



State Bar of Texas Internal Audit Services

Public Funds Investment Act Compliance Audit Report #18-001

January 11, 2018
As Prepared by
McConnell & Jones LLP



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

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January 11, 2018

Stat Bar of Texas
Audit & Finance Committee
1414 Colorado Street
Austin, TX 78701

Dear Audit & Finance Committee Chair:

Attached is Internal Audit Report #18-001 Public Funds Investment Act Compliance Audit. This audit was performed as part of the approved FY 2017 Annual Internal Audit Plan.

We assessed the State Bar of Texas' (SBOT) compliance with Texas Government Code Chapter 2256 Public Funds Investment and determined that the agency was compliant with all requirements except delivering the biennial report of Subchapter A, Chapter 2256. Management took corrective action when this was brought to their attention and this is no longer a non-compliance item. Additionally, management's internal controls for investment processes and reporting are effective and working as designed.

Please contact Darlene Brown at 281.740.0017 if you should have any questions about this audit report.

Sincerely,

Odysseus Lanier, CPA
Partner

1.0 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 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 does invest public funds and therefore is required to comply with Texas Government Code Chapter 2256 Public Funds Investment. These 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 2017 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

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

May 31, 2017 Investment Account Balances

The Texas State Bar has a total of \$37 million in the following investment funds:

- ✓ General Fund \$27,946,199
- ✓ Texas Law Center - \$3,324,440
- ✓ Client Security Fund - \$2,883,785
- ✓ Texas Board of Legal Specialization - \$1,694,216
- ✓ Annual Meetings Fund - \$575,752
- ✓ Texas Bar College - \$346,369
- ✓ Hatton Summers Grant - \$294,671

audit objectives and scope, our assessment based on our audit objectives and the audit approach.

Objectives and Scope

The purpose of this audit is 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 agency's 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 imbedded in the State Bar of Texas Board of Directors Policy Manual (September 2017). 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
- ✓ Annual audit

The scope period was June 1, 2016 through May 31, 2017.

Conclusion

The State Bar of Texas is in compliance with all applicable requirements of Texas Government Code Chapter 2256 Public Funds Investment except delivering the biennial training report. All required individuals have completed the investment training. Management took immediate action to begin including a statement of training completed in the quarterly investment reports. SBOT is also 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 are some of the most comprehensive investment reports we have seen provided to boards.

2.0 COMPLIANCE AUDIT DETAILS

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

- ✓ General Fund
- ✓ Client Service Fund (CSF)
- ✓ Texas Board of Legal Specialization (TBLS)
- ✓ Texas Bar College (TBC)
- ✓ Hatton Sumners Grants (HSG)
- ✓ Texas Law Center (TLC)
- ✓ Annual Meetings Fund (AM)

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.

Figure IP1 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)(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.	N/A SBOT does not invest in pooled fund groups.
(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	

Texas Government Code Sec. 2256.005 Section	PFIA Investment Policy Requirements	SBOT Investment Policy Meets Requirement
	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.	

Conclusion

SBOT is in compliance with Section 2256.005 Investment Policies, Investment Strategies; Investment Officer.

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.

- ✓ Reviewed quarterly investment reports and reports on Subchapter A, Chapter 2256, provided to SBOT’s governing body.

Figure IT1 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.	N/A
(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 not later than the 180th day after the last day of each regular session of the legislature.	

Figure IT1: Texas Government Code Training Requirements Compared to SBOT’s Training Taken SBOT’s investment officers and board members have completed training required by the Texas Government Code within the required time frames.

Conclusion

SBOT is in compliance with Section 2256.007, except for providing the biennial report regarding Subchapter A, Chapter 2256, to the Commission and Board. Management took immediate action to address this issue and is now in compliance with Subchapter A.

Additionally, SBOT’s investment policy included in the State Bar Board Policy Manual – September 2017, Section 3.05.06 (D), is not aligned with PFIA Section 2256.007 (a) which requires training to be completed within six months of Board members and investment officers taking office or assuming investment duties. SBOT’s investment policy states that investment officers and the persons authorized to execute investment transactions

shall attend at least one investment training session within 12 months after taking office or assuming duties. The spreadsheet used by the Finance Division Director states the training must be taken within six months. SBOT’s process requires all initial training must be completed within the initial six months of taking office or assuming duties, and all required individuals had completed the training.

Recommendation

SBOT’s Finance Division Director should deliver a biennial training report to SBOT’s governing body as required in section 2256.007(d). Additionally, SBOT’s investment policy should be updated to reflect that new Board member and investment officer

investment training must be completed within six months of assuming duties.

Managements Response

Management agrees with the findings of this report. SBOT will update the investment policy to align with the PFIA requirements when the Board approves the investment policy in September.

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 provides detailed investment reports compiled by their investment manager, PFM Asset Management LLC. The investment reports are signed/certified by the SBOT Executive Director, Finance Division Director 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 trail balance report to determine completeness and accuracy.

Figure MR1 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	

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

Figure MR1: Texas Government Code Reporting Requirements Compared to SBOT's Management Reports
SBOT's Investment Reports contain information items required by the Texas Government Code
 Legend:

Conclusion

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