

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

Basic Financial Statements

August 31, 2015

# 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	9
Statement of Revenues, Expenses, and Changes in Net Position – Proprietary Fund	11
Statement of Cash Flows – Proprietary Fund	12
Statement of Fiduciary Net Position – Fiduciary Funds	13
Statement of Changes in Fiduciary Net Position – Fiduciary Fund	14
Notes to the Financial Statements	15
Required Supplementary Information (unaudited)	
Schedule of Changes in Proportionate Share of the Net Pension Liability	40
Schedule of Contributions	41
Notes to Required Supplementary Information	42
Supplementary Information	
Combining Schedule – Balance Sheet Information – Agency Fund	43
Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	44



# Padgett Stratemann

## Independent Auditor's Report

To the Honorable Glenn Hegar  
Comptroller of Public Accounts of the State of Texas  
Austin, 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) as of and for the year ended August 31, 2015, 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*

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 Texas Trust'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 on the effectiveness of the Texas Trust'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.

#### **AUSTIN**

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

#### **HOUSTON**

1980 POST OAK BOULEVARD, SUITE 1100  
HOUSTON, TEXAS 77056  
713 335 8630

#### **SAN ANTONIO**

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

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, 2015, 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, 2015, and the changes in its financial position for the year then ended, in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

As described in Note 7 to the financial statements, effective September 1, 2014, Texas Trust implemented Governmental Accounting Standards Board (“GASB”) Statement No. 68, *Accounting and Financial Reporting for Pensions – An Amendment of GASB Statement No. 27* and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date, an amendment of GASB Statement No. 68*. Our opinion is not modified with respect to this matter.

## ***Other Matters***

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

Accounting principles generally accepted in the United States of America require that the Management’s Discussion and Analysis, the Schedule of Proportionate Share of the Net Pension Liability, and the Schedule of Contributions, 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 the Governmental Accounting Standards Board, 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 43 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 December 4, 2015 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, Statemann + Co., LLP

Austin, Texas  
December 4, 2015

# Texas Treasury Safekeeping Trust Company

## Management's Discussion and Analysis

August 31, 2015

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, 2015, 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 fifty-eight (58) billion dollars at August 31, 2015.
- Texas Trust had fees for services in fiscal year 2015 of \$25,088,503 and non-operating revenues of \$42,274 (interest income). Operating expenses were \$15,831,486.

### Overview of the Financial Statements

This report consists of five 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; Notes to the Financial Statements and Required Supplementary Information.

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, deferred outflows of resources, liabilities, and deferred inflows of resources, with the difference 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 fund categories (investment trust fund and agency fund) for a fee designed on a cost recovery basis. In Fiscal Year (FY) 2015, the Texas Trust charged client funds \$25,088,503 in fees and incurred \$15,831,486 in related service expense generating those fees.

# Texas Treasury Safekeeping Trust Company

## Management's Discussion and Analysis

August 31, 2015

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.

Effective September 1, 2014, the Texas Trust implemented GASB Statement No. 68 *Accounting and Financial Reporting for Pensions – An Amendment of GASB Statements No. 27*, and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date, an amendment of GASB Statement No. 68*. Implementation of this statement required the Trust Company to report in the Enterprise Fund its proportionate share of net pension liability, deferred outflows of resources, and deferred inflows of resources and related pension expenses of the Employee Retirement System of Texas Plan (ERS Plan). The proportionate share is an actuarial calculation based on ERS records of actual contributions from the Texas Trust in fiscal year 2014 as a percentage of total contributions from all other plan participants. Texas Trust's proportionate share was calculated as 0.099568291%. The Texas Trust's proportionate share of net pension liability at August 31, 2015 is \$14,398,372. The implementation resulted in a restatement of the beginning net position in fiscal year 2015. The restatement decreased net position by \$13,654,681. See Notes to the Financial Statements for additional detail information.

# Texas Treasury Safekeeping Trust Company

## Management's Discussion and Analysis

August 31, 2015

### Condensed Financial Information for 2015 and 2014 (in 000's)

	<b>2015</b>	<b>2014</b>
	<b>Business-Type</b>	<b>Business-Type</b>
	<b>Activities</b>	<b>Activities</b>
	<u>                    </u>	<u>                    </u>
<b>Assets</b>		
Current assets	\$ 35,757	\$ 26,140
Capital assets	425	73
Noncurrent assets	<u>34,555</u>	<u>34,260</u>
Total assets	<u>70,737</u>	<u>60,473</u>
<b>Deferred Outflows of Resources</b>		
State pension plan assumption changes and contributions after measurement date	<u>1,354</u>	<u>-</u>
Total deferred outflows of resources	<u>1,354</u>	<u>-</u>
<b>Liabilities</b>		
Current liabilities	3,131	2,938
Noncurrent liabilities	<u>14,732</u>	<u>294</u>
Total liabilities	<u>17,863</u>	<u>3,232</u>
<b>Deferred Inflows of Resources</b>		
State pension plan experience and investment return differences	<u>1,342</u>	<u>-</u>
Total deferred inflows of resources	<u>1,342</u>	<u>-</u>
<b>Net position:</b>		
Invested in capital assets	425	73
Unrestricted	<u>52,460</u>	<u>57,168</u>
Total net position prior to restatement	52,885	57,241
Restatement for implementation of new accounting standard	<u>-</u>	<u>(13,655)</u>
<b>Total net position, restated</b>	<u>\$ 52,885</u>	<u>\$ 43,586</u>

