An Audit Report on

Financial Processes at the Texas Public Finance Authority

May 2016

Report No. 16-029

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Overall Conclusion

The Texas Public Finance Authority (TPFA) has generally implemented controls over its financial processes, but it should make improvements in its (1) documentation of the selection and evaluation of bond-related contracts and (2) processes for the review and approval of its payroll, travel, other expenditures, and annual financial report. Specifically TPFA:

- Had adequate controls over issuing bonds and commercial paper and paying related debt service. However, it should improve the review and approval process for costs of issuance and other bond-related items.
- Had adequate controls over (1) transferring funds to and from state agencies and (2) monitoring and making arbitrage rebate payments.
- Should document and implement an evaluation and selection process for its underwriter, bond counsel, financial advisor, and arbitrage contracts.
- Had adequate controls over its inventory, payroll, travel, and expenditure processes; however, it should improve its review and approval process over those areas.
- Had adequate controls over financial reporting; however, it should document its procedures and improve its review and approval process over that area.
- Had adequate controls to protect data in the automated systems tested from unauthorized use.

> **Background Information**
>
> The Legislature created the Texas Public Finance Authority (TPFA) in 1984 to provide financing for the construction or acquisition of facilities for state agencies.
>
> Pursuant to Texas Government Code, Chapters 1232, 1401, and 1403, TPFA:
>
> - Issues general obligation and revenue bonds for state agencies.
> - Maintains the Master Lease Purchase Program, which is a revenue commercial paper program used primarily to finance equipment acquisitions by state agencies.
>
> TPFA received $1.1 million in appropriations for fiscal year 2015 for administrative operations.
>
> Sources: TPFA and the General Appropriations Act (83rd Legislature).

There are no statutory requirements that TPFA must follow to select consultants on bond-related contracts. Texas Government Code, Chapter 1201, gives TPFA exclusive authority to select, contract with, and determine the basis for compensation of entities that provide legal and other services. However, not having documented procedures or adequate controls over the evaluation and selection processes diminishes the accountability and transparency of TPFA's contracting process.

This audit was conducted in accordance with Texas Government Code, Sections 321.0131 and 321.0132.

For more information regarding this report, please contact Verma Elliott, Assistant State Auditor, or Lisa Collier, First Assistant State Auditor, at (512) 936-9500.

Table 1 presents a summary of the findings in this report and the related issue rating. (See Appendix 2 for more information about the issue rating classifications and descriptions.)

Table 1

Summary of Chapters/Subchapters and Related Issue Ratings		
Chapter/ Subchapter	Title	Issue Rating [a]
1-A	TPFA Had Controls to Help Ensure That It Issued Debt, Paid Associated Debt Service and Other Related Costs Using State Funds, and Appropriately Transferred Funds in Accordance with State Law and Other Requirements	Low
1-B	TPFA Had Controls to Help Ensure That It Properly Monitored and Made Arbitrage Rebate Payments	Low
2	TPFA Should Make Improvements by Documenting Its Process for the Selection and Evaluation of Its Bond-related Contracts	Medium
3-A	TPFA Did Not Consistently Follow Its Procedures for Review and Approval of Payroll Time Reports Within 30 Days of Payroll Processing	Low
3-B	TPFA Had Documentation Showing That It Paid Travel and Other Expenditures Accurately and Appropriately and That Inventory Was Properly Maintained	Low
4	TPFA Should Establish and Document Annual Financial Report Procedures and a More Thorough Review Process	Medium

[a] A chapter/subchapter is rated Priority if the issues identified present risks or effects that if not addressed could critically affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern and reduce risks to the audited entity.

A chapter/subchapter is rated High if the issues identified present risks or effects that if not addressed could substantially affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concern and reduce risks to the audited entity.

A chapter/subchapter is rated Medium if the issues identified present risks or effects that if not addressed could moderately affect the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern and reduce risks to a more desirable level.

A chapter/subchapter is rated Low if the audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

Auditors communicated other, less significant issues in writing to TPFA management.

Summary of Management's Response

At the end of each chapter/subchapter in this report, auditors made recommendations to address the issues identified during this audit. TPFA's detailed management response is presented immediately following the recommendations at the end of each chapter in this report. TPFA's overall management response is presented in Appendix 7.

TPFA management agreed with recommendations in Chapters 1 and 3, but it did not agree with certain findings and other issues in Chapters 2 and 4. The information in TPFA's management response did not cause the State Auditor's Office to modify the findings and conclusions in this report.

Audit Objective and Scope

The objective of this audit was to determine whether selected general government agencies in the General Appropriations Act have processes and related controls to help ensure that they administer financial transactions in accordance with applicable statutes, rules, and agency policies and procedures.

The scope of this audit covered TPFA activities related to debt management, bond-related contracting, inventory management, payroll, travel, purchasing, financial reporting, and the related information systems between September 1, 2014, and August 31, 2015.

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Detailed Results

Chapter 1

TPFA Had Controls to Help Ensure That It Provided Financing for the Construction or Acquisition of Facilities for State Agencies and Properly Managed Related Transfers and Expenditures

> **TPFA's** Debt Issuance Process
>
> According to information obtained from TPFA, it uses the following process to issue debt:
>
> 1. Legislature authorizes a project or program and the issuance of debt for that project or program.
> 2. The governing board of the state agency responsible for the project or program adopts a resolution authorizing a request for financing.
> 3. The state agency responsible for the project or program submits a request for financing to TPFA.
> 4. The TPFA board approves the request for financing and determines the method of sale.
> 5. The TPFA structures the debt issue.
> 6. The Bond Review Board approves the issuance of debt.
> 7. Financing documents such as financing agreements are signed by the state agency and TPFA.
> 8. Sale of debt instrument.
> 9. Closing of Bond Sale.
> 10. Funding the client agency project.
>
> Sources: The TPFA and Bond Review Board.

The primary mission of the Texas Public Finance Authority (TPFA) is to provide the most cost-effective financing available to fund capital projects, equipment acquisitions, and programs as authorized by the Legislature. Before TPFA may issue bonds for the acquisition or construction of a building for a state agency, the Legislature must authorize the specific project for which the bonds are to be issued and the estimated cost of the project or the maximum amount of bonded indebtedness that may be incurred by the issuance of bonds (see Appendix 3 for a list of TPFA's client agencies).

Auditors tested TPFA's debt issuance process (see text box for more information about that process) and determined that TPFA's controls were operating effectively to help ensure that debt was issued in accordance with requirements. The processes tested were related to (1) bond issuance or refunds, (2) paying bond debt service, (3) commercial paper issuance, (4) paying commercial paper-related debt service, (5) transferring funds to and from state agencies, and (6) paying associated costs of issuance and ongoing bond administration fees.

