

**Texas Treasury Safekeeping Trust Company**  
(A Component Unit of the State of Texas)

Basic Financial Statements

August 31, 2013

# Texas Treasury Safekeeping Trust Company

## Table of Contents

|  | <b>Page</b> |
|--|-------------|
| Independent Auditor's Report   | 1           |
| Management's Discussion and Analysis   | 4           |
| Basic Financial Statements   |             |
| Statement of Net Position – Proprietary Fund   | 8           |
| Statement of Revenues, Expenses, and Changes in<br>Net Position – Proprietary Fund   | 9           |
| Statement of Cash Flows – Proprietary Fund   | 10          |
| Statement of Fiduciary Net Position – Fiduciary Funds  | 11          |
| Statement of Changes in Fiduciary Net Position –<br>Fiduciary Funds  | 12          |
| Notes to the Financial Statements  | 13          |
| Supplemental Information – Combining Schedule – Balance Sheet<br>Information – Agency Fund   | 30          |
| Independent Auditor's Report on Internal Control Over Financial<br>Reporting and on Compliance and Other Matters Based on an<br>Audit of Financial Statements Performed in Accordance with<br><i>Government Auditing Standards</i> | 31          |

## Independent Auditor's Report

The Honorable Susan Combs  
Comptroller of Public Accounts of the State of Texas

### *Report on the Financial Statements*

We have audited the accompanying financial statements of the business-type activities, each major fund, and the aggregate remaining fund information of the Texas Treasury Safekeeping Trust Company (Texas Trust), a component unit of the State of Texas, as of and for the year ended August 31, 2013, and the related notes to the financial statements, which collectively comprise the Texas Trust's basic financial statements, as listed in the table of contents.

### *Management's Responsibility for the Financial Statements*

Texas Trust's management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditor's Responsibility*

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion of the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

**SAN ANTONIO**

100 N.E. LOOP 410, SUITE 1100  
SAN ANTONIO, TEXAS 78216  
210 828 6281

**AUSTIN**

811 BARTON SPRINGS ROAD, SUITE 550  
AUSTIN, TEXAS 78704  
512 476 0717

TOLL FREE: 800 879 4966

WEB: PADGETT-CPA.COM

### ***Opinions***

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities, each major fund, and the aggregate remaining fund information of Texas Trust, as of August 31, 2013, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

### ***Emphasis of Matters***

As described in Note 1 to the financial statements, these financial statements present only the financial statements of Texas Trust and do not purport to, and do not, present fairly the financial position of the State of Texas as of August 31, 2013, and the changes in its financial position thereof for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1 to the financial statements, effective September 1, 2012, Texas Trust implemented Governmental Accounting Standards Board (GASB) Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, and GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. Our opinions are not modified with respect to these matters.

### ***Other Matters***

#### ***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 4 through 7, as listed in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by GASB, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

#### ***Other Information***

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise Texas Trust's basic financial statements. The accompanying supplemental information on page 30 is presented for purposes of additional analysis and is not a required part of the basic financial statements.

The supplemental information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplemental information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

***Other Reporting Required by Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated November 19, 2013 on our consideration of Texas Trust's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Texas Trust's internal control over financial reporting and compliance.

*Padgett, Stratemann + Co., LLP*

Certified Public Accountants  
Austin, Texas  
November 19, 2013

# Texas Treasury Safekeeping Trust Company

## Management's Discussion and Analysis

August 31, 2013

This section of the Texas Treasury Safekeeping Trust Company's (Texas Trust) annual financial report presents discussion and analysis of its financial performance during the fiscal year ended August 31, 2013, and should be read in conjunction with Texas Trust's financial statements, which follow this section.

### Financial Highlights

- Texas Trust's total managed funds, including pooled funds, exceeded forty-eight (48) billion dollars at August 31, 2013.
- Texas Trust had fees for services in fiscal year 2013 of \$20,473,196 and non-operating revenues of \$10,673 (interest income). Operating expenses were \$13,591,227.

### Overview of the Financial Statements

This report consists of four parts that explain some of the information in the financial statements in more detail – Independent Auditor's Report; Management's Discussion and Analysis (this section); Financial Statements; and, Notes to the Financial Statements.

The proprietary fund financial statements presented herein include the operations of the Texas Trust using the approach as prescribed by Governmental Accounting Standards Board Statement in its publication Codification of Governmental Accounting and Financial Reporting Standards. They present the financial statements of the Texas Trust from the economic resources measurement focus using the accrual basis of accounting.

The Statement of Net Position presents information on all of the Texas Trust's assets and liabilities, with the difference between the two reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the Texas Trust is improving or deteriorating. Additionally, certain eliminations have occurred in regards to interfund activity, payables, and receivables.

The Statement of Revenues, Expenses, and Changes in Net Position presents information showing how the Texas Trust's net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the time of related cash flows. Thus, revenues and expenses are reported for some items that will only result in cash flows in future fiscal periods. The business-type activities of Texas Trust include providing investment management and custody services. Management fees charged to customers support these activities.

The fund financial statements include statements for each of the following funds - enterprise fund, investment trust fund, and agency fund.

The Texas Trust Enterprise Fund is used to report any activity for which a fee is charged to users for services such as investment management and custodial services. The pricing policies of the activity establish fees and charges designed to recover its costs, including capital costs. The Texas Trust accounts for its daily operations using an enterprise fund. The Texas Trust performs custodial and investment services for entities in the other two fiduciary fund categories (investment trust fund and agency fund) for a fee designed on a cost recovery basis. In Fiscal Year (FY) 2013, the Texas Trust charged client funds \$20,473,196 in fees and incurred \$13,591,227 in related service expense generating those fees.

# Texas Treasury Safekeeping Trust Company

## Management's Discussion and Analysis

August 31, 2013

Investment Trust Funds are used to report the external portion of investment pools reported by the sponsoring government. The Texas Trust accounts for monies constituting the Texas Local Government Investment Pool and the Texas Local Government Investment Pool Prime in an investment trust fund.

Agency Funds are used to report resources held by the reporting government in a purely custodial capacity. Agency funds typically involve only the receipt, temporary investment, and remittance of fiduciary resources to individuals, private organizations, or other governments. The Texas Trust accounts for monies held for certain state agencies including the Treasury Pool, Tobacco Settlement Permanent Trust Fund and securities held on behalf of their owners or beneficiaries in agency funds. Those agencies contract with the Texas Trust for investment management and custodial services.

The Enterprise Fund, which represents Texas Trust's operating funds, is reported as a proprietary component unit of the State of Texas, and as such is accounted for using the flow of economic resources measurement focus and accrual basis of accounting. Accordingly, revenues are recognized when earned and expenses are recognized when the liability is incurred regardless of the timing of the related cash flow, similar to private sector companies.