# Texas Treasury Safekeeping Trust Company

## Management's Discussion and Analysis

August 31, 2015

### Condensed Financial Information for 2015 and 2014 (in 000's) (continued)

Changes in Net Position	2015	2014
	Business-Type Activities	Business-Type Activities
Charges for service	\$ 25,088	\$ 20,131
Interest Income	42	5
Total revenues	25,130	20,136
Total expenses	15,831	13,638
Change in net position	\$ 9,299	\$ 6,498

### Overall Financial Analysis

#### Business-Type Activities

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, Treasury Pool, and the Investment Trust Funds slightly increased during fiscal year 2015, while average balances for Endowment and State Water Implementation Fund for Texas (SWIFT) funds decreased in fiscal year 2015. Business-type activities generated revenue of \$25.1 million, including charges for services of \$25.1 million, an increase of \$5.0 million during FY 2015. Total expenses for business-type activities were \$15.8 million, an increase of \$2.2 million during FY 2015.

#### 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, 2015 totals \$13.5 billion and the net increase in fiduciary net position for FY 2015 is \$51.6 million.

##### 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, 2015 is \$45.2 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, 2015

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

The Texas Trust's investment in capital assets for its business type activities as of August 31, 2015 amounts to \$425,324 (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 at (512) 463-3129.

## Basic Financial Statements

# Texas Treasury Safekeeping Trust Company

## Statement of Net Position – Proprietary Fund

August 31, 2015

	<b>Enterprise Fund</b>
<b>Assets</b>	
Current assets:	
Cash and cash equivalents	
Cash in bank	\$ 52,433
Cash in State Treasury	737,752
Investments in repurchase agreements	30,748,859
Receivables from:	
Management fees	3,929,538
Interest	220
Other	10,840
Prepaid expenses	<u>277,624</u>
Total current assets	<u>35,757,266</u>
Non-current assets:	
Restricted cash and cash equivalents	
Cash in bank	34,297,026
Restricted investments	257,235
Capital assets:	
Depreciable:	
Software (net)	-
Building and building improvements (net)	236,742
Furniture and equipment (net)	<u>188,582</u>
Total non-current assets	<u>34,979,585</u>
Total assets	<u>70,736,851</u>
<b>Deferred Outflows of Resources</b>	
State pension plan assumption changes and contributions after measurement date	<u>1,354,403</u>
Total deferred outflows of resources	<u>1,354,403</u>

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

# Texas Treasury Safekeeping Trust Company

## Statement of Net Position – Proprietary Fund – Continued

August 31, 2015

### Liabilities

#### Current liabilities:

Accounts payable	\$ 917,898
Payroll payable	1,743,177
Employee's compensable leave	<u>470,326</u>

Total current liabilities 3,131,401

#### Non-current liabilities:

Employees' compensable leave	333,991
Net pension liability	<u>14,398,372</u>

Total non-current liabilities 14,732,363

Total liabilities 17,863,764

### Deferred Inflows of Resources

State pension plan experience and investment return differences 1,341,926

Total deferred inflows of resources 1,341,926

#### Net position:

Invested in capital assets	425,324
Unrestricted	<u>52,460,240</u>

Total net position \$ 52,885,564

*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, 2015

	<u>Enterprise Fund</u>
Operating revenue – management fees	\$ 25,088,503
Operating expenses:	
Salaries and wages	7,715,000
Payroll related costs	1,048,669
Pension expense	1,259,077
Professional fees and services	3,184,524
Travel	148,651
Materials and supplies	652,679
Communication and utilities	585,940
Repairs and maintenance	370,046
Rentals and leases	28,499
Printing and reproduction	11,943
Depreciation and amortization	43,744
Other operating expenses	782,714
Total operating expenses	<u>15,831,486</u>
Operating income	<u>9,257,017</u>
Nonoperating revenue:	
Investment income	<u>42,274</u>
Net nonoperating revenues	<u>42,274</u>
Change in net position	9,299,291
Total net position at beginning of year, prior to restatement	<u>57,240,954</u>
Restatement for implementation of new accounting standard	<u>(13,654,681)</u>
Total net position at end of year	<u>\$ 52,885,564</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, 2015

	<u>Enterprise Fund</u>
Cash flows from operating activities:	
Proceeds from management fees	\$ 24,908,489
Payments to employees	(9,300,414)
Payments for operating expenses	<u>(5,577,876)</u>
Net cash provided by operating activities	<u>10,030,199</u>
Cash flows from capital and related financing activities:	
Payments for additions to capital assets	<u>(396,088)</u>
Net cash used for capital and related financing activities	<u>(396,088)</u>
Cash flows from investing activities:	
Purchases of investments	(162,440)
Proceeds from interest and investment income	<u>42,211</u>
Net cash used in investing activities	<u>(120,229)</u>
Net increase in cash and cash equivalents	9,513,882
Cash and cash equivalents at beginning of year	<u>56,322,188</u>
Cash and cash equivalents at end of year	<u>\$ 65,836,070</u>
Reconciliation of operating income to net cash provided by operating activities:	
Operating income	\$ 9,257,017
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation expense	43,744
Changes in assets/liabilities:	
Receivables	(180,014)
Prepaid expenses	(55,504)
Benefits payable	731,214
Payables	<u>233,742</u>
Net cash provided by operating activities	<u>\$ 10,030,199</u>
Displayed as:	
Cash in bank	\$ 52,433
Cash in State Treasury	737,752
Investments in repurchase agreements	30,748,859
Restricted cash in bank	<u>34,297,026</u>
Total cash and cash equivalents	<u>\$ 65,836,070</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, 2015