Chapter 1-A

TPFA Had Controls to Help Ensure That It Issued Debt, Paid Associated Debt Service and Other Related Costs Using State Funds, and Appropriately Transferred Funds in Accordance with State Law and Other Requirements

Chapter 1-A Rating:

Low [1]

Refunded Bonds: To finance projects and programs, TPFA may choose to issue long-term debt (debt with a maturity of five or more years) in the form of bonds. Bonds or other debt instruments may be refunded to obtain a lower overall cost of financing. For fiscal year 2015, TPFA refunded approximately $223.0 million for 7 previously issued outstanding bonds by issuing refunding bonds. Auditors reviewed transactions related to the refunding of those seven previously issued outstanding bonds and determined that TPFA (1) properly reviewed and approved deposit vouchers while maintaining segregation of duties, (2) properly deposited bond proceeds, and (3) maintained required documentation to show that it provided proper notice in accordance with its *Business Operating Procedures* and *Debt Management Guidelines*.

Bond Debt Servicing: Debt service refers to the amount of money needed to make payment on the principal and interest for an outstanding debt/loan. TPFA usually pays debt service for the bonds it issues on a semiannual basis. Auditors tested 9 (10.3 percent) of the 87 bond debt service payments TPFA made during fiscal year 2015. Those 9 bond debt service payments totaled approximately $71.9 million (10.9 percent) of the $661.0 million total debt service payments made for the fiscal year. Auditors determined that TPFA properly reviewed and approved those nine payments while maintaining segregation of duties; received confirmations from third-party participants; and made those payments in accordance with bond resolutions, schedules, and other internal documentation.

Commercial Paper Issuances: In addition to long-term debt, TPFA can also issue short-term debt (debt with a maturity of 1 to 270 days) in the form of commercial paper. For fiscal year 2015, TPFA issued approximately $299.4 million in commercial paper transactions. Auditors tested $270.5 million in commercial paper transactions, which represented approximately 90.3 percent of the total issuances for fiscal year 2015. Auditors determined that TPFA properly reviewed and approved deposit vouchers while maintaining segregation of duties; properly deposited commercial paper proceeds; and

[1] The risk related to the issues discussed in Chapter 1-A are rated as Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

maintained required documentation to show that it provided proper notice of the issuance to the Comptroller of Public Accounts.

Commercial Paper Debt Service: TPFA made $19.8 million in commercial paper debt service payments during fiscal year 2015. Auditors tested $12.1 million (61.1 percent) of those debt service payments and determined that TPFA properly reviewed and approved those payments while maintaining segregation of duties; received confirmations from third-party trustees; and made those payments in accordance with schedules and other internal documentation.

Transfers: Auditors reviewed TPFA's process for transferring funds to account for bond proceeds, pay debt service obligations, and pay for other costs of issuance and ongoing bond administration costs. Auditors tested 25 fund transfers in and 25 fund transfers out to determine whether the amounts being transferred were accurate, properly approved, and supported. TPFA had controls to ensure that it accurately and appropriately transferred funds to and from state agencies. In addition, it obtained the required approvals and maintained segregation of duties, which helped to ensure that it processed those transfers appropriately.

Cost of Issuance and Ongoing Bond Administration: Costs associated with the issuance of bond and commercial paper are known as costs of issuance. Those costs include expenses such as legal services, travel costs, ratings fees, financial advisory fees, and delivery fees. According to TPFA, ongoing bond administration costs refers to post issuance responsibilities associated with administering outstanding bonds and commercial paper notes, including payments of insurance premiums, IRS rebatable arbitrage, liquidity fees, paying agent fees, dealer fees and rating agency fees. For fiscal year 2015, auditors determined that 22 (88.0 percent) of the 25 vouchers tested were accurately processed in the Uniform Statewide Accounting System (USAS) and supported with internal summary spreadsheets and invoices. In addition, all seven vouchers required to reimburse General Revenue with bond proceeds did so accurately and properly. However, for three vouchers, TPFA did not ensure that the invoices were properly approved in accordance with its internal business operating procedures and were identified as errors due to missing approval dates.

Recommendation

TPFA should ensure that it continues to document its review and approval of payment vouchers, as required by its internal business operating procedures.

Management's Response

The accurate and timely payment of bond debt service is TPFA's most important function, critical to the maintenance of the state's "AAA" bond rating. TPFA will continue follow its internal operating procedures to ensure that payment vouchers for debt service, costs of issuance and bond administration are reviewed, approved and dated in accordance with the procedures.

Chapter 1-B

TPFA Had Controls to Help Ensure That It Properly Monitored and Made Arbitrage Rebate Payments

Chapter 1-B Rating:

Low [2]

During fiscal year 2015, TPFA contracted with one firm (see Appendix 5 for more information on professional consultants) to monitor compliance with arbitrage requirements and calculate the amount of any arbitrage rebates, if applicable (see text box for more information about arbitrage rebate payments). Based on documentation reviewed by auditors, TPFA:

- Complied with U.S. Internal Revenue Service requirements to appropriately make arbitrage rebate payments, when required.
- Collected and reviewed arbitrage monitoring reports from its contractor as required by the contract terms and TPFA's *Business Operating Procedures*.

Arbitrage Rebates

Arbitrage rebates are owed to the U.S. Internal Revenue Service if the earnings on tax-free bond proceeds exceed a specific rate that is calculated in accordance with the U.S. Internal Revenue Code. That may occur if the proceeds from a tax-exempt bond are invested at a rate that is higher than the rate paid on the tax-exempt bonds.

Source: The TPFA.

[2] The risk related to the issues discussed in Chapter 1-B are rated as Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

Chapter 2

TPFA Should Make Improvements by Documenting Its Process for the Selection and Evaluation of Its Bond-related Contracts

Chapter 2 Rating:

Medium [3]

As discussed in Chapter 1, the primary mission of TPFA is to provide the most cost-effective financing available to fund capital projects, equipment acquisitions, and programs as authorized by the Legislature. According to Chapter 1, auditors determined that TPFA has controls in place to help ensure that it successfully complies with its primary mission.

TPFA accomplishes its primary mission by contracting with firms for underwriting, financial advisory services, arbitrage, and bond counsel services. TPFA has implemented some controls over its bond-related contracting processes. However, TPFA should improve previously established controls to increase the accountability and transparency of its contracting processes.

TPFA usually issues a request for proposals for its professional services. After TPFA receives responses from firms interested in providing the advertised services, TPFA management either creates a pool of firms eligible to work on selected bond and commercial paper transactions or it selects one firm or more firms to work on selected transactions based on recommendations TPFA staff make to the agency's Board of Directors. (See Appendix 5 for a list of professional/consulting and legal service fees.)

TPFA's current management has been in place since September 2014. The current management issued only one request for proposals in July 2015 for underwriting services. All of the remaining requests for proposals and contracts discussed in this chapter were issued by prior management at TPFA. Because pools had not been refreshed on a regular basis, the current management used firms for its 2015 transactions that prior management created.

