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CASH MANAGEMENT

Synopsis

- 1) Cash management is a vital function of local government finance. Written cash management policies should be developed.
- 2) Effective cash management programs identify sources of receipts and include a system for the prompt billing and receipting of moneys.
- 3) G.S. 159-32 requires that funds collected be deposited daily unless board approval has been obtained to delay deposits until a specific amount has been collected. Deposits should be made on the last day of the month regardless of amounts on hand.
- 4) Adequate records for daily receipts and deposits should be maintained.
- 5) Use of a central depository recordkeeping system may simplify recordkeeping and maximize the amount of cash available for investment.
- 6) Use of a central depository may require only one general checking account and an imprest payroll account. Policy should require the use of as few bank accounts as possible to operate effectively.
- 7) Legal and contractual restrictions may require that bond funds and long-term funds be accounted for separately.
- 8) When using a central depository system, a method for allocating investment earnings must be selected. The allocation should be based on the equity of each member fund.
- 9) According to G.S. 159-31(b), all funds on deposit must be secured by deposit insurance, surety bonds, or authorized investment securities.
- 10) There are two methods of collateralizing public deposits. Under the Dedicated method, responsibility for monitoring collateral is the unit's, while under the Pooling method, the responsibility is the State Treasurer's.

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- 11) G.S. 159-30 authorizes the investment of public moneys belonging to all funds of a unit without restrictions on pooling of funds for investment purposes so long as the funds and the income thereon clearly remain identified with the appropriate fund. Eligible investments for local governments are detailed in G.S. 159-30(c).
- 12) The investment program should emphasize safety and liquidity first, with yield being a secondary consideration.
- 13) G.S. 159-30(d) requires a public investor to seek the highest level of ownership available.
- 14) Cash flow forecasts should be used to determine that funds will be available to meet future commitments, that an amount of idle cash will be available for investment, and the period of time that such funds will be available.
- 15) The disbursement system should be designed to allow moneys to be invested for the maximum time possible, while ensuring the timely payments of amounts due.
- 16) The cash disbursements journal should be designed to conform to the central depository records when a central depository system is used.
- 17) Strong banking relationships can be achieved through the use of formal, written banking policies. Use of the Request for Proposals (RFP) process should result in the selection of banking relationship(s) that provide the most benefit to the unit.
- 18) Evaluation of the financial soundness of institutions being considered during the bidding process is a key factor in the decision to award the bank contract. Even after a contract is awarded, it is necessary to monitor the financial soundness of the institution selected.
- 19) An effective cash management plan will include procedures for monitoring and reporting on the plan. The reporting system will address results of the plan and identify areas where adjustments are necessary.
- 20) G.S. 159-33 and 33.1 require that the finance officer submit semiannually the Report of Deposits and Investments (LGC-203), which reports on the status of deposits and investments held by the unit.

Introduction

Effective management of cash resources is a vital function of local government finance. Generating interest income, an important goal of any cash management plan, is an efficient way to increase non-tax revenues to aid in meeting funding needs. As a result of the growing instability among some financial institutions and securities dealers, it is essential that all local governments have a cash management and investment policy in place that emphasizes safety and liquidity of public funds. Earning higher rates of return should be secondary to the safeguarding of public funds. Establishing and following a plan can help to reduce the personal liability of government officials making cash management-related decisions. A written cash management policy should address five specific areas. These areas include cash receipts, cash mobilization and management of available resources (deposits/investments), cash disbursements, banking relations, and monitoring and reporting on the plan.

Cash Receipts

Local units receive a variety of revenues. These include ad valorem taxes, State-administered taxes, State and federal taxes, utility fees, and various intergovernmental revenues. As a result, collection procedures are an integral part of cash management. An effective cash management program should identify potential sources of receipts and include a system for the prompt billing and receipting of moneys due to the local unit.

Collection Process

The first step in instituting an effective collections process is to identify the various types of collections. There are generally four types of collections:

- . Collections for services provided,
- . Collections dictated by State or local law,
- . federal or State grant receipts, and
- . immediate and unpredictable collections.

Collections for services provided by the governmental unit should include such items as water service, electrical service, and garbage collection. These collections are for

recurring services and would involve the generation of a bill to be returned with payment. These collections typically represent a large portion of a unit's collection activity, both in amounts collected and in internal processing time.

Receivables resulting from State or local law tend to involve large dollar amounts and require considerable amounts of processing by staff due to the number of items handled. Some of these revenues are collected on an annual basis, such as property taxes, licenses, and permits; while others are collected quarterly, such as sales and excise taxes.

Cash receipts from federal and State grants are often predictable as to the time of receipt and the amount. Some of these collections may be reimbursements of expenditures made that originally were paid for by the unit.

Finally, units of government receive collections for such items as traffic fines, parking fines, court fines, and registration for permits. These collections usually involve small dollar amounts with prediction of collection amounts and periods being more difficult.

Methods of Collection

Efficient and effective collection procedures can speed up collection of funds and increase cash available for investment. There are several methods of cash collection that can be used.

One method of improving collection operations is by using cycle billing. Cycle billing is designed to target certain geographic areas of the unit at specific times during the billing cycle. This creates a regular pattern of generating and processing bills, and makes it easier to predict cash flows; thus, increasing amounts available for investment. (For more information on cycle billing, see User Fees, Section 55 of this manual.)