<b>Assets</b>	<b>Investment Trust Fund</b>	<b>Agency Fund</b>
Cash in State Treasury	\$ -	\$ 217,679,367
Cash in bank	152,211	34,964,919
Deposits	-	444,643,500
Investments	13,499,466,152	44,432,979,972
Accrued interest receivable	9,511,418	24,666,793
Trades pending settlement	25,005,471	-
Total assets	\$ 13,534,135,252	\$ 45,154,934,551
<b>Liabilities</b>		
Accounts payable	\$ 45,505	\$ 2,766,890
Interest payable	-	13
Amounts payable to participants	908,567	-
Trades pending settlement	25,000,000	-
Management fees reserved for operating expenses	427,381	-
Obligations under reverse repurchase agreements	-	47,143,843
Funds held for others	-	45,105,023,805
Total liabilities	26,381,453	\$ 45,154,934,551
<b>Net Position</b>		
Held in trust for pool participants and other purposes	\$ 13,507,753,799	

*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, 2015

	<u>Investment Trust Fund</u>
<b>Additions:</b>	
Investment income:	
Interest income	\$ 14,815,265
Expenses:	
Management fees and expenses	<u>(7,238,102)</u>
Net investment income	<u>7,577,163</u>
<b>Deductions:</b>	
Earnings paid to investors from net investment income	(7,622,465)
Net change in management fees reserved for operating expenses	45,302
Net increase in participant investments	<u>51,648,897</u>
Net increase in net position	51,648,897
Net position at beginning of year	<u>13,456,104,902</u>
Net position at end of year	<u>\$ 13,507,753,799</u>

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

## Notes to the Financial Statements

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2015

### (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), the Tobacco Settlement Permanent Trust Fund (Tobacco Trust), and the State Water Implementation Fund for Texas (SWIFT) 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, 2015

**(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.

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.

*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.

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2015

(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, \$297,026 in cash was held at DTC as of August 31, 2015, 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, 2015. The Texas Trust Federal Reserve account balance reported in restricted cash on August 31, 2015 was \$34,000,000.

(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.

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;

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2015

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);
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, 2015, the Texas Trust had no tri-party agreements outstanding.

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2015

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, 2015, the Agency Fund had \$47,143,843 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.

**(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 Useful Lives</u>
Software	3 years
Office equipment	5 years
Computer equipment	5 years
Building improvements	10 years

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2015

**(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, 2015 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.

**(l) *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.

**(m) *Pensions***

The fiduciary net position of the Employees Retirement System of Texas Plan (ERS) has been determined using the flow of economic resources measurement focus and the accrual basis of accounting. This includes for purposes of Texas Trust's measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, pension expense, and information about assets, liabilities and additions to/deductions from ERS's fiduciary net position. Benefit payments by ERS (including refunds of employee contributions) are recognized when due and payable in accordance with the terms of the plan. Investments of ERS are reported at fair value.

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2015

### (2) Deposits and Investments

#### (a) Deposits

Cash deposits 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 deposits less than Deposit Insurance levels made with any qualifying institution are fully insured by the Federal Deposit Insurance Corporation (FDIC) or the National Credit Union Share Insurance Fund (NCUSIF). Deposits made in any single financial institution, which are in excess of its Deposit Insurance levels, may be made only if fully collateralized in accordance with the State Depository Handbook. Collateral is held by a qualifying institution. 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, 2015 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 were either insured or collateralized with securities held by the Texas Trust.

Bank balance	\$	514,481,496
Carrying amount		514,110,089
Proprietary cash at bank	\$	52,433
Proprietary Funds non-current restricted cash at bank		34,297,026
Investment Trust Fund cash at bank		152,211
Agency Fund cash at bank		34,964,919
Agency Funds deposits		<u>444,643,500</u>
Total deposits carrying amount	\$	<u><u>514,110,089</u></u>

#### (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.

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2015

### Enterprise Fund

Investments for the Enterprise Fund, as of August 31, 2015 are as follows:

<u>Investment Type</u>	<u>Fair Value</u>
Repurchase agreements	\$ 30,748,859
Equity securities	<u>257,235</u>
	<u>\$ 31,006,094</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.

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

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2015

### TexPool and TexPool Prime Investment Trust Fund

Investments for TexPool and TexPool Prime, as of August 31, 2015 are as follows:

<u>Investment Type</u>	<u>Carrying Value</u>	<u>Fair Value</u>
Repurchase agreements	\$ 2,456,401,381	\$ 2,456,373,331
Commercial paper	649,613,742	649,623,136
Money market mutual funds	370,035,146	370,035,146
United States government treasuries	643,620,647	643,592,947
United States government agencies	<u>9,379,795,236</u>	<u>9,380,182,370</u>
Total TexPool and TexPool Prime	<u>\$ 13,499,466,152</u>	<u>\$ 13,499,806,930</u>

*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, 2015, 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, P-1 by Moody's and F-1 by Fitch. Money market mutual funds were rated AAA by Standard and Poor's, Aaa by Moody's and AAA by Fitch ratings as of August 31, 2015.