There are no statutory requirements that TPFA must follow to select consultants on bond-related contracts. Texas Government Code, Chapter 1201, gives TPFA exclusive authority to select, contract with, and determine the basis for compensation of entities that provide legal and other services. TPFA noted that according to Title 1, Texas Administrative Code, Chapter 57, and Texas Government Code, Section 402.0212, there are specific requirements that TPFA must follow in the selection of and contracting with bond-related legal service providers. (See Appendix 6 for excerpts from

[3] The risk related to the issues discussed in Chapter 2 are rated as Medium because the issues identified present risks or effects that if not addressed could moderately affect the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concerns and reduce risks to a more desirable level.

Texas Government Code, Chapters 1201.) While auditors did not identify any issues indicating that TPFA selected firms that were not competent to provide the contracted services, TPFA did not implement a consistent process for evaluating similar contracting services. Auditors identified several weaknesses in TPFA's evaluation and selection processes that diminish the accountability and transparency of its contracting process.

TPFA created a pool of firms eligible to work on transactions based on criteria identified in its request for proposals without documenting how its staff evaluated that criteria.

As previously noted, TPFA's current management issued a request for proposals for underwriting services in July 2015. Some of the firms that responded to that request for proposals will eventually be selected to provide services for fiscal year 2016 bond and commercial paper transactions. Of the 33 firms that responded to the request for proposals, 20 firms were selected for inclusion in TPFA's underwriting pool, members of which are eligible to work on selected bond and commercial paper transactions. TPFA management stated that there was a discussion in a working group session of the Board of Directors that was open to the public concerning how the 20 firms were selected. However, neither the minutes of the working group meeting nor the minutes of the Board of Directors meeting contain sufficient detail to show how the 20 firms were selected. Additionally, TPFA staff also did not have evaluation procedures or documentation showing how its staff evaluated the firms for inclusion in the underwriting pool based on the criteria identified in the request for proposals.

In addition, TPFA issued a request for proposal for arbitrage services in January 2012 before TPFA's current management was in place. At that time, TPFA staff received responses from seven firms. According to TPFA, staff reviewed and evaluated the responses in order to recommend to its Board of Directors one firm to provide arbitrage services during fiscal year 2015. However, TPFA staff did not have documentation showing how it evaluated any of the seven prospective firms based on the criteria outlined in the January 2012 request for proposal. The only documentation available was a summary of the responses the seven firms provided to the request for proposals. TPFA asserted that the summary information was discussed in a Board of Directors meeting and the summary information was used to select a firm. However, the minutes of the Board of Directors meeting did not contain enough detail to show how the Board evaluated the firms. TPFA used the same firm selected in 2012 to provide arbitrage services through fiscal year 2015.

TPFA's current management asserted that its prior management chose to use scoring matrices to evaluate responses to request for proposals in some cases. However, the prior management team did not always ensure that all scorers used or clearly defined the scoring criteria used in those matrices. TPFA staff used scoring matrices to evaluate firms that responded to TPFA's requests for proposals for bond counsel services and financial advisory services issued in January 2012 and January 2010, respectively. The bond counsel scoring matrix and the financial advisor scoring matrix included criteria to evaluate the firms. For each of the factors used to evaluate the bond counsel and financial advisory firms, TPFA staff assigned points based on the defined criteria. Total points resulted in a ranking of the respondents, which TPFA used to support staff recommendations to its board. However, auditors noted the following weaknesses:

- Bond counsel firms: Staff (1) deviated from the defined scoring criteria in TPFA's bond counsel scoring matrix without any documented explanation for the deviation and (2) inaccurately summarized 8 of 13 prospective bond counsel firms' responses in the scoring matrix used for the responses to one request for proposals that auditors reviewed.

- Financial advisors: TPFA did not define the criteria it used to assign points to firms that responded to its request for proposal for any of the evaluation scoring categories. Because the TPFA did not document its evaluation of the proposals to explain why certain points were assigned, auditors could not determine whether the evaluators appropriately assigned the points. In addition, staff inaccurately calculated the score for a prospective financial advisory firm that responded to TPFA's January 2010 request for proposals. The calculation errors that auditors identified did not change the overall rankings of the firms evaluated.

Based on the results of this scoring, TPFA staff made a recommendation to the Board of Directors to create two pools: (1) a pool in January 2012 for bond counsel and (2) a separate pool in January 2010 to provide advisory services in which staff recommended two financial advisor firms be included. Firms from the bond counsel and financial advisor pools were subsequently selected to provide services for bond and commercial paper transactions that occurred during fiscal year 2015. Based on subsequent discussions, TPFA's current management asserted that the agency is not going to use scoring matrices to recommend firms in the future.

TPFA**’s current** staff recommended firms from the pools created during its 2012 and 2010 request for proposals process to its Board of Directors to provide services in fiscal year 2015 for selected bond or commercial paper transactions without documenting how the staff evaluated and selected those firms.

Auditors reviewed the process TPFA staff used to recommend firms to the Board that provided bond and commercial paper transactions services and identified the following weaknesses:

- Auditors tested eight recommendations for bond counsel assignments. For five of the eight firms selected, TPFA did not have documentation showing the procedures the staff used to evaluate the criteria and make recommendations to the Board of Directors for awarding work for bond and commercial paper transactions. For the remaining three firms selected, TPFA’s board meeting minutes documented a discussion indicating that the firms were selected based on the firms’ previous experience working with TPFA.

- TPFA staff did not have documentation to support its recommendations to the Board of Directors showing how the staff evaluated and selected firms from its underwriting pool for work on bond and commercial paper transactions.

In contrast to the weaknesses identified in TPFA’s prior process to recommend firms to the Board of Directors for bond counsel, and underwriting firm services, TPFA’s board meeting minutes documented discussions between the board members and TPFA staff to select two firms to provide financial advisory services for selected bond or commercial paper transactions based on a consideration of several factors. Those factors included whether both firms had an established municipal bond business and the “marked difference” between the scores for those two firms and the remaining two firms that responded to the request for proposals for those services. Similar discussions were documented for the selection of the firm to provide arbitrage services.

Recommendations

To improve its current processes, TPFA should:

- Ensure that its staff documents the evaluation method and the selection process of firms for inclusion in the pools.

- Ensure that its staff implements procedures and documents the selection of firms that are recommended to the Board of Directors for the selections of firms from the pools for assigned work on specific bond and commercial paper transactions.

- Ensure that its staff documents final selection of firms.

To the extent that scoring matrices are used, TPFA should:

- Consistently apply scoring criteria when evaluating and selecting bond counsel firms and document that criteria in a scoring instrument, such as the scoring matrix or another scoring document.
- Verify that information the bond counsel and financial advisor firms submit is reflected accurately in its scoring instrument, and implement a review process to ensure that it calculates and documents scores accurately.

Management's Response

TPFA's management response reflects the view of both the agency and the board of directors.

TPFA firmly disagrees with the Auditor's assessment of risk related to TPFA's process of selecting bond service providers. TPFA believes that its bond service provider selection process complies with State law, is effective and efficient and poses low control risk, if any. Both the Request for Proposal (RFP) process and the direct TPFA board involvement have been consistent, robust, and transparent in a public setting.