Another method of improving collection operations would be to encourage the use of electronic drafts as a means of payment for recurring charges to customers. This method would reduce the staff time required for processing receipts and is relatively inexpensive to use. The use of electronic drafts also makes it easier for cash managers to predict when cash will be received; therefore, the funds can be invested immediately. When using this method, it is even possible to have the collected amounts directly deposited to an interest bearing account, thus increasing investment earnings by eliminating float time. Collection float time can be defined as the time elapsed from the receipt of funds

by the local government until the moneys are available for investment. Collection float includes mail time, internal processing time, and check clearing time.

As a method of improving collection rates and collection speed, penalties and interest on late payments should be charged. If this is already being done, the governmental unit may consider increasing these charges as an incentive for timely payments. A system should be implemented to immediately identify and aggressively follow-up on delinquent accounts. However, it should be noted that such a system may require more staff time and additional resources.

Handling Cash Receipts

Cash collections should be recorded in a manner that will disclose the source and nature of each item and the fund to which it belongs, together with evidence of its deposit in a financial institution.

Daily Collection Report

A daily collection report should be used to record all cash receipts. Each unit's daily collection report should be tailored to accommodate the unit's particular operations and accounts. A sample daily collection report can be seen on Exhibit A. The code numbers to be used should be determined from a review of the budget, recent months' operating statements, or trial balances. Code numbers and account names should be listed in numerical sequence. The form should be completed daily with totals verified to the daily cash balance report to ensure all receipts have been posted. (see Exhibit B for a sample cash balance report). At month end, totals for the month should be posted to the general ledger. For internal control purposes, the posting date and the name of the person performing the posting should be recorded on the report.

Daily Deposits

According to G.S. 159-32, funds are required to be deposited daily. The total on the bank deposit ticket must equal the amounts entered on the Cash Receipts Journal as debits to "Cash on Deposit". (see Exhibit C for a sample Cash Receipts Journal). This will ensure that all items recorded are included in the deposit. Deposits should be made by the close of the financial institution's business day (usually 2:00 p.m.) to ensure same-day credit. Postponing the deposit will cause the unit to lose one-day's interest on the funds. The deposits by bank account and fund should be

entered on the cash balance report of the central depository record. A description of a central depository is included on pages 8-13 of this policy.

Daily Mail Collections

Reasonable internal controls should be established for the handling of funds received by mail. In order to adequately control receipts by mail, one person should open all mail and remove any checks. The person opening the mail should not be the person recording cash receipts or making daily deposits. Incoming checks should be restrictively endorsed upon receipt in order to prevent mishandling.

Effective September 1, 1988, the Federal Reserve Board issued Regulation CC, which defines endorsement standards. This regulation was issued as a result of a federal law known as the "Expedited Availability Act."

This regulation designates areas for respective parties' endorsements on the back of checks. The law prohibits any printing or endorsement in the area designated "depository bank." The purpose of this ruling is to ensure the readability of the endorsement in the event the item is dishonored and must be returned. This law affects the endorsement on all checks written by or received by a local government. The law stipulates that any dishonored item which is not returned timely as the result of any party's encroachment into the area (causing the endorsement to be unreadable) may result in the financial liability being borne by the encroacher. (See Exhibit D for an illustration of the restricted area.)

All depositors should note two special areas of concern regarding this issue. There should be no pre-printed information in the restricted area. Any lengthy pre-printed information should be printed on the front of the check due to the limited space allowed for the payee's endorsement. Secondly, all endorsements should be in the area designated for the payee. It also is required that endorsements only be in black or blue ink.

All check or remittance processing equipment vendors should be aware of this regulation. Most check printers even provide blocked areas on the back of the checks to designate the respective parties' areas. However, to avoid liability, it is important to be aware of and adhere to the endorsement requirements.

All checks received should be recorded on the daily mail collection report. The report should include detail as to the payee of the check, the drawer of the check, and the amount of the check. The checks should be totaled, with the total compared to the daily mail collection report to

identify any checks not logged. The checks and the completed report should be forwarded to the person responsible for the daily bank deposit.

Cash Receipts through Lockbox Service

Many banks offer lockbox services whereby payments are mailed to a designated post office box, picked up, and processed by the bank. These items are deposited into the local unit's account upon receipt. The documentation is then forwarded to the finance officer so that the unit's records can be updated. Using such a service can allow finance personnel more time to handle transactions presented in the office. However, the unit should evaluate the costs of such a program before entering into a lockbox processing agreement. There are several types of payments that could be collected through a lockbox service, which include utility and property tax collections. Legislation enacted during the 1991 session of the General Assembly authorizes local governments to contract with a bank or other financial institution for the collection of taxes payable. It may be advantageous to use these services during the peak time for collection of tax payments. If a local government decides to utilize lockbox services, it should negotiate a charge for these services based on the time the services will actually be used. Once an agreement has been executed, the unit should obtain check copies, deposit tickets, and any other items put into the lockbox daily. All checks received should be listed on the daily mail collection report. The checks should be totalled and compared to the total on the daily mail collection report to ensure they are all included on the listing.

