

FINANCIAL MANAGEMENT FOR GEORGIA LOCAL UNITS OF ADMINISTRATION

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NATURE AND PURPOSE

Cash management is the process of managing monies of a local unit of administration (LUA) in order to ensure maximum cash availability and maximum yield on short-term investment of idle cash. It is concerned with what happens between the point that an LUA has a claim on the revenue and an expenditure/expense payment clears the bank.

More specifically the cash management activity is concerned with the conversion of accounts receivable to cash receipts, the conversion of accounts payable to cash disbursements, the rate at which cash disbursements clear a bank account and how the cash balances are invested in the interim.

Cash Management issues relating to federal monies are included in Chapter V-1.

Objectives of a Cash Management System

The overriding goals of the cash management system are to maximize cash availability and to maximize yield from an LUA's idle cash. This goal is achieved by maximizing investment yield on cash between its collection and disbursement. To reduce cash management to the twin goals of maximizing available cash and maximizing yield, however, is to oversimplify. The constraints under which the LUA operates and the inherent conflicts between investment yield and risk dictate that the LUA strives toward a number of subsidiary objectives as well.

- **Objective 1 - The Cash Management System Should Support the Operations of the LUA, Not the Other Way Around.** The recent focus on cash management can give the impression that LUAs are in the business of making money through aggressive investing.

Cash should not be maximized at the expense of paying vendors late, nor should yield be maximized at the expense of other goals. Where conflicts exist between the two primary goals of cash management, the LUA should put a higher priority on cash availability than on yield.

- **Objective 2 - The Cash Management System Must Meet All Legal Obligations and Constraints Placed Upon it.** Cash management systems do not operate within a legal vacuum. Every state including Georgia regulates the cash management activities of its LUAs to some extent. For example, revenue collection activities are constrained by state legislation specifying the payment schedule and collection process for collecting property taxes.

It is in the area of investments, however, that state law plays the greatest role in the cash management system. In Georgia, there are some legal restrictions on what investment instruments LUAs may purchase. These authorized investment instruments are discussed later in this chapter.

- **Objective 3 - The Cash Management Program Must Protect the Assets of the LUA at All Times.** Cash management is really another form of risk management. Any time that an LUA earns revenue, makes an investment, or commits to an expenditure, it incurs a certain amount of risk. The LUA must recognize and minimize the LUA's exposure to five distinct types of risk, as discussed below.

Credit risk applies mainly to investments, but also could come into play with simple checking accounts. Credit risk means some or all of the principal amount of an investment or account will not be available due to failure by the issuer, securities dealer or broker, bank or other financial institution. Credit risk is best avoided by carefully screening investment dealers and banks for potential default problems, by limiting investments to those instruments which are least likely to result in default, and by requiring good collateral against all investments.

Market risk means that changes in the financial markets may reduce the value of the LUA's investment. In extreme cases (usually periods of rapidly rising interest rates), the market value of the LUA's investment may fall below the

principal amount invested. The LUA can protect against market risk by avoiding instruments that are traditionally subject to rapid market swings and by investing with the intent of holding all instruments to maturity.

Custodial credit risk - the rise of electronic funds transfers and creative investment instruments has spawned a whole new process of investing, in which many LUAs never see the instrument in which they are investing, if the instrument even exists in tangible form. Many banks, brokers, and dealers prefer to issue a safekeeping certificate or use another simple method to evidence receipt of the principal. Although not required by Georgia law (O.C.G.A. 45-8-12), some LUAs protect against "external" safekeeping risk by insisting that the collateral securities be delivered physically to the LUA as a condition of making the investment. Practically speaking, custodial credit risk occurs any time that cash or investment assets are being held or transferred.

- **Objective 4 - The Cash Management System Must Provide Adequate Liquidity to Meet All Expected and Unexpected Obligations.** Idle cash is only idle and available to invest until it is needed to pay employees or vendor invoices. An important objective of an effective cash management program is to time investments so that they mature at the same time they are needed to meet these obligations. If they mature too early, the LUA is losing interest earnings and if they mature too late, the LUA risks a potentially damaging problem of illiquidity, or not having cash available to meet obligations due.
- **Objective 5 - The Cash Management System Must be Well-Documented and Accountable.** Because of the risks inherent in cash management, it is essential that the cash management system include a strong accounting and reporting element. The superintendent, business official, independent auditor, elected school board members, and citizens must be guaranteed that all receipts are recorded properly and credited, that expenditures are charged properly, and that investments are tracked and earnings properly prorated among funds that provided the principal for the investment.

DEVELOPING CASH AND INVESTMENT POLICIES

Both the school board and the superintendent will be more comfortable when the LUA operates under a set of adopted cash management policies than when major policy decisions are made as and when needed. Sound cash management policies improve consistency, create accountability, help insure that laws and ordinances are followed, and create goals by which to measure performance. The following cash and investment policies are discussed in this section of this chapter.

- **Should cash and investments be pooled?**
- **How should depository banks be chosen?**
- **Should investments be purchased on a competitive basis?**
- **Should the Georgia Local Government Investment Pool be utilized?**
- **What should be the contents of general investment policies?**

Should Cash and Investments be Pooled?

Some LUAs maintain separate checking accounts for each fund that they maintain. If practicable, a single checking account or minimum number of accounts should be maintained. Some LUAs may maintain a separate checking accounts for general activity and a separate checking account for payroll activity. The primary advantage of maintaining a minimum number of checking accounts is that it facilitates the investment of available resources in larger amounts which will increase interest revenue. Often, the larger the investment, particularly with certificates of deposit, the greater return on the investment. Therefore, pooling investments from different funds is a suggested practice. However, the allocation of earned interest to contributing funds becomes more difficult (this issue is discussed later in this chapter).

A sample pooling policy follows:

"All investment funds will be maintained in a single account, except where legally required to be separate. Interest revenue will be allocated according to fund ownership."

How Should Depository Banks be Chosen?

Georgia law (O.C.G.A. 45-8-14) authorize LUAs to deposit funds in one or more solvent banks, insured Federal savings and loan associations, or insured State chartered building and loan associations. (Note: the proceeds from bond issues in certificates of deposit is limited to financial institutions located with this State).

It is difficult to discuss banking services for LUAs without addressing political considerations. Political involvement in an LUA's banking relations can range from minimal to extensive. Unfortunately in many LUAs, banking relations are determined solely by politics. The main problem posed by politics is that it hinders free and open competition in the procurement of banking services at the lowest cost for the services rendered. A growing number of LUAs, however, have been able to set aside politics and approach their banking relations on a business-like basis. Today, most banking officials endorse and support free and open competition for banking services.