TPFA will consider the Auditor's recommendations regarding bond service provider selection to the extent to that those recommendations would provide for a more effective process.

TPFA concurs with the Auditor's recommendation to more explicitly document bond-related service provider pool selections and transactional appointments.

As previously noted, TPFA believes that bond service provider evaluation and selection controls are in place to mitigate risk. The TPFA bond service provider selections are made by the TPFA board of directors in open meetings, providing for both transparency and accountability. The evaluation criteria utilized by the TPFA in selecting its bond service providers is fully documented in the respective RFP issued by the TPFA for each type of service provider. Each service provider's qualifications, based on the RFP evaluation criteria, are presented to the board for its consideration. Further, selection of bond services providers is subject to final review and approval by the Bond Review Board and, for bond counsel, the Office of the Attorney General.

All firms selected to a bond service provider pool are qualified, according to the criteria specified in the RFP, to perform services for TPFA. Utilizing a "pool" approach allows TPFA to include larger firms with extensive track records and capital, as well as HUB firms and smaller regional and Texas-based firms. Work can then be allocated to HUB firms and smaller firms, as the project complexity dictates, thus giving those firms an opportunity to perform and demonstrate their competencies.

For each bond transaction, staff recommends service providers to the board. From among the pools of underwriters, financial advisors and bond counsel, staff identifies service providers best suited to work on the specific transaction. RFP criteria considered in making recommendations include: the capacity of a firm to work on a transaction due to its size, specific expertise to work on a transaction having unique characteristics; the capacity of professional staff available to perform services for TPFA, the specific expertise of professionals; the location of services providers; experience on similar transactions; past performance on TPFA transactions; the ability of a firm to lead or support the transaction; ensuring participation of regional firms, Historically Underutilized Businesses and other minority, women or disabled service veteran owned firms; and rotation among service providers to provide opportunities for pre-selected pool service providers to participate in TPFA transactions. Staff presents its bond service provider recommendations, and the basis of those recommendations, to the TPFA board of directors in open meetings for its specific decisions.

As indicated by the Auditor, TPFA discarded the use of scoring matrix tools for bond service provider vendor selection. Previous scoring served only to summarize RFP results to the board for its consideration. Selection by scoring for bond service providers is not effective due to the many qualitative considerations in selecting professional firms for bond transactions. In particular with respect to bond counsel services, Texas Government Code §2254.004 requires that TPFA select the most qualified law firm "on the basis of demonstrated competence and qualifications." TPFA complies with this statute by selecting a pool of the most qualified firms through an evaluation of the criteria set forth in the RFP and based on evaluation of prior experience with the firms.

Auditor Follow-up Comment

The auditors have reviewed and considered management's responses regarding TPFA's process for the selection and evaluation of bond-related contracts. The auditors' conclusion and related risk rating have not changed. The issues presented in this chapter, if not addressed, present risks that could moderately affect TPFA's ability to effectively administer the functions audited.

Chapter 3

TPFA Had Procedures to Help Ensure That Processing of Expenditures and Its Inventory Management Were Accurate; However, It Did Not Consistently Follow Those Procedures

TPFA had implemented controls to help ensure that it accurately processed expenditures related to payroll, travel, and procurement. In addition, TPFA had controls to safeguard inventory. However, it should improve internal procedures related to its review and approval of those expenditures, as required by TPFA's internal procedures.

Chapter 3-A

TPFA Did Not Consistently Follow Its Procedures for Review and Approval of Payroll Time Reports Within 30 Days of Payroll Processing

Chapter 3-A Rating:

Low [4]

For fiscal year 2015, TPFA processed approximately $861,000 in salaries for its employees and compensatory per diem for board members. TPFA used the Uniform Statewide Payroll/Personnel System (USPS) to process its salary transactions. Auditors tested 23 employee salary transactions and 4 board member compensation transactions and determined that TPFA maintained accurate employee information in its personnel files and made payments for active employees for the correct amounts. However, for 21 (95.5 percent) of the 22 applicable employee salary transactions tested, TPFA did not approve supporting time records in accordance with its internal payroll procedures before it processed the salary transactions. As a result, time records supporting salary transactions were approved an average of 61 days after the payroll was processed in the USPS. Timely approval of time records helps to ensure that employees are paid for the actual hours worked or leave taken.

Auditors also tested all six pay actions for fiscal year 2015, which included new hires, promotions, and employee transfers from other state agencies to TPFA. Auditors determined that all six pay actions were properly approved, supported, and accurately reflected in USPS. In addition, TPFA assigned user access to USPS to appropriate personnel.

[4] The risk related to the issues discussed in Chapter 3-A are rated as Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

Recommendation

TPFA should ensure that it reviews and approves time records in a timely manner to support salary transactions, in accordance with its internal payroll procedures.

Management's Response

Management acknowledges that leave time records examined during the audit period were not approved on a timely basis and this practice has been addressed.

It should be noted that TPFA time keeping for leave balance accounting is a function independent of payroll. TPFA processes its payroll in accordance with the Comptroller's requirement that payroll be processed in advance of the end of the period for which payroll is being paid. Thus, payroll is always processed prior to the review and approval of time records for any given pay period. Finally, all TPFA employees are FLSA-exempt salaried employees and thus not subject to payment on an hourly basis. TPFA's delay in signing the time records never results in payroll overpayments due to insufficient leave balances.

Chapter 3-B

TPFA Had Documentation Showing That It Paid Travel and Other Expenditures Accurately and Appropriately and That Inventory Was Properly Maintained

Chapter 3-B Rating:

Low [5]

Travel: TPFA paid approximately $21,519 for in-state travel expenses during fiscal year 2015. For the 18 travel vouchers tested,[6] TPFA properly reimbursed travel per diem amounts in accordance with the Office of the Comptroller of Public Accounts' travel reimbursement rates; used the correct account codes for those payments in USAS; maintained evidence that travel was for a valid business reason; and maintained supporting documentation, such as meal, lodging, and fuel receipts. TPFA also properly approved travel reimbursement for 17 (94.4 percent) of the 18 travel vouchers tested, in accordance with its internal travel policy. The one travel voucher that auditors identified as an error was missing the approval date on the voucher.

[5] The risk related to the issues discussed in Chapter 3-B are rated as Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

[6] Out-of-state travel was tested as part of the cost of issuance and bond administration discussed in Chapter 1-A.

Other Expenditures: For fiscal year 2015, other TPFA operating expenditures totaled approximately $1.8 million. Those expenditures include categories such as temporary services, storage fees, and office consumables. Auditors tested 25 expenditures and determined that TPFA used the correct account codes for those payments in USAS and ensured that the payments were for the correct amounts. In addition, TPFA maintained documentation showing that it approved 21 (84.0 percent) of 25 purchase vouchers tested in accordance with its internal business operating procedures. Auditors determined that, for the four remaining expenditures auditors identified as errors, either the approval or processed dates were missing or the approval date was incorrectly recorded.