### Condensed Financial Information for 2013 and 2012 (in 000's)

|                            | <b>2013</b>          | <b>2012</b>          |
|----------------------------|----------------------|----------------------|
|                            | <b>Business-Type</b> | <b>Business-Type</b> |
|                            | <b>Activities</b>    | <b>Activities</b>    |
|                            | <hr/>                | <hr/>                |
| <b>Assets</b>              |                      |                      |
| Current assets             | \$ 20,328            | \$ 12,347            |
| Capital assets             | 155                  | 231                  |
| Noncurrent assets          | <hr/> 34,226         | <hr/> 34,221         |
| Total assets               | <hr/> 54,709         | <hr/> 46,799         |
| <b>Liabilities</b>         |                      |                      |
| Current liabilities        | 3,688                | 2,701                |
| Noncurrent liabilities     | <hr/> 278            | <hr/> 248            |
| Total liabilities          | <hr/> 3,966          | <hr/> 2,949          |
| <b>Net position</b>        | 50,743               | 43,850               |
| Invested in capital assets | 155                  | 231                  |
| Unrestricted               | <hr/> 50,588         | <hr/> 43,619         |
| <b>Total net position</b>  | <hr/> \$ 50,743      | <hr/> \$ 43,850      |

# Texas Treasury Safekeeping Trust Company

## Management's Discussion and Analysis

August 31, 2013

### Condensed Financial Information for 2013 and 2012 (in 000's) (continued)

|                                | <b>2013</b>                         | <b>2012</b>                         |
|--------------------------------|-------------------------------------|-------------------------------------|
| <b>Changes in Net Position</b> | <b>Business-Type<br/>Activities</b> | <b>Business-Type<br/>Activities</b> |
| Charges for service            | \$ 20,473                           | \$ 19,162                           |
| Interest Income                | 11                                  | 36                                  |
| Total revenues                 | 20,484                              | 19,198                              |
| Total expenses                 | 13,591                              | 12,875                              |
| Change in net position         | <u>\$ 6,893</u>                     | <u>\$ 6,323</u>                     |

### Overall Financial Analysis

#### Business-Type Activities

Business-type activities generated revenue of \$20.5 million, including charges for services of \$20.5 million, an increase of \$1.3 million during FY 2013. Total expenses for business-type activities were \$13.6 million, an increase of \$0.7 million during FY 2013. The Texas Trust earns a fee based upon the assets under management for each client; consequently, revenue is directly related to the total assets under management by Texas Trust. Average balances under management for other state agencies and for endowment funds slightly increased during fiscal year 2013, while average balances for Treasury Pool and the Investment Trust Funds decreased in fiscal year 2013.

#### Individual Fund Financial Analysis

##### Investment Trust Fund

The fund balance includes the Texas Local Government Investment Pool (TexPool) and the Texas Local Government Investment Pool Prime (TexPool Prime) that is operated for the benefit of local governments.

The net position in the fund at August 31, 2013 totals \$15.3 billion and the net increase in fiduciary net position for FY 2013 is \$0.7 billion.

##### Agency Fund

This fund includes assets held by the Texas Trust on behalf of various agencies and special accounts. The balance of funds held for others at August 31, 2013 is \$32.8 billion. There is no change in fund balance as Texas Trust holds these amounts as custodial assets only.

# **Texas Treasury Safekeeping Trust Company**

## **Management's Discussion and Analysis**

August 31, 2013

### **Capital Assets and Long-Term Debt**

The Texas Trust's investment in capital assets for its business type activities as of August 31, 2013 amounts to \$155 thousand (net of accumulated depreciation). This investment in capital assets includes leasehold improvements, furniture, equipment, and software.

Texas Trust has no long-term debt and only short-term trade payables. The Texas Trust maintains an account with the Federal Reserve, which establishes a reserve requirement for the Texas Trust. In order to meet the reserve requirement, the Texas Trust must maintain an average balance for the weekly measurement period that surpasses the required reserve amount.

### **Contacting Texas Trust's Financial Management**

This financial report is designed to provide Texas Trust customers, business partners and creditors with a general overview of its finances. Questions about this report can be directed to Texas Trust's Chief Financial Officer, Frank Zahn at (512) 463-3129.

# Texas Treasury Safekeeping Trust Company

## Statement of Net Position – Proprietary Fund

August 31, 2013

| <b>Assets</b>                            | <b>Enterprise<br/>Fund</b> |
|--|----------------------------|
| Current assets:                          |                            |
| Cash and cash equivalents                |                            |
| Cash in bank                             | \$ 52,365                  |
| Cash in State Treasury                   | 643,621                    |
| Investments in repurchase agreements     | 16,671,793                 |
| Receivables from:                        |                            |
| Management fees                          | 2,688,707                  |
| Interest                                 | 112                        |
| Other                                    | 13,233                     |
| Prepaid expenses                         | 258,552                    |
| Total current assets                     | <u>20,328,383</u>          |
| Non-current assets:                      |                            |
| Restricted cash and cash equivalents     |                            |
| Cash in bank                             | 34,152,896                 |
| Restricted investments                   | 73,392                     |
| Capital assets:                          |                            |
| Depreciable:                             |                            |
| Software (net)                           | 27,056                     |
| Building and building improvements (net) | 14,953                     |
| Furniture and equipment (net)            | 112,598                    |
| Total non-current assets                 | <u>34,380,895</u>          |
| Total assets                             | <u>54,709,278</u>          |
| <b>Liabilities</b>                       |                            |
| Current liabilities:                     |                            |
| Accounts payable                         | 1,463,798                  |
| Payroll payable                          | 1,829,594                  |
| Employee's compensable leave             | 394,881                    |
| Total current liabilities                | <u>3,688,273</u>           |
| Non-current liabilities:                 |                            |
| Employees' compensable leave             | 278,488                    |
| Total non-current liabilities            | <u>278,488</u>             |
| Total liabilities                        | <u>3,966,761</u>           |
| Net position:                            |                            |
| Invested in capital assets               | 154,607                    |
| Unrestricted                             | 50,587,910                 |
| Total net position                       | <u>\$ 50,742,517</u>       |

Notes to financial statements are an integral part of these financial statements.

## Texas Treasury Safekeeping Trust Company

### Statement of Revenues, Expenses, and Changes in Net Position – Proprietary Fund

Year Ended August 31, 2013

|   | <b>Enterprise<br/>Fund</b>  |
|---|-----------------------------|
|   | <u>                    </u> |
| Operating revenue – management fees     | \$ 20,473,196               |
| Operating expenses:                     |                             |
| Salaries and wages                      | 6,930,522                   |
| Payroll related costs                   | 1,260,487                   |
| Professional fees and services          | 2,944,918                   |
| Travel                                  | 132,481                     |
| Materials and supplies                  | 722,856                     |
| Communication and utilities             | 481,202                     |
| Repairs and maintenance                 | 384,177                     |
| Rentals and leases                      | 25,562                      |
| Printing and reproduction               | 13,028                      |
| Depreciation and amortization           | 149,537                     |
| Other operating expenses                | 546,457                     |
|   | <u>                    </u> |
| Total operating expenses                | 13,591,227                  |
|   | <u>                    </u> |
| Operating income                        | 6,881,969                   |
|   | <u>                    </u> |
| Nonoperating revenue:                   |                             |
| Investment income                       | 10,673                      |
|   | <u>                    </u> |
| Net nonoperating revenues               | 10,673                      |
|   | <u>                    </u> |
| Change in net position                  | 6,892,642                   |
|   | <u>                    </u> |
| Total net position at beginning of year | 43,849,875                  |
|   | <u>                    </u> |
| Total net position at end of year       | \$ <u>50,742,517</u>        |