*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, 2015 5.04% of the TexPool Prime assets were invested in commercial paper issued by Fairway Finance Company; 5.09% of the TexPool Prime assets were invested in commercial paper issued by BMW US Capital; 5.09% of the TexPool Prime assets were invested in commercial paper issued by General Electric Corp; 5.09% of the TexPool Prime assets were invested in commercial paper issued by Manhattan Asset Fdg; and 5.00% of the TexPool Prime assets were invested in commercial paper issued by Toyota Motor Credit. The percentage ownership of each was below 5% at the time of purchase. No more than 5% of TexPool Prime assets at the time of purchase may be invested in a single corporate entity.

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2015

*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:

Investment Type	Weighted Average Maturity (Days)	
	TexPool	TexPool Prime
Repurchase agreements	3	1
Commercial paper	-	29
Money market mutual funds	8	1
United States government agency securities	51	29
United States government treasury securities	42	168
Weighted average maturity	41	25

### Treasury Pool

Investments for the Treasury Pool, as of August 31, 2015 are as follows:

	Carrying Value	Fair Value
United States government agencies	\$ 11,561,502,442	\$ 11,561,296,196
United States government treasuries	2,213,636,112	2,213,658,445
Government mortgage-backed securities	2,534,203,282	2,534,203,282
Commercial paper	7,794,558,503	7,794,558,503
Repurchase agreements	2,250,000,000	2,250,000,000
Supranational	1,250,224,900	1,250,224,900
Corporate obligations	3,324,833,921	3,324,833,921
Asset backed securities	3,017,885,969	3,017,885,969
Small business administration	34,663,367	34,663,367
Stock in Texas Trust	1,000,000	1,000,000
Money market mutual funds	823,000,000	823,000,000
 Total Treasury Pool without Lottery Securities	 34,805,508,496	 34,805,324,583
United States government agencies – Refco	472,565,032	472,565,032
United States government agencies – Lottery		
Treasury Strips	229,907,616	229,907,617
 Total Treasury Pool	 \$ 35,507,981,144	 \$ 35,507,797,232

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2015

*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.

The following table lists Standard & Poor’s credit rating by investment type at fair value 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	\$ -	\$ 11,561,296,196	\$ -	\$ -	\$ -
Government mortgage-backed securities	9,189,245	2,525,014,037	-	-	-
Commercial paper	-	-	-	7,794,558,503	-
Corporate obligations	-	1,744,150,271	300,567,744	-	1,280,115,906
Asset-backed securities	1,924,824,816	28,166,962	-	-	1,064,894,191
Repurchase agreements	-	2,250,000,000	-	-	-
Small business administration	-	-	-	-	34,663,367
Supranational	1,200,227,000	-	49,997,900	-	-
Mutual funds (2A 7-Like)	823,000,000	-	-	-	-

*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 Home Loan Bank, the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association. These investments are 18.78%, 11.05%, and 8.16% respectively.

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2015

*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	0.682
United States government treasuries	2.045
Government mortgaged-backed securities	3.500
Commercial paper	0.368
Corporate obligations	0.804
Asset-backed securities	1.057
Repurchase agreements	0.003
Small Business Administration	17.842
Supranational	0.293
Placement of deposits with financial institutions	0.327
Treasury portfolio modification duration	0.935

*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, 2015 was \$47,143,856 including accrued interest. The aggregate fair value of the securities underlying those agreements, including accrued interest, was \$46,940,979. There was no credit exposure at year-end.

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2015

### Endowment Funds

Investments for the Endowment Funds, as of August 31, 2015 are as follows:

Investment Type	Fair Value
Mutual funds – global equities	\$ 50,595,920
Mutual funds – global fixed income	260,507,497
Mutual funds – commodities	68,272,414
Fund of funds	207,559,549
Direct funds	1,878,751,490
Alternative investments domestic	949,574,419
Alternative investments international	75,450,088
Investment in short-term investment fund	107,668,260
Total endowment fund investments	\$ 3,598,379,637

*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 & Poor’s.

Standard & Poor’s Credit Ratings	Mutual Funds – Global Fixed Income	Investments in Short-Term Investment Fund
AAA	\$ -	\$ 107,668,260
Not rated	260,507,497	-
Total	\$ 260,507,497	\$ 107,668,260

*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.

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2015

*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.

<u>Investment Type</u>	<u>Effective Duration (Years)</u>
Mutual funds – global fixed income	1.52
	<u>Weighted-Average Maturity</u>
Investments in short-term investment fund	24 days

*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>Alternative Investment</u>	<u>Total</u>
Euros	\$ <u>75,450,088</u>	\$ <u>75,450,088</u>

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2015

### State Water Implementation Fund for Texas (SWIFT)

Investments for the SWIFT, as of August 31, 2015 are as follows:

<b>Investment Type</b>	<b>Fair Value</b>
Mutual funds – global fixed income	\$ 913,664,569
Hedge funds – direct funds	627,917,981
Alternative investments – domestic	111,360,244
Investment in short-term investment fund	<u>124,603,467</u>
Total fund investments	<u>\$ 1,777,546,261</u>

*Credit Risk.* The following schedule lists Standard & Poor’s credit rating by investment type for those investments subject to credit risk.