Master Lease Purchase Program

According to TPFA, under the Master Lease Purchase Program, it borrows money to pay for a state agency's equipment or other project by issuing tax-exempt revenue commercial paper notes. The TPFA takes title to the equipment or other project and leases it to the agency, which is then required to make lease payments to TPFA. The TPFA uses the lease payments to repay the principal and interest on the commercial paper notes. When the lease is fully paid, the state agency receives title to the equipment or other financed project.

Auditors also reviewed expenditures related to TPFA's Master Lease Purchase Program, which is a lease financing program primarily to finance capital equipment acquisitions by state agencies (see text box for more information about the Master Lease Purchase Program). During fiscal year 2015, TPFA processed 7 Master Lease Purchase Program expenditures that totaled $491,751. All seven of those expenditures were adequately supported, properly approved, and accurately entered and coded in USAS.

In addition, TPFA had controls over access to USAS, which TPFA used to process its financial transactions, to limit access to appropriate staff.

Inventory Management: TPFA's inventory management process properly segregated the duties of maintaining property, conducting inventory, and updating the State Property Accounting (SPA) system. Specifically, TPFA maintained documentation for all 6 assets tested to support the asset values, in-service dates, and physical locations specified in its inventory system. TPFA also had adequate controls to ensure that only authorized staff had access to SPA, which it used to maintain information about its capital assets.

Recommendation

TPFA should continue to properly review and approve travel and other expenditures in accordance with its internal policies and procedures.

Management's Response

Management concurs with the Auditor's findings and recommendation. TPFA will continue to follow its internal procedures for the review and approval of travel and other expenditures and ensure that all travel vouchers and purchase vouchers are properly dated and recorded with processing dates.

Chapter 4

TPFA Should Establish and Document Annual Financial Report Procedures and a More Thorough Review Process

Chapter 4
Rating:

Medium [7]

TPFA generally had appropriate processes and controls to help ensure that it reported selected accounts correctly on its fiscal year 2015 annual financial report. Auditors tested significant TPFA transactions and determined that the transactions were accurately recorded in USAS. In addition, in its annual financial report for fiscal year 2015, TPFA ensured that the General Revenue Fund, a fund shared by most state agencies and higher education institutions, accurately included all of TPFA's transactions for the fiscal year reported.

However, TPFA should improve certain controls over financial reporting. TPFA uses the Office of the Comptroller of Public Accounts' *Reporting Requirements for Annual Financial Reports of State Agencies and Universities* to prepare its annual financial report; however, it does not have internal policies and procedures and a documented review and approval process for the preparation of its annual financial report. As a result, auditors noted inaccuracies and inconsistencies in TPFA's annual financial report for fiscal year 2015. Specifically:

- TPFA's Long-Term Debt Liabilities Adjustment Interest Payable balance reported on its Combined Balance Sheet/Statement of Activities–Governmental Funds statement was not recalculated and updated with the fiscal year 2015 balance.

- TPFA did not update the balances for its Private-Purpose Trust Funds Statements with its fiscal year 2015 balances.

- TPFA's Note 5—Long-Term Liabilities Unamortized (Discount) Premium—balance was not updated for fiscal year 2015 balances and, consequently, the Note 5 balances did not support the financial statements.

Having documented policies and procedures would help to ensure that TPFA's annual financial report is complete. Likewise, having a documented review process that ensures its annual reports are thoroughly reviewed would help TPFA ensure that it continues to report accurate information.

[7] The risk related to the issues discussed in Chapter 4 are rated as Medium because the issues identified present risks or effects that if not addressed could moderately affect the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concerns and reduce risks to a more desirable level.

Recommendations

TPFA should:

- Develop internal policies and procedures that provide specific procedures regarding the preparation of its annual financial report and the maintenance of its supporting documentation.
- Implement a documented review and approval process.

Management's Response

TPFA prepares its Annual Financial Report (AFR) in accordance the Comptroller's requirements, including the accounting policies established therein. Those policies are documented by the Comptroller in its Reporting Requirements for Annual Financial Reports. Further, the TPFA fully discloses the significant accounting policies used to prepare its Annual Financial Report.

Management concurs with the Auditor's recommendations that the TPFA develop and implement specific internal review procedures and document the review and approval process to be applied to the preparation of the Annual Financial Report. These procedures, including checklists and review and approval procedures, will be implemented prior to the next annual reporting period.

Management does not believe that the risk associated with the Auditor's findings is significant. Although errors were identified within the body of the TPFA Annual Financial Report, all entries were correctly recorded in the State's Uniform Statewide Accounting System and thus accurately represented for the preparation of the Comptroller's statewide Comprehensive Annual Financial Report.

Appendices

Appendix 1

Objective, Scope, and Methodology

Objective

The objective of this audit was to determine whether selected general government agencies in the General Appropriations Act have processes and related controls to help ensure that they administer financial transactions in accordance with applicable statutes, rules, and agency policies and procedures.

Scope

The scope of this audit covered Texas Public Finance Authority (TPFA) activities related to debt management, bond-related contracting, inventory management, payroll, travel, purchasing, financial reporting, and the related information systems between September 1, 2014, and August 31, 2015.

Methodology

The audit methodology included interviewing TPFA staff regarding financial and operational processes; testing documentation related to debt management, purchasing, assets, financial reporting, payroll, travel, and bond related contracts; and conducting physical inventory of TPFA's assets.

Sampling Methodology

Auditors selected a nonstatistical, random sample of transactions and expenditures related to capital assets, debt service for bonds, transfers, costs of issuance for bonds and commercial paper, payroll, travel, and purchasing. Those samples were designed to be representative of the population and results may be extrapolated to the population, but the accuracy of the extrapolation cannot be measured.

For commercial paper debt service and commercial paper issuance/refunding, auditors selected a nonstatistical, random sample and also used professional judgment to select items for testing. Those sample items generally were not representative of the population and, therefore, it would not be appropriate to extrapolate those results to the population.

In addition, auditors tested 100 percent of transactions related to capitalized personal property, bond issuances/refunds, arbitrage expenditures, pay actions, underwriter agreements, financial advisor contracts, and outside counsel contracts (bond counsel contracts).

Data Reliability

Auditors used expenditure information in the Uniform Statewide Accounting System (USAS) and relied on previous State Auditor's Office audit work on USAS to determine that data was sufficiently reliable for the purposes of this audit.

To determine the reliability of the data from the Uniform Statewide Payroll/Personnel System and the State Property Accounting (SPA) system, auditors reviewed the data for accuracy and completeness by (1) reviewing data query language, (2) performing a high-level review of data fields and contents for appropriateness, and (3) tracing a sample of selected detailed transactions from the data to source documents. Auditors determined that the data in those systems was sufficiently reliable for the purposes of this audit.

Auditors used vendor/contractor information maintained in TPFA's manual tracking spreadsheets. While auditors determined those data sets were of undetermined reliability, they were the most complete populations available and, therefore, auditors determined they were sufficient to sample for compliance with bond-related contract requirements. As a result, the findings and conclusions in this report are subject to that limitation.