Providing services to LUAs can be a profitable business for banks, and maintaining this relationship has been important to them. It was not unusual a few years ago to find bank and LUA relationships lasting several decades. As more and more new banks opened, there was increasing pressure to divide the business among all the banks in the LUA's geographic area. Recently, there has been an increasing trend by LUAs to use competitive bidding in selecting banks. Generally, there are three alternatives available to LUAs for choosing depositories as follows:

- The LUA maintains bank accounts at each of the financial institutions within the community.**
- The LUA rotates the banking business to each bank within the community on an annual or other periodic basis.**
- The LUA chooses a depository through competitive proposals (i.e., issue request for proposals)**

Utilizing All Local Banks. Sharing the LUA's deposits with all or most of the banks in a community (i.e., use of all local banks) is the most common arrangement for handling banking relations. Normally, this policy is unwritten. Unfortunately, it is also the least desirable method. Once established, this method is difficult to reverse, since all of the banks are benefiting from the LUA's business. The sharing method evolved many decades ago as a means by which elected school board members compensated banking officials for assistance provided in previous elections. Furthermore, it had the advantage of maintaining political tranquility among the banks and between the banks and the LUA. In some communities, these reasons continue to be as compelling today as they were many years ago. While the advantages of this arrangement are political, the disadvantages are economic, which can produce very ineffective cash and investment management programs and inefficient operations. These are some of the disadvantages associated with the sharing arrangement:

- Reduces the ability to pool cash for improved investment earnings.**
- Requires minimum account balances be maintained for each account, thus reducing potential investment earnings.**

- **Administrative processing costs associated with handling multiple accounts can be significant.**
- **Prevents pooling of cash to cover unforeseen cash emergencies.**

In summary, multiple accounts can result in lost interest, reduced yields due to smaller amounts being invested, and additional personnel costs associated with maintaining records. Although the sharing method occasionally may be politically advantageous and economically acceptable when invested funds legally must be segregated, generally it is discouraged since no one gains. None of the banks acquire sufficient deposits to make the endeavor profitable, and the LUA does not earn sufficient interest to offset the cost and inefficiencies encountered.

Rotating Services Between Local Banks. Some LUAs elect to rotate the banking business to each bank within the community on an annual or other periodic basis. Rotating banking business, although not as common, is preferable to the sharing arrangement. Under this arrangement, the accounts are maintained in one bank in the city or county which houses the LUA and then periodically rotated to other banks. Usually this rotation occurs without the benefit of bidding. Once again, competition is limited, and the local banks are not motivated to offer additional or improved banking services to the LUA.

In comparison with the sharing method, the rotation method has several advantages. Some of the advantages of this policy basically are the opposite of the above policy:

- **Certain efficiencies are achieved by having all accounts with one bank.**
- **Processing costs associated with multiple banks are reduced.**
- **Investment earnings have the potential to be increased.**

The disadvantages of this type of policy are:

- **Rotation generally is based on informal policies that are subject to change.**
- **The rotation policy may not include a process for handling new banks or mergers.**
- **In larger LUAs, the rotation period is usually one year long since there are more banks.**
- **There may be disagreement over the length of the rotation period for each participating bank (i.e., a larger bank might object to having the same rotation period as that of a smaller bank).**

Although preferable to the sharing method, the rotation method is not the best approach for an LUA to use in obtaining banking services. The rotation method is in reality just another means to achieve political peace with the local banking community and has only marginal financial benefits to the LUA. However, rotation might serve as a way to increase competition and eventually lead to a bidding process.

Issuing a Banking Request for Proposal. Generally, choosing a depository through the issuance of a request for proposals is considered the best method from a sound financial management standpoint.

The primary advantages to this policy include:

- **Additional interest earnings resulting from:**
 - **Improved yields.**
 - **An overall increase in amounts available for investments.**
- **Additional bank services available for the same amount of bank service charges or compensating balance remaining at the bank.**
- **Reduced bank service charges/compensating balance requirements.**
- **An overall increase in efficiency of cash management operations. A sample policy relating to choosing depositories follows:**

"Biennially, the superintendent will issue a request for banking services to all qualified financial institutions located within a reasonable distance from the district's facilities. The award of banking services will be made solely on the response to the request for proposal. After a depository is chosen, a banking services contract will be negotiated and approved by the board."

Should Investments be Purchased on a Competitive Basis?

As a general rule, competition results in a higher interest return for the LUA. Usually, the purchase of short-term investments is not incorporated in the banking services agreement as discussed above. The most common investment instruments used by LUAs when investing in the short-term are certificates of deposits and treasury bills. Most banking institutions offer these types of investment instruments, so LUAs just invest through their local bank without competitive bidding. However, it is recommended that competitive bidding be used each time investments are made. A sample investment policy regarding competitive bidding might be:

"Before the superintendent invests any surplus resources, a competitive "bid" process will shall be conducted. If a specific maturity date is required, either

for cash flow purposes or for compliance with maturity guidelines, bids will be requested for instruments which meet the maturity requirement. If no specific maturity is required, the superintendent shall endeavor to obtain the best available return on the investment.”

Should Georgia Fund 1 (Local Government Investment Pool) be Utilized?

The Georgia Office of Treasury and Fiscal Services provides the opportunity for all local governments including LUAs to combine their cash assets with the state's cash assets for investment purposes. Georgia law (O.C.G.A.36-83-8) authorizes LUAs to participate in this investment pool, known as "Georgia Fund 1 (GF1)." Georgia Fund 1 has a maximum maturity of sixty days. In addition, the Georgia Extended Asset Pool (GEAP) is also available and has maturities ranging from six to eighteen months. Some of the advantages for using these investment alternatives include:

- Safety - Investments authorized by statute for the GF1 and GEAP are essentially the same as those for purchased by local governments individually.**
- Higher Interest Rates - By pooling of LUA resources into the GF1 or GEAP, a pool large enough to invest in diversified instruments at higher rates is created. Usually, the larger amount of the investment, the greater the yield.**
- Liquidity - LUAs are able to withdraw their resources invested with the GF1 within twenty-four hours after their request.**
- Investment Expertise - Personnel working with the GF1 and GEAP are well trained and LUAs are able to utilize this same full-time expertise.**
- Monthly Statements - Monthly, LUAs receive statements of their account activity.**

When LUAs are investing surplus resources, it is suggested that the current interest rates earned by GF1 and GEAP be reviewed to determine if the rates of return are higher than those available from other institutions. However, the GF1 cannot guarantee rates for selected time periods (i.e., 60 days). GF1 does provide comparisons of their rate of return on a monthly basis for the last four years with average Standard & Poor's Rated Government Investment Pool Index. This comparison can assist with past analysis performance. A sample policy relating to the use of LGIP follows:

"The superintendent will utilize the Georgia Fund 1 anytime the rate of return is higher than the rate determined through requests from banks."

What Should the Contents of General Investment Policies Include?

The most common cash management policy is the investment policy. It should clearly state the objectives of the investment activity, assign responsibility, establish internal controls, define safekeeping and collateral procedures, and establish a system of monitoring and reporting performance. Investment policies usually establish limits on the maximum maturity for investments and guidelines for diversification of maturity schedules. They also define the instruments in which the LUA may invest and requirements for diversifying the portfolio between these different instruments and among financial institutions. Many investment policies set standards for selecting and monitoring securities dealers and brokers and guidelines for making individual investment decisions.