Funds Received Via the State Treasurer's Electronic Payments System (STEPS) or the Governmental Moneys Transfer System (GMTS)

The State Treasurer's Electronic Payments System (STEPS) is an electronic funds transfer program used by local governmental units to electronically remit moneys due to the State (STEPS-IN) or electronically receive moneys due for the State (STEPS-OUT). The STEPS program will replace the Governmental Moneys Transfer System (GMTS), which is a system that utilizes wire transfers so local units can receive revenues from the State on a date certain with the funds being automatically invested. Those units participating in GMTS will become participants in STEPS. GMTS is a centralized process; however, the STEPS program is decentralized because local government participants deal directly with the various State agencies that are responsible for fund distributions to or from the local governmental unit.

The STEPS program allows each governmental unit to select either a local bank account or its North Carolina Capital Management Trust (NCCMT) account as the account to be debited/credited for payments due to/from the State. The Automated Clearing House (ACH) debit/credit system is used for payments to (STEPS-IN) and payments from (STEPS-OUT) the State. The first State agency to participate in STEPS was the Retirement System. All State agencies which utilize GMTS are being converted to STEPS. After the conversion to STEPS is complete, GMTS will be eliminated.

Automatic Deposits

There may be several instances where a unit receives funds via an automatic bank deposit. The receipt of federal grants is often through the use of "letters of credit", wire transfer receipts, or other direct bank transactions. In these instances, the advice from the bank will be treated as the receipt of cash by mail. Therefore, any advices received should be attached to the mail collection report upon receipt. The total of the advices should be added to the total receipts for the day and entered on the daily collection report.

Central Depository

The term central depository refers to a recordkeeping system which combines the cash and short-term investments of various unrelated funds. The central depository functions as a trust account for these funds. A central depository system is designed to simplify recordkeeping and to maximize the amount of cash available for investment. The advantages and disadvantages associated with a central depository include the following:

Advantages

- 1 - improved cash management,
- 2 - increased ability to invest funds efficiently,
- 3 - larger income from invested funds (this can help reduce property tax rates), and
- 4 - simpler cash journals to be maintained and fewer bank reconciliations to be performed.

Disadvantages

- 1 - greater chance of overdrafts in member funds, and
- 2 - additional recordkeeping required.

In considering the disadvantages, however, it should be noted that good internal controls and the use of an encumbrance system require that appropriations be checked for availability before approving invoices or making payments. Proper use of the encumbrance system should eliminate the chance of overdrafts in member funds. In considering disadvantage number 2, it is necessary to consider advantage number 4. In past years, units of government maintained numerous bank accounts to assist in accounting operations, with the growing use of EDP equipment, this is no longer recommended, especially considering the potential for reduced investment income. Under normal circumstances, the central depository should eliminate more work than it creates.

Bank Account Required

A central depository may operate with one general checking account and an imprest payroll account. (Imprest refers to depositing the exact amount needed to make payroll, with no ending balance maintained.) A local government's policy should direct that only these two accounts be used unless specific situations dictate the use of additional accounts. These situations would include: 1) considerations determined by the executive level of the unit; 2) operating reasons which indicate savings by use of an additional account, e.g. a subdivision of the unit is located near a branch of another bank, but is not located near the principal bank's nearest branch; or 3) the required use of a separate account for grant moneys or other financial assistance received. (Note: Even in this case, local officials should attempt to obtain permission from the grantor agency to allow grant moneys to be invested through a central depository account.) If the governing board feels that funds need to be kept in more accounts, it may be beneficial to limit the other accounts to certificates of deposit. This would simplify the problems of operating the central depository without drastically lessening the advantages of the additional bank.

Bond Funds

Legal and contractual restrictions may require that bond funds be accounted for separately. The Tax Reform Act of 1986 and subsequent U.S. Treasury regulations have put detailed requirements on investment earnings on the proceeds of bonds and other debt obligations. Although moneys from some bond issues are exempt from these federal requirements

(specifically the arbitrage rebate regulations) and could therefore be pooled with other moneys of a local government for investment purposes, bond proceeds that are subject to the arbitrage rebate provisions should be accounted for separately. They should not be pooled with other moneys of the unit. Placing bond proceeds in a mutual fund, such as the North Carolina Cash Management Trust is usually acceptable, but investment earnings on bond proceeds should be carefully tracked. Due to the complexity of the arbitrage rebate regulations, local officials should discuss this issue with their bond counsel.

Investment Transactions

All investment transactions of a unit are made in the same way for a central depository system as they would be if they were for the individual funds, except that amounts are invested in relation to the total of all combined cash available, regardless of the source. Investments are made for the joint benefit of all member funds, enabling smaller funds to be a part of larger investments that may earn a higher rate of return, thus allowing them to earn more investment income. Any purchase or sale transactions are made as if the central depository were the real owner. Records of individual investments should be maintained in the same manner as investment records for a separate fund.

Allocating Investment Earnings

G.S. 159-30(e) requires investment income to be allocated to the appropriate member fund. There are several methods that can be used to allocate earnings.

The simplest method, and the one that is specifically permitted by law, is allocation based on the equity of each member fund (cash balance of each fund in the central depository) at the end of the month immediately preceding the month of receipt of income. See Exhibit G for an example of how to calculate the investment earnings ratio.

