

STATE OF TEXAS

Notes to Schedule of Expenditures of Federal Awards

For the Year Ended August 31, 2008

(1) Summary of Significant Accounting Policies

(a) Reporting Entity

The Schedule of Expenditures of Federal Awards (the "Schedule") includes the activity of all federal award programs administered by the State of Texas (the "State"), except for four component units, for the fiscal year ended Aug. 31, 2008. Those component units, the Texas Guaranteed Student Loan Corporation, Texas A&M Research Foundation, Texas Health Insurance Risk Pool of the Department of Insurance and Boll Weevil Foundation of the Department of Agriculture, are subject to separate audits in compliance with Office of Management Budget (OMB) Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. The federal transactions for these four entities are excluded from the Schedule.

The Texas A&M Research Foundation is a blended component unit of the Texas A&M University System and is included as part of the primary government in the State of Texas Comprehensive Annual Financial Report (CAFR). The Texas Guaranteed Student Loan Corporation, Texas Health Insurance Risk Pool and Boll Weevil Foundation are discrete component units and are not part of the primary government in the CAFR.

Federal award programs include expenditures, pass-throughs to non-state agencies (i.e. payments to subrecipients), non-monetary assistance and loan programs.

(b) Basis of Presentation

The Schedule presents total federal awards expended for each individual federal program in accordance with OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. Federal award program titles are reported as presented in the Catalog of Federal Domestic Assistance (CFDA). Federal award program titles not presented in the Catalog are identified by Federal Agency number followed by (.XXX).

(c) Basis of Accounting

The expenditures for each of the federal financial assistance programs are presented in the Schedule on the accounting basis as presented on the fund financial statements. For entities with governmental funds, expenditures are presented on a modified accrual basis. For entities with proprietary funds, expenditures are presented on the accrual basis.

Both the modified accrual and accrual basis of accounting incorporate an estimation approach to determine the amount of expenditures incurred if not yet billed by a vendor. Thus, those Federal programs presenting negative amounts on the Schedule are the result of prior year estimates being overstated and/or reimbursements due back to the grantor.

(d) Matching Costs

Matching costs, the nonfederal share of certain program costs, are not included in the Schedule, except for the State's share of unemployment insurance (See Note 4).

(2) Relationship to Federal Financial Reports

The regulations and guidelines governing the preparation of Federal financial reports vary by Federal agency and among programs administered by the same agency. Accordingly, the amounts reported in the Federal financial reports do not necessarily agree with the amounts reported in the accompanying Schedule which is prepared on the basis explained in Note 1(c).

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(3) Relations to Revenues in the State of Texas' Fund Financial Statements

The following is a reconciliation of total federal awards expended as reported in the Schedule to federal revenues reported in the fund financial statements.

Federal Revenues

Statement of Revenues, Expenditures,
and Changes in Fund Balances – Governmental
Funds, Federal Revenue \$ 28,656,215,142

Statement of Revenues, Expenses, and Changes
in Net Assets – Proprietary Funds,
Federal Revenue 2,646,655,836

Statement of Revenues, Expenses, and Changes
in Net Assets – Proprietary Funds, Capital
Contributions- Federal 27,411,763

Statement of Changes in Fiduciary Net Assets 106,209,407

Total Federal Revenue per Fund Financial Statements 31,436,492,148

Reconciling Items

Non-Cash Federal Commodities/Vaccines/Surplus
Property/Other (Note 6) 370,912,793

Various Loans Processed by
Universities and Agencies (Note 5) 2,136,479,864

State Unemployment Funds (Note 4) 1,329,629,094

Cash rebates to participants in the Special Supplemental
Food Program for Woman Infants and Children (WIC) (Note 7) 241,079,164

Other * (104,784,295)

Blended Component Unit not included in the Schedule of
Expenditures of Federal Awards (Note 1(a)) (175,714,109)

Expenditures per Schedule of Expenditures of Federal Awards \$ 35,234,094,659

* This amount includes deductions of \$1,864,095 for fixed fee contracts; \$2,275,668 of vendor transactions; \$101,774,145 for Medicare portion of Part D which is not subject to OMB A-133 since it does not include any Medicaid funds; and \$368,078 for deferred revenues recognized in fund financial statements but not in the Schedule. This amount also includes additions \$1,466,929 for deferred revenues recognized on the Schedule but not in the fund financial statements and \$50,682 of other transactions. An addition of \$80 is also included to account for rounding in the Schedule.

