund –

\$3,047,094

Texas Board of Legal Specialization –

\$1,929,122

Annual Meetings Fund –

\$249,424

Texas Bar College –

\$791,186

Law Focused Education (Hatton Sumner Grant)

- \$538,713

Objective, Conclusion, and Internal Control Rating

The purpose of this audit was to assess SBOT’s compliance with the PFIA’s specific requirements. In doing so, we also evaluated management controls in place to ensure that the funds are invested according to SBOT’s investment policy and that the investment reports are accurately compiled and distributed in a timely manner.



Texas Government Code Chapter 2256 Public Funds Investment sections applicable to SBOT are:

- ✓ Section 2256.005 Investment Policies, Investment Strategies; Investment Officer
- ✓ Section 2256.007 Investment Training; State Agency Board Members and Officers
- ✓ Section 2256.023 Internal Management Reports

The State Bar of Texas' applicable investment policy requirements are based upon its investment standard to preserve and safeguard the principal amount invested, provide liquidity to meet operating cash flow needs, and earn the highest yield possible considering the required safeguards. SBOT's investment policy is embedded in the State Bar of Texas Board of Directors Policy Manual. The investment policy contains the following components:

- ✓ Approved investment vehicles,
- ✓ Investment concentrations,
- ✓ Maturity periods,
- ✓ Investment rating,
- ✓ Reporting,
- ✓ Training,
- ✓ Investment principals,
- ✓ Investment settlement,
- ✓ Compliance with the Public Funds Investment Act, and
- ✓ Annual audit.

The scope period was June 1, 2021 through May 31, 2022.

SBOT has implemented best practice processes with effective internal controls to ensure that investment activities are authorized and recorded in a complete, accurate and timely manner.

SBOT is in compliance with the State Bar of Texas Board of Directors Policy Manual Investment Policy Section 3.05.06. Additionally, management's internal controls for investment activities and reporting are effective and working as designed.

We noted that the investment reports provided by the SBOT's Investment Manager are comprehensive and provide summary level investment balances and transactions in addition to a significant amount of detailed analysis. The investment reports provided to the SBOT Audit & Finance Committee continue to provide the information in a format that is user friendly and facilitates decision-making.

This audit identified findings that resulted in an overall internal control rating of: **Best practice processes with effective internal controls.**

| | | |
|--|--|--|
| Best Practices Processes with Effective Internal Controls | | <p>SBOT's internal controls over investment activity are effective. Investment balances provided to the Board and recorded in the financial system agree to the investment statements.</p> <p>Best practice processes and controls also ensure compliance with the State Bar of Texas Board of Directors Policy Manual Investment Policy Section 3.05.06 and Texas Government Code 2256 Public Funds Investment.</p> |
| | <p style="text-align: center;">RATING DESCRIPTION</p> <p>Best Practices Processes – Observations indicate best practice opportunities identified during the course of the review that may add value to the function/department/organization. Best practices do not require management comments and do not require internal follow-up to validate implementation status.</p> <p>Effective – Controls evaluated are adequate, appropriate, and effective to provide reasonable assurance that risks are being managed and objectives should be met.</p> <p>Some Improvement Needed – A few specific control weaknesses were noted; generally however, controls evaluated are adequate, appropriate, and effective to provide reasonable assurance that risks are being managed and objectives should be met.</p> <p>Major Improvement Needed – Numerous specific control weaknesses were noted. Controls evaluated are unlikely to provide reasonable assurance that risks are being managed and objectives should be met.</p> <p>Unsatisfactory – Controls evaluated are not adequate, appropriate, or effective to provide reasonable assurance that risks are being managed and objectives should be met.</p> | |

Exhibit 1: Internal control rating description.

SBOT's Chief Financial Officer (CFO) is the organization's designated investment officer. As such, this individual is authorized to execute investment transactions on behalf of SBOT. The CFO and the Audit & Finance Committee members work closely with the contracted investment firm to ensure that the organization's funds are invested in the highest return vehicles allowed by statute. The investment firm provides detailed investment reports each quarter which are discussed at the Audit & Finance Committee meetings.