Information collected and reviewed included the following:

- TPFA's *Business Operating Procedures*.
- TPFA's *Payroll Procedures*.
- TPFA's travel policy.
- TPFA's purchasing policy.
- Data on assets from SPA.
- Expenditure data from USAS.
- Minutes from TPFA's board meetings.
- TPFA documentation such as payroll records, invoices, journal vouchers, bond documents, debt service schedules, and calculation spreadsheets.

Procedures and tests conducted included the following:

- Interviewed TPFA staff to identify TPFA's financial and operational processes, including financial and administrative internal controls.
- Tested documentation related to debt management, purchasing, assets, financial reporting, payroll, travel, and bond-related contracts to determine compliance with TPFA's policies and procedures and state laws and regulations.
- Conducted physical inventory of TPFA's assets and compared the results with information in SPA and TPFA's property records.
- Tested journal entries and transfer documentation to determine whether they were appropriate, supported, and approved.
- Reviewed selected line items from TPFA's fiscal year 2015 annual financial report to determine whether they were supported.

Criteria used included the following:

- TPFA policies, procedures, and guidelines.
- Office of the Comptroller of Public Accounts' State Property Accounting (SPA) Process User's Guide.
- Texas Government Code, Chapter 1201.
- Title 34, Texas Administrative Code, Chapter 225.

Project Information

Audit fieldwork was conducted from August 2015 through February 2016. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The following members of the State Auditor's staff performed the audit:

- Courtney Ambres-Wade, CGAP (Project Manager)
- Bill Morris, CPA (Assistant Project Manager)
- Bianca F. Pineda, CGAP
- Shelby Rounsaville
- Alexander Sumners
- Dennis Ray Bushnell, CPA (Quality Control Reviewer)
- Verma L. Elliott, CPA, CIA, CGAP, MBA (Assistant State Auditor)

Appendix 2

Issue Rating Classifications and Descriptions

Auditors used professional judgement and rated the audit findings identified in this report. Those issue ratings are summarized in the report chapters/sub-chapters. The issue ratings were determined based on the degree of risk or effect of the findings in relation to the audit objective(s).

In determining the ratings of audit findings, auditors considered factors such as financial impact; potential failure to meet program/function objectives; violation of state statute(s), rules, regulations, and other requirements or criteria; and the inadequacy of the design and/or operating effectiveness of internal controls. In addition, evidence of potential fraud, waste, or abuse; significant control environment issues; and little to no corrective action for issues previously identified could increase the ratings for audit findings. Auditors also identified and considered other factors when appropriate.

Table 2 provides a description of the issue ratings presented in this report.

Table 2

Summary of Issue Ratings	
Issue Rating	Description of Rating
Low	The audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.
Medium	Issues identified present risks or effects that if not addressed could moderately affect the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern(s) and reduce risks to a more desirable level.
High	Issues identified present risks or effects that if not addressed could substantially affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concern(s) and reduce risks to the audited entity.
Priority	Issues identified present risks or effects that if not addressed could critically affect the audited entity's ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern(s) and reduce risks to the audited entity.

Appendix 3

TPFA's Client Agencies

Pursuant to Texas Government Code, Chapters 1232 (the Texas Public Finance Authority's (TPFA) enabling law), 1401, and 1403, TPFA issues general obligation and revenue bonds for designated state agencies and higher education institutions (known as "client agencies").

TPFA can also provide financing to any state agency[8] or higher education institution under the Master Lease Purchase Program, which is a revenue commercial paper program used primarily to finance equipment acquisitions. In addition, according to TPFA, it can issue debt for municipal power agencies and other entities, as authorized by Texas Government Code, Section 1232.1071, and for alternative fuels projects authorized by Texas Government Code, Sections 1231.107 through 1232.104.

Table 3 lists the state agencies or higher education institutions for which TPFA may issue debt.

Table 3

TPFA's Client Agencies [a]
Cancer Prevention and Research Institute of Texas
Commission on Environmental Quality
Department of Aging and Disability Services
Department of Agriculture
Department of Criminal Justice
Department of Insurance
Department of Public Safety
Department of State Health Services
Department of Transportation (Colonia Roadway Grant Program)
Facilities Commission
Health and Human Services Commission
Historical Commission
Juvenile Justice Department
Midwestern State University
Parks and Wildlife Department
School for the Blind and Visually Impaired
School for the Deaf
Texas Military Department
Texas Military Preparedness Commission (Texas Military Value Revolving Loan Fund)

[8] A "state agency" means a board, commission, department, office, agency, or other governmental entity in the executive, judicial, or legislative branch of state government.

TPFA's Client Agencies [a]
Texas State Preservation Board
Texas Windstorm Insurance Association [b]
Texas Workforce Commission
Texas Southern University

[a] TPFA is authorized to issue debt for institutions of higher education at the institution's request.

[b] The Texas Windstorm Insurance Association is not a state agency or institution of higher education. It is an insurance company established by the Texas Legislature in 1971 to provide windstorm and hail insurance to Texas seacoast residents and is governed by Texas Insurance Code, Chapter 2210.

Sources: TPFA and Texas Windstorm Insurance Agency Web site.

Appendix 4

Glossary of Selected Terms Related to Debt Management

Table 4 lists the definitions for certain terms used in the management and administration of debt issuance.

Table 4

Glossary of Selected Terms Related to Debt Management	
Term	**Definition**
Arbitrage	Arbitrage rebates are owed to the U.S. Internal Revenue Service if the earnings on tax-free bond proceeds exceed a specific rate that is calculated in accordance with the U. S. Internal Revenue Code. That may occur if the proceeds from a tax-exempt bond are invested at a rate that is higher than the rate paid on the tax-exempt bonds. (See Chapter 1-B for more information about arbitrage.)
Bond Counsel	An attorney retained by the issuer of proposed securities to give a legal opinion that (1) the issuer is authorized to issue the proposed securities, (2) the legal requirements necessary for issuance have been met, and (3) the proposed securities will be exempt from federal income taxation and state and local taxation where applicable.
Bond	Debt instrument in which an investor loans money to the issuer that specifies when the loan is due (“term” or “maturity” such as 20 years); the interest rate the borrower will pay (such as 5 percent); when the payments will be made (such as monthly, semi-annually, annually); and the revenue source pledged to make the payments.
Commercial Paper	Short-term, unsecured promissory notes that mature within 270 days and are backed by a liquidity provider (usually a bank) that will provide liquidity in the event the notes are not remarketed or redeemed at maturity.
Costs of Issuance	The expenses associated with the sale of a new issue of municipal securities including underwriting costs, legal fees, financial advisory fees, rating agency fees, and other fees associated with the transaction.
Financial Advisor	A securities firm that assists an issuer on matters pertaining to a proposed issue such as structuring, timing, marketing, fairness of pricing, terms, and debt ratings.
Refunding	Bonds issued to retire or redeem all or a portion of outstanding bonds.
Underwriter	An investment banking firm that purchases securities directly from the issuer and resells them to investors.