Because of the potential of losses as a result of poor investing practices, all LUAs should have written, approved investment policies. An investment policy could include the following considerations:

- **Scope**
- **Objectives**
- **Reporting**
- **Investment instruments**
- **Relationships with banks and dealers**
- **Maturities**
- **Diversification**
- **Delegation and authority**
- **Prudence**
- **Ethics and conflicts of interest**
- **Internal controls**
- **Investment committee**
- **Safekeeping and custody**
- **Performance evaluation**

Investment policies of smaller LUA's may not need to address all of these issues. Each of these

issues is explained briefly below:

Scope. The policy should explain which funds are included in the adopted policies. This policy may not be essential for an LUA since most investments are short-term rather than long-term. However, pension trust funds and some permanent funds operated by LUAs often have long-term investments which might operate under separate policies. A sample scope policy follows:

"The financial assets of all funds maintained in the LUA shall be invested unless legally prohibited; provided, however, that cash needs shall not be impaired."

Objectives. Every LUA investment policy should contain a concise and clear statement of investment objectives. This policy should not be vague or contradictory. The foremost investment objective should be to "protect the principal." The LUA has fiduciary responsibility and stewardship for these resources and must ensure that they not be lost. A suggested policy relating to safety of principal might be:

"Safety of principal is the foremost investment objective of the investment portfolio. Each investment transaction shall first seek to ensure that capital losses are avoided, whether they be from securities defaults or erosion of market value."

The second objective, which can conflict with the first, is to maximize the return on investment. In addition, cash flow must be considered. A policy regarding rate of return can be somewhat general:

"The investment portfolio shall be designed to attain a market-average rate of return throughout budgetary and economic cycles, taking into account the investment risk and cash flow requirements."

Reporting. Investment reports provide a mechanism for school board monitoring. Generally an investment policy will require two types of reports, interim and annual. An investment report policy follows:

"The superintendent shall prepare a quarterly investment report which summarizes recent market conditions, economic developments and anticipated investment conditions. The report shall include an activity report of all transactions, as well as the outstanding investment on the last day of the quarter. By August 31 of each year, the superintendent shall present a comprehensive annual report on the investment program and investment activity. The report shall include average rates of return, comparison with applicable indices and average percentage of cash invested."

Instruments. The selection of authorized investment instruments should be addressed in an investment policy. Obviously, the first consideration is the types of investment instruments

that Georgia law allows. Georgia law (O.C.G.A 36-83-4) authorizes LUAs to invest in the following types of instruments:

- Obligations issued by the State of Georgia or by other states
- Obligations issued by the United States government
- Obligations fully insured or guaranteed by the United States government or a United States government agency
- Obligations of any corporation of the United States
- Prime banker's acceptances
- The local government investment pool established by Code Section 36-83-8;
- Repurchase Agreements
- Obligations of other political subdivisions of the State of Georgia
- Certificates of Deposit

Each of the above investment instruments are defined below:

Obligations issued by the State of Georgia or by other states. This type of investment is in the form of general obligation bonds and is not normally suited as an LUA investment as the maturity is longer than one year.

Obligations of the United States Government. There are a variety of U.S. Treasury obligations that are available to LUAs, however, U.S. Treasury bills (i.e., known as T-bills) are the most common. A T-bill is an obligation of the U.S. government to pay the bearer a fixed sum on a specific date. T-bills are short-term obligations issued at a discount from their par maturity value. For example, a one-year T-bill issued at a 6 percent discount with a \$100,000 maturity would be sold initially at $100 - 6 = 94$ for a price of \$94,000 and a total return to maturity of 6.38 percent (i.e., .06 divided by .94).

Treasury bills are auctioned weekly, with cash settlement required on Thursdays. Each weekly auction of T-bills includes 4-week, 13-week and 26-week maturities. LUAs may purchase T-bills at the auction by submitting bids through dealers or banks, or directly through the Treasury.

Normally, LUAs purchase the bills in the secondary market. The secondary market for T-bills is the market between dealers, banks and investors. This over-the-counter, telephonic market

has no centralized marketplace like a stock exchange. Instead, buyers and sellers conduct their business over the telephone or other electronic media. Commissions are not paid; instead, the dealer collects a profit by matching buyers and sellers and collecting a small spread between the two. The advantage of the secondary market for public investors is that they can purchase the T-bills on any day of the week, and likewise can sell a T-bill on any day instead of waiting for maturity.

Ordinarily, T-bills are used only when no alternative form of investment yields a higher rate. This is because T-bills are considered risk free and very liquid instruments with a high degree of marketability. Therefore, their yields tend to be the lowest of all money market instruments. Thus, many LUAs elect alternative investment securities to obtain higher yields. T-bills do offer excellent collateral for bank deposits and repurchase agreements, however. Sometimes, when the interest rate spread between T-bills and other instruments such as bank deposits is unusually narrow, investors purchase the T-bills despite their slightly lower yields, expecting that on a future date, they can sell the bills and reinvest the cash proceeds in a higher-yielding instrument at a wider spread.

A final advantage of the T-bill market is that newspapers carry the T-bill discount rates and bond equivalent yields on a daily basis for all the maturities. This disclosure enables the LUA to compare other money market instruments against the T-bill yield curve (i.e., interest rate structure).

In addition to the T-bill series, the U.S. government also issues coupon securities called notes and bonds. These instruments pay interest every six months just like municipal bonds. Unlike T-bills, which are quoted on a discount basis, Treasury bonds and notes are traded in the bond market with prices based on par equaling 100.

Notes and bonds are virtually identical in their investment features, except that notes are issued originally with maturities of 10 years or less, whereas bond maturities are longer than 10 years. LUAs rarely invest in instruments with maturities exceeding one year.

Obligations fully insured or guaranteed by the United States government or a United States government agency. In addition to the U.S. Treasury, Congress also has authorized numerous federal agencies and government-sponsored corporations (instrumentalities) to issue debt. Some of these obligations are guaranteed by the full faith and credit of the U.S. government, but most of them carry only a "moral obligation" of the Congress to protect investors. One advantage of these instruments, besides their generally higher yields, is that the investor can choose a specific maturity to match known cash flow requirements. Of these investment instruments, the most popular among governmental investors have been the Federal National Mortgage Association (FNMA or Fannie Mae), the Government National Mortgage Association (GNMA or Ginni Mae), the Federal Home Loan Bank, and the Federal Farm Credit Bank (FFCB).

Obligations of any corporation of the United States. Over 1,000 American corporations issue

unsecured promissory notes maturing in less than 270 days. These instruments are known as commercial paper, and represent an alternative to government securities and depository instruments. Obviously, because these debt instruments carry no government guarantees or insurance, they entail considerably higher credit risks. To control these risks, broad portfolio diversification is needed. Most small LUAs are unable to properly construct a portfolio of high-quality commercial paper, with each issue representing only one or two percent of the total holdings. Accordingly, many LUAs use the LGIP or money market funds as the vehicle through which to invest in commercial paper. Several rating agencies now rate commercial paper, and LUAs should restrict their investments to the highest quality (A-I or P-I) ratings.