<b>Standard &amp; Poor’s Credit Rating</b>	<b>Mutual Funds – Global Fixed Income</b>	<b>Investments in Short-Term Investment Fund</b>
AAA	\$ -	\$ 124,603,467
Not rated	<u>913,664,569</u>	<u>-</u>
Total	<u>\$ 913,664,569</u>	<u>\$ 124,603,467</u>

*Concentration Risk:* As of August 31, 2015, no more than 5% of the portfolio was invested in securities of one issuer.

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2015

*Interest Rate Risk:* The Fund's investment policy does not limit investment maturities. The following schedule reflects the average effective duration of the endowment funds by investment type. The investments in the short-term investment fund use a weighted average maturity to reflect the interest rate risk.

<u>Investment Type</u>	<u>Effective Duration</u>
Mutual funds:	
Global fixed income	0.82 years
	<u>Weighted Average Maturity</u>
Investment in short-term investment fund	24 days

### 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, 2015 are as follows:

<u>Investment Type</u>	<u>Fair Value</u>
Repurchase agreements	<u>\$ 1,380,082,467</u>

*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 one day.

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2015

### 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.

Investments for these other trust activities, as of August 31, 2015 are as follows:

<u>Investment Type</u>	<u>Fair Value</u>
United States government treasuries	\$ 543,777,301
United States government agencies	465,927,026
Government mortgage-backed securities	62,425,754
Asset-backed securities	19,843
Political subdivision bonds	22,719,157
Corporate obligations	106,822,321
Repurchase agreements	393,295,669
Commercial paper	133,638,274
Warrants	69,641
Equities	344,817,377
Mutual funds	53,637,363
Investment in real estate trust fund	5,995,767
Investment in guaranteed investment contracts	<u>35,844,970</u>
Total other trust activities	<u>\$ 2,168,990,463</u>

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2015

### (3) Capital Assets

Capital asset activity for the year ended August 31, 2015 was as follows:

<u>Business-Type Activities</u>	<u>Primary Government</u>			<u>Balance 08/31/15</u>
	<u>Balance 09/01/14</u>	<u>Additions</u>	<u>Deletions</u>	
Depreciable assets:				
Buildings and building improvements	\$ 311,520	\$ 238,955	\$ -	\$ 550,475
Furniture and equipment	744,952	157,133	-	902,085
Total depreciable assets at historical cost	<u>1,056,472</u>	<u>396,088</u>	<u>-</u>	<u>1,452,560</u>
Less accumulated depreciation for:				
Buildings and building improvements	(302,829)	(10,904)	-	(313,733)
Furniture and equipment	(680,663)	(32,840)	-	(713,503)
Total accumulated depreciation	<u>(983,492)</u>	<u>(43,744)</u>	<u>-</u>	<u>(1,027,236)</u>
Total depreciable assets, net	<u>72,980</u>	<u>352,344</u>	<u>-</u>	<u>425,324</u>
Amortizable assets-intangible:				
Computer software	2,231,060	-	-	2,231,060
Total amortizable assets-intangible	<u>2,231,060</u>	<u>-</u>	<u>-</u>	<u>2,231,060</u>
Less Accumulated amortization for:				
Computer software	(2,231,060)	-	-	(2,231,060)
Total accumulated amortization	<u>(2,231,060)</u>	<u>-</u>	<u>-</u>	<u>(2,231,060)</u>
Amortizable assets – intangible, net	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Business-type activities – capital assets, net	<u>\$ 72,980</u>	<u>\$ 352,344</u>	<u>\$ -</u>	<u>\$ 425,324</u>

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2015

### (4) Pension Plan

The state of Texas has three retirement systems in its financial reporting entity – Employees Retirement System (ERS), Teacher Retirement System (TRS), and Texas Emergency Services Retirement System (TESRS). These three retirement systems administer the following six defined benefit pension plans:

- ERS – the Employees Retirement System of Texas Plan (ERS Plan), the Law Enforcement and Custodial Officer Supplemental Retirement Plan (LECOS), the Judicial Retirement System of Texas Plan One (JRS 1) and Judicial Retirement System of Texas Plan Two (JRS2).
- TRS – the Teacher Retirement System of Texas (TRS) plan
- TESRS – the Texas Emergency Services Retirement System (TESRS) plan.

ERS, LECOS, JRS2, TRS, and TESRS plans are administered through trust; JRS1 plan is on a pay-as-you-go basis.

#### **ERS Plan**

The Board of Trustees of ERS is the administrator of four pension plans that provide a standard monthly benefit in a life annuity at retirement and death and disability benefits for members. In addition to the state of Texas, the employers of the ERS plan include various component units of the state. The Employees Retirement System and the Texas Trust, which are blended component units, and the State Bar of Texas, which is a discrete component unit, are also employers of the ERS plan. The Employees Retirement System of Texas Plan is considered a single employer defined benefit plan under GASB Statement No. 68 Accounting and Financial Reporting for Pensions.

ERS Plan covers members in employee and elected classes. Employee class includes employees and appointed officers of the agencies of the state of Texas except those who included in the coverage of Teacher Retirement System of Texas, Judicial Retirement System Plan I (JRS 1) and Plan II (JRS II). Elected class includes elected state officials not included in the coverage of JRS 1 and JRS II, and members of the Legislature and district and criminal district attorneys.