*Notes to financial statements are an integral part of these financial statements.*

# Texas Treasury Safekeeping Trust Company

## Statement of Cash Flows – Proprietary Fund

Year Ended August 31, 2013

|   | <u>Enterprise<br/>Fund</u> |
|---|----------------------------|
| Cash flows from operating activities:   |                            |
| Proceeds from management fees   | \$ 20,306,352              |
| Payments to employees   | (7,989,866)                |
| Payments for operating expenses   | (4,447,284)                |
|   | <u>7,869,202</u>           |
| Net cash provided by operating activities   | <u>7,869,202</u>           |
| Cash flows from capital and related financing activities:                               |                            |
| Payments for additions to capital assets  | (73,245)                   |
|   | <u>(73,245)</u>            |
| Net cash used for capital and related financing activities                              | <u>(73,245)</u>            |
| Cash flows from investing activities:   |                            |
| Proceeds from interest and investment income  | 21,019                     |
|   | <u>21,019</u>              |
| Net cash provided by investing activities   | <u>21,019</u>              |
| Net increase in cash and cash equivalents   | 7,816,976                  |
| Cash and cash equivalents at beginning of year  | <u>43,703,699</u>          |
| Cash and cash equivalents at end of year  | <u>\$ 51,520,675</u>       |
| Reconciliation of operating income to net cash provided by operating activities:        |                            |
| Operating income  | \$ 6,881,969               |
| Adjustments to reconcile operating income to net cash provided by operating activities: |                            |
| Depreciation expense  | 149,537                    |
| Changes in assets/liabilities:  |                            |
| Receivables   | (166,844)                  |
| Prepaid expenses  | (13,824)                   |
| Payables  | 1,018,364                  |
|   | <u>1,018,364</u>           |
| Net cash provided by operating activities   | <u>\$ 7,869,202</u>        |
| Displayed as:   |                            |
| Cash in bank  | \$ 52,365                  |
| Cash in State Treasury  | 643,621                    |
| Investments in repurchase agreements  | 16,671,793                 |
| Restricted cash in bank   | 34,152,896                 |
|   | <u>34,152,896</u>          |
| Total cash and cash equivalents   | <u>\$ 51,520,675</u>       |

*Notes to financial statements are an integral part of these financial statements.*

# Texas Treasury Safekeeping Trust Company

## Statement of Fiduciary Net Position – Fiduciary Funds

August 31, 2013

| <b>Assets</b>   | <b>Investment<br/>Trust Fund</b> | <b>Agency<br/>Fund</b>      |
|---|----------------------------------|-----------------------------|
|   | <u>                    </u>      | <u>                    </u> |
| Cash in bank  | \$ —                             | \$ 548,835,619              |
| Deposits  | —                                | 444,749,600                 |
| Investments   | 15,423,096,817                   | 31,840,869,121              |
| Accrued interest receivable                               | 13,846,873                       | 35,401,654                  |
|   | <u>                    </u>      | <u>                    </u> |
| Total assets  | \$ <u>15,436,943,690</u>         | \$ <u>32,869,855,994</u>    |
| <b>Liabilities</b>  |                                  |                             |
| Accounts payable  | \$ 11,020,701                    | \$ 1,658,001                |
| Interest payable  | —                                | 35                          |
| Amounts payable to participants                           | 617,790                          | —                           |
| Trades pending settlement                                 | 82,500,000                       | —                           |
| Management fees reserved<br>for operating expenses        | 521,654                          | —                           |
| Obligations under reverse<br>repurchase agreements        | —                                | 51,272,611                  |
| Funds held for others                                     | —                                | 32,816,925,347              |
|   | <u>                    </u>      | <u>                    </u> |
| Total liabilities   | <u>94,660,145</u>                | \$ <u>32,869,855,994</u>    |
| <b>Net Position</b>                                       |                                  |                             |
| Held in trust for pool participants<br>and other purposes | <u>\$ 15,342,283,545</u>         |                             |

*Notes to financial statements are an integral part of these financial statements.*

# Texas Treasury Safekeeping Trust Company

## Statement of Changes in Fiduciary Net Position – Fiduciary Fund

Year Ended August 31, 2013

|   | <u>Investment<br/>Trust Fund</u> |
|---|----------------------------------|
| <b>Additions:</b>   |                                  |
| Investment income:  |                                  |
| Interest income   | \$ 25,700,470                    |
| Expenses:   |                                  |
| Management fees and expenses                                  | <u>(8,178,043)</u>               |
| Net investment income   | <u>17,522,427</u>                |
| <b>Deductions:</b>  |                                  |
| Earnings paid to investors from net investment income         | (17,567,470)                     |
| Net change in management fees reserved for operating expenses | 45,043                           |
| Net increase in participant investments                       | <u>718,000,358</u>               |
| Net increase in net position                                  | 718,000,358                      |
| Net position at beginning of year                             | <u>14,624,283,187</u>            |
| Net position at end of year                                   | <u>\$ 15,342,283,545</u>         |

*Notes to financial statements are an integral part of these financial statements.*

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2013

### (1) Summary of Significant Accounting Policies

#### (a) Reporting Entity

In 1986, the 69<sup>th</sup> Texas Legislature authorized the incorporation of the Texas Treasury Safekeeping Trust Company (Texas Trust) to give the Treasurer of the State of Texas access to the Federal Reserve System. The 77<sup>th</sup> Legislature amended the Texas Trust statute and the Texas Trust began operations as a separate State entity on September 1, 2001. The Comptroller of Public Accounts (Comptroller) is the single shareholder of the Texas Trust and is charged with managing the Texas Trust. Texas Trust is reported as a blended, proprietary component unit of the State of Texas.

The Texas Trust is authorized to manage, disburse, transfer, safekeep, and invest funds and securities provided by statute or belonging to state and local entities and gives the Comptroller direct access to services provided by the Federal Reserve System. The enabling legislation also provides for:

- Specifically exempting the Texas Trust from other state laws regulating or limiting state purchasing or a purchasing decision if it is determined the purchase or decision relates to its fiduciary duties.
- The Texas Trust to enter into contracts, trust agreements, or other fiduciary instruments with the Comptroller, the Federal Reserve System, the Depository Trust Company and other third parties.
- The Comptroller appointing an investment advisory board to advise the Comptroller with respect to managing the assets held by the Texas Trust.
- The Comptroller appointing a person to serve as Chief Executive Officer in managing the Texas Trust and carrying out its duties.
- The development of a fee schedule in the amount necessary to recover costs of service and to retain adequate reserves to support the operations of the Texas Trust.