Prime Banker's Acceptances. To finance foreign trade transactions, several large banks issue acceptances of trade bills. These instruments are usually high-quality money market securities, and usually trade in denominations of \$1 million or \$10 million. Bankers' acceptances are popular, and generally are perceived as high-quality money market securities. Of course, any crisis in the international financial community could affect these instruments more than domestic bankers' acceptances. Most banker's acceptances trade in the secondary market on a discount with maturities under 60 days. Because of their large denominations, it is difficult for small LUAs to construct a properly diversified portfolio including banker's acceptances. Only banker's acceptances that are "prime" rated are allowable investments.

Georgia Fund 1 or Georgia Extended Asset Pool, the local government investment pool administrated by the Georgia Office of Treasury and Fiscal Services. Georgia law (O.C.G.A. 36-83-8) authorizes LUAs to invest in either of these pools. Any local government, including LUAs, which has resources on hand that are not immediately needed for payment of obligations can send those resources to the GF1 or GEAP for investment. These resources are pooled for investment purposes with the objectives of preservation of capital first and maximizing income second.

At the end of each calendar month, earnings are credited to the accounts of the participating governments on a basis directly proportional to the amounts on deposit in the pool and the length of time such deposits have remained. The literature lists the following advantages of using this investment pool as follows:

- A voluntary flexible pool.
- Safety
- Higher interest rates.
- Liquidity
- Investment expertise

To participate in these pools, LUAs should contact:

200 Piedmont Avenue
Suite 1202 West Tower
Atlanta, GA 30334
Phone - (404) 656-2168
Fax - (404) 656-9048
Email - OTFSweb@otfs.ga.gov

Repurchase agreements. A repurchase agreement, despite its legal complexity, is essentially a simple, two-way transaction. An investing LUA exchanges cash to receive government securities for a specified period of time. In other words, the LUA purchases a portion of the seller's portfolio (e.g., a bank). Again care must be taken to insure that this investment can be made for overnight, for a specific term (maturity), or on an indefinite (open) basis. The interest rate paid for the use of the government's cash is determined by negotiation or bidding, and typically is related closely to the Fed funds rate on overnight borrowing in the banking network. Upon maturity, the investing LUA returns the securities and receives cash plus accumulated interest. The market value of the securities transferred to the LUA should exceed the amount invested. As a protection against fraud, the bank or dealer should not be permitted to hold the collateral securities in its own safekeeping department but should instead deliver them to an independent third-party institution.

LUAs are advised to arrange all repurchase agreement transactions through the use of a written master repurchase agreement. This document specifies the intentions, rights and obligations of both parties to the transaction, and provides remedies in the event of default. Industry experts consider a master repurchase agreement to be a vital protection against possible losses that could occur in the event of default.

Obligations of other political subdivisions of the State of Georgia. This type of investment in the form of bonds issued by local governments is also long-term and is not generally suited as an LUA investment.

Certificates of Deposit. Georgia law (O.C.G.A. 20-2-411) adds certificates of deposit as an authorized investment of LUA funds. Banks and savings and loan associations offer several instruments that can strengthen the cash management program. In fact, for years bank certificates of deposit (CDs) were the backbone of most LUAs' investment programs. As the financial marketplace becomes more complex, many LUAs are exploring additional alternatives, but many LUAs still are investing in CDs. CDs presently must mature in seven or more days.

Most small LUAs purchase non-negotiable local bank CDs, and elect maturities that coincide with payroll, accounts payable distributions or debt service payment dates. The interest rate on CDs is negotiable, although most banks post a specified rate and allow the investing LUA to

"shop the market." Most institutions pay interest using a 360-day year, but many are still known to calculate interest 365-day using a year. When comparing investment yields, it becomes important to know the basis of the interest calculation.

Although the above investments are legal, local boards may as a matter of conservatism elect to limit the types of investments the superintendent may use.

A sample policy follows:

"The superintendent may invest surplus funds in any of the following instruments (insert applicable investments from the above list)."

Relationships with Banks and Dealers. The investment policy should require a formal process be used to select depositories and broker/dealers in money market instruments. This policy is similar to that discussed above.

"The superintendent may invest idle, surplus funds through the open market, competitive procurement process, which shall include a formal request for proposals issued every two years. In selecting depositories, the credit worthiness of institutions shall be considered."

Maturities. Generally, LUAs only invest in maturities that are one year or less (except possibly for capital project resources from a general obligation bond issue), therefore this policy area is not critical. The following policy addresses maturities:

"Investments for all operating funds shall be made in maturities of twelve months or less, unless a temporary extension of maturities is approved by the board."

Diversification. The primary purpose of diversification is to reduce the overall portfolio risks while attaining market average rates of return. Diversification should consider type of investment, maturity and issuer. Although Georgia law limits the types of investments in which LUAs may invest, the amount of each investment is at the option of the LUA. This policy may be a general statement of intent,

"Assets held in the pooled funds and other investment funds shall be diversified to eliminate the risk of loss resulting from concentration of assets in a specific maturity, a specific issuer or a specific class of securities.

- Liquidity shall be assured through practices ensuring that the next disbursement date and payroll date are covered through maturing investments or marketable U.S. treasury issues.**
- The superintendent shall establish strategies and guidelines for the percentage**

of total portfolios that may be invested in securities other than U.S. treasury issues."

Though not illustrated here, a comprehensive policy addressing diversification could limit the percent of portfolio for each type of instrument, by financial institution and by maturity.

Delegation and Authority. It is important that only selected individuals within the LUA have the authority to invest resources. If a number of LUA official have investment authority, the financial policy should address this issue. For example:

"The responsibility for authorizing investment transactions resides with the superintendent, or designee, responsible for investment decisions and activities. Written administrative procedures for the operation of the program shall be developed, consistent with all investment policies. No person may engage in an investment transaction except upon written authorization from the superintendent, or designee."

Prudence. Simply stated, the rule of prudence is that the investment officer will not take any action that a cautious, well informed person, knowing all the circumstances, wouldn't take. It is important that the LUA's investment policy address this issue:

"Investments shall be made with judgment and care, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, considering the probable safety of their capital as well as the probable revenue to be derived (prudent person rule). The superintendent shall observe and apply the prudent person rule to the management of the investment portfolio."

Ethics and Conflicts of Interest. It is suggested that the investment policies address ethical conduct and conflicts of interest of LUA personnel. For example:

"Business officials involved in the investment process shall refrain from personal business activity that could conflict with proper execution of the investment program, or which could impair their ability to make impartial investment decisions. Business officials shall disclose to the superintendent any material financial interests in financial institutions that conduct business with the board, and they shall further disclose any large personal financial/investment positions that could be related to the performance of the portfolio."

Internal Controls. Generally, LUAs should maintain strict internal controls for a variety of financial activities. The local board should require LUA officials to develop and maintain a system of internal controls. The policy also can provide for periodic reviews and monitoring of the controls. A sample policy follows:

"The superintendent shall establish a system of internal controls for investments, which shall be documented in writing. The internal controls shall be reviewed by the investment committee and with the independent auditor. The controls shall be designed to prevent losses of funds arising from fraud, employee error, misrepresentations by third parties, unanticipated changes in financial markets, or imprudent actions by employees."