This method is fair when the investment program is designed to have investments maturing in almost every month. However, if the program has only a few investments and they are large and extend over periods longer than a month, variations of the basic method may be more appropriate. These variations are described as follows:

Variation 1: Most useful when investment transactions and income are infrequently recorded (less than once per week).

This method requires that each time investment income is received during the month, income is allocated to each fund using the ratio determined in the previously described method. This would require computing the

ratio each time investment income is received. A miscellaneous receipt showing the total amount of investment income received should be created. Also, each member fund will show a credit to revenue. It should be noted that if investments are sold or redeemed at this time, both interest and principal can be included on the same receipt if received in one check.

If investments include premiums or discounts, they should be amortized on a pro rata monthly basis. Amortization is included as a change in the value of the investment and allocated to adjust income in each fund. However, if this amount is immaterial, it may be impractical to allocate it to each fund. In this case, it would probably be practical to charge the amount of the amortization to only the largest fund.

Investment income received should be posted with the other collections for the day on the daily collection report each time an allocation is made.

Variation 2: Most useful when investment transactions and income are more frequently recorded (five or more times per week).

This method requires that each item of investment income be credited to Investment Income - Central Depository as earned. If investments are sold or redeemed, interest and principal proceeds should be included on the same receipt, if they are included in the same check. The receipt should be posted with the other collections for the day. At the end of the month, the total amount of investment income received should be determined and the investment accounts adjusted for any amortization to be taken on a pro rata monthly basis. The allocation of these totals to the member funds should be computed based on the ratio determined in the original method. This method requires allocating investment income to the member funds monthly. The following entry should be posted to the general ledger and the central depository record:

Investment Income - Central Depository	xx
Revenue Code()- General Fund	xx
Revenue Code()- Water/Sewer Fund	xx
Revenue Code()- Capital Reserve Fund	xx

Central Depository Records

Once a plan for a central depository has been established, it is necessary to set up records for the depository. The central depository records constitute a complete balanced ledger. (For an example, see Exhibit E.) At the end of

each day's posting, the new balances should be computed and verified. The sum of debit balances should equal the sum of credit balances. If these do not equal, an error has been made. In the general ledger, the central depository is considered a separate fund. However, the central depository will not appear as a separate fund on any financial statements. The amounts due to each member fund would be presented as cash and investments in those funds. It also should be noted that any overdrafts in member funds should not be shown on the financial statements as negative cash. Instead, there should be a liability account called Due To Other Funds with a corresponding Due From Other Funds asset account included on the balance sheet of the lending fund.

The records to be kept in the central depository should be in any form and detail which the local unit deems appropriate. However, it is imperative that the records properly reflect the balances in the various bank accounts, investment accounts, and equity (member fund) accounts. Following these procedures should ensure that no errors go undetected at the end of each day. Some suggestions for setting up central depository records are as follows:

1. The bank accounts to be used, the forms of investment to be used, and the member funds to be included should be obtained from the resolution of the governing board setting up the central depository.
2. One column or two columns should be provided for each bank account, form of investment, and fund counted in Step 1 above.
3. The design of the central depository ledger may be adjusted as amendments to the accounting or the investment program are made by the board. (See Exhibit E for a sample Central Depository Record).
4. The design of the cash disbursements journal (see Exhibit F) should be modified to conform to the central depository record. This change will make it easier to post the daily data to the central depository record.

Maintenance of Records

Daily maintenance of records will vary slightly depending on how the central depository is designed. An example of the posting procedures required for the sample central depository are detailed below:

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1. The balances brought forward from the previous month in each account should be entered on the first line.
2. Next, the cash receipts transactions for the first business day should be entered from the Cash Receipts Journal.
3. On the next line, the cash disbursements transactions summarized for the first business day of the month should be entered from the Cash Disbursement Journal.
4. On the next line, as necessary, any journal vouchers issued during the day to transfer moneys between funds that own equities in the central depository should be entered. Each cash journal voucher should be shown on a separate line with its number in the description column.
5. Any adjustments to the accounts posted by the bank should be entered as necessary. (A running record of all adjustments to be included in a journal voucher at the end of the month should be kept.) In addition, any journal voucher affecting cash, other than the above, should be entered on the day of occurrence.
6. The balance as of the end of the day in each account should be computed and recorded. Balances should be crossfooted to determine that total debits are equal to total credits. If they do not equal, an error has been made.
7. The fund account balances should be scanned to determine if any debit balance appears. If so, this indicates a fund has made disbursements in excess of the cash and investments available to it in the central depository. Such overdrafts should not be permitted. Therefore, it is recommended that this step be completed before the day's checks are released for delivery to the payees. A critical control point in the administration of the central depository is avoiding overdrafts, and any laxity in this area may result in loss of control over cash.
8. Each official depository should have sufficient insurance and/or collateral to equal 100% of the ending balances.
9. At the end of the month, balances in the "due to" accounts on the central depository record should be compared with the related general ledger

accounts. If these do not agree, differences should be reconciled and the appropriate adjustment should be recorded by journal voucher.