The Texas Trust is exempt from federal income taxation as a governmental entity under Internal Revenue Code Section 115. The accompanying financial statements present the activities and operations of the Texas Trust. The primary business functions provided by the Texas Trust are investment management and custodial services and therefore, the majority of the funds accounted for by the Texas Trust are fiduciary in nature. Separate audited financial statements are available for the Texas Local Government Investment Pool (TexPool), the Texas Local Government Investment Pool Prime (TexPool Prime) and the Tobacco Settlement Permanent Trust Fund (Tobacco Trust) and may be obtained from the Comptroller's Office by writing:

Texas Comptroller of Public Accounts  
Post Office Box 13528  
Austin, Texas 78711-3528

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2013

**(b) Financial Statements**

The Texas Trust financial statements report information on all of the non-fiduciary activities of the Texas Trust. Separate financial statements are provided for Texas Trust's proprietary fund and fiduciary funds. All capital asset depreciation is reported as a direct expense of the proprietary fund. Operating revenues include charges for services relating to assets under management.

**(c) Measurement Focus, Basis of Accounting, and Financial Statement Presentation**

The Texas Trust financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the fiduciary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

Effective September 1, 2012, Texas Trust implemented GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* (Statement No. 62), and GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, (Statement No. 63). Statement No. 62 incorporates 1) FASB Statements and Interpretations, 2) Accounting Principles Board Opinions, and 3) Accounting Research Bulletins, issued on or before November 30, 1989 that do not conflict or contradict GASB pronouncements into GASB's authoritative literature. Statement No. 63 renames the statement of net assets as the statement of net position and provides guidance for reporting deferred outflows of resources and deferred inflows of resources within the financial statements of governmental entities. The adoption of these standards did not have a significant impact on Texas Trust's financial statements

The Texas Trust financial statements include financial statements for each of the following fund classifications: a proprietary fund and fiduciary funds.

The Texas Trust reports the following major proprietary fund:

*Enterprise Fund.* Enterprise funds are used to report any activity for which a fee is charged to external users for services such as investment management and custodial services. The Texas Trust accounts for its daily operations using an enterprise fund. Operating revenues result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. Non-operating revenues, such as investment earnings, result from non-exchange transactions or ancillary activities. Operating expenses include the cost of services, administrative expenses, and depreciation of capital assets.

The Texas Trust reports the following fiduciary funds:

*Investment Trust Fund.* Investment trust funds are used to report the external portion of investment pools reported by the sponsoring government. The Texas Trust accounts for monies constituting TexPool and TexPool Prime in an investment trust fund.

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2013

*Agency Fund.* Agency funds are used to report resources held by the reporting government in a purely custodial capacity. Agency funds typically involve only the receipt, temporary investment, and remittance of fiduciary resources to individuals, private organizations, or other governments. The Texas Trust accounts for monies for individual state agencies contracting with the Texas Trust for investment management and custodial services in agency funds.

**(d) *Cash and Cash Equivalents***

For purposes of the statement of cash flows, demand deposits and short-term highly liquid investments in the Enterprise Fund with an original maturity of three months or less are considered cash equivalents. For purposes of the statement of net position presentation, investments in repurchase agreements and cash in state treasury are included in cash and cash equivalents.

**(e) *Restricted Cash and Cash Equivalents***

The Texas Trust maintains an account with the Depository Trust Company (DTC). In accordance with the agreement between DTC and the Texas Trust, \$152,922 in cash was held at DTC as of August 31, 2013, in order to maintain the account.

The Texas Trust maintains an account with the Federal Reserve, which establishes a reserve requirement for the Texas Trust. In order to meet the reserve requirement, the Texas Trust must maintain an average balance for the weekly measurement period that surpasses the required reserve amount.

The Federal Reserve's reserve requirement is \$34 million as of August 31, 2013. The Texas Trust Federal Reserve account balance reported in restricted cash on August 31, 2013 was \$33,999,974.

**(f) *Deposits and Investments***

Investments, other than money market instruments in the Investment Trust Fund and the Treasury Pool, are reported at fair value based upon quoted market prices, or when quoted market prices are not readily determinable, estimated fair values based on market conditions and information provided by the investment administrators are used. For investments in limited partnerships where no readily determinable fair value exists, the fair value of the investment is based on the most recent capital account balance of each limited partnership as communicated by the investment administrator, adjusted for subsequent contributions, distributions, and withdrawals and adjusted as necessary by Texas Trust for current market conditions. For investments in fund of hedge funds and direct investments in hedge funds, the fair value is based on net asset value information provided by the designated fund administrator and adjusted as necessary by Texas Trust for current market conditions. Money market instruments in the Investment Trust Fund and the Treasury Pool are reported at amortized cost.

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2013

The Texas Trust manages the fiduciary funds and enterprise fund investments in accordance with the Comptroller's Investment Policy and Government Code Section 404.024. The portfolio of investments may include:

1. Direct security repurchase agreements;
2. Reverse security repurchase agreements;
3. Obligations of the United States or its agencies and instrumentalities, other than mortgage-backed securities interest only and principal only strips;
4. Bankers' acceptances that:
  - (a) do not exceed 270 days to maturity; and
  - (b) are issued by a bank that has received the highest short-term credit rating by a nationally recognized investment rating firm;
5. Commercial paper that:
  - (a) does not exceed 270 days to maturity; and
  - (b) except as provided by Subsection (i) of Government Code Section 404.024, has received the highest short-term credit rating by a nationally recognized investment rating firm;
6. Contracts written by the treasury in which the treasury grants the purchaser the right to purchase securities in the treasury's marketable securities portfolio at a specified price over a specified period and for which the treasury is paid a fee and specifically prohibits naked-option or uncovered option trading;
7. Direct obligations of or obligations guaranteed by the Inter-American Development Bank, the International Bank for Reconstruction and Development (the World Bank), the African Development Bank, the Asian Development Bank, and the International Finance Corporation that have received the highest credit rating by a nationally recognized investment rating firm;
8. Bonds issued, assumed, or guaranteed by the State of Israel;
9. Obligations of a state or an agency, county, city, or other political subdivision of a state that have received at least a single A rating or its equivalent by a nationally recognized investment rating firm as provided for by Government Code Section 404.024, Subsection (i);

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2013

10. Mutual funds secured by obligations that are described by Subdivisions (1) through (6);
11. Foreign currency for the sole purpose of facilitating investment by state agencies that have the authority to invest in foreign securities; and
12. Such other investments as may be authorized by Government Code Section 404.024.

Fiduciary funds are managed in accordance with the respective entities' investment policy and governing statutes.

Security transactions are recorded on a trade date basis. Investments in securities traded on a national securities exchange are stated at the last reported sales price on the day of valuation. TexPool and TexPool Prime are short-term investment pools. The investments in TexPool and TexPool Prime along with Rule 2a-7 like pools and money market mutual funds are carried at amortized cost, which approximates fair value.

In connection with transactions in repurchase agreements, it is the Texas Trust's policy to hold the underlying collateral securities in their account at the Federal Reserve Bank of Dallas, San Antonio branch, in the name of the Texas Trust. The fair value of the underlying collateral securities exceeds the principal amount of the repurchase transaction, including accrued interest, at all times. Where tri-party agreements have been executed, the Texas Trust may enter into repurchase agreements whereby a third party custodian holds the collateral in a segregated account in Texas Trust's name. As of August 31, 2013 the Texas Trust had no tri-party agreements outstanding.

