INDEPENDENT AUDIT SERVICES FOR ACFR FOR
TEXAS PERMANENT SCHOOL FUND CORPORATION
RFQ 706-24-002

ADDENDUM 1
Clarifying Questions and Answers

To all proposers, questions received close of business on February 29, 2024, have been de-identified and answered in random order. Please consider all questions and answers significant to the proposal process.

Q1: Does the Permanent School Fund (PSF) utilize the statewide accounting systems for their general ledger and cash transactions?
Do you use the Texas Comptroller of Public Accounts instance of CAPPS and USAS?
If no, what systems do you use for your general ledger and banking transactions.

A1: Yes, PSF utilizes the statewide accounting systems for general ledger and cash transactions. Yes, the Texas Comptroller of Public Accounts instance of CAPPS and USAS are used.

Q2: Do you anticipate vendors will be able to utilize their offshore services for audit assistance?

A2: While vendors are not disqualified from utilizing off-shore personnel services for audit assistance, provided all state qualifications and other requirements from the RFQ are met, it is expected that the project manager and other key personnel will be in Texas for the duration of the project and it is preferred that the entire team be in Texas for the duration of the project.

Q3: Some audit software and related tools are hosted in the Cloud. We would like to confirm that will be acceptable to PSF.

A3: Yes, provided that relevant steps are taken in coordination with the Texas PSF IT team to ensure that measures protecting the security of the information are in place.

Q4: The RFQ on page 5, IV D notes review of internal audit work, if in place, to obtain reliance and to reduce the necessary scope of audit work. First, when does PSF expect to have an internal audit function established as we are unable to find mention on your website? Please clarify what your expectation is for IV D.

A4: The Internal Audit function is in formation stages. Texas PSF does not expect to have a fully operational internal audit department for fiscal year ending August 31, 2024.

Q5: The RFQ on page 5, IV H notes assistance with compilation of the ACFR. Due to independence guidelines, auditors should not be compiling client ACFRs. We would review and offer suggestions on presentation and disclosures after PSF staff have drafted the ACFR. Is this an acceptable scope modification?

A5: Yes.

Q6: The RFQ on page 5, IV J notes performance of an AUP relate to the Texas incentive compensation program. Are you able to share a prior year report such that adequate scoping and pricing can be provided in our response?

A6: Not at this time; we expect this to be a bookmark for future negotiation if considered necessary.

Q7: With regard to the NAV investments, approximately how many funds are included in the portfolio?

A7: Approximately 700 alternative investments/funds held at NAV with around 50 new investments per year.

Q8: With regard to the NAV investments, how many funds individually exceed 5% within the portfolio?

A8: None.

Q9: With regard to the NAV investments, what is the estimated value of the NAVs that do not have audit reports?

A9: All are audited.

Q10: With regard to the NAV investments, considering that most funds have a year-end of December 31st, could you please explain or provide process documentation (with policies & procedure) as to PSF's valuation methodology for NAVs? Additionally, how does PSF roll the value from the December 31st audited financials to the PSF year-end of August 31st?

A10: Our YE process rolls the latest valuation (typically 6/30) to the adjusted ending value at 8/31. This is followed month after month so the 6/30 has rolled in the audited financial number from prior calendar YE (12/31), and these amounts are typically completed by May.

Q11: Are there any investments that are not carried at fair value? If yes, could you please provide an approximate value for those investments.

A11: At August 31, 2023, $24.7 billion in portfolio assets were carried at Net Asset Value. All others ($27.4 billion) were carried at fair value.

Q12: Does PSF invest in any Texas fund such as TexPool? If yes, could you please specify which funds and provide an approximate value for those investments.

A12: No.

Q13: November 16, 2023, minutes note a discussion under #6 regarding a new Texas PSF facility and pending lease agreement and architectural plans and construction drawings. Are you building your own building or moving into one of the State buildings? When is the move/transition expected to occur?

A13: The Texas PSF is leasing office space in Innovation Tower located at 1300 Red River St., Austin, Texas. The University of Texas is the landlord of Innovation Tower.
The move is expected during the December 2024/January 2024 timeframe.