Sources: The Texas Public Finance Authority; the *Bond Review Board 2015 Annual Report;* and the Bond Review Board’s Web site at http://www.brb.state.tx.us/pub/bfo/AR/AR2015.pdf.

Appendix 5

Professional/Consulting and Legal Service Fees Paid by TPFA

In fiscal year 2015, the Texas Public Finance Authority (TPFA) paid $1,883,606 in professional/consulting fees and legal service fees. Some of the services provided include bond counsel services, financial advisory services, and arbitrage computation services. Table 5 lists TPFA's professional/consulting fees and legal service fees from fiscal years 2010 through 2015.

Table 5

Professional/Consulting and Legal Service Fees Paid by TPFA Fiscal Years 2010 through 2015								
Firm	Type	Fiscal Year 2010	Fiscal Year 2011	Fiscal Year 2012	Fiscal Year 2013	Fiscal Year 2014	Fiscal Year 2015	Totals
Professional/Consulting Fees								
PFM Asset Management LLC	Arbitrage Computation Services	$22,500	$19,000	$26,000	$37,250	$19,000	$38,100	$161,850
Texas Workforce Commission [a]	Compliance Audit	0	2,714	0	0	0	0	2,714
Alliance Work Partners [a]	Consultant Services	785	785	0	0	0	0	1,570
The Waters Consulting Group, Inc [a]	Consultant Services	0	0	27,500	0	0	0	27,500
Workers Assistance Program, Inc. [a]	Consultant Services	0	0	785	1,291	1,460	785	4,321
CUSIP Service Bureau	Bond CUSIP Services	0	0	0	0	0	545	545
Texas Treasury Safekeeping Trust Company	Escrow Agent Services	1,250	1,250	0	0	750	3,500	6,750
Coastal Securities, Inc.	Financial Advisory Services	170,750	156,000	0	0	194,897	69,989	591,636
First Southwest Company	Financial Advisory Services	0	0	68,296	4,800	0	332,051	405,147
McDermott Will & Emery LLP	Financial Advisory Services	0	0	3,500	0	0	0	3,500
Sumitomo Mitsui Banking Corporation	Liquidity Services	0	0	465,359	281,918	0	0	747,277
Office of the Comptroller of Public Accounts	Liquidity Services	644,715	895,970	354,402	425,822	757,810	678,302	3,757,021

Professional/Consulting and Legal Service Fees Paid by TPFA Fiscal Years 2010 through 2015								
Firm	Type	Fiscal Year 2010	Fiscal Year 2011	Fiscal Year 2012	Fiscal Year 2013	Fiscal Year 2014	Fiscal Year 2015	Totals
Wells Fargo Bank NA	Liquidity Services	0	0	165,003	64,015	0	0	229,018
Bank of New York Mellon Trust Company	Paying Agent Services	2,572	2,692	0	0	0	0	5,264
Deutsche Bank Trust Company Americas	Paying Agent Services	16,935	405	35,175	17,835	0	0	70,350
U.S. Bank	Paying Agent Services	10,766	8,462	8,802	7,646	20,940	15,394	72,010
The University of Texas at Austin	Professional Services	309	0	0	0	0	0	309
Fitch Inc.	Rating Services	49,500	72,000	84,000	6,000	20,000	85,000	316,500
McGraw-Hill Company, Inc.	Rating Services	89,462	59,200	1,006	0	14,700	43,300	207,668
Moody's Investors Service	Rating Services	117,950	41,100	120,350	46,500	110,250	135,938	572,088
Standard and Poor's Ratings Services	Rating Services	0	0	0	0	0	20,000	20,000
Barclays Capital, Inc.	Remarketing Services	29,630	39,307	269,450	259,409	0	0	597,796
Goldman Sachs & Co.	Remarketing Services	89,520	71,761	42,835	94,215	84,935	73,997	457,263
Jefferies & Company, Inc.	Remarketing Services	14,057	84,576	23,781	24,662	0	0	147,076
J.P. Morgan Securities, Inc. Cash Management	Remarketing Services	24,527	16,094	18,066	12,879	12,523	1,269	85,358
Leucadia National Corporation	Remarketing Services	0	0	0	30,171	82,846	45,830	158,847
Grant Thornton LLP	Verification Services	5,000	0	5,000	0	0	0	10,000
Causey Demgen & Moore P.C.	Verification Services	0	0	0	0	0	2,990	2,990
Totals for Professional/ Consulting Fees		$1,290,228	$1,471,316	$1,719,310	$1,314,413	$1,320,111	$1,546,990	$8,662,368
Legal Service Fees								
Adorno Yoss White & Wiggins LLP	Bond Counsel Services	$9,482	$3,868	$0	$0	$0	$0	$13,350
Andrews Kurth LLP	Bond Counsel Services	0	0	51,500	0	0	43,313	94,813

Professional/Consulting and Legal Service Fees Paid by TPFA Fiscal Years 2010 through 2015								
Firm	Type	Fiscal Year 2010	Fiscal Year 2011	Fiscal Year 2012	Fiscal Year 2013	Fiscal Year 2014	Fiscal Year 2015	Totals
Bickerstaff Heath Delgado Acosta LLP	Bond Counsel Services	25,000	0	0	0	0	0	25,000
Bracewell & Giuliani LLP	Bond Counsel Services	0	0	0	0	42,897	14,973	57,870
Fulbright & Jaworski LLP	Bond Counsel Services	0	0	140,302	34,422	0	0	174,724
McCall Parkhurst & Horton LLP	Bond Counsel Services	47,359	67,569	57,711	0	82,800	60,280	315,719
Norton Rose Fullbright	Bond Counsel Services	0	0	0	0	0	160,000	160,000
Vinson & Elkins LLP	Bond Counsel Services	82,551	0	164,885	0	0	0	247,436
Office of the Attorney General	Bond Transcript Filing Fees	38,000	19,000	38,000	27,250	28,500	58,050	208,800
Totals for Legal Service Fees		$202,392	$90,437	$452,398	$61,672	$154,197	$336,616	$1,297,712
Grand Totals		$1,492,620	$1,561,753	$2,171,708	$1,376,085	$1,474,308	$1,883,606	$9,960,080

[a] Amounts listed for this firm are not reflective of payments for bond costs of issuance and ongoing bond administration.

Source: TPFA's *Annual Report of Nonfinancial Data* for the years ending August, 31, 2010, through August 31, 2015.

Excerpt from Texas Government Code, Chapter 1201

Texas Government Code, Chapter 1201, gives the Texas Public Finance Authority exclusive authority to select, contract with, and determine the basis for compensation of entities that provide it legal and other services. Below is the excerpt from Texas Government Code, Chapter 1201 (effective September 1, 2007) that is relevant to contracting for debt issuance and other related services.

Section 1201.027. AUTHORITY OF ISSUER TO CONTRACT FOR SERVICES.