If the seller defaults, and the fair value of the collateral declines, realization of the collateral held by the Texas Trust may be delayed or limited. Repurchase agreements may be entered into only with State or National banks doing business in Texas or with primary dealers approved by the Federal Reserve System.

Government Code Section 404.024 provides for the use of reverse repurchase agreements by the Comptroller. In connection with transactions in reverse repurchase agreements (reverse), it is the Texas Trust's policy, consistent with Government Code Section 404.024, to match the maturity of the reverse with the maturity of securities purchased with the proceeds from the reverse. Further, proceeds from reverses are used to purchase securities. At August 31, 2013, the Agency Fund had \$51,272,611 in reverse repurchase agreements.

In accordance with Government Code Section 404.021 and the State Depository Handbook, the Texas Trust may deposit state funds with approved national and state banks, savings and loan associations and credit unions doing business in Texas through a main office or one or more branches. Any entity where total deposits are in excess of \$237,500 requires acceptable collateral in an amount not less than 105% of the total deposit balance held in the Texas Trust's account at the Federal Reserve. Collateralization of 125% is required for any securities pledged that have a declining principal balance.

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2013

**(g) Receivables and Payables**

All trade receivables are shown net of an allowance for uncollectible amounts. The liabilities are for the value of assets or services received at or before year-end for which payment was not made as of year-end.

**(h) Capital Assets**

Assets with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of one year are capitalized. Assets are capitalized at cost when acquired, or estimated historical cost, if actual historical cost is not available. Donated assets are reported at fair value on the acquisition date. All capital assets are depreciated using the straight-line method over the following estimated useful lives:

| <u>Asset Class</u>    | <u>Estimated<br/>Useful<br/>Lives</u> |
|-----------------------|---------------------------------------|
| Software              | 3 years                               |
| Office equipment      | 5 years                               |
| Computer equipment    | 5 years                               |
| Building improvements | 10 years                              |

**(i) Compensable Leave**

A state employee is entitled to be paid for all unused vacation time accrued, in the event of the employee's resignation, dismissal, or separation from state employment, provided the employee has had continuous employment with the state for six months. Therefore, the liability for unused vacation time has been recorded. No liability is recorded for non-vesting accumulating rights to receive sick pay benefits.

**(j) Common Stock**

One share of common stock issued and outstanding at August 31, 2013 is held by the Comptroller with a par value of \$1,000,000. This amount is reflected in the Proprietary Fund's Statement of Net Position within the unrestricted net position balance.

**(k) Use of Estimates**

The preparation of the Texas Trust financial statements, in conformity with accounting principles generally accepted in the United States of America, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and fund equity at the date of the financial statements. Actual results could differ from those estimates.

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2013

(1) **Risk Management**

The Texas Trust provides investment management and custodial services. Investments are managed for other State agencies in accordance with their applicable investment guidelines. Although every effort is made to preserve principal, the Texas Trust does not provide any guarantee or insurance against loss.

(2) **Deposits and Investments**

(a) **Deposits**

Cash deposits (CD's) are made in state or national banks, savings and loan associations, or credit unions doing business in Texas through a main office or one or more branches. Single direct placements of \$237,500 or less made with any qualifying institution are fully insured by the Federal Deposit Insurance Corporation (FDIC). Deposits made in any single financial institution, which are in excess of \$237,500, may be made only if fully collateralized in accordance with the State Depository Handbook. Collateral is held in the Texas Trust's Federal Reserve account. Cash in State Treasury is not considered a deposit with a financial institution for Texas Trust reporting purposes since the State Treasury is not a bank.

Securities pledged as collateral on August 31, 2013 were categorized under the Political Subdivision Securities or U.S. Government Securities as U.S. Treasury Bills or U.S. Treasury Notes and Bonds.

All bank balances except \$379,757 were either insured or collateralized with securities held by the Texas Trust. The \$379,757 was a distribution from a European limited partnership and was uninsured and uncollateralized and therefore subject to custodial risk. The following schedule reflects the bank balance and the carrying amount of deposits held by the Texas Trust.

|   |                         |
|---|-------------------------|
| Bank balance  | \$ 1,028,015,031        |
| Carrying amount                                       | 1,027,790,480           |
| Proprietary cash at bank                              | \$ 52,365               |
| Proprietary Funds non-current restricted cash at bank | 34,152,896              |
| Agency Fund cash at bank                              | 548,835,619             |
| Agency Funds deposits                                 | <u>444,749,600</u>      |
| Total deposits carrying amount                        | <u>\$ 1,027,790,480</u> |

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2013

### (b) *Investments*

*Custodial Credit Risk.* The Texas Trust's investments are insured or registered or the securities are held by the Texas Trust or its agent in the Texas Trust's name.

Investment risks addressed by Texas Trust's investment policy, including credit risk, interest rate risk, concentration risk and foreign currency risk, are disclosed below by investment type, if applicable.

#### **Enterprise Fund**

Investments for the Enterprise Fund, as of August 31, 2013 are as follows:

| <u>Investment Type</u> | <u>Fair Value</u>    |
|------------------------|----------------------|
| Repurchase agreements  | \$ 16,671,793        |
| Equity securities      | <u>73,392</u>        |
|                        | <u>\$ 16,745,185</u> |

*Credit Risk* is the risk that an issuer or other counterparty to an investment will not fulfill its obligation. The Enterprise Fund invests in the repurchase agreements various pool ("REPO Various") which the Texas Trust administers. The underlying securities in the various repurchase agreement pools are rated AA+ by Standard & Poor's and Aaa by Moody's in accordance with Government Code Section 404.024.

*Interest Rate Risk.* All repurchase agreement pools are in overnight repurchase agreements. The weighted average maturity of the repurchase agreement pools are one day.

#### **TexPool and TexPool Prime Investment Trust Fund**

Investments for TexPool and TexPool Prime, as of August 31, 2013 are as follows:

| <u>Investment Type</u>              | <u>Carrying Value</u>    | <u>Fair Value</u>        |
|-------------------------------------|--------------------------|--------------------------|
| Repurchase agreements               | \$ 4,650,521,653         | \$ 4,650,486,218         |
| Commercial paper                    | 703,609,377              | 703,592,068              |
| Corporate obligations               | 30,000,000               | 30,001,200               |
| United States government treasuries | 2,790,457,498            | 2,790,441,404            |
| United States government agencies   | <u>7,248,508,289</u>     | <u>7,249,631,960</u>     |
| Total TexPool and TexPool Prime     | <u>\$ 15,423,096,817</u> | <u>\$ 15,424,152,850</u> |

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2013

*Credit Risk.* TexPool and TexPool Prime portfolios are designed and managed to ensure that they maintain an AAAM rating (or the equivalent) by a nationally recognized statistical rating organization (“NRSRO”). As of August 31, 2013, TexPool and TexPool Prime’s investments in United States government securities, commercial paper and the underlying securities of the Repurchase Agreements were A-1+ by Standard and Poor’s, P1 by Moody’s and F-1+ by Fitch.