Investment Committee. Often, boards may not have the investment expertise to monitor an investment portfolio. Therefore some LUAs, usually the larger LUAs, have instituted investment committees. This committee might consist of board members, employees, and volunteer experts from the private sector. An investment committee policy might include the following:

"There is hereby created an investment committee consisting of (designate membership by title) who shall be appointed by the board chairperson. Members of the investment committee shall serve without compensation and shall meet at least quarterly to determine general strategies and monitor results. All written investment policies shall be approved by the investment committee before being presented to the board."

Safekeeping and Custody. Local board members will feel more secure about the LUA's investments if they know that the securities are physically safe. Investment policies typically include a clause regarding third-party safekeeping and custody of securities and collateral. A sample investment policy follows:

"All investment securities purchased by the local unit of administration (LUA) shall be held in third-party safekeeping by an institution designated as primary agent. The primary agent shall issue a safekeeping receipt to the local board listing the specific instrument, rate, maturity and other pertinent information."

Collateralization of investments/deposits. Georgia law (O.C.G.A 45-8-12) provides that there shall not be on deposit at any time in any depository for a time longer than ten days a sum of money which has not been secured by surety bond, by guarantee of insurance, or by collateral in an amount of not less than 110 percent of the public funds being secured after the deduction of the amount of deposit insurance. However, Georgia law (O.C.G.A. 45-8-11) provides that an officer holding public funds may in his discretion, waive the requirement for security in the case of operating funds placed in demand deposit checking accounts.

Georgia law (O.C.G.A. 50-17-59) prescribes the acceptable security for deposit of LUA funds as follows:

- 1. Surety bond signed by a surety company duly qualified and authorized to transact business with the State of Georgia. See**

http://www.fms.treas.gov/c570/c570_a-z.html to identify companies.

2. **Insurance on accounts provided by the Federal Deposit Insurance Corporation (FDIC) limited to \$100,000 per account.**
3. **Bonds, bills, notes, certificates of indebtedness or other direct obligations of the United States of or the State of Georgia.**
4. **Bonds, bills, notes, certificates of indebtedness or other obligations of the counties or municipalities of the State of Georgia.**
5. **Bonds of any public authority created by the laws of the State of Georgia, providing that the statute that created the authority authorized the use of the bonds for this purpose.**
6. **Industrial revenue bonds and bonds of development authorities created by the laws of the State of Georgia,**
7. **Bonds, bills, notes, certificates of indebtedness, or other obligations of a subsidiary corporation of the United States government, which are fully guaranteed by the United States government both as to principal and interest and debt obligations issued by the Federal Land Bank, the Federal Home Loan Bank, the Intermediate Credit Bank, the Central Bank for Cooperatives, the Farm Credit Banks, the Federal Home Loan Mortgage Association, and the Federal National Mortgage Association.**

Performance Evaluation. Yield objectives are important. The investment policy should require a formal reporting system to evaluate performance.

"The quarterly and annual investment reports submitted to the board shall contain sufficient information to permit an independent organization to evaluate the performance of the investment program. Every three years the superintendent shall retain an independent firm to evaluate investment performance. The purpose of this evaluation shall be to obtain suggestions for improved future performance, and to verify that investment officials have acted in accordance with the investment policy and written investment procedures."

CASH CONTROLS AND REPORTING SYSTEMS

Cash control and reporting systems, vital to the operations of all cash management programs, should have three objectives:

- **To assure the recording of cash receipts and disbursements on a timely basis;**

- To assure that sufficient funds are on hand to meet operational and capital expenditure needs; and
- To facilitate the investment of idle cash to maximize revenues, thus permitting an increase in the level of service provided by the LUA or the setting aside of funds in reserve for future needs.

By accurately reporting cash on hand and facilitating the forecasting of cash flows, cash control and reporting systems can help to identify surplus cash and potentially boost investment earnings. It is sometimes observed that only large LUAs can afford to establish and maintain an effective cash control and reporting system, but this notion is entirely mistaken. While larger LUAs must have a control and reporting system to simply account for their greater resources, smaller LUAs have an even more critical need since they lack the margin of safety and greater tolerance of error of larger LUAs. An overlooked investment opportunity, while unfortunate for a large LUA, may be disastrous for a smaller LUA because of its relatively greater dependence on each resource.

Because of the risk inherent in handling cash and investments, internal control is an important consideration, especially for smaller LUAs with fewer personnel. Independent auditors consider an adequate internal control environment essential for the reliability of financial statements.

The ability to maintain an adequate cash flow and properly invest surplus cash is one of the most important cash management functions. Cash reporting systems facilitate the performance of this function, and have the following components, each interacting and relying on the other:

- A cash accounting system;
- An investment and interest apportionment accounting system; and
- A reconciliation reporting system of cash and investments consisting of bank reconciliations and treasurer's reports.

The above concepts are discussed in Chapters III-1 and III-2.

COLLECTION, DEPOSIT AND DISBURSEMENT PROCEDURES

An effective cash management program will maximize the amount of surplus cash available to an LUA. By maximizing the amount of surplus cash, an LUA can increase its investment earnings and reduce the property tax burden. Effective collection methods are those that speed up the collection and deposit of revenues due the LUA.

Effective disbursement methods, on the other hand, are those that slow the outflow of cash

from an LUA. New technologies, particularly in the data processing and telecommunications areas, have had a significant impact on cash management during this decade. Electronic funds transfers or machines that read scannable documents can improve the efficiency of the collection process and enable LUAs to disburse funds to their creditors at the appropriate time, thereby increasing the amount of cash available for investment and possibly boosting investment earnings.

Collection Procedures

The major goal of any revenue collection system is to increase the amount of surplus cash by speeding collections to an LUA's bank account. Funds cannot be invested until checks that are deposited in an LUA's bank account are presented to the bank on which the checks are drawn. At this point, check deposits become usable cash, or collected funds. Until the LUA has usable cash, the checks deposited are considered deposit float. For the purpose of investment it is better that checks and other receivables be deposited in a single account, such as a concentration account (a concentration account is explained later in this chapter). The slow processing of such items can result in foregone revenue opportunities.

Improved collection efficiency can be accomplished in a number of ways. This section discusses the different types of collections, how LUAs can make effective use of staff, and improving the efficiency of the collections process. The first step in developing effective collections procedures is to identify the various types of collections. This is important because different types of collections place different demands on staff time. There are generally four types of collections:

- **Collections driven by services provided;**
- **Collections dictated by state or local law;**
- **Immediate and unpredictable collections; and**
- **Federal or state grants.**

Collections driven by services provided by the LUA generally involve the generation of an invoice to be returned with payment. Some examples are tuition, building rentals and some school food revenues. There are three ways to bill for these types of recurring services:

- **Pre-billing before the service is delivered;**
- **Billing upon service delivery; and**
- **Billing after service has been provided.**

The second type of collections is the result of various state or local laws and are collected on a

periodic basis. These could be property taxes and earnings from the Quality Basic Education Act (QBE). These receivables involve much larger dollar amounts per transaction than other types of collections. The timing of their collection is determined by state law.

LUAAs also receive monies from immediate and unpredictable collections. These receipts will be for such items as sale of capital assets, insurance and damage recoveries, and reimbursement for lost and damaged textbooks. Most of these involve smaller dollar amounts and represent a small percentage of total LUA collections.