The benefit and contribution provisions of the ERS Plan are authorized by state law and may be amended by the Legislature. The monthly benefit may vary by membership class:

The monthly standard annuity of the employee class is determined by a statutory percentage of 2.3% of a member's average monthly compensation multiplied by number of years of service credit. The average monthly compensation of the employee class may vary depending on the hire date. For members hired on or before August 31, 2009, the average monthly compensation is the average of the highest 36 months of compensation. For members hired on or after September 1, 2009 and before September 1, 2013, the average monthly compensation is the average of the highest 48 months of compensation. For members hired on or after September 1, 2013, the average monthly compensation is the average of highest 60 months of compensation.

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2015

The monthly standard annuity of the elected class equals the statutory percentage of 2.3% of the current state salary of a district judge multiplied by the number of years of service credit. Retirement benefits are automatically adjusted as state judicial salaries change.

ERS plan's membership as of the measurement date of August 31, 2014 is presented in the table below:

### Employees Retirement System's Membership

	<b>ERS Plan</b>
Retirees and Beneficiaries Currently Receiving Benefits	95,840
Terminated Employees Entitled to Benefits But Not Yet Receiving Them	96,507
Current Employees Vested and Non-Vested	134,162
Total Members	326,509

The contribution rates for the state and the members for the ERS Plan for the measurement period of fiscal 2014 are presented in the table below:

### Required Contribution Rates – ERS Plan

Employer			Members		
Employee Class	Elected Class – Legislators	Elected Class – Other	Employee Class	Elected Class – Legislators	Elected Class – Other
8.00%	8.00%	8.00%	6.60%	8.00%	6.60%

The amount of Texas Trust's contributions recognized by the ERS plan during the fiscal 2014 measurement period was \$480,157.

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2015

The total pension liability is determined by an annual actuarial valuation. The methods and assumptions applied, except discount rate, in the actuarial valuation were based on an experience study covering the five-year period from September 1, 2006 through August 31, 2011. Additionally, the actuarial valuation as of August 31, 2014 also incorporates the across-the-board pay increases budgeted by the state Legislature for the current fiscal 2014-2015 biennium. The table below presents the actuarial methods and assumptions used to measure the total pension liability as of the August 31, 2014:

### Actuarial Methods and Assumptions

	ERS Plan
Actuarial Valuation Date	August 31, 2014
Actuarial Cost Method	Entry Age Normal
Amortization Method	Level Percent of Payroll, Open
Actuarial Assumptions:	
Discount Rate	6.07%
Investment Rate of Return	8.00%
Inflation	3.50%
Salary Increase	0% to 11.5%
Mortality	1994 Group Annuity Mortality Table with no setback for males and set forward two years for females. Generational mortality improvements in accordance with Scale AA are projected from the year 2000.
Cost-of-living Adjustments	None – Employee 3.5% – Elected

A single blended discount rate of 6.07% was applied to measure the total pension liability. The 6.07% discount rate incorporated an 8.00% long-term expected rate of return on pension plan investments and 4.17% 20-year municipal bond rate based on Federal Reserve Statistical Release H. 15. The long-term expected investment rate of return was applied to projected benefit payments through fiscal 2041 and the municipal bond rate was applied to all benefit payments thereafter.

The projections of cash flows used to determine this single discount rate assumed that plan member and employer contributions will be made at the current statutory levels and remain a level percentage of payroll. The projected cash flows from the employers are based on contributions for the most recent five year period as of the measurement date, adjusted on consideration of subsequent events. There have been indicators of Legislature's commitment to increase funding for the pension funds, such as changes in the statute in the last and current legislative sessions. Considering these above events, the projected employer contributions are based on fiscal 2015 funding level.

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2015

The long-term expected rate of return on plan investments was developed using a building-block method with assumptions including asset class of investment portfolio, target allocation, real rate of return on investments, and inflation factor. Under this method, best estimate ranges of expected future real rates of return (net of investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighing the expected future real rates of return by the target asset allocation percentage and by adding expected inflation.

The target allocation and best estimates of arithmetic real rates of return for each major asset class for the plan's investment portfolio are presented below:

<u>Asset Class</u>	<u>Target Allocation</u>	<u>Long-Term Expected Arithmetic Real Rate of Return</u>
Global Equity	55%	4.02%
Global Credit	10%	0.19%
Intermediate Treasuries	15%	0.18%
Real Estate	10%	0.43%
Infrastructure	4%	0.25%
Hedge Funds	5%	0.35%
Cash	1%	0.00%
Total	100%	

Sensitivity analysis was performed on the impact of changes in the discount rate on the proportionate share of Texas Trust's net pension liability. The result of the analysis is presented in the table below:

	<u>1% Decrease 5.07%</u>	<u>Current Discount Rate 6.07%</u>	<u>1% Increase 7.07%</u>
Texas Trust's proportionate share of the net pension liability	\$ 19,379,903	\$ 14,398,372	\$ 10,252,055

The pension plan's fiduciary net position is determined using economic resources measurement focus and the accrual basis of accounting, which is the same basis used by Employees Retirement System. Benefits and refunds of contributions are recognized when due and payable in accordance with the terms of the plan. Investments of the pension trust fund are reported at fair value in accordance with GASB Statements No. 67 and 31. The fair value of investments is based on published market prices and quotations from major investment brokers at available current exchange rates. However, corporate bonds in general are valued based on currently available yields of comparable securities by issuers with similar credit ratings. Employees Retirement System issues stand-alone audited Comprehensive Annual Financial Report (CAFR).