*Concentration of Credit Risk.* No more than 5% of TexPool Prime assets at the time of purchase may be invested in a single corporate entity. As of August 31, 2013 5.68% of the TexPool Prime assets were invested in commercial paper issued by FCAR Owner Trust; 5.68% of the TexPool Prime assets were invested in commercial paper issued by Toyota Motor Credit; 5.41% of the TexPool Prime assets were invested in commercial paper issued by Market Street Funding Corporation; 5.41% of the TexPool Prime assets were invested in commercial paper issued by Honeywell International; and 5.07% of the TexPool Prime assets were invested in commercial paper issued by Sanofi-Aventis. The percentage ownership was below 5% at the time of purchase. TexPool and TexPool Prime’s investment policy has no limit on the amount it may invest in any single Governmental Sponsored Enterprise. More than 5% of the TexPool investments are with the Federal Home Loan Bank and the Federal Home Loan Mortgage Corporation. These investments are 27.09% and 12.21% respectively, at August 31, 2013.

*Interest Rate Risk.* The weighted average maturity of the portfolio is limited to 60 days calculated using the reset date for variable rate notes (“VRNs”) and 90 days or fewer using the final maturity date for VRNs, with the maximum maturity for any individual security in the portfolio not exceeding 397 days for fixed rate securities and 24 months for VRNs. The following schedule reflects the weighted average maturity by investment type and as a whole:

| <u>Investment Type</u>                       | <u>Weighted Average Maturity<br/>(Days)</u> |                          |
|--|---|--------------------------|
|  | <u>TexPool</u>                              | <u>TexPool<br/>Prime</u> |
| Repurchase agreements                        | 6   | 4                        |
| Commercial paper                             | -   | 60                       |
| Corporate obligations                        | -   | 10                       |
| United States government agency securities   | 95  | 127                      |
| United States government treasury securities | 33  | 130                      |
| Weighted average maturity                    | 56  | 49                       |

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2013

### Treasury Pool

Investments for the Treasury Pool, as of August 31, 2013 are as follows:

|   | <b>Carrying<br/>Value</b> | <b>Fair<br/>Value</b> |
|---|---------------------------|-----------------------|
| United States government agencies                             | \$ 5,381,458,038          | \$ 5,382,306,026      |
| United States government treasuries                           | 7,485,415,908             | 7,485,538,821         |
| Government mortgage-backed securities                         | 2,206,698,449             | 2,206,698,449         |
| Commercial paper  | 3,530,547,085             | 3,530,547,085         |
| Repurchase agreements   | 900,000,000               | 900,000,000           |
| Supranational   | 837,820,310               | 837,820,310           |
| Corporate obligations   | 2,897,656,572             | 2,897,656,572         |
| Asset backed securities                                       | 2,399,504,254             | 2,399,504,254         |
| Small business administration                                 | 51,317,275                | 51,317,275            |
| Stock In Texas Trust  | 1,000,000                 | 1,000,000             |
| Money market mutual funds                                     | 6,000,000                 | 6,000,000             |
| Total Treasury Pool without Lottery Securities                | 25,697,417,891            | 25,698,388,792        |
| United States government agencies – Refco                     | 646,443,546               | 646,443,546           |
| United States government agencies – Lottery – Treasury Strips | 231,062,416               | 231,062,416           |
| Total Treasury Pool   | \$ 26,574,923,853         | \$ 26,575,894,754     |

*Credit Risk* is the risk that an issuer or other counterparty to an investment will not fulfill its obligation. Pursuant to Government Code section 404.024(a) and (b), treasury funds may be invested in fully collateralized repurchase agreements secured by obligations of the U.S., its agencies, or Government Sponsored Enterprises (GSEs), including mortgage-backed securities of such agencies and GSEs, as set out in section 404.001 of the Government Code. The Comptroller may purchase direct obligations of or obligations, the principal and interest of which are guaranteed by the U.S.; and direct obligations of, or obligations guaranteed by U.S. agencies or GSEs. Mortgage-backed securities are eligible for purchase except those specifically prohibited by section 404.024 (e) of the Government Code. Treasury funds may invest in commercial paper that has received the highest short-term credit rating by a nationally recognized investment rating organization or “NRSRO.” “Highest short-term credit rating” includes at least one of the following short-term credit ratings, Moody’s (P-1), Standard & Poor’s (A-1), or Fitch, Inc. (F-1). Money market funds must be rated AAAM by a NRSRO. The asset backed securities, corporate obligations, and small business administration obligations, that are not rated, are issued by Government Sponsored Enterprises that are rated AA+. The Treasury portfolio is rated AA+ by Standard & Poor’s.

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2013

The following table lists Standard & Poor's credit rating by investment type for the Treasury Pool securities that are subject to credit risk.

| <u>Investment Type</u>                | <u>AAA</u>    | <u>AA</u>        | <u>A</u>    | <u>A-1</u>    | <u>Not Rated</u> |
|---------------------------------------|---------------|------------------|-------------|---------------|------------------|
| United States government agencies     | \$ -          | \$ 5,382,306,026 | \$ -        | \$ -          | \$ -             |
| Government mortgage-backed securities | -             | 2,206,698,449    | -           | -             | -                |
| Commercial paper                      | -             | -                | -           | 3,530,547,085 | -                |
| Corporate obligations                 | 448,515,403   | 1,438,433,075    | 438,113,000 | -             | 572,595,094      |
| Asset-backed securities               | 1,399,560,670 | 14,418,336       | -           | -             | 985,525,248      |
| Repurchase agreements                 | -             | 900,000,000      | -           | -             | -                |
| Small business administration         | -             | -                | -           | -             | 51,317,275       |
| Supranational                         | 99,939,940    | 499,985,000      | 37,973,370  | -             | 199,922,000      |
| Mutual funds (2A 7-Like)              | 6,000,000     | -                | -           | -             | -                |

*Concentration of Credit Risk:* The Comptroller places no limit on the amount the Treasury Pool may invest in any one issuer. More than 5 percent of the Treasury Pool investments are with the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation. These investments are 7.31% and 16.09% respectively.

*Interest Rate Risk.* In accordance with its investment policy, the Treasury Pool manages its exposure to interest rate risk by maintaining a weighted-average maturity of no more than two (2) years. The following schedule reflects the average modified duration (a measure of the price sensitivity of a bond to interest rate movements) of the Treasury Pool by investment type and as a whole:

| <u>Investment Type</u>                            | <u>Modified Duration (Years)</u> |
|---|----------------------------------|
| United States government agencies                 | 0.708                            |
| United States government treasuries               | 1.290                            |
| Government mortgaged-backed securities            | 3.100                            |
| Commercial paper                                  | 0.191                            |
| Corporate obligations                             | 1.904                            |
| Asset-backed securities                           | 0.987                            |
| Repurchase agreements                             | 0.008                            |
| Small Business Administration                     | 19.333                           |
| Supranational                                     | 0.771                            |
| Placement of deposits with financial institutions | 0.328                            |
| Treasury portfolio modified duration              | 1.247                            |

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2013

*Reverse Repurchase Agreements.* The Treasury Pool may enter into reverse repurchase agreements for up to 35% of the pools assets. The Treasury Pool's aggregate amount of reverse repurchase agreement obligations at August 31, 2013 was \$51,272,646 including accrued interest. The aggregate fair value of the securities underlying those agreements, including accrued interest, was \$51,195,656. There was no credit exposure at year-end.