The last major type of collections is those from the federal or state governments in the form of grants or other assistance. In such cases, the revenue stream may be of a limited duration and is usually governed by time of year or month.

LUAAs may want to explore methods to speed up the collections process. However, the only real option, since the QBE payments are determined by state law, is to work with the tax commissioner to ensure that taxes are remitted to the LUA as frequently as possible. See Chapter III-1, Cash Receipts, relating to laws that tax commissioners must comply with.

LUAAs not only must increase the speed of the collection of LUA receivables and revenues but also increase the speed of funds deposit, as interest does not begin to be earned until funds have been deposited in an interest-bearing bank account or used to purchase an investment security. The traditional system of collecting and depositing LUA revenues involved LUAAs collecting the revenues and then depositing them in a bank account. That method of depositing LUA monies has been altered in the last decade, with the collecting and depositing of funds occurring almost simultaneously.

No longer does it have to take days for LUA revenues to be deposited in the bank. Today banks often collect much of the revenue due an LUA and credit LUA accounts almost immediately.

Deposit Procedures

By increasing the speed of the collection and deposit process LUAAs can increase the amount of surplus cash and possibly improve investment earnings. There are three steps LUAAs can do to achieve these objectives:

- **Reduce float in receivables;**
- **Collect accurate accounting information;**
- **Take advantage of lock box processing;**

The receipt of LUA revenues can be accelerated by reducing the float that occurs in checks received. There are three types of deposit float:

- **Mail float**
- **Administrative float**
- **Collection float**

Mail float is the amount of time a payment remains in the mail system until the LUA has physical possession of the check. Mail float can be reduced by assigning post office box numbers for LUA receipts. Mail float can further be reduced by multiple pick-ups throughout the day that bring items into the processing stream faster. However, because of the type of revenues LUAs receive, this method of reducing mail float is not practicable.

It is very important that grant funds from the Georgia Department of Education be received and deposited as quickly as possible. The system uses the automated clearing house (ACH) to electronically credit the QBE earnings to each LUA's bank account on the last working day of the month except those months when the funds are transferred earlier to accommodate school vacation periods such as Christmas and Thanksgiving holidays. All other grant funds are electronically transmitted weekly.

If an LUA changes its bank account, notification in the form of a preprinted deposit slip or bank letter identifying the new bank and account number should be sent to the Georgia Department of Education, Grants Accounting Unit, 1652 Twin Towers East, 205 Jesse Hill Jr. Drive, SE, Atlanta, Georgia 30334-5050, by the tenth calendar day of the month in which the change is made. Changes received after that date will be effective the following month.

Administrative float is the amount of time necessary to process the check, and is totally under the LUA's control. Because of the limited revenue sources in LUAs, this type of float should be minimized by the prompt deposit of all collections. Whether the LUA accounting system is a paper-based general ledger system or a computerized system, there is often a time delay before checks are deposited into the LUA's bank account. From a management point of view, it is imperative to determine what information must be collected before a check can be deposited. If staff can work from a photocopy or a scanned electronic copy of the check long after the check has been deposited in the bank, the process of collecting and depositing checks can be accelerated while, at the same time, the necessary updates to the LUA's accounting records are provided on a timely basis.

Collection float is the amount of time taken by the bank to credit an LUA's bank account after a check has been deposited. In other words, the time necessary for an LUA to receive collected funds (the payor's check has cleared the bank). Collection float is a function of banking procedure. LUAs should request a bank's availability schedule which states how long checks must be deposited with the bank until the LUA has available funds.

Lock box collections involve the interception of the designated revenues of an LUA by one or

more third parties, usually a bank, to pick up remittances addressed to a specific post office box number assigned by the LUA. Lock box processing is used for high volume, daily collections and is not suited for LUAs.

Disbursement Procedures

The major goal of an LUA's disbursement system is to slow the payment of funds so that the maximum amount of monies are available for investment for the longest possible time period, while at the same time ensuring that timely payments are made.

By taking advantage of disbursement float, which is the period between the time when a check is prepared and the time when it is presented for payment. Utilizing effective disbursement procedures, LUAs can accomplish this objective. Developing an efficient disbursement system requires:

- An analysis of disbursement patterns; and
- Efficient management of disbursements.

Disbursement Patterns. An analysis of disbursement patterns can help LUAs identify disbursement float and opportunities for greater investment. Determination of payment due dates is a key component of effective disbursement management. The intent of the LUA should be to pay all invoices on time. On time means on the due date, not before or not after.

An analysis of payment due dates will identify disbursement patterns. Some of the larger payment patterns revolve around the salary disbursements, utility payments, debt service and large vendor or service providers to the LUA. This analysis will be helpful for the following reasons:

- It will determine the in-house lead time needed to prepare a disbursement document.
- It can match large disbursements with investment maturities.
- It will maximize the time before payment is due except when prepayment discounts are cost-effective.

By taking advantage of the disbursement float LUAs can potentially boost investment earnings. Disbursement float has three components:

- **Delivery float** - the time it takes to deliver a check to the payee after it has been prepared for disbursement.
- **Processing float** - the time it takes for an LUA to process an invoice for

payment.

- **Transit float - the time that it takes a check to clear the banking system, from its deposit to its deduction from an LUA's account balance.**

The efficient and effective disbursement of funds requires the use of effective disbursement procedures and the effective management of an LUA's banking arrangements. Once a data base of due dates has been established and estimates of disbursement float developed, it is necessary to determine the most cost-effective way to manage disbursements. The two main ways LUAs disburse funds are through:

- **Commercial bank checks.**
- **Electronic Funds transfers.**

Commercial Bank Checks. A commercial bank check is still the most widely used disbursement mechanism employed by LUAs today. A check is simply an order to pay money on demand to the payee from the LUA's bank account. It is not cash, but rather a credit instrument that is presented for cash.

Electronic Funds Transfers (EFT). EFT move resources between banks electronically. Because resources can be moved almost immediately, payments can be made to vendors at the last possible moment, allowing cash balances to remain for a longer time in an LUA's central bank account. EFT are particularly useful with large payments such as for debt service and construction contracts.

Other Disbursement Alternatives

One of the keys to increasing investment earnings is to centralize all LUA funds in a single, centralized bank account. In most cases LUAs will want to utilize a concentration/zero-balance account system. Under this system a concentration account is established to hold the LUA's available funds, while a number of other accounts, containing zero balances, are set up to handle disbursements. As checks are presented for payment, these disbursement accounts are drawn upon. At the end of each business day, funds are transferred electronically from the central account to the disbursement accounts to cover checks presented throughout the day. Excess funds remain in the master account of the LUA to pay banks for services. This balance is known as a compensating balance.

Direct deposit of payroll is one of the original electronic technologies available to LUAs. In direct deposit of payroll, a data file is generated by an LUA and given to a commercial bank before the disbursement date. The commercial bank then transmits the data to the local automated clearinghouse house (ACH) and moves funds from the LUA's account to the recipient's account on the designated business day.

