



John Keel, CPA
State Auditor

An Audit Report on
**Certification of the Permanent School Fund's
Bond Guarantee Program for Fiscal Year 2012**

March 22, 2013

Members of the Legislative Audit Committee:

The State Auditor's Office certifies that, for the fiscal year ended August 31, 2012, the amount of school district bonds guaranteed by the Permanent School Fund's (Fund) Bond Guarantee Program (Program) was within all three limits applicable to the Program. As of August 31, 2012, the total principal of the 2,634 outstanding bond issues guaranteed by the Program was \$53.6 billion (see the attachment to this letter for a summary of the Program's activity during fiscal year 2012). Also as of that date, the bond guarantee capacity of the Program under the State Board of Education (Board) limit was \$75.5 billion, and the Board held in reserve \$3.8 billion of that capacity. The bond guarantee capacity under the Internal Revenue Service (IRS) limit was \$117.3 billion.

The Board's rules set a limit by allowing the Board to hold guarantee capacity in reserve, as permitted by Texas Education Code, Section 45.0531(a). The Board may use the reserve to award guarantees to school districts with unforeseen catastrophes or emergencies that require renovation or replacement of school facilities as described in the Title 19, Texas Administrative Code, Section 33.65 (d)(5). IRS Notice 2010-5, issued on December 16, 2009, establishes a limit, which is intended to prevent reductions in federal tax receipts due to bond arbitrage (issuing tax-exempt bonds for the purpose of investing the proceeds at higher rates than the rates paid on tax-exempt bonds).

The guarantee saves school districts money by enhancing their bond ratings to the highest possible rating. Without the guarantee of this Program, school districts would need to (1) purchase private bond insurance or (2) pay higher interest rates on the bonds they sell.

Recent changes have been made to Program statutes and rules.

The 82nd Legislature passed Senate Bill 1, which contained a provision that called for the inclusion of charter schools in the Program. That provision went into effect on September 28, 2011. In October 2011, the State of Texas requested an IRS ruling on whether the inclusion of charter schools in the Program might cause the Program to violate current arbitrage laws, which could result in the loss of the Program's tax-free status. The Fund will not make any guarantees for charter

Objective, Scope, and Methodology

The objective of this audit was to determine whether the total amount of school district bonds guaranteed by the Permanent School Fund's (Fund) Bond Guarantee Program is within applicable statutory limits.

The scope of this audit covered the Fund's valuation and all bonds guaranteed by the Fund during fiscal year 2012.

The audit methodology included analyzing investment data obtained from the Texas Education Agency, analyzing bond data originating at the Municipal Advisory Council, and performing procedures to verify the calculation of the state limit and reserve.

Audit fieldwork was conducted from February 2013 through March 2013. 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 staff of the State Auditor's Office performed the audit:

- Ben Carter (Project Manager)
- Jennifer Ranea Robinson, MBA, CPA
- Charles P. Dunlap, Jr., CPA (Quality Control Reviewer)
- Angelica Ramirez, CPA (Audit Manager)

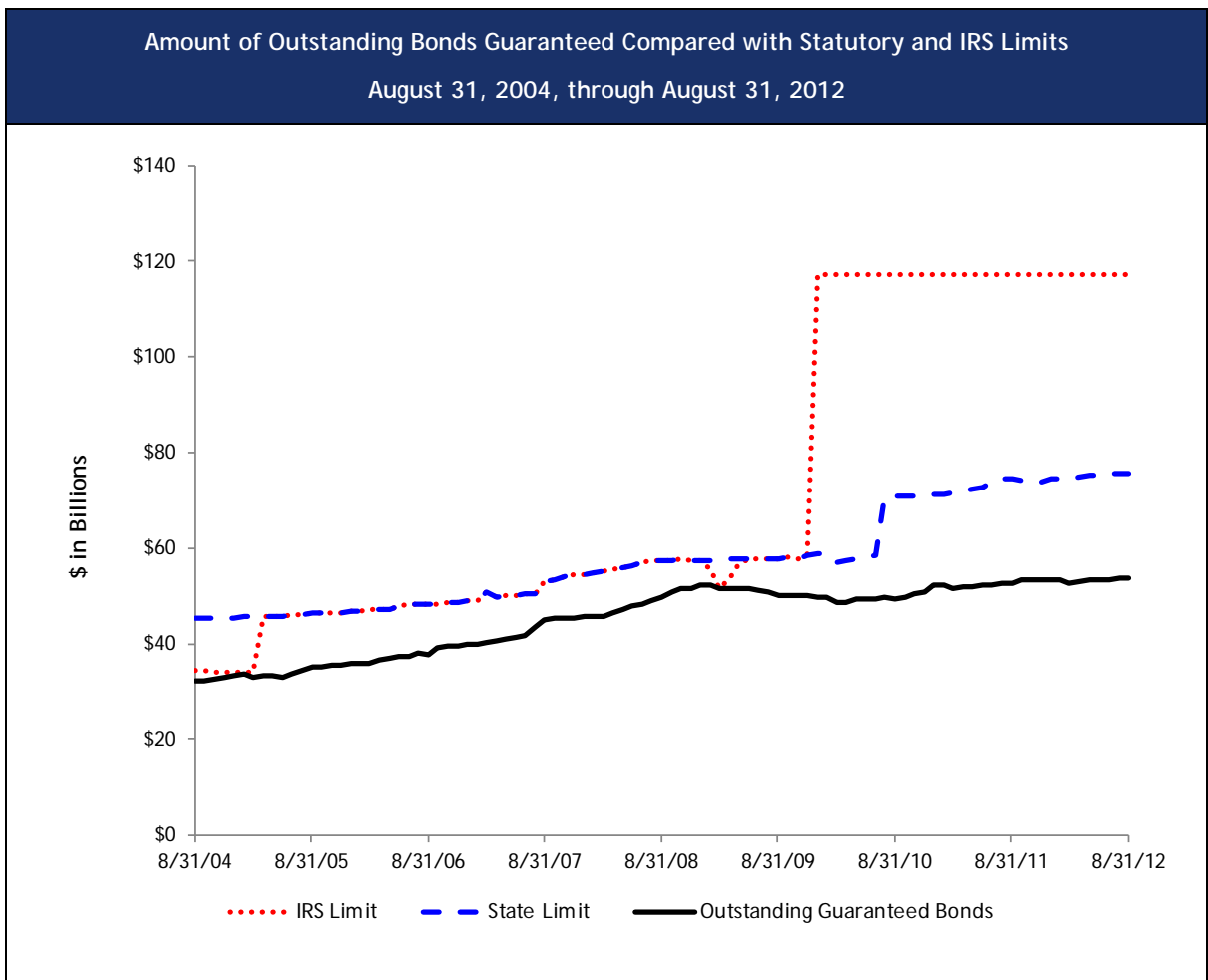
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schools until the State receives assurance from the IRS that the inclusion of charter schools will not change the Program's current tax-exempt status.