Q14: What is PSF management's expectation for conducting fieldwork? Do you expect the audit team to be on-site, remote, or hybrid?

A14: Hybrid. In-person appearance for in-charge auditor and audit manager is expected for board meetings. In-person appearance for in-charge auditor and audit manager is preferred for committee meetings and certain meetings with Texas PSF staff and leadership. See also response to #2 above.

Q15: Audits expect to attend two board meeting to present the audit planning and audit results. Are there any additional board or executive level meetings you would expect the auditor to attend?

A15: Audit and Ethics Committee meetings for updates as well as certain meetings with Texas PSF staff and leadership. See response to #2 above.

Q16: How much assistance does Texas PSF anticipate needing to prepare the ACFR?

A16: In the past, Texas PSF has prepared the financial statement, note, schedule, and other content and has required assistance in finalizing the report.

Q17: Can you provide copies of the PY management letter and Those Charged with Governance Letter?

A17: Yes, report 24-008 is available at the State Auditor's website (sao.texas.gov).

Q18: Can you describe you methodology/process for estimating the fair value of the alternative investments reported at NAV?

A18: Real Estate, Private Equity, Real Assets NAV based on latest capital account balance or valuation data, adjusted for contributions and withdrawals subsequent to latest valuation or reporting date. All others provided by the investment advisor.

Q19: Can you provide an approximate number of the alternative investments/funds held at NAV? How many new alternative investments held at NAV does Texas PSF usually add per year (range is fine)?

A19: Approximately 700 alternative investments/funds held at NAV with around 50 new investments per year.

Q20: Of the total number of alternative investment funds at NAV, how many of the total funds provide audited financials and what is the timing of the audits?

A20: All are audited. Nearly all of them have year ends of 12/31 and their audit timing is subsequent to their year ends.

Q21: How is the information housed/stored for the alternative investments at NAV?

A21: It is stored either by the asset manager or in a primary book of record system. The Texas PSF custodian bank serves as the investment accounting book of record.

Q22: Will the auditor have direct read only access to the system of record for the information used to value the alternative investment at NAV OR will a request need to be submitted for the compilation of all information that is needed for testing?

A22: Read only access will be provided to the custodian bank's online reporting system.

Q23: Any significant changes in the types of investments held (i.e. level 3 investments)?

A23: None to date, although some changes yet to be determined are anticipated.

Q24: Can you provide who Texas PSF uses for their custodian?

A24: The Bank of New York Mellon.

Q25: Are you aware of any contingency matters such as litigation, non-compliance with laws or regulations, or fraud matters?

A25: No.

Q26: What information can be provided about the expected state of the internal audit function at the time of 2024 audit fieldwork?

A26: See response for #4.

Q27: Can you elaborate on this service, "Compilation of Annual Consolidated Financial Report, as may be necessary or requested"?

A27: See #16 above.

Q28: Please provide the conflict of interest provisions that may appear in a contract.

A28: A copy of the Respondent's code of ethics may be requested. Respondents must agree to comply with the applicable state laws, ethics policies and any conflict-of-interest provisions in an awarded contract. Appendix A of the RFQ includes the Standard Terms and Conditions. A copy of the current Texas PSF Ethics Policy is available on the Texas PSF website at https://texaspsf.org/policies/

Q29: What IT systems are used to track financial data (general ledger, payment processing, investments, capital assets and leases, financial reporting, and any other systems)? Are there any anticipated changes in those systems during the proposed contract term?

A29: Texas PSF uses an Oracle-based ERP administered by the Texas Comptroller of Public Accounts for its general ledger system, commonly known as CAPPS.

Q30: Are there any limitations for using audit resources outside of the United States?

A30: See #2 and #14 above.

Q31: Are financial statements prepared on a monthly or quarterly basis?

A31: No.

Q32: Please provide information related to timing from period close date to when financial information is finalized and would be available to the audit team. Please indicate if timing is different for the year end closing process.