(a) An issuer has exclusive authority to select, contract with, and determine the basis for compensation of a person to provide legal and other services as may be determined by the issuer to be necessary in connection with the issuer's issuance of public securities or administration of its affairs that pertain to the issuance of public securities. The selection of legal counsel shall be made in accordance with the provisions of Subchapter A, Chapter 2254, applicable to the selection by a governmental entity of a provider of professional engineering services.

(b) Subsection (a) does not impair the authority of the attorney general under Section 402.0212 to approve a contract for legal services entered into by a state agency.

(c) Except as provided by Subsection (b), to the extent of a conflict between this section and another law or a municipal charter, this section controls.

(d) An issuer of a state security, as defined by Section 1231.001, that selects or contracts with a person to provide services under Subsection (a) shall, on request, submit to the Bond Review Board:

(1) the request for proposals to provide the services not later than the date the request for proposals is published;

(2) each final proposal received to provide the services before a contract for the services is entered into by the issuer; and

(3) an executed contract entered into by an issuer for services under Subsection (a).

Appendix 7

TPFA's Overall Management's Response

TEXAS PUBLIC FINANCE AUTHORITY

BOARD OF DIRECTORS:
Billy M. Atkinson, Jr., Chair
Ruth C. Schiermeyer, Vice Chair
Gerald B. Alley, Secretary
Ramon Manning
Walker N. Moody
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EXECUTIVE DIRECTOR
Lee Deviney

May 16, 2016

State Auditor's Office
ATTN: Courtney Ambres-Wade
P.O. Box 12067
Austin, Texas 78711-2067

The Texas Public Finance Authority (TPFA), its management staff and board of directors, have provided the attached "Management Responses" to *An Audit Report on Financial Processes at the Texas Public Finance Authority (the "Audit Report").* Relative to the Management Responses and the final draft of your Audit Report, TPFA provides the following observations regarding Chapter 2 of the Audit Report:

TPFA believes that the process for selection and evaluation of its bond related service providers is among the most important functions of this agency. TPFA acknowledges that the related selection and decision processes could be more explicitly documented, however we disagree with the assertion that *"TPFA has weaknesses in its evaluation and selection processes"* as discussed below. Further, TPFA believes that the title of Chapter 2 be stated as *"TPFA Should Expand Documentation of Its Process for the Selection and Evaluation of Its Bond-related Contracts".*

The Auditor states that *"TPFA usually issues a request for proposals for its professional services."* TPFA is not aware of an instance when TPFA has not issued an RFP for its bond-related professional services. "Usually" could be misinterpreted to indicate that TPFA does not always issue an RFP for its bond-related professional services. Such is not the case.

Regarding the Audit Report paragraph relating to the bond service provider pools in place during FY2015, the Auditor states that *"Because pools had not been refreshed on a regular basis, the current management used firms for its 2015 transactions that prior management created."* Due to key agency staff vacancies from 2012 - 2014, including its Executive Director and General Counsel, the TPFA board of directors made an affirmative decision to extend the pools constituted prior to FY2015 until a complete agency management structure was in place to issue new RFP's for bond counsel, financial advisor and underwriter services in the proper manner and with board confidence. RFP's were issued and new bond service provider pools were designated during FY2015 and early in FY2016. It was the prerogative of the agency board to make those decisions under the circumstances.

The Audit Report states that "*TPFA did not implement a consistent process for evaluating similar contracting services. Auditors identified several weaknesses in TPFA's evaluation and selection processes that diminish the accountability and transparency of its contracting process.*" TPFA disagrees with this assertion as being without basis, especially within the stated audit period. For each bond service provider pool appointment or transaction appointment, the process was consistently vetted such that in properly noticed open meetings, key evaluation criteria was presented to the board of directors, staff provided its recommendations as to which firms were best qualified to either serve in a pool or be appointed to a transaction. The Governor-appointed board of directors accepts, rejects or modifies staff recommendations based upon their independent judgement. TPFA met the objectives of consistency, accountability and transparency. As we have discussed and acknowledged, the related selection and decision processes can and will be more explicitly documented by TPFA in its confidential files. As we have concluded, the extent of decision documentation by the board is the only issue on this subject.

The Audit Report refers to the use, once each in 2010 and 2012, of scoring matrices for evaluating respondents to RFP's being considered for appointment in a service provider pool. The Audit Report noted mathematical errors and apparent inconsistencies in the assignment of scores. Those staff scoring matrices were internal working documents. As noted in the Audit Report, scoring is not used by TPFA as a basis for bond service provider selection. While metrics provided by the staff are considered, the bond service provider selection process requires a qualitative decision of the board of directors.

A weakness identified in the Audit Report was that "*TPFA staff did not have documentation to support its recommendations to the Board of Directors showing how the staff evaluated and selected firms from its underwriting pool for work on bond and commercial paper transactions.*" TPFA has responded that sufficient documentation was presented to the board of directors to support recommendations for the underwriting pool. In recognition of anticipated transaction workload for the FY2016-2017 biennium, staff identified a suggested pool size of 18 firms, and in conformance with board policy objectives, TPFA staff recommended to the board that the 18 firms be composed in equal numbers of national ("Wall Street") firms, regional and Texas based firms, and HUB and other minority, women and disabled service veteran owned firms. Within each pool segment, staff also ranked the recommended firms based on each firm's financial capacity and experience in underwriting bond issues. Based on board discussion of the information presented by staff in a public meeting, the board adopted a new pool consisting of 20 firms. In a public meeting, the board announced its decisions resulting from the RFP process.

Our board members have read the final Audit Report draft and have been individually briefed on the related issues. In addition to the Chapter 2 issues, our management has provided you with their responses to the other audit report chapters, which the board members have also read.

On behalf of the board, I want to thank the audit team for their courtesies and cooperation during this audit process. I know it has been difficult and taken longer than expected. I want you to know, however, that our comments and Management Responses are consistent with our earlier meeting with you and are certainly made with all due respect to you, the Office of the State Auditor and the role of your agency.

Should you have any questions, please contact TPFA's Executive Director, Lee Deviney, or me.

Sincerely,

Billy M. Atkinson

Billy M Atkinson Jr.
Chair, Texas Public Finance Authority

Copies of this report have been distributed to the following:

Legislative Audit Committee

The Honorable Dan Patrick, Lieutenant Governor, Joint Chair
The Honorable Joe Straus III, Speaker of the House, Joint Chair
The Honorable Jane Nelson, Senate Finance Committee
The Honorable Robert Nichols, Member, Texas Senate
The Honorable John Otto, House Appropriations Committee
The Honorable Dennis Bonnen, House Ways and Means Committee

Office of the Governor

The Honorable Greg Abbott, Governor

Texas Public Finance Authority

Members of the Texas Public Finance Authority Board of Directors
- Mr. Billy M. Atkinson, Jr., Chair
- Ms. Ruth C. Schiermeyer, Vice Chair
- Mr. Gerald Alley, Secretary
- Mr. Ramon Manning
- Mr. Walker N. Moody
- Mr. Rodney K. Moore
- Mr. Robert T. Roddy, Jr.

Mr. Lee Deviney, Executive Director

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