In addition, Texas Education Code, Section 45.0532, stipulates that the State's commissioner of education may not approve charter school bonds for guarantee if that guarantee would result in a lower bond rating for the Program. Based on this stipulation, the Program has indicated that it will obtain updated rating letters from the bond rating agencies to determine whether the Program will maintain its current bond rating if charter schools are included in the Program.

Figure 1 shows the amounts of outstanding bonds guaranteed and the statutory and IRS guarantee limits from August 31, 2004, through August 31, 2012. The Board's additional reserve is not presented in the graph.

Figure 1



The Program's remaining statutory capacity, net of the Board's \$3.8 billion reserve, was \$18.1 billion at the end of fiscal year 2012.

The attachment to this letter provides additional information on the Program's fiscal year 2012 activity. As of August 31, 2012, the Program could guarantee an additional \$18.1 billion in bonds before reaching the limit imposed by the Board's reserve of 5 percent of the Program's total statutory limit.

Auditors identified issues that were not directly related to the objective of this audit and communicated those issues to Texas Education Agency management separately in writing.

We appreciate the Texas Education Agency's cooperation during this audit. If you have any questions, please contact Angelica Ramirez, Audit Manager, or me at (512) 936-9500.

Sincerely,

John Keel, CPA
State Auditor

Attachment

cc: Members of the State Board of Education

Mrs. Barbara Cargill, Chair
Mr. Lawrence A. Allen, Jr.
Mrs. Donna Bahorich
Mr. David Bradley
Mr. Ruben Cortez, Jr.
Dr. Martha M. Dominguez
Ms. Patricia Hardy
Mrs. Mavis B. Knight
Mr. Tom Maynard
Ms. Sue Melton
Mr. Ken Mercer
Mrs. Geraldine "Tincy" Miller
Ms. Marisa B. Perez
Mr. Thomas Ratliff
Mr. Marty Rowley

Texas Education Agency

Mr. Michael L. Williams, Commissioner of Education
Mr. Holland Timmins, CFA, Executive Administrator and Chief Investment Officer,
Permanent School Fund



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Attachment

Bond Guarantee Program Summary

The following tables provide a summary of fiscal year 2012 activity for the Permanent School Fund's Bond Guarantee Program (Program). Tables 1 and 2 show the changes in the number and dollar amount of outstanding bonds guaranteed by the Program.

Table 1

Number of Guaranteed Bonds Outstanding	
Category	Number of Issues
Balance on August 31, 2011	2,536
Issued during fiscal year 2012	348
Issues that matured during fiscal year 2012	(173)
Issues that were refunded during fiscal year 2012	<u>(77)</u>
Number on August 31, 2012	2,634

Source: Permanent School Fund's Bond Guarantee Program *Fiscal Year-end Summary*.

Table 2

Dollar Amount of Guaranteed Bonds Outstanding	
Category	Dollar Amount of Issues
Balance on August 31, 2011	\$52,653,930,545
Issued during fiscal year 2012	7,196,995,486
Issues that matured during fiscal year 2012	(1,823,488,307)
Issues that were refunded during fiscal year 2012	(4,383,846,900)
Other adjustments	<u>(9,135,683)</u>
Amount on August 31, 2012	\$53,634,455,141

Source: Permanent School Fund's Bond Guarantee Program *Fiscal Year-end Summary*.