SBOT has exercised sound stewardship over membership fees and closely monitors revenue generating activities. The total investment balance as of May 31, 2022 was \$45.14 million, which is an increase of 24.18% from \$36.35 million as of May 31, 2021. All funds except the Client Security Fund, Hatton Sumners Grant, and the Texas Law Center increased their balances from the prior year. **Exhibit 2** provides a summary of SBOT's investment balances by quarter between May 31, 2021 and May 31, 2022.

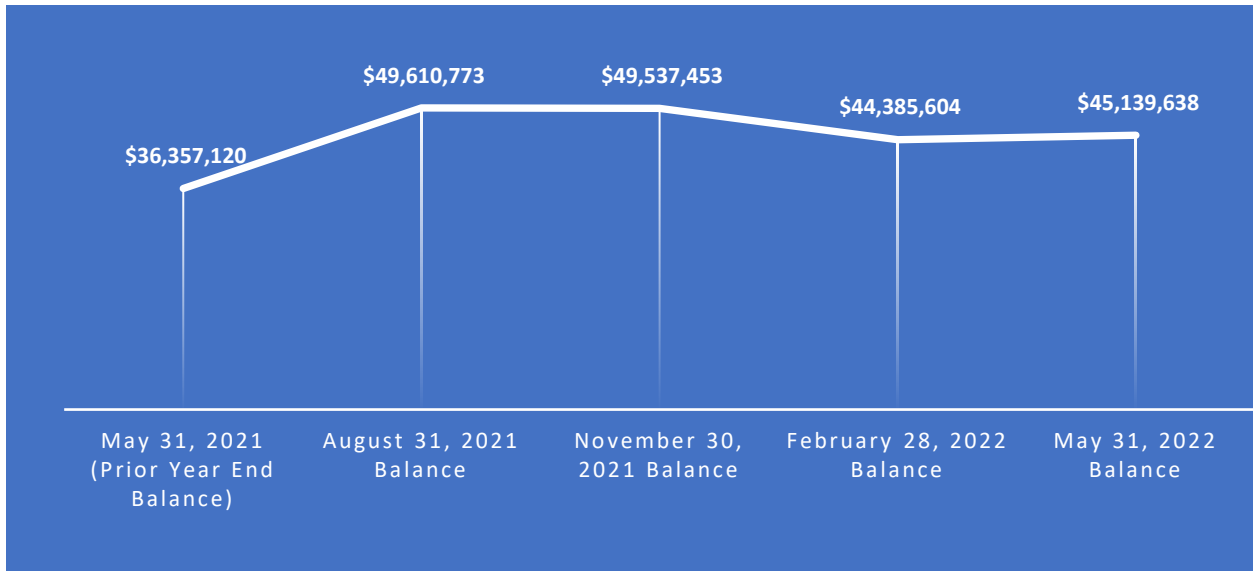


Exhibit 2: SBOT Total Investment Balances by Quarter May 31, 2021 to May 31, 2022.

SBOT’s funds are invested in a combination of short-term and long-term investment instruments. SBOT uses over-night investments to the extent possible to allow for some degree of interest to be earned yet have the funds readily available for operating expenses when needed. The General Fund account is where the operating funds are invested, as such this account has the most investment balance fluctuations while the other six investment funds remain relatively stable.