**Cash Mobilization and Management of Available Resources
(DEPOSITS/INVESTMENTS)**

The objective of cash mobilization and management is to make moneys available for investment as quickly as possible and to invest these funds at the highest reasonable rates available without risking the principal. In order for this objective to be realized, procedures should be in place for 1) depositing funds, 2) investing funds, and 3) predicting cash flows.

Deposit of Funds

The first step in cash mobilization should be the prompt depositing of public funds. G.S. 159-30(b) states that "moneys may be deposited at interest in any bank, savings and loan association, or trust company in this State."

G.S. 159-32 requires daily deposits of cash receipts, unless board approval has been obtained to make deposits only when receipts on hand reach a certain level, to a maximum of \$250. It is required that regardless of the amounts on hand, a deposit should be made on the last business day of the month.

As a means of improving cash management, all deposits should be made in a single cash concentration account. This account should be a NOW account or a money market checking account to ensure that all public moneys are fully invested. Use of such an account will enable the finance officer to get a better idea of the actual funds on hand, which allows more beneficial investment decisions. Use of a cash concentration account will require the establishment of a central depository system as a means of record-keeping. (See pages 8-13 of this policy for a description of the operations of a central depository.)

All the funds on deposit must be secured by deposit insurance, surety bonds, or investment securities as required by G.S. 159-31(b). When deposits are secured according to this General Statute, no public officer or employee can be held liable for any losses due to insolvency of the depository. All demand deposits (non-interest bearing accounts) are insured up to \$100,000 through the Federal Deposit Insurance Corporation (FDIC). All time deposits (including regular savings, certificates of deposit, and interest bearing checking accounts) are additionally insured for the same amount. When a unit's

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deposits are in excess of the insured amounts, eligible securities must be pledged as collateral for the unit's funds. A complete list of eligible collateral securities pursuant to the North Carolina Administrative Code is shown on Exhibit H.

There are two methods of collateralization available to depositories. Under the Dedicated method (formerly the Option 1 method), responsibility for monitoring collateral is with the unit, while under the Pooling method (formerly the Option 2 method), the responsibility is with the State Treasurer. Use of the Dedicated method requires that a signed escrow agreement (Dedicated Method) (Form INV-94B) with a third party escrow agent be in place for each Dedicated method depository holding uninsured deposits. Also required for each Dedicated method depository is a signed "Security Agreement with Resolution" (Dedicated Method) (Form INV-94A). It is the responsibility of the finance officer to monitor periodic reports of pledged collateral for eligibility and adequate market value of the pledged securities. Under the Pooling method, depositories are allowed to secure all public deposits in one escrow account. The escrow account is used for all Pooling method depositories for all units and is established with an eligible escrow agent in the name of the State Treasurer. To establish a Pooling method account, signed "Escrow Agent Agreement (Pooling Method)" (Form INV-93B) and "Security Agreement with Resolution (Pooling Method)" (Form INV-93A) are required. Depositories may use either method; however, the depository must use the same method for all public deposits on hand. If a depository does not elect Pooling method status, it is automatically the Dedicated method. The only exception is that institutions holding deposits for housing authorities are required by the U.S. Department of Housing and Urban Development (HUD) regulations to use the Dedicated method of collateralization.

G.S. 159-31(b) provides that no securities are required for the protection of funds of a unit remitted to and received by any bank, savings and loan, or trust company acting as agent for the sole and exclusive purpose of paying the maturities of principal and interest on the bonds or notes of the unit when such funds are remitted within sixty (60) days prior to the scheduled maturity date. (Note: In some situations these moneys will have additional FDIC deposit insurance coverage.)

Knowing the financial institutions that you deal with and monitoring the security of assets held by those institutions are vital parts of cash management.

Deposits and Investments

The single primary objective of an investment program is to earn interest income on idle cash. The law specifically requires that safety and liquidity be the most important standards of the program. It requires that the money be available when needed. Short maturities and high quality investments help to assure liquidity and safety. Sound judgement and care should be exercised to reduce the risks inherent in any investment program to the lowest reasonable level. Sufficient provision should be made to allow for the conversion of investments into usable funds in case of an emergency or an unanticipated change in circumstances.

The investment program must be operated within the requirements of the law. G.S. 159-30(c) specifically lists the types of investments which a governmental unit may make and only includes investments with the highest standards of safety. Public officials should never take unnecessary risks with public moneys in order to earn slightly more investment income. In addition, finance officers should never invest in a security that they do not fully understand.

G.S. 159-30(e) permits investments of public moneys belonging to all funds of a government or public authority, without restrictions on pooling of funds for investment purposes, so long as the funds and the income thereon clearly remain identified with the owning fund. However, local law or the governing body may restrict the source, the extent and manner of pooling of funds, the manner of investing, or the investments to be made. Therefore, it is important that formal investment programs address the following:

1. All restrictions on the sources of funds,
2. The approvals required and the manner in which the investments will be made,
3. The types of investments allowed, and
4. Any standards relating to return on investment which the governing board wishes to impose.

Although the law specifically requires that the purchase, sale, or redemption of investments be transacted by the finance officer, the governing body may establish any procedures it deems appropriate to control the approval process relating to the timing, the amount, and the specific type of investment before such investment is made.

Types of Deposits and Investments

The following is a brief and general description of eligible deposits and investments for local units. These descriptions are intended to give only an overall understanding of the deposits and investments. The list is not meant to be all inclusive. G.S. 159-30(c) should be used as the definitive source to identify eligible investment vehicles.

