



TEA Contract #3331

PO # 36914

VIN # 3308308308

September 5, 2017

Mr. Mike Morath, Commissioner of Education
Texas Education Agency
1701 North Congress Avenue
Austin, TX 78701-1494

Subject: Engagement Letter for Engagement Letter for an Audit of the Permanent School
Fund's Financial Statements for Fiscal Year 2017

Dear Commissioner Morath:

This letter outlines the understanding of the State Auditor's Office with respect to the audit of Permanent School Fund (Fund) for the fiscal year ended August 31, 2017.

The objectives of our audit are as follows:

- Express an opinion on whether the Fund's fiscal year 2017 financial statements are fairly presented, in all material respects, in conformity with U. S. generally accepted accounting principles.
- Report on any significant deficiencies and material weaknesses in internal control over financial reporting and compliance with laws, regulations, and provisions of contracts or grant agreements based on an audit of financial statements performed in accordance with the standards applicable to financial audits contained in *Government Auditing Standards*.
- Determine whether the total amount of school district and charter district bonds the Permanent School Fund Bond Guarantee Program guarantees is within the limits established by state statute.

The Management Discussion and Analysis is not part of the basic financial statements but is required by the Governmental Accounting Standards Board. Such information will be subjected to limited procedures in accordance with auditing standards generally accepted in the United States of America. We will not express an opinion or provide any assurance on that information.

The Introduction, Statistical Summary, Bond Guarantee Program, and Supplemental Schedules are presented for purposes of additional analysis and are not a required part of the basic financial statements. We will not audit that information or express an opinion on it.

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MANAGEMENT'S RESPONSIBILITIES

Our audit will be conducted on the basis that management acknowledges and understands that it is responsible for:

- The preparation and fair presentation of the Fund's financial statements in accordance with accounting principles generally accepted in the United States of America and the selection and application of the accounting policies.
- Identifying and ensuring that the Fund complies with laws, regulations, and the provisions of contracts and grants applicable to its activities.
- The design, implementation, and maintenance of internal control over compliance and internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.
- Informing auditors of all significant deficiencies and material weaknesses in the design or operation of controls of which it has knowledge.
- Providing (1) access to all records and information that are relevant to the preparation and fair presentation of the financial statements and to compliance with provisions of laws, regulations, contracts, and grant agreements; (2) access to additional information that the auditor may request for the purpose of the audit; and (3) unrestricted access to persons within the Fund from whom auditors determine it is necessary to obtain audit evidence.
- Adjusting the financial statements to correct material misstatements and for affirming to the auditor in the management representation letter that the effects of any uncorrected misstatements aggregated by the auditor during the current engagement and pertaining to the latest period presented are immaterial, both individually and in aggregate, to the financial statements taken as a whole.
- Designing and implementing programs and controls to prevent and detect fraud; and taking timely and appropriate steps to remedy fraud and noncompliance with provisions of laws, regulations, contracts, and grant agreements or abuse that the auditor reports.
- Informing the auditor of events occurring or facts discovered subsequent to the date of the financial statements, of which management may become aware, that may affect the financial statements.

The audit does not relieve management or those charged with governance of their responsibilities.

In accordance with *Government Auditing Standards*, as part of our audit planning, we will evaluate whether management has taken appropriate corrective action to address findings and recommendations from previous engagements that could have a material effect on the financial statements. To assist us, management agrees to identify previous audits, attestation engagements, or other studies that relate to the objectives of the audit, including whether related recommendations have been implemented, prior to first day of audit fieldwork.

At the conclusion of the engagement, management will provide the State Auditor's Office with a letter that confirms certain representations made during the audit. We will provide a draft representation letter for management to review at a later date. The representations in that letter should be completed and dated December 20, 2017. At the end of the audit, we will also request a legal representation letter that lists all outstanding lawsuits, and that letter should be dated December 20, 2017.

AUDITOR'S RESPONSIBILITIES AND SCOPE OF WORK

We are responsible for conducting the audit in accordance with generally accepted government auditing standards. Those standards require that we obtain reasonable rather than absolute assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. Because of the inherent limitations of an audit, together with the inherent limitations of internal control, an unavoidable risk exists that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with generally accepted auditing standards. In addition, an audit is not designed to detect error or fraud that is immaterial to the financial statements. If, for any reason, we are unable to complete the audit or are unable to form or have not formed an opinion, we may decline to express an opinion or decline to issue a report as a result of the engagement.

An audit includes obtaining an understanding of the Fund and its environment, including its internal control, sufficient to (1) assess the risks of material misstatement of the financial statements and (2) design the nature, timing, and extent of further audit procedures. An audit is not designed to provide assurance on internal control or to identify deficiencies in internal control. However, we are responsible for ensuring that those charged with governance are aware of any deficiencies in internal control that come to our attention.

To begin evaluating those areas, we request that current information be provided as soon as possible regarding any noncompliance, errors, fraudulent activity, or misappropriation of assets that are known or are presently under investigation.

In the interest of facilitating the audit, the State Auditor's Office plans to use a desktop screen-sharing tool to obtain and observe audit documentation in limited circumstances. The desktop screen-sharing tool is a secure communication tool that is housed and operated by the State Auditor's Office, and it does not involve third-party or "cloud" services. While the use of that tool is not required, if the Fund chooses to use that tool, your staff will not need to install executable programs because the desktop screen-sharing tool is entirely accessible through a standard Internet browser.