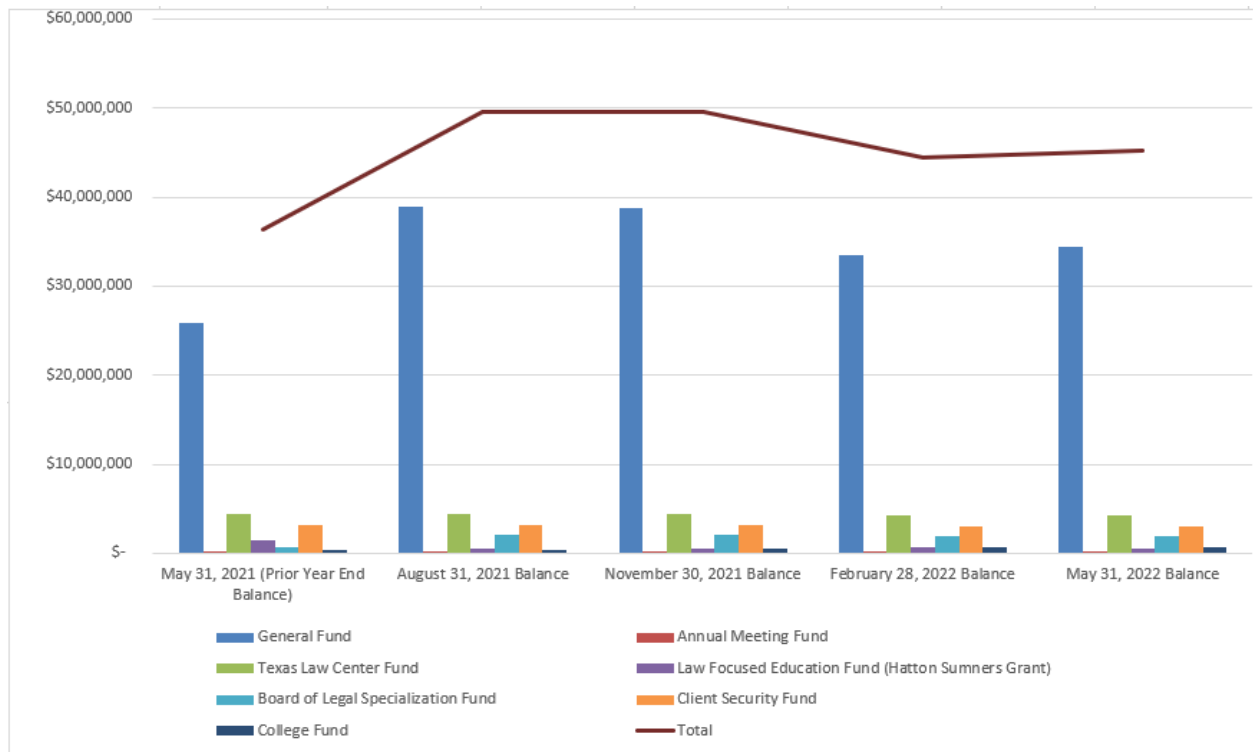


Figure 3 Summary of Individual Investment Fund Balances by Quarter Between May 31, 2021, and May 31, 2022.



Compliance Audit Details

The State Bar of Texas maintains investments for seven funds. These funds are:

- ✓ General Fund
- ✓ Texas Law Center (TLC)
- ✓ Client Security Fund (CSF)
- ✓ Texas Board of Legal Specialization (TBLS)
- ✓ Annual Meetings Fund
- ✓ Texas Bar College (TBC), which includes an Endowment Fund
- ✓ Law Focused Education - Hatton Sumners Grants (HSG)

A. Investment Policy

The PFIA requires state organizations that invest public funds to have a written investment policy that is reviewed at least once per year by the governing body. Section 2256.005 Investment Policies, Investment Strategies; Investment Officer lists specific topics that must be included in the agency's investment policy.

Audit procedures applied to determine compliance with these requirements included:

- ✓ Reviewed SBOT's investment policy and compared it to requirements listed in Section 2256.005.