*Covered Call Options* – The Treasury Pool writes covered call options on treasury notes owned by the pool. When the Treasury Pool writes an option, the premium received is recorded as a liability and is adjusted to the current market value of the option written on a monthly basis. Premiums received from writing options that expire unexercised are treated as realized gains. If the premium received is greater than the amount paid when closing a position, the difference is treated as a realized gain, or, if the premium is less than the amount paid for the closing purchase transaction, as a realized loss. If a call option is exercised, the premium is added to the proceeds from the sale of the underlying security in determining whether the Treasury Pool has a realized gain or loss. The Treasury Pool, as the writer of an option, bears the market risk of an unfavorable change in the price of the security underlying the written option. There were no outstanding covered call options as of August 31, 2013.

### Endowment Funds

Investments for the Endowment Funds, as of August 31, 2013 are as follows:

| <u>Investment Type</u>                   | <u>Fair Value</u>       |
|--|-------------------------|
| Equities                                 | \$ 396,034              |
| Mutual funds – global equities           | 4,236,477               |
| Mutual funds – domestic fixed income     | 10,855,076              |
| Mutual funds – global fixed income       | 243,030,134             |
| Mutual funds – commodities               | 138,494,730             |
| Fund of funds                            | 227,670,920             |
| Direct funds                             | 1,738,058,009           |
| Alternative investments domestic         | 706,122,798             |
| Alternative investments international    | 95,796,303              |
| Repurchase agreements                    | 193,308                 |
| Investment in short-term investment fund | <u>76,837,350</u>       |
| Total endowment fund investments         | <u>\$ 3,241,691,139</u> |

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2013

*Credit Risk.* Corporate obligations must be rated investment grade by at least one NRSRO and not rated below investment grade by any NRSRO. Short-term securities must be rated in the highest rating category by an NRSRO. The average quality rating of the high-yield fixed income portfolio shall be B1/B+ or higher. All high-yield securities when purchased must be rated at least CCC. The following schedule lists Standard & Poor's credit rating by investment type for the Endowment Fund securities that are subject to credit risk. The high-yield securities not rated by Standard & Poor's are rated Ba or B by Moody's. The investments in the short-term investment fund are investments in State Street's Institutional Liquid Reserve fund which is rated AAAM by Standard & Pooors.

| <b>Standard &amp; Poor's Credit Ratings</b> | <b>Mutual Funds - Domestic Fixed Income</b> | <b>Mutual Funds - Global Fixed Income</b> | <b>Investments in Short-Term Investment Fund</b> | <b>Repurchase Agreements</b> |
|---|---|---|--|------------------------------|
| AAA   | \$ -  | \$ -                                      | \$ 76,837,350                                    | \$ -                         |
| AA+   | -   | -   | -  | 193,308                      |
| Not rated                                   | 10,855,076                                  | 243,030,134                               | -  | -                            |
| <b>Total</b>                                | <b>\$ 10,855,076</b>                        | <b>\$ 243,030,134</b>                     | <b>\$ 76,837,350</b>                             | <b>\$ 193,308</b>            |

*Concentration Risk:* Excluding securities issued or guaranteed by the U.S. Government, its agencies, instrumentalities, and GSE's, no more than 5% of the portfolio at the time of purchase, shall be invested in securities of one issuer.

*Interest Rate Risk:* The endowment funds do not have a formal investment policy that limits investment maturities. The following schedule reflects the average effective duration of the Endowment Funds by investment type. The investments in the securities lending cash collateral pool and the short-term investment fund use a weighted average maturity to reflect the interest rate risk.

| <b>Investment Type</b>                    | <b>Effective Duration (Years)</b> |
|---|-----------------------------------|
| Mutual funds – domestic fixed income      | 4.60                              |
| Mutual funds – global fixed income        | 4.40                              |
|   | <b>Weighted-Average Maturity</b>  |
| Investments in short-term investment fund | 35 days                           |
| Repurchase agreements                     | 4 days                            |

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2013

*Foreign Currency Risk.* The endowment funds do not have a formal investment policy that limits foreign currencies. The endowment funds exposure to foreign currency risk derives from its position in foreign currency-denominated investment in Alternative Investments.

| <u>Currency</u> | <u>Cash</u> | <u>Alternative<br/>Investment</u> | <u>Total</u>  |
|-----------------|-------------|-----------------------------------|---------------|
| Euros           | \$ 379,757  | \$ 95,796,303                     | \$ 96,176,060 |

### Repurchase Agreement Pool

The Texas Trust operates a Repurchase Agreement Pool in which state entities may invest non-appropriated funds. Investments for the Repurchase Agreement Pool, as of August 31, 2013 are as follows:

| <u>Investment Type</u> | <u>Fair<br/>Value</u> |
|------------------------|-----------------------|
| Repurchase agreements  | \$ 610,861,757        |

*Credit Risk.* The credit rating on the underlying securities that are subject to credit risk for repurchase agreements are rated AA+ by Standard & Poor's.

*Interest Rate Risk.* All Repurchase agreement pools are in overnight repurchase agreements. The weighted average maturity of the Repurchase agreement pool is four days.

### Other Trust activities

The Texas Trust functions as a custodian and/or depository to several state agencies. The functions are strictly fiduciary. Credit risk, interest rate risk, and concentration risk are not risks of the Texas Trust but of the clients its serves as a custodian or depository. Each respective state agency performs their own investment management activities within the parameters of their own respective investment policies.

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2013

Investments for these other trust activities, as of August 31, 2013 are as follows:

| <u>Investment Type</u>                        | <u>Fair Value</u>              |
|---|--------------------------------|
| United States government treasuries           | \$ 522,062,652                 |
| United States government agencies             | 70,014,195                     |
| REFCO strips                                  | 529                            |
| Government mortgage-backed securities         | 14,621,780                     |
| Asset-backed securities                       | 14,750                         |
| Political subdivision bonds                   | 22,287,371                     |
| Corporate obligations                         | 109,293,433                    |
| Repurchase agreements                         | 318,533,667                    |
| Commercial paper                              | 44,960,712                     |
| Negotiable certificates of deposit            | 248,000                        |
| Warrants                                      | 99,887                         |
| Equities                                      | 267,534,687                    |
| Mutual funds                                  | 3,938,008                      |
| Investment in real estate trust fund          | 4,196,327                      |
| Investment in guaranteed investment contracts | 35,586,374                     |
|   | <hr/>                          |
| Total other trust activities                  | \$ <u><u>1,413,392,372</u></u> |