A32: Financial information should be finalized by the end of October.

Q33: Please provide the approximate number of financial institutions and bank accounts for your cash and cash equivalents.

A33: Two financial institutions, cash accounts are set up for all asset classes.

Q34: What level of anticipated future contributions are expected during FYE 2024 and thereafter?

A34: Please review the FY23 ACFR for information on Texas PSF assets. Please note that Texas PSF is not a pension plan.

Q35: Is Bank of New York Mellon Corporation the sole custodian? If not, what additional custodial relationships does the organization have?

A35: Yes, Bank of New York Mellon is the sole custodian.

Q36: How many external managers are used for internal equity type of investments (Level 1 investments per Table 3B.1: Investments Measured at Fair Value, page 37 of the Annual Comprehensive Financial Report ("ACFR"))?

A36: One.

Q37: Is a third-party administrator involved with the investments' fund accounting or is everything performed internally?

A37: Both.

Q38: For short-term securities noted on the table on page 18 of the ACFR, are there any other instruments used other than money market funds and US treasury securities? Please provide clarification on the short-term investment facility within Table 3.B.1 on page 37 of the ACFR.

A38: Not presently. Either held and invested at the Texas State Treasury or invested in an overnight sweep account by the custodian.

Q39: Can you provide us with a copy of your valuation policy and details of the pricing sources used for equities and bonds (i.e. Level 1 and 2 securities in Table 3.B.1 on page 37 of the ACFR) if not included in such policy?

A39: See the Investment Policy Statement at texaspsf.org/policies/. Pricing sources are provided by the custodian bank as described in its most recent Global Pricing Guidelines.

Q40: Please provide the number of fund of funds each category consists of by investment type as included in Table 3.B.3 on page 39 of the ACFR.

A40: None.

Q41: Can you provide your due diligence process for the investments in fund of funds?

A41: Texas PSF does not currently have any investments in fund of funds. Texas PSF undertakes a thorough investment due diligence process prior to making any investments.

Q42: Are any adjustments made to the NAV provided by the fund's investor advisor to determine fair value at August 31, other than for capital activity after June 30?

A42: Private Equity NAV is adjusted for the investment advisor's accrued carry liability.

Q43: Are all investee funds audited?

A43: Yes.

Q44: Are all investee funds reporting using US GAAP or IFRS? Are there any reporting on a non-fair value basis (i.e. cost or tax basis investments)?

A44: Yes. No.

Q45: Are the majority of funds December 31 year-ends? To what extent are there other year-ends?

A45: Yes. None to very limited.

Q46: How many funds do you get information more than 45 days after quarter-end?

A46: Virtually all private markets quarterly valuations are not available until approximately 100 to 130 days after quarter-end.

Q47: To what extent do you have investments in fund of funds that do not provide information on a quarterly basis?

A47: Not applicable, see #41 above.

Q48: Are the alternative investments referred to on page 35 (B. Investment Value Measurement) considered investments in fund of funds, or does it include other types?

A48: Primarily includes hedge funds and private markets investments.

Q49: On page 30, it states "fair values of real estate investments are estimated by management using the latest valuation provided by the general partners, adjusted for contributions and withdrawals after the latest available valuation reporting date." Are these investments in real estate funds since it appears that it may be valuations provided by the general partners, adjusted for cash flows?

A49: Yes.

Q50: On page 31, it states "fair values of emerging market debt [equity] investments are based on NAV provided to management by the investment advisor for each investment structure." Can you please provide additional information on these structures?

A50: See MD&A "Investment Management" discussion in the annual report.

Q51: Overview of investment valuation process including any external expert or pricings services used.

A51: Priced by our custodial bank in accordance with its pricing policy, as the Texas PSF's accounting book of record.

Q52: Are investments held at multiple custodians? If so, how many custodians?

A52: No.

Q53: Any difficulty in past audits for investment confirmation process?

A53: No.

Q54: Investments at fair value, Can you provide approximate number of investments?