Exhibit 3 compares Section 2256.005 requirements to SBOT's investment policy.

| Texas Government Code Sec. 2256.005 Section | PFIA Investment Policy Requirements | SBOT Investment Policy Meets Requirement |
|---|---|--|
| (b)(1) | The investment policies must be written. | |
| (b)(2) | Primarily emphasize safety of principal and liquidity. | |
| (b)(3) | Address investment diversification, yield, and maturity and the quality and capability of investment management. | |
| (b)(4)(A) | Include a list of the types of authorized investments in which the investing entity's funds may be invested. | |
| (b)(4)(B) | Include the maximum allowable stated maturity of any individual investment owned by the entity. | |
| (b)(4)(C) | Include for pooled fund groups, the maximum dollar weighted average maturity allowed based on the stated maturity date for the portfolio. | |










| Texas Government Code Sec. 2256.005 Section | PFIA Investment Policy Requirements | SBOT Investment Policy Meets Requirement |
|---|--|---|
| (b)(4)(D) | Include methods to monitor the market price of investments acquired with public funds. |  |
| (b)(4)(E) | Include a requirement for settlement of all transactions, except investment pool funds and mutual funds, on a delivery versus payment basis. |  |
| (b)(4)(F) | Include procedures to monitor rating changes in investments acquired with public funds and the liquidation of such investments consistent with the provisions of Section 2256.021. |  |
| (d) | As an integral part of an investment policy, the governing body shall adopt a separate written investment strategy for each of the funds or group of funds under its control. Each investment strategy must describe the investment objectives for the particular fund using the following priorities in order of importance: (1) understanding of the suitability of the investment to the financial requirements of the entity; (2) preservation and safety of principal; (3) liquidity; (4) marketability of the investment if the need arises to liquidate the investment before maturity; (5) diversification of the investment portfolio; and (6) yield. |  |
| (e) | The governing body of an investing entity shall review its investment policy and investment strategies not less than annually. |  |
| (e) | The governing body shall adopt a written instrument by rule, order, ordinance, or resolution stating that it has reviewed the investment policy and investment strategies and that the written instrument so adopted shall record any changes made to either the investment policy or investment strategies. |  |
| (f) | Each investing entity shall designate, by rule, order, ordinance, or resolution, as appropriate, one or more officers or employees of the state agency, local government, or investment pool as investment officer to be responsible for the investment of its funds consistent with the investment policy adopted by the entity. |  |

Exhibit3: Section 2256.005 requirements and SBOT's compliance.*Legend:*

Internal controls are effective and SBOT is in compliance with requirement; no observations noted.





Conclusion

SBOT is in compliance with Section 2256.005 Investment Policies, Investment Strategies; Investment Officer. Our audit procedures resulted in no exceptions noted.

Recommendation

No recommendations are made for this compliance requirement.

Management’s Response

Management response is not required as no observations were noted for this compliance requirement.

B. Investment Officer, State Agency Board Member and Officer Training

The PFIA section 2256.007 lists specific training requirements for the agency investment officers, board members and officers.

Audit procedures applied to determine compliance with these requirements included:

- ✓ Reviewed SBOT’s investment training records to determine compliance with the requirements of section 2256.007.

Exhibit 4 compares section 2256.007 training requirements to SBOT’s records of investment officer training taken.

| Texas Government Code Sec. 2256.007 Section | INVESTMENT TRAINING; STATE AGENCY BOARD MEMBERS AND OFFICERS. | SBOT Investment Officer and Officers Training Meet Requirements |
|---|---|---|
| (a) | Each member of the governing board of a state agency and its investment officer shall attend at least one training session relating to the person's responsibilities under this chapter within six months after taking office or assuming duties. | |
| (b) | The Texas Higher Education Coordinating Board shall provide the training under this section. | |
| (c) | Training under this section must include education in investment controls, security risks, strategy risks, market risks, diversification of investment portfolio, and compliance with this chapter. | |
| (d) | An investment officer shall attend a training session not less than once each state fiscal biennium and may receive training from any independent source approved by the governing body of the state agency. | |
| (d) | The investment officer shall prepare a report on this subchapter and deliver the report to the governing body of the state agency | |



| Texas Government Code Sec. 2256.007 Section | INVESTMENT TRAINING; STATE AGENCY BOARD MEMBERS AND OFFICERS. | SBOT Investment Officer and Officers Training Meet Requirements |
|---|---|---|
| | not later than the 180th day after the last day of each regular session of the legislature. | |

Exhibit 4: Texas Government Code training requirements compared to SBOT’s training taken.