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2013

### (3) Capital Assets

Capital asset activity for the year ended August 31, 2013 was as follows:

| Business-Type Activities                          | Primary Government  |             |           | Balance<br>08/31/13 |
|---|---------------------|-------------|-----------|---------------------|
|   | Balance<br>09/01/12 | Additions   | Deletions |                     |
| Depreciable assets:                               |                     |             |           |                     |
| Buildings and building improvements               | \$ 311,520          | \$ -        | \$ -      | \$ 311,520          |
| Furniture and equipment                           | 671,707             | 73,245      | -         | 744,952             |
| Total depreciable assets at historical cost       | 983,227             | 73,245      | -         | 1,056,472           |
| Less accumulated depreciation for:                |                     |             |           |                     |
| Buildings and building improvements               | (289,267)           | (7,300)     | -         | (296,567)           |
| Furniture and equipment                           | (589,783)           | (42,571)    | -         | (632,354)           |
| Total accumulated depreciation                    | (879,050)           | (49,871)    | -         | (928,921)           |
| Total depreciable assets, net                     | 104,177             | 23,374      | -         | 127,551             |
| Amortizable assets-intangible:                    |                     |             |           |                     |
| Computer software                                 | 2,231,060           | -           | -         | 2,231,060           |
| Total amortizable assets-intangible               | 2,231,060           | -           | -         | 2,231,060           |
| Less Accumulated amortization for:                |                     |             |           |                     |
| Computer software                                 | (2,104,338)         | (99,666)    | -         | (2,204,004)         |
| Total accumulated amortization                    | (2,104,338)         | (99,666)    | -         | (2,204,004)         |
| Amortizable assets-intangible, net                | 126,722             | (99,666)    | -         | 27,056              |
| Business-type activities –<br>capital assets, net | \$ 230,899          | \$ (76,292) | \$ -      | \$ 154,607          |

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2013

### (4) Contributions to Pension Plan

The Employees Retirement System of Texas (ERS) operates under Title 8 of the Texas Government Code. ERS operates a single-employer defined benefit plan and provides retirement, disability, and death benefits for qualified employees of the State. ERS issues a separate comprehensive annual financial report. Copies of the annual financial report may be obtained by requesting a copy through ERS:

ERS of Texas  
Customer Service Division  
18<sup>th</sup> and Brazos Streets  
P.O. Box 13207  
Austin, Texas 78711-3207

Active plan members in ERS are required to contribute a percentage of their annual covered salary. Currently, state employees contribute 6.5%. The State provides a matching contribution of 6.95% of the employees' current annual compensation. Texas Trust recognized \$375,283 in expense for the year ended August 31, 2013 for its share of ERS required contributions.

### (5) Related Party Transactions

The Texas Trust has entered into a services agreement with the Comptroller of Public Accounts (CPA). The agreement provides for specified rates based on hours of utilization. For the fiscal year ended August 31, 2013, the Texas Trust paid CPA \$35,678 for services provided. At August 31, 2013, the Texas Trust had accrued \$9,542 for services provided by CPA and this amount is included in accounts payable.

The Texas Trust utilizes the CPA Payroll Department to service its payroll. Prior to the end of each month, the approximate amount of the Texas Trust's monthly payroll is transferred from the Texas Trust to the Comptroller's Office. At August 31, 2013, the Comptroller held \$643,621 to pay for the Texas Trust's September 1, 2013 payroll.

### (6) Changes in Long-Term Liabilities

During the year ended August 31, 2013 the following changes occurred in long-term liabilities:

|                   | <u>Balance</u><br><u>09/01/12</u> | <u>Additions</u> | <u>Reductions</u> | <u>Balance</u><br><u>08/31/13</u> | <u>Amounts Due</u><br><u>Within One Year</u> |
|-------------------|-----------------------------------|------------------|-------------------|-----------------------------------|--|
| Compensable leave | \$ 616,662                        | \$ 538,182       | \$ 481,475        | \$ 673,369                        | \$ 394,881                                   |
| Total             | \$ 616,662                        | \$ 538,182       | \$ 481,475        | \$ 673,369                        | \$ 394,881                                   |

## Supplemental Information

# Texas Treasury Safekeeping Trust Company

## Combining Schedule – Balance Sheet Information – Agency Fund

August 31, 2013

| Assets   | <u>Endowment<br/>Funds</u>  | <u>Treasury<br/>Pool</u>     | <u>Repurchase<br/>Agreement<br/>Pool</u> | <u>Other<br/>Agency<br/>Funds</u> | <u>Totals</u>                |
|--|-----------------------------|------------------------------|--|-----------------------------------|------------------------------|
| Current assets:                                    |                             |                              |  |                                   |                              |
| Cash in bank                                       | \$ 379,757                  | \$ 522,218,078               | \$ 646,496                               | \$ 25,591,288                     | \$ 548,835,619               |
| Deposits   | -                           | 444,749,600                  | -  | -                                 | 444,749,600                  |
| Investments  | 3,241,691,139               | 26,574,923,853               | 610,861,757                              | 1,413,392,372                     | 31,840,869,121               |
| Receivables from:                                  |                             |                              |  |                                   |                              |
| Interest and dividends                             | <u>4,830</u>                | <u>31,431,563</u>            | <u>679</u>                               | <u>3,964,582</u>                  | <u>35,401,654</u>            |
| <br>Total assets                                   | <br><u>\$ 3,242,075,726</u> | <br><u>\$ 27,573,323,094</u> | <br><u>\$ 611,508,932</u>                | <br><u>\$ 1,442,948,242</u>       | <br><u>\$ 32,869,855,994</u> |
| <br><b>Liabilities</b>                             |                             |                              |  |                                   |                              |
| Liabilities:                                       |                             |                              |  |                                   |                              |
| Accounts payable                                   | \$ 1,658,001                | \$ -                         | \$ -                                     | \$ -                              | \$ 1,658,001                 |
| Interest payable                                   | -                           | 35                           | -  | -                                 | 35                           |
| Obligations under reverse<br>repurchase agreements | -                           | 51,272,611                   | -  | -                                 | 51,272,611                   |
| Funds held for others                              | <u>3,240,417,725</u>        | <u>27,522,050,448</u>        | <u>611,508,932</u>                       | <u>1,442,948,242</u>              | <u>32,816,925,347</u>        |
| <br>Total liabilities                              | <br><u>\$ 3,242,075,726</u> | <br><u>\$ 27,573,323,094</u> | <br><u>\$ 611,508,932</u>                | <br><u>\$ 1,442,948,242</u>       | <br><u>\$ 32,869,855,994</u> |

*See accompanying independent auditor's report.*

Independent Auditors' Report on Internal Control Over  
Financial Reporting and on Compliance and Other Matters  
Based on an Audit of Financial Statements Performed in  
Accordance With *Government Auditing Standards*

The Honorable Susan Combs  
Comptroller of Public Accounts of the State of Texas

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the business-type activities, each major fund, and the aggregate remaining fund information of the Texas Treasury Safekeeping Trust Company (Texas Trust) as of and for the year ended August 31, 2013, and the related notes to the financial statements, which collectively comprise Texas Trust's basic financial statements, and have issued our report thereon dated November 19, 2013.

***Internal Control Over Financial Reporting***

In planning and performing our audit of the financial statements, we considered Texas Trust's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Texas Trust's internal control. Accordingly, we do not express an opinion on the effectiveness of Texas Trust's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

### ***Compliance and Other Matters***

As part of obtaining reasonable assurance about whether Texas Trust's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

### ***Purpose of This Report***

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Texas Trust's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Texas Trust's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*Padgett, Stratemann + Co., LLP*

Certified Public Accountants  
Austin, Texas  
November 19, 2013