(Continued on page 17)

Savings Accounts

The regular savings account offers a fixed rate of return and permits withdrawal at any time with no penalty. This form of investment may be used effectively by smaller units (revenues of less than \$30,000 per year) as the primary form of investment. It also may be useful to larger units as a part of the overall investment program.

Certificates of Deposit

This is a deposit evidenced by a negotiable or nonnegotiable instrument for which interest is paid. Funds are "locked in" until the certificate matures unless the unit is willing to pay a penalty for early withdrawal. Maturities range from one to twelve months, and interest rates vary according to the maturity selected and the yield currently available from U.S. Treasury obligations of comparable maturity. The 182-day "money market certificate" whose rate is based on the latest six month treasury bill rate is a type of certificate of deposit. G.S. 159-30(b) requires that deposits be made with banks, savings and loan associations, or trust companies in North Carolina only. Certificates of deposit must be insured or collateralized up to 100% of their current market value.

Negotiable Order of Withdrawal Account

Negotiable Order of Withdrawal (NOW) accounts and "Super NOW" accounts are available to all governmental units in North Carolina as official depository accounts pursuant to G.S. 159-31(a). The main differences in these two types of accounts are the interest rate, minimum balance requirements, and proper notification prior to withdrawal from the "Super NOW" account. There is often a requirement to maintain transaction reserves on these accounts that may cause interest earned on these funds to be less than on other investments. However, the advantage of a NOW account does not lie in its use as a primary means of investment, but with the idea that it enables a unit to earn interest on money in transit, either to or from other investment opportunities or in payment of ordinary obligations.

Money Market Deposit Accounts

"Money Market Deposit Accounts" (MMDA) are forms of time deposits available to all governmental units in North Carolina pursuant to G.S. 159-30(b). The characteristics of the MMDA and the "Super NOW" accounts are very similar except the "Super NOW" accounts can be used as an official depository. MMDA's are limited to a specific number of preauthorized transfers per month, with a restriction as to how many of these withdrawals can be checks.

U.S. Treasury Securities

U.S. Treasury securities are eligible investments according to G.S. 159-30(c)(1). There are two basic types of marketable U.S. Treasury securities. These are: 1) the treasury bills, which are sold at a discount and 2) the coupon issues which may be in the form of notes or bonds. These issues are direct obligations and are backed by the full faith and credit of the U.S. Government. All treasury obligations may be obtained from the various financial institutions in North Carolina that deal in government securities and from government bond dealers. The treasury securities can be sold for immediate credit and are very useful investments when a unit's cash needs fluctuate widely. Although there are many different types of treasury obligations, the most advantageous ones for local units include treasury bills, notes, and bonds.

Treasury Bills - Treasury bills provide the most liquid form of investment. These securities may be purchased with maturities ranging from a few days to one year and may be sold for delivery on the same day if the funds become needed before maturity. Bills are issued at a discount. Weekly offerings are normally made each Monday, with payment and delivery the following Thursday. Dealers in government securities provide a market for treasury bills in which purchases and sales are made at a net price expressed on a discount basis. Because of their ready marketability and the small difference between the bid and asked prices, treasury bills can usually be sold after being held for only a few days. This makes treasury bills very liquid investments.

Treasury Notes - Treasury notes are intermediate term securities with maturities ranging from one year to ten years. There are various issues available for investment with a wide range of coupons, which are payable semiannually. Notes have been used quite extensively by the Treasury because there is no interest rate ceiling on these securities as there is on Treasury bonds. Shorter term notes, those maturing within eighteen months from the date of purchase, are quite useful as investments for local governments.

Treasury Bonds - U.S. Treasury bonds may be issued with any maturity, but generally have an original maturity in excess of ten years. Some bonds that are nearing maturity may provide a good yield despite their low coupon rate since they can be purchased at deep discounts. Treasury bonds are available in registered as well as coupon form and are interchangeable. The books at the Treasury close for the transfer of registered bonds one month prior to each interest date.

Government Agency Securities

Certain direct obligations of U.S. Government Agencies and Instrumentalities are eligible investments pursuant to G.S. 159-30(c)(2). A complete listing of these agencies can be found in the General Statutes. Agency securities are usually issued at par; however, if there is a decline in bond prices they may decline in market value. Therefore, agencies are best purchased with the intent of holding them until maturity.

A few of these securities (e.g. Government National Mortgage Association) carry the full faith and credit of the U.S. Government; however, most are only guaranteed by the issuing agency. These securities usually have a yield in excess of comparable Treasury securities, but also carry a higher degree of credit risk and market risk. Credit risk is the risk that the parties to an investment transaction will not fulfill their obligation, thus making the safety of the securities decline. Credit risk exposure can be affected by a concentration of investments with any one issuer or in any one type of investment. Market risk is the risk that prices may fluctuate in the future. The single factor that most often influences market risk is length of maturity of a specific security. Usually, the longer the maturity of a security, the more volatile the price. It is important to note that "direct obligations" refers to direct debt of the issuing agency. This would include notes and debentures. Any direct debt of the agency would be disclosed in the financial statements of the agency as a liability. Specific agencies may issue securities which may be guaranteed by the agency, but which are not direct obligations of the agency. Because these securities are not direct obligations of the agency, they are often ineligible investments for local units. It is important to review carefully the prospectus of a security before investing in that security. It also may be necessary to consult with legal counsel as to whether specific offerings are in compliance with the North Carolina General Statutes before making an investment decision.