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2015

More detailed information on the plan's investment valuation, investment policy, assets, and fiduciary net position may be obtained from ERS' fiscal 2014 CAFR:

Employees Retirement System of Texas  
P. O. Box 13207  
Austin, Texas 78711-3207

Texas Trust's total pension liability is based on an actuarial valuation performed as of August 31, 2014. For fiscal 2015 reporting, the measurement date of Texas Trust's net pension liability is August 31, 2014. The schedule of changes in Texas Trust's net pension liability for the fiscal year ending August 31, 2015 is presented below:

<b>Total Pension Liability</b>	
Service Cost	\$ 1,134,532
Interest on the Total Pension Liability	2,314,146
Difference between Expected and Actual Experience of the Total Pension Liability	(251,875)
Assumption Changes	1,193,891 *
Benefit Payments and Refunds	<u>(1,955,005)</u>
<b>Net Change in Total Pension Liability</b>	<b>\$ <u>2,435,689</u></b>
<b>Total Pension Liability – Beginning</b>	<b>\$ <u>36,904,655</u></b>
<b>Total Pension Liability – Ending</b>	<b>\$ <u><u>39,340,344</u></u></b>
<b>Plan Fiduciary Net Position</b>	
Contributions – Employer	\$ 480,157
Contributions— Member	428,736
Pension Plan Net Investment Income	3,238,376
Benefit Payments and Refunds	(1,955,005)
Pension Plan Administrative Expense	<u>(20,108)</u>
<b>Net Change in Plan Fiduciary Net Position</b>	<b>\$ <u>2,172,156</u></b>
<b>Plan Fiduciary Net Position – Beginning</b>	<b>\$ <u>22,769,816</u></b>
<b>Plan Fiduciary Net Position – Ending</b>	<b>\$ <u><u>24,941,972</u></u></b>
<b>Net Pension Liability – Beginning</b>	<b>\$ 14,134,839</b>
<b>Net Pension Liability – Ending</b>	<b>\$ 14,398,372</b>

\* The change in the total pension liability due to the change in the single discount rate is included as an assumption change.

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2015

The change of discount rate which resulted in an increase in the total pension liability is the only assumption change during the current measurement period. There have been no changes to the benefit terms of the plan since the prior measurement date.

For the fiscal year ending August 31, 2015, Texas Trust recognized pension expense of \$1,259,077. At August 31, 2015, Texas Trust reported deferred outflows of resources and deferred inflows of resources from the following sources:

	<b>Deferred Outflows of Resources</b>	<b>Deferred Inflows of Resources</b>
Difference between expected and actual experience	\$ -	\$ 174,375
Changes of assumptions	826,540	-
Net difference between projected and actual investment return	-	1,167,551
Contributions subsequent to the measurement date	527,863	-
Total	<u>\$ 1,354,403</u>	<u>\$ 1,341,926</u>

The \$527,863 reported as deferred outflows of resources resulting from contributions subsequent to the measurement date will be recognized as a reduction in the net pension liability for the year ending August 31, 2016.

Amounts reported as deferred outflows and inflows of resources related to pensions will be recognized in pension expense in the following years:

Year ended August 31:

2016	\$ (2,037)
2017	(2,037)
2018	(219,425)
2019	(291,888)
2020	-
Thereafter	-

# Texas Treasury Safekeeping Trust Company

## Notes to the Financial Statements

August 31, 2015

### (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, 2015, the Texas Trust paid CPA \$37,584 for services provided. At August 31, 2015, the Texas Trust had accrued \$8,922 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, 2015, the Comptroller held \$737,752 to pay for the Texas Trust's September 1, 2015 payroll.

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

During the year ended August 31, 2015 the following changes occurred in long-term liabilities:

	<b>Balance September 1, 2014</b>	<b>Additions</b>	<b>Reductions</b>	<b>Balance August 31, 2015</b>	<b>Amounts Due Within One Year</b>
Compensable leave	\$ 727,534	\$ 768,364	\$ 691,581	\$ 804,317	\$ 470,326
Net pension liability	-	14,398,372	-	14,398,372	-
Total	\$ 727,534	\$ 15,166,736	\$ 691,581	\$ 15,202,689	\$ 470,326

### (7) Pension Restatement

Effective September 1, 2014, the Texas Trust implemented GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – An Amendment of GASB Statement No. 27*, and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date, an amendment of GASB Statement No. 68*. Upon adoption, net pension liability, deferred inflows and outflows and pension expense are now reflected on the financial statements in accordance with the guidance provided for within the standards. The implementation resulted in a restatement of the beginning net position in 2015, the year in which the provisions of GASB Statement No. 68 were adopted. The adoption decreased net position by \$13,654,681.