CASH FORECASTING

Cash forecasting is an important, but often overlooked, component of an effective cash management program. Cash forecasts are projections of anticipated receipts, disbursements and cash balances over a certain period of time, typically a year. An accurate cash forecast is an important cash management tool:

- **It can improve investment earnings by forecasting the amount of cash that will be available for investment and for what time period;**
- **It can identify temporary cash deficits that require short-term debt financing.**
- **It can ensure liquidity by providing estimates of the amount of cash on hand for timely disbursements;**
- **It can enhance credit worthiness, through improved cash management practices, thereby reducing the costs of borrowing to debt issuers; and,**
- **It can warn of impending problems with the annual fiscal budget through the identification of potential revenue shortfalls or unexpectedly large disbursements that could result in budget deficits.**

There are certain difficulties in cash forecasting:

- **A tendency to think in terms of budget years, rather than actual dates of cash receipts and disbursements.**
- **The unpredictability of revenues and expenditures.**
- **Inadequate time and staff for the collection of the necessary data.**
- **Failure of key supervisors and principals to recognize the benefits of a successful cash management system.**

While all cash forecasts estimate an LUA's cash position over a period of time, they differ in the period for which cash position is measured. The three most common are annual, monthly and weekly forecasts. At the least, cash forecasts should be prepared on an annual basis with cash position estimated monthly. More frequent cash forecasting will depend on a number of factors, including:

- **The time and resources available and the user's sophistication;**
- **The amount of funds under management and other characteristics of an LUA's**

cash flows;

- **The desire to improve the cash management program;**
- **The need for accurate information regarding cash position.**

Annual Forecasts. Annual cash forecasts provide monthly estimates of cash position, including the level of positive and negative cash balances. They are useful in determining the amount of cash available for investment in instruments with maturities of 30 days or more.

Monthly Forecasts. Monthly cash forecasts provide weekly estimates of cash position. They can be used to monitor the accuracy of the annual forecast and are useful in making decisions involving investment instruments in the 0-90 day range.

Weekly Forecasts. Weekly forecasts provide daily estimates of cash position. They can be used to monitor the accuracy of the monthly forecast, and can be used for investment decision making involving instruments with maturities of fewer than seven days. The daily monitoring of cash position can improve investment opportunities and lead to greater investment earnings.

Preparing a Cash Forecast. An LUA's future cash position can be estimated through an analysis of historical patterns of receipts and disbursements and of budgeted revenues and expenditures.

The receipts and disbursements that flow to and from an LUA can be characterized as either recurring or nonrecurring. Recurring flows are regular and predictable. The timing and amount are usually known well in advance of their occurrence. In Georgia LUAs, examples of recurring flows are receipts from the state for QBE, and local property taxes and disbursements for salaries and benefits and taxes. Disbursements for vendor payments are recurring but will have larger disbursements at the beginning of the fiscal year as a result of heavy purchasing to prepare for the new school year.

Nonrecurring flows are irregular and unpredictable. The timing and amount are usually not known very far in advance of their occurrence. Examples of nonrecurring flows are receipts from the sale of an LUA's assets and disbursements for capital projects.

Accurately forecasting the timing of disbursements for these projects will be the biggest challenge facing LUAs in the development of the cash forecast. In constructing a cash forecast, information must be gathered on these flows. Information can be obtained from a number of sources including the following:

- **Monthly financial reports for the previous three years (or five years if needed) that include revenues by type and amount and expenditures made by type and amount;**

- **The current year fiscal budget for both revenues and expenditures;**
- **Capital project spending projections;**
- **Debt service expenditures if applicable;**
- **A summary of maturity dates for the current investment portfolio.**

The object of forecasting receipts is to determine the level of tax and non-tax revenues an LUA can expect to receive by month (or some other period, e.g., week) over the course of the fiscal year. In order to accurately forecast receipts, LUAs need to gather information from two sources, the current fiscal budget and monthly financial reports from prior years. A rule of thumb is to evaluate only those sources that account for 15 percent or more of an LUA's total revenues; the rationale being that the other revenue sources will not have a significant impact on the cash forecast. This usually means that only four or five revenue sources will be studied. Projecting revenues for QBE funds, property taxes, federal grants and other revenue should be adequate to project cash receipt.

The object of forecasting disbursements is to determine the amount of disbursements an LUA may expect to make by month over the course of a year. While all disbursements should be considered in the development of the cash forecast, there are several of prime importance, including:

- **Salaries and wages**
- **Taxes withheld**
- **Employee benefits**
- **Debt service**
- **Capital expenditures**
- **Materials and supplies**
- **Utility payments**
- **Other expenditures**

LUA departments and schools must assist in the development of a report that estimates disbursements by month for both recurring (such as for payroll) and nonrecurring (such as for capital projects) items.

The business official should evaluate the report of projected monthly expenditures in light of the LUA's past expenditure experience, and determine whether those projected expenditures are reasonable. Then, using expert judgment and the information at hand, a forecast of disbursements by month should be created.

BANKING RELATIONS

The success in establishing banking relations will be determined to a large extent by political considerations and capabilities of the banking community as well as the ability of the LUA to develop the best banking arrangement.

The first step in selecting the best mix of financial services is to define the available banking services. They generally consist of the four types of services:

- **Collection**
- **Disbursement**
- **Investment**
- **Credit**

Collection Services

As discussed earlier in this chapter, collection services have a primary objective of accelerating cash receipts. Banks provide a number of services designed to improve the processing of funds into an LUA. Acceleration of cash receipts is achieved by a reduction of the collection float. Electronic wire transfers and lock box systems are the two services sometimes used by LUAs. The primary objective of these services is to accelerate the availability of funds by decreasing the collection float.

Banks accept all checks subject to funds being received from the remitter's bank. Most banks, however, provide credit before the funds actually are received. This important feature should be required of banks competing for the LUA's business.

Electronic Funds Transfers (EFT) provide an excellent means of accelerating receipt and deposit of large incoming payments. Used in lieu of checks, transfers involve the electronic transmission of payments from one bank to another through the Fedwire Funds Service (the Fedwire). The Fedwire is used for several important reasons: transaction costs are generally less; there is daily settlement between banks; all banks may participate; and security of the transfer is guaranteed by the Federal Reserve, rather than by the participating banks.

Disbursement Services

Electronic funds transfers (EFT) can be utilized for delaying disbursements in much the same manner as they are used for accelerating collections. Electronic funds transfers, as compared with checks, will reduce the disbursement float rather than lengthen it, since EFT provide an additional time period in which the funds can remain invested before the transfer is made. EFT often are used for large debt service payments or large contractor payments.

Another very important usage of EFT is the initiation of investment transactions outside the local area. When an LUA wants to purchase certificates of deposit from banks in distant large urban areas (e.g., Atlanta), it will need to electronically transfer the appropriate funds. Automated Clearing House (ACH) systems can be used to process electronic payments. To date, ACH has been used primarily in the direct deposit of payroll; however, some districts use this method of disbursing travel reimbursements and reimbursements for flexible benefit plans. Direct deposit of payroll is convenient and a benefit to the employees. A concentration/zero-balance account (ZBA) structure is an excellent tool for managing disbursement float. As the name implies, all balances are maintained in the concentration account. Checks are presented against the various ZBAs which have zero balances, thus causing the ZBAs to be overdrawn by the amount of checks presented. At the end of each business day, or early the next day, funds automatically are transferred from the concentration account to each ZBA so that their balances become zero.