A54: See Holdings published at texaspsf.org/reports/

Q55: Investments at Net Asset Value:

a. Number of NAV investments?

b. Are audited financial statements available for investee funds?

A55: a. See #19 above.
b. See #43 above.

Q56: What is the reason for change from the State Auditor?

A56: Looking for specialized expertise in auditing of investment operations of a governmental corporation. See Sec. 43.068(b) of the Texas Education Code.

Q57: Can you elaborate more on the relationship the auditors will have with the State Auditor, specifically:

a. Is this a subcontractor relationship between the accounting firm and the SAO? Or is the accounting firm engaged directly with Texas PSF?

b. Is the accounting firm issuing the opinion?

c. Will the SAO be dictating any sort of sample sizes or scope? If so, specify what that would be.

A57: a. Directly engaged with Texas PSF
b. Yes
c. No
See also, attached Delegation of Authority letter from the SAO dated February 5, 2024.

Q58: Is there an internal audit function? What are/will be the areas of audit focus in FY 24 of internal audit?

A58: See #4 above.

Q59: Will management of Texas PSF prepare the financial statements and related disclosures?

A59: Yes.

Q60: Will the audit be performed on site, remotely, or hybrid?

A60: See #2 above.

Q61: What is the preferred timing of the work: Interim? Final?

A61: Prefer timing to be as much work as possible up front.

Q62: Any current year operational changes or planned changes before issuance of audit report?

A62: Yes.

Q63: Any significant litigations or claims of which we should be aware?

A63: No.

Q64: What are the key things management and the Board want to see in their relationship with their professional service provider?

A64: Efficiency, regular communication, status reports, immediate alerts to anything that needs attention, partnership in suggestions for improvement the auditor may see.

Q65: Does PSF engage a third-party administrator to prepare books and records and/or generate financial statements?

A65: Texas PSF has previously engaged an accounting firm to compile financial statements prepared and generated by Texas PSF staff.

Q66: Are there any ancillary services anticipated to be requested beyond those audit services enumerated in the RFQ? Examples often include reference to provision of specified tax services (even for not-forprofit institutions) or 'agreed upon procedures' exercises.

A66: Potential agreed-upon procedure exercises.

Q67: Under Section IV. Scope (D), references to Internal Audit are used "if such a function is in place". Can PSF please summarily describe the applicability, scope and responsibilities of any relevant internal audit functions?

A67: See #4 above.

Q68: Are there any FYE 2024 investment allocations, investment manager concentrations, or unique investments (Level 3 assets, e.g.) within the portfolio that are anticipated to substantially/materially differ from the portfolio composition as of FYE 2023?

A68: Yes.

Q69: We have reviewed the FY 2023 Annual Comprehensive Financial Report, in addition to the associated Holdings materials of public equities and bonds made available online. Can PSF provide the number (or ranges) of both private investment funds and asset managers utilized by PSF in order to assist with scoping determinations?

A69: See #19 above.

Q70: We note derivative instruments owned by PSF consist exclusively of futures contracts. Please confirm that FY 2024 volumes are consistent with historical periods. In addition, are these instruments held directly by PSF or through a separately managed account (SMA)? Please also describe any SMA activity (if applicable).

A70: Strategies are consistent with historical periods; volumes may be more in line with opportunity.
Instruments are both held directly by Texas PSF and through SMA.
One portfolio that is externally managed holds derivative instruments that are held and managed by the external manager.

Q71: Are there any secondary transactions anticipated to be applicable for PSF as of August 31, 2024?

A71: Possibly

Q72: We observe "Accumulated Incentive Allocation" presented in Table 3.B.3 for Investments Measured at NAV. Does PSF aggregate this information from capital statements received from underlying fund managers? Is the balance specifically identifiable or applicable to PE investments only?

A72: No.
Applicable to Private Equity Investments only.

Q73: We observe "Credit Risk for Debt Investments" presented in Table 3.E.1 categorizing assets by debt ratings by NRSROs. Does PSF anticipate this information on ratings to continue to be subject to audit?

A73: Yes.