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(4) Unemployment Insurance Funds

State unemployment tax revenues and the government and non-profit contributions in lieu of state taxes (State UI funds) must be deposited into the Unemployment Trust Fund in the U.S. Treasury. Use of these funds is restricted to pay benefits under the federally approved State Unemployment Law. State UI funds as well as federal funds are reported in the Schedule under CFDA 17.225. The State portion in the amount of \$1,329,629,094 is a reconciling item in the reconciliation of the Schedule to revenues in the fund financial statements (See Note 3).

(5) Federally Funded Loan Programs

The State participates in various federally funded loan programs. The programs can be grouped into two broad categories:

- Federally Funded Student Loan Programs
- Other Federally Funded Loan Programs

a) ***Federally Funded Student Loan Programs***

The State participates in student loan programs on which the federal government imposes continuing compliance requirements. Additionally, the State participates in other student loan programs that do not require continuing compliance. The charts below summarize activity by the State for federally funded student loan programs:

Student Loan Programs with Continuing Compliance Requirements

| CFDA Number | Program Name | Ending Balances of Previous Year's Loans | New Loans Processed |
|----------------|---|--|------------------------|
| 84.038 | Federal Perkins Loan Program (Perkins) | \$ 134,143,144 | \$ 29,983,606 |
| 93.342 | Health Professions Student Loans (HPSL) | 6,531,312 | 2,226,879 |
| 93.364 | Nursing Student Loans | 2,735,140 | 477,624 |
| | | <u>\$143,409,596</u> | <u>\$ 32,688,109</u> |

Other Student Loan Programs

| CFDA Number | Program Name | New Loans Processed |
|----------------|---|--------------------------------|
| 84.032 | Federal Family Education Loan Program (FFELP) | \$ 1,934,121,157 |
| 84.268 | Federal Direct Student Loans (Direct Loans) | 167,307,340 |
| 93.264 | Nursing Faculty Loan Program | 53,434 |
| | | <u>\$ 2,101,481,931</u> |
| | Total New Loans Processed | <u><u>\$ 2,134,170,040</u></u> |

The total new loans processed amount of \$2,134,170,040 is included in the Schedule and as part of a reconciling item on Note 3.

The Federal Family Education Loan Program (FFELP, CFDA 84.032) and the Federal Direct Student Loans Program (Direct Loans, CFDA 84.268) do not require universities to disburse funds. The proceeds are disbursed by lending institutions for FFELP and by the federal government for Direct

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Loans. For both programs, loan guarantees are issued by the Texas Guaranteed Student Loan Corporation or other guarantee agencies. The federal government reinsures these guarantee agencies.

The Texas Higher Education Coordinating Board (THECB) participated in the Federal Family Education Loan Program (FFELP, CFDA 84.032L) as a servicer of the loans. During the year ended Aug. 31, 2008, THECB received \$317,357 in interest subsidy payments that are included in the Schedule. For the year ended Aug. 31, 2008, THECB originated loans of \$2,309,824 to university students that are included in the Schedule. As of Aug. 31, 2008, THECB services approximately \$53.4 million of FFELP loans.

b) *Other Federally Funded Loan Programs*

The State participates in other federally funded revolving loan programs. The chart below summarizes activity by the State for these programs:

| CFDA Number | Program Name | New Loans Processed |
|------------------------|--|--------------------------------|
| 66.458 | Clean Water State Revolving Funds (CWSRF) | \$ 58,886,149 |
| 66.468 | Drinking Water State Revolving Funds (DWSRF) | 78,750,811 |
| | Total New Loans Processed | <u>\$ 137,636,960</u> |

Clean Water State Revolving Funds (CWSRF, CFDA 66.458)

The Water Development Board receives capitalization grants to create and maintain Clean Water State Revolving Funds programs (CWSRF, CFDA 66.458). The State can use capitalization grant funds to provide a long-term source of State financing for construction of wastewater treatment facilities and implementation of other water quality management activities.