Ideally, the transfers from the concentration account to the ZBAs should be done automatically during the evening of the day the checks are presented. This should not present any problems, as long as the daily balance reporting system shows the transfer as having occurred and the ZBAs with zero balances. ZBAs can be established for any type of payment, the same as regular checking accounts. Typically, ZBAs are established for accounts payable and payroll. More accounts can be added, or if desired, all accounts combined into a single ZBA.

Daily deposits, regardless of the collection method, generally are deposited into the concentration account. Those deposits that are not immediately available (i.e., collected funds) will remain in the concentration account unusable until they become available. A concentration account containing both available and unavailable funds can be difficult to manage.

Funds within the concentration account can be used for either disbursement or investment, provided they are available. Any funds not needed for disbursing can be invested, either overnight or over a range of maturities. Many LUAs invest a certain percentage, or a certain amount of the available investment funds in an overnight or open repurchase agreement for liquidity purposes. Good cash management programs accelerate receipts, delay disbursements, and minimize idle balances; however, the investment practices provide the real measure of overall effectiveness. LUA should pursue a good investment program with the same zeal that goes into developing a good cash management program.

Investment Services

Investment services and specific investment techniques are available to LUAs to assist them in their investment programs. Most LUAs are accustomed to dealing with their local banks for investment services. A key issue within the investment services area is whether these services are used by LUAs more for political than for economic considerations.

Although banks offer various types of investment services to LUAs, it is widely recommended that LUAs retain the investment responsibility for themselves, or seek independent advice from an investment banker. Contracts for banking services should expressly state that the LUA reserves the right to make investment decisions with any bank or brokerage firm it chooses. Shopping for investment services should be kept separate from shopping for other banking services.

LUA officials should never lose sight of the fact that the investment services offered by banks can be accepted or rejected. LUA officials should not hesitate to consider all alternatives when they are shopping for investment services.

In evaluating these services, LUAs are encouraged to consider national money market yields and other opportunities that are available outside the local banking community.

Financial Advisory Services

Financial Advisory services are available to LUAs that borrow money for short-term (e.g., through tax anticipation notes) or long-term purposes (i.e., through general obligation bonds). Generally, these services can range from direct loans to support functions relating to the administration of an LUA's bond issue.

Negotiating For Banking Services

Almost without exception, competitive bidding will prove beneficial to LUAs and some of the benefits that can be obtained through competition are:

- **Additional interest earnings resulting from improved yields if investments are separated from routine banking services;**
- **Additional interest earnings resulting from an overall increase in amounts available for investments through better use of a bank's collection services;**
- **Additional bank services available for the same amount of bank service charges or compensating balance currently remaining at the bank;**

- **Reduced bank service charges or compensating balances as a direct result of the competition; and/or**
- **An overall increase in efficiency of cash management operations.**

There also will be certain costs associated with competitive bidding. These may include:

- **Costs related to the bidding process (e.g., staff time, legal fees, advertising, and possible use of consultants);**
- **Costs incurred when changing established procedures (e.g., forms, computer software, training, and errors arising from misunderstandings and unfamiliarity with the new procedures).**

Generally, the competitive bidding process will include the following steps:

- **Review present system and determine what bank services are desired and available;**
- **Prepare a request for proposal (RFP) and distribute to all banks in the designated area (city, county, region, or state);**
- **Hold a pre-bid conference for all potential bidders to answer questions and to clarify the RFP;**
- **Banks prepare and submit proposals;**
- **Evaluate proposals;**
- **Recommend the best proposal to the local board;**
- **Award contract to the approved bank;**
- **Execute a banking services contract; and**
- **Implement the contract.**

Money Market Funds

Though not classified as an investment instrument, some LUAs utilize money market funds. Like their retail counterparts, several investment companies offer institutional money market funds to governmental investors. Mutual funds are regulated by the Securities and Exchange Commission (SEC). Most funds require delivery versus payment for their portfolio, and conduct transactions through electronic funds transfers so that the portfolio managers and

officers never have access to the client's cash. So although they carry no federal guarantee, money market funds are an extremely safe way to invest short-term cash.

However, care must be taken to insure that the money market fund that the LUA uses only invests in securities which are allowed by Georgia statute. Unfortunately, many money market funds invest a portion of their portfolios in securities not allowed for Georgia LUAs. Usually, only money market funds that invest exclusively in government securities should be used.

Money market funds seek to maintain a constant \$1 net asset value. Under SEC-regulations, the funds must maintain an average maturity of less than 120 days, although in practice most maintain portfolio maturities averaging 30-60 days. No single instrument can be purchased with a maturity of more than one year.

INVESTMENT SAFEKEEPING

Georgia statutes require all LUA investments to be fully collateralized. Prudent LUAs avoid several risks by arranging for their investment securities to be held by an independent third party-somebody different from the bank, dealer or investment company who sells securities to you. Although dealers and local bankers may attempt to discourage you from implementing sound safekeeping practices because it raises their costs, it is important that you act to protect the public's interest. The following general guidelines apply to different investment instruments.

- *Government Securities* - Ownership of U.S. Treasury securities and some federal agency securities is recorded by computerized "book entry" on the records of a Federal Reserve Bank. The custodian bank usually will be listed on the Fed's book entry system, with the LUA ownership shown as "customer account" or "trust account." LUAs generally cannot have their own name shown on the book-entry system. Therefore, it is very important that ownership be placed with an independent party-either a financial institution other than the one acting as seller, or possibly in the trust department of a local bank (provided there is a written trust agreement). A written safekeeping confirmation should be provided for each security held by the custodian.
- *Repo Collateral* - Securities purchased under a repurchase agreement (repo) should also be delivered to an independent custodian or a bank trust department, subject to a written safekeeping/custodial agreement. LUAs should avoid "hold in custody" repos, in which the dealer or bank holds the collateral with no segregation and independent verification to protect the customer.
- *Deposit Collateral* - To protect public deposits, some states require each bank to segregate LUA securities. Collateral usually can be transferred to a Federal Reserve Bank or to a third-party bank, which protects the LUA against financial failure.

- ***Mutual Funds* - Most mutual funds employ independent bank custodians for their portfolio safekeeping. Before investing in a money market mutual fund or a short-term LUA bond mutual fund, investors should verify:**
 - **Whether the portfolio is held by an independent custodian.**
 - **Whether the fund requires delivery versus payment in its portfolio transactions.**
 - **Whether the fund purchases insurance against fraud, embezzlement and computer errors.**

These protections are offered by many mutual funds and should not be overlooked.

Summary

Managing cash and investments is a critical function of LUAs. It is important to safely earn a return on available funds while at the same time meeting required disbursement deadlines. It is important for LUA staff to be aware of state laws and accounting requirements related to cash in investments prior to setting investment policies. Many alternatives exist for earning returns on public funds; however, care should be taken to understand investments purchased.