Auditing standards require our auditors to exercise professional skepticism and increased awareness to detect potential fraud and noncompliance with provisions of laws, regulations, contracts, and grant agreements. As a result, interviews with employees at all levels as appropriate will include specific questions to help us assess fraud risk at the Fund.

In accordance with *Government Auditing Standards*, in certain circumstances we are also required to report fraud or noncompliance directly to parties outside of the Fund. However, because the determination of abuse is subjective, *Government Auditing Standards* do not require auditors to detect abuse.

STATE AUDITOR'S OFFICE CONTACTS

Hillary Eckford is the audit manager overseeing the audit and can be reached at (512) 936-9495 or Hillary.Eckford@sao.texas.gov. Bill Hunter is the overall project manager and can be reached at (512) 936-9646 or Bill.Hunter@sao.texas.gov.

Your contact manager, who serves as your resource for information and assistance throughout the year, is Jim Timberlake. He is kept informed of all audit projects related to the Fund. Please feel free to contact him regarding any questions, suggestions, concerns, or comments about this project or any other issue.

A copy of the most recent external quality control review report on the State Auditor's Office is available at <http://www.sao.texas.gov/About/PeerReviews/>. *Government Auditing Standards* include a requirement for audit organizations to have an external review every three years. The most recent review found that the State Auditor's Office conducts audits in accordance with auditing standards.

AUDIT FINDINGS AND RESULTS

Findings or exceptions noted will be provided to management for written responses. A written management response to the findings is expected within 10 working days of receipt. However, the response time may be fewer than 10 working days, based on the significance of any issues identified during the engagement. A draft of our findings and recommendations will be delivered to management prior to the exit conference.

Management's final responses, including corrective action plans for current and prior year findings, should be typed on Fund letterhead and accompanied by your signature. In certain circumstances, auditor follow-up comments may be included in the findings.

The results of the Fund's 2017 financial statement audit will be issued in a written report (opinion). We cannot provide assurance that an unmodified opinion will be expressed. Circumstances may arise in which it is necessary for us to modify our opinion or withdraw from the engagement. The written report on the Fund's internal control over financial reporting and compliance with laws, regulations, and provisions of contracts or grant agreements will be issued on completion of the audit. We will also summarize the results of our audit in a report to the Legislative Audit Committee and communicate certain matters required by auditing standards to those charged with governance.

ESTIMATED CHARGES

Reimbursement to the State Auditor's Office is authorized by Article IX, Section 6.20(b)(1), of the State's General Appropriations Act and the Interagency Cooperation Act (Texas Government Code, Chapter 771). The State Auditor's Office will invoice the Fund for services provided. The Fund shall reimburse the State Auditor's Office within thirty (30) days after the receipt of invoices from the State Auditor's Office from appropriation items or accounts from which like expenditures normally would be paid for similar resources, based upon vouchers drawn by the Fund payable to the State Auditor's Office. The State Auditor's Office will credit Fund payments to current appropriation item(s) or account(s) from which the expenditures of that character originally were made. Payment shall be made in accordance with Texas Government Code, Section 771.008.

Based on our preliminary estimates of the work to be done and an hourly rate of \$93, we estimate the billing will be \$120,500.

That estimate may change as the audit progresses. Any significant changes in the estimated billing will be discussed with management at the time the changes are identified.

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CONCLUDING REMARKS

We are currently gathering information to assist with the planning phase of the audit. To avoid duplicating audit efforts, we will coordinate our work with your internal auditor. We have also prepared an engagement expectations memo to document what the Fund can expect from the State Auditor's Office and what the State Auditor's Office can expect from the Fund (see attachment).

We anticipate completing our onsite audit work by December 20, 2017.

Our office looks forward to working with the Fund's personnel over the next few months.

If the terms of this engagement as outlined above are acceptable, please indicate by signing below. Please return this letter to the State Auditor's Office. THE UNDERSIGNED PARTIES do hereby certify that (1) the services specified above are necessary and essential for activities that are properly within the statutory functions and programs of the affected agencies of State Government; (2) the proposed arrangement serves the interest of the economical administration of the State Government, and (3) the services, supplies, or material that are the subject of this agreement are not required by Section 21 of Article 16 of the Constitution of Texas to be supplied under contract given to the lowest responsible bidder. The Fund further certifies that it has the authority to contract for the above services.

The undersigned parties bind themselves to the faithful performance of this agreement.

Sincerely,



Lisa R. Collier, CPA, CFE, CIDA
First Assistant State Auditor

Attachment

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cc: Members of the State Board of Education

Ms. Donna Bahorich, Chair
Mr. Marty Rowley, Vice Chair
Mr. Ruben Cortez, Jr., Secretary
Mr. Lawrence A. Allen, Jr.
Ms. Erika Beltran
Mr. David Bradley
Ms. Barbara Cargill
Mr. Kevin Ellis
Ms. Patricia Hardy
Mr. Tom Maynard
Ms. Sue Melton-Malone
Mr. Ken Mercer
Ms. Geraldine Miller
Ms. Georgina Perez
Ms. Marisa Perez-Diaz
Ms. Kara Belew, Chief Deputy, Texas Education Agency
Mr. Holland Timmins, CFA, Executive Administrator and Chief Investment Officer,
Permanent School Fund
Ms. Catherine Civileto, CPA, Deputy Executive Administrator, Permanent School Fund
Mr. William Wilson, CPA, CIA, Director of Internal Audit, Texas Education Agency

Acknowledged and agreed to on behalf of Permanent School Fund by:


Name


Title


Date