There are several types of securities issued by agencies that are commonly marketed to local governments that are not eligible investments. The Student Loan Marketing Association (SLMA) issues notes to finance student loans. These variable rate notes are not U.S. guaranteed, and the Student Loan Marketing Association is not an agency included in G.S. 159-30(c)(2). Therefore, these securities are not eligible investments for local units.

Another commonly marketed security is issued by the Federal National Mortgage Association (FNMA). It is called a Real Estate Mortgage Investment Conduit (REMIC). A REMIC Trust for which FNMA is the trustee issues the securities. Although FNMA guarantees these obligations, they are

considered "contingent liabilities" and not direct obligations of FNMA. Therefore, there is currently no authority for local governments to invest in these securities because these securities are not direct obligations and are only guaranteed by FNMA.

Savings and Loan Association Shares

North Carolina local governments also may invest in savings certificates, investment certificates, shares of, or deposits in State-chartered savings and loan associations or federally-chartered associations, that have their principal office in North Carolina under G.S. 159-30(c)(5). Units may invest in these associations only to the amount insured by the United States of America or an agency thereof or by a mutual deposit guaranty association approved by the Commissioner of Insurance of North Carolina to do business in North Carolina pursuant to Article 9A, Chapter 54 of the General Statutes.

Commercial Paper

Commercial paper is an unsecured loan or promissory note issued by finance companies and other large corporations, including bank holding companies. The money raised by issuing this paper is normally used for short-term working capital. According to G.S. 159-30(c)(6), commercial paper is an eligible investment only if it bears "the highest rating of at least one nationally recognized rating service and not bearing a rating below the highest by any nationally recognized rating service which rates the particular obligation." These ratings are A-1 by Standard and Poor's and P-1 by Moody's. Only one rating at the highest level is needed for commercial paper to be an eligible investment for a unit government; however, if an issuer has "split ratings" on its commercial paper (e.g. A-1, P-2), this would not be an eligible investment.

Interest rates offered on commercial paper reflect the issuer's needs. For instance, a very low rate in a particular maturity will discourage investors in that area. In addition, rates paid on commercial paper also reflect market conditions, as well as the relative credit risk of the issuer. For this reason, the yields on commercial paper are usually higher than those on treasury securities of similar maturities.

Bankers' Acceptances

A bankers' acceptance is by definition "...a draft or bill of exchange, whether payable in the United States or abroad

and whether payable in dollars or some other money, accepted by a bank or trust company, or a firm, company, or corporation engaged generally in the business of granting bankers' acceptance credits by the Federal Reserve Board."

A bankers' acceptance constitutes an irrevocable primary obligation of the accepting bank and a contingent obligation of the drawer and of any endorser whose name appears upon it. The bank is protected by its customer's agreement to provide good funds in advance of the maturity of the acceptance and generally also protected by the pledge of documents such as invoices, bills of lading, independent warehouse or terminal receipts, trust receipts, and other papers evidencing ownership and insurance of the goods financed.

Since a bankers' acceptance is an obligation of the accepting bank, the law limits the banks whose bankers' acceptances are qualifying investments. G.S. 159-30(c)(7) allows this type of investment "...provided that the accepting bank or its holding company is either (i) incorporated in the State of North Carolina or (ii) has outstanding publicly held obligations bearing the highest rating of at least one nationally recognized rating service and not bearing a rating below the highest by any nationally recognized rating service which rates the particular obligations." Bankers' acceptances are secured obligations with the unit of government being able to look to the bank and then to the initiating company for payment. It is, however, important for a local government to analyze the financial soundness of the financial institution issuing the bankers' acceptance.

Mutual Fund

A mutual fund is an arrangement which pools the resources of its shareholders for reinvestment in a diversified portfolio of securities. This type of investment is typically liquid, while offering a rate of return comparable to longer-term investments. G.S. 159-30(c)(8) limits participation to a mutual fund certified by the Local Government Commission. At the present time, the only mutual fund to be certified by the Local Government Commission is the North Carolina Capital Management Trust (NCCMT). For further information, the NCCMT may be reached at 1-800-222-3232.

General Statute 159-30(c)(13) authorizes the investment of bond proceeds in participating shares in mutual funds other than the NCCMT provided the funds meet specific requirements. It is required that such funds must be able to provide services in connection with the calculation of arbitrage rebate requirements under federal income tax law,

if applicable. In addition, the investments of the mutual funds must be limited to those bearing one of the two highest ratings of at least one nationally recognized rating service and not bearing a rating below that rating by any nationally recognized rating service that rates the fund (e.g. there can be no split ratings of securities held by the fund).

Repurchase Agreements

A repurchase agreement is an agreement with a bank or securities dealer to buy short-term securities from the institution for immediate delivery and to sell them back to the same institution at a higher price for a guaranteed rate of return. These agreements will be closely tailored to the special needs of both the buyer and the seller at the time of the transaction.