	<b>Total</b>
Net position at end of year – as previously reported	\$ 57,240,954
Implementation of GASB Statement Nos. 68 and 71	(13,654,681)
Net position at beginning of year – as restated	\$ 43,586,273

Required Supplementary Information  
(Unaudited)

## Texas Treasury Safekeeping Trust Company

### Schedule of Change in Proportionate Share of the Net Pension Liability

August 31, 2015

	<b>2015</b>
<b>Total Pension Liability</b>	
Service Cost	\$ 1,134,532
Interest on the Total Pension Liability	2,314,146
Difference between Expected and Actual Experience of the Total Pension Liability	(251,875)
Assumption Changes	1,193,891 *
Benefit Payments and Refunds	(1,955,005)
<b>Net Change in Total Pension Liability</b>	<b>\$ 2,435,689</b>
<b>Total Pension Liability – Beginning</b>	<b>\$ 36,904,655</b>
<b>Total Pension Liability – Ending</b>	<b>\$ 39,340,344</b>
<b>Plan Fiduciary Net Position</b>	
Contributions - Employer	\$ 480,157
Contributions - Member	428,736
Pension Plan Net Investment Income	3,238,376
Benefit Payments and Refunds	(1,955,005)
Pension Plan Administrative Expense	(20,108)
<b>Net Change in Plan Fiduciary Net Position</b>	<b>\$ 2,172,156</b>
<b>Plan Fiduciary Net Position – Beginning</b>	<b>\$ 22,769,816</b>
<b>Plan Fiduciary Net Position – Ending</b>	<b>\$ 24,941,972</b>
<b>Net Pension Liability – Beginning</b>	<b>\$ 14,134,839</b>
<b>Net Pension Liability – Ending</b>	<b>\$ 14,398,372</b>
Texas Trust’s covered-employee payroll	\$ 5,929,750 **
Texas Trust’s proportionate share of the net pension liability as a percentage of its covered-employee payroll	242.82%
Plan fiduciary net position as a percentage of total pension liability	63.40%

\* The change in the total pension liability due to the change in the single discount rate is included as an assumption change.

\*\* The covered employee payroll is the actual annual payroll for fiscal 2014, the measurement period.

*See accompanying independent auditor’s report.*

# Texas Treasury Safekeeping Trust Company

## Schedule of Contributions

August 31, 2015

	<u>2015</u>	<u>2014</u>
Actuarially determined contributions	\$ 777,573	\$ 724,750
Contributions in relation to the actuarially determined contributions	\$ 527,863	\$ 480,157
Contribution deficiency (excess)	\$ 249,710	\$ 244,593
Covered-employee payroll	\$ 6,487,794	\$ 5,929,750
Contributions as a percentage of covered-employee payroll	8.14%	8.10%

*See accompanying independent auditor's report.*

# **Texas Treasury Safekeeping Trust Company**

## **Notes to Required Supplementary Information**

August 31, 2015

**(1) Changes of benefit terms**

There were no benefit changes during the year.

**(2) Changes of assumptions**

Actuarially determined contributions are adjusted for actual payroll and administrative expenses.

## Supplemental Information

# Texas Treasury Safekeeping Trust Company

## Combining Schedule – Balance Sheet Information – Agency Fund

August 31, 2015

Assets	<u>Endowment Funds</u>	<u>State Water Implementation Fund</u>	<u>Treasury Pool</u>	<u>Repurchase Agreement Pool</u>	<u>Other Agency Funds</u>	<u>Totals</u>
Current assets:						
Cash in State Treasury	\$ -	\$ 217,679,367	\$ -	\$ -	\$ -	\$ 217,679,367
Cash in bank	-	-	5,720,594	661,945	28,582,380	34,964,919
Deposits	-	-	444,643,500	-	-	444,643,500
Investments	3,598,379,637	1,777,546,261	35,507,981,144	1,380,082,467	2,168,990,463	44,432,979,972
Receivables from:						
Interest and dividends	<u>10,756</u>	<u>91,208</u>	<u>20,977,203</u>	<u>3,271</u>	<u>3,584,355</u>	<u>24,666,793</u>
 Total assets	 <u>\$ 3,598,390,393</u>	 <u>\$ 1,995,316,836</u>	 <u>\$ 35,979,322,441</u>	 <u>\$ 1,380,747,683</u>	 <u>\$ 2,201,157,198</u>	 <u>\$ 45,154,934,551</u>
 <b>Liabilities</b>						
Liabilities:						
Accounts payable	\$ 1,854,445	\$ 912,445	\$ -	\$ -	\$ -	\$ 2,766,890
Interest payable	-	-	13	-	-	13
Obligations under reverse repurchase agreements	-	-	47,143,843	-	-	47,143,843
Funds held for others	<u>3,596,535,948</u>	<u>1,994,404,391</u>	<u>35,932,178,585</u>	<u>1,380,747,683</u>	<u>2,201,157,198</u>	<u>45,105,023,805</u>
 Total liabilities	 <u>\$ 3,598,390,393</u>	 <u>\$ 1,995,316,836</u>	 <u>\$ 35,979,322,441</u>	 <u>\$ 1,380,747,683</u>	 <u>\$ 2,201,157,198</u>	 <u>\$ 45,154,934,551</u>

*See accompanying independent auditor's report.*



## Padgett Stratemann

### **Independent Auditor's 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***

To the Honorable Glenn Hegar  
Comptroller of Public Accounts of the State of Texas  
Austin, 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, 2015, and the related notes to the financial statements, which collectively comprise Texas Trust's basic financial statements, and have issued our report thereon dated December 4, 2015.

#### ***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 Texas Trust'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.

#### **AUSTIN**

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

#### **HOUSTON**

1980 POST OAK BOULEVARD, SUITE 1100  
HOUSTON, TEXAS 77056  
713 335 8630

#### **SAN ANTONIO**

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

TOLL FREE: 800 879 4966

WEB: PADGETT-CPA.COM

### ***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 Texas Trust's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*Padgett, Statemann + Co., LLP*

Austin, Texas  
December 4, 2015