Legend:



Internal controls are effective and SBOT is in compliance with requirement; no observations noted.

Conclusion

SBOT was in compliance with PFIA section 2256.007. SBOT’s investment officer has completed all training required to perform the role of an investment officer.

Recommendation

No recommendations are made for this compliance requirement.

Managements Response

Management response is not required as no observations were noted for this compliance requirement.

Management Reports

The PFIA requires state agencies that invest public funds provide investment management reports to its governing body. Section 2256.023 Internal Management Reports lists specific information that must be included in the investment management reports.










SBOT’s CFO works with SBOT’s investment manager, PFM Asset Management LLC, to prepare detailed investment reports. The investment reports are signed/certified by the SBOT Executive Director, CFO, and PFM. The investment reports are provided to the SBOT Audit & Finance Committee each quarter.

Audit procedures applied to determine compliance with Section 2256.023 requirements included:

- ✓ Reviewed quarterly investment reports for completion and content compliance with Section 2256.023.
- ✓ Compared quarterly investment reports to SBOT Balance Sheets and trial balance report to determine completeness and accuracy.



Exhibit 5 compares the Section 2256.023 investment management report requirements to SBOT's investment reports.

| Texas Government Code Sec. 2256.023 Section | Internal Management Reports | SBOT Investment Management Reports Meet Requirements |
|---|--|---|
| (a) | Not less than quarterly, the investment officer shall prepare and submit to the governing body of the entity a written report of investment transactions for all funds covered by this chapter for the preceding reporting period. |  |
| (b)(1)(2)(3) | The report must: (1) describe in detail the investment position of the entity on the date of the report; (2) be prepared jointly by all investment officers of the entity; (3) be signed by each investment officer of the entity; |  |
| (b)(4) | contain a summary statement of each pooled fund group that states the: (A) beginning market value for the reporting period; (B) ending market value for the period; and (C) fully accrued interest for the reporting period; |  |
| (b)(5) | state the book value and market value of each separately invested asset at the end of the reporting period by the type of asset and fund type invested; |  |
| (b)(6) | state the maturity date of each separately invested asset that has a maturity date; |  |
| (b)(7) | state the account or fund or pooled group fund in the state agency or local government for which each individual investment was acquired; |  |
| (b)(8) | state the compliance of the investment portfolio of the state agency or local government as it relates to: (A) the investment strategy expressed in the agency's or local government's investment policy; and (B) relevant provisions of this chapter. |  |
| (c) | The report shall be presented not less than quarterly to the governing body and the chief executive officer of the entity within a reasonable time after the end of the period. |  |
| (d) | If an entity invests in other than money market mutual funds, investment pools or accounts offered by its depository bank in the form of certificates of deposit, or money market accounts or similar accounts, the reports prepared by the investment officers under this section shall be formally reviewed at least annually by an independent auditor, and the |  |



| Texas Government Code Sec. 2256.023 Section | Internal Management Reports | SBOT Investment Management Reports Meet Requirements |
|---|---|--|
| | result of the review shall be reported to the governing body by that auditor. | |

Exhibit 5: Texas Government Code reporting requirements compared to SBOT's management reports.

Legend:



Internal controls are effective and SBOT is in compliance with requirement; no observations noted.

Conclusion

SBOT's investment reports are in compliance with Section 2256.023. Additionally, the monthly investment reports were complete and accurate.

Recommendation

No recommendations are made for this compliance requirement.

Management's Response

Management response is not required as no observations were noted for this compliance requirement.