The CWSRF provides loans at interest rates lower than what can be obtained through commercial markets. Fixed rate loans offer net long-term interest rates of 0.95 percent below market rates for those applicants financing the origination charge. For applicants who pay for the origination charge from other sources, the interest rate is 0.70 percent below the rate the borrower would receive in the open market at the time of closing. The maximum repayment period for most CWSRF loans is 20 years from completion of construction. Capitalization grants received for CWSRF for the year ended Aug. 31, 2008, were approximately \$58.9 million and are included in the Schedule. CWSRF outstanding loans, with no continuing audit requirements, at Aug. 31, 2008, were approximately \$2.3 billion.

Drinking Water State Revolving Funds (DWSRF, CFDA 66.468)

The Water Development Board receives capitalization grants to create and maintain Drinking Water State Revolving Funds programs (DWSRF, CFDA 66.468). The State can use capitalization grant funds to establish a revolving loan fund. The revolving loan fund can assist public water systems in financing the costs of infrastructure needed to achieve or maintain compliance with the Safe Drinking Water Act. These compliance requirements ensure the public health objectives of the Safe Drinking Water Act.

The DWSRF can provide loans at interest rates lower than the market or provide other types of financial assistance for qualified communities, local agencies and private entities. The DWSRF offers a net long-term interest lending rate of 1.2 percent below the rate the borrower would receive in the open market at the time of closing. The maximum repayment period for most DWSRF loans is 20 years from the completion of construction. Capitalization grants received for DWSRF for the year ended Aug. 31, 2008, were approximately \$78.8 million and are included in the Schedule. DWSRF

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outstanding loans, with no continuing audit requirements, at Aug. 31, 2008, were approximately \$269.6 million.

The State also participates in a federally funded credit enhancement program.

Credit Enhancement for Charter School Facilities (CFDA 84.354)

In 2005, the Texas Public Finance Authority Charter School Finance Corporation formed a consortium with the Texas Education Agency and the Texas Charter School Resource Center to apply for a federal grant to assist charter schools. In November 2006, the consortium received \$10.1 million in federal grants to establish the Texas Credit Enhancement Program (“TCEP”). The \$10.5 million of federal grants received and interest earned in fiscal 2007 are subject to continuing audit requirements and are included in the Schedule. In addition, approximately \$464 thousand of interest earned on the federal grant monies drawn down in fiscal 2008 is also included in the Schedule.

The TCEP provides credit enhancement to eligible charter schools by funding debt service reserve funds for bonds issued on behalf of the schools to finance education facilities. As of Aug. 31, 2008, \$8.5 million of the federal grant funds had been allocated to various charter schools.

(6) Non-Monetary Assistance

The State is the recipient of federal financial assistance programs that do not result in cash receipts or disbursements and are therefore not recorded in the State’s fund financial statements. Awards received by the State which include cash and non-cash amounts are included in the Schedule as follows:

| <u>CFDA Number</u> | <u>Program Name</u> | <u>Grant Awards</u> |
|------------------------|---|-----------------------|
| 10.550 | Food Distribution | \$ 106,253,436 |
| 10.565 | Commodity Supplemental Food Program | 4,150,111 |
| 10.569 | Emergency Food Assistance Program | 29,563,369 |
| 17.002 | Labor Force Statistics | 346 |
| 17.207 | Employment Services | 45,678 |
| 17.225 | Unemployment Insurance | 328,516 |
| 39.003 | Donation of Federal Surplus Personal Property | 11,328,174 |
| 93.268 | Immunization Grants | 229,243,163 |
| | Total | <u>\$ 370,912,793</u> |

(7) Rebates from the Special Supplemental Food Program for Women, Infants, and Children (WIC)

During fiscal 2008, the State received cash rebates from infant formula manufacturers in the amount of approximately \$241.1 million on sales of formula to participants in the WIC program (CFDA 10.557), which are netted against total expenditures included in the Schedule. Rebate contracts with infant formula manufacturers are authorized by Code of Federal Regulations, Title 7: Agriculture, Chapter II, Subchapter A, Part 246.16(m) as a cost containment measure. Rebates represent a reduction of expenditures previously incurred for WIC food benefit costs. Applying the rebates received to such costs enabled the State to extend

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program benefits to more participants than could have been serviced this fiscal year in the absence of the rebate contract.

(8) Depository Libraries for Government Publications

Several State agencies and universities participate as depository libraries in the Government Printing Office's Depository Libraries for Government Publications program (CFDA 40.001). The State agencies and universities are the legal custodian of government publications, which remain the property of the federal government. The publications are not assigned value by the Government Printing Office.