G.S. 159-30(c)(12) requires that the securities purchased with respect to the repurchase agreement be 1) direct obligations of the U.S., or 2) obligations for which the principal and interest are guaranteed by the U.S. In addition, it is required that the value of the underlying obligations shall be maintained at a current market value of not less than 100% of the repurchase price. In order to ensure that the value of the underlying collateral is adequate, a technique known as marking-to-the-market may be used. This would involve making daily comparisons of the market price of the underlying securities to the repurchase amount. If the price of the securities falls below the investment value, the issuer of the agreement will pledge additional collateral to make up for the shortage. This technique can help to reduce market risk by providing a means to constantly monitor the adequacy of the value of the underlying collateral. It is also stipulated that the depository issuing the safekeeping receipt is not the provider of the repurchase agreement. The law requires third-party safekeeping for the underlying collateral in order to reduce the risk that the broker will use the collateral securities for other purposes. The safekeeping arrangement should be evidenced by a written agreement that addresses delivery and substitutions of collateral. Only substitutions of eligible collateral with adequate value should be allowed.

Common Stock

Common stock is not an eligible investment for local governments pursuant to G.S. 159-30. According to an opinion from the Attorney General's Office, even if the unit receives the common stock as a gift, the unit becomes the trustee of the funds. Although such gifts are appropriate

for receipt, it is inappropriate to hold such investments. It is recommended that the unit take whatever action is necessary to ensure that there is no liability for any losses resulting from holding such an investment. The best insurance would be to follow the procedures of G.S. 159-30 and liquidate the investment so that the money can be invested per G.S. 159-30. The Attorney General's Office also suggested that even in situations where the stock is received with a condition that it be held without sale, it is possible to get a court determination to change the gift conditions. It is suggested that whenever it appears that this can be done successfully, the unit should do so. This should be accomplished by working with the unit of government's attorney.

Custody of Investments

According to G.S. 159-30(d), "securities and deposit certificates shall be in the custody of the finance officer who shall be responsible for their safekeeping and for keeping accurate investment accounts and records." This requires a public investor to seek the highest level of ownership available.

There are two types of custody: 1) physical possession and 2) custodial agreements. Physical delivery is the best way to perfect custody of an investment. However, because some securities do not actually exist in physical form, possession is not always possible. For securities issued only in book-entry form (e.g., treasuries), ownership of these securities is evidenced by the entries on the books of the depository institutions, the Federal Reserve Banks, and the U.S. Treasury. In this situation, the law requires that the unit's custodian, not the seller of the security, be the safekeeping agent and hold the securities in the name of the unit. Additionally, the custodian must have an account with the Federal Reserve and must be authorized to conduct trust business in North Carolina. Finally, the custodial relationship should be evidenced by a contract between the custodian and the governmental unit. For certificated securities (e.g., commercial paper), the law requires that the securities be in the custody of the finance officer.

Perfecting custody of investments is a vital cash management function. Adequate custody of investments decreases the possibility of suffering losses from investments of public funds. It is highly recommended that adequate consideration be given to custodial arrangements, and that these arrangements be reviewed by the unit's attorney for compliance with G.S. 159-30(d).

Forecasting Cash Flows

Cash flow forecasts are an integral part of cash mobilization and management. Cash flow forecasts are designed to provide information used in determining that funds will be available to meet future commitments, that an amount of idle cash will be available for investment, and the period of time these funds will be available. A cash flow forecast should be prepared on a continuing basis with adjustments made to reflect actual results. A rolling projection can be prepared which requires that an additional month be added to replace the month that has just passed.

It is necessary to evaluate historical patterns of receipts and disbursements when preparing a cash flow forecast. It is recommended that data from the previous 3-5 years be used. By analyzing the unit's cash position over time, a more accurate forecast can be achieved. Determining the timing of cash receipts and disbursements is crucial to effective cash forecasting. Receipts and disbursements can be classified as recurring and nonrecurring. Recurring flows are regular and predictable. Timing and amounts of such flows are usually known in advance. Examples include property tax collections and payroll disbursements. Nonrecurring flows are irregular and unpredictable. Examples would include receipts from sales of assets and capital project disbursements. Timing and amounts of these flows are usually not known well in advance.

In order to effectively forecast cash flows, it is necessary to identify these flows and gather information on historical patterns and current operations. There are several sources from which this can be obtained:

- monthly financial reports from previous years,
- current year budget (revenues and expenditures),
- capital project spending projections, and
- summary of maturity dates for investments.

Forecasting Receipts

Forecasting receipts involves determining the revenues a government can expect to receive and the period in which they are expected. The three basic steps in creating such a forecast include reviewing the annual budget, developing an historical analysis of receipts, and creating a forecast of expected receipts. In order to do this it is necessary to evaluate revenue sources. These sources can include the following:

- . property taxes,
- . sales and use taxes,
- . excise taxes (deed stamp),

- . federal and State financial assistance,
- . user fees, and
- . other revenues.

When evaluating these revenue sources, an analysis of recent revenue collection history is a good means of determining when revenues are most likely to be collected. It is crucial to identify types of receipts with the period of expected receipt when forecasting cash flows. However, it may be impractical to forecast every type of receipt, thus making it necessary to summarize receipts into categories. By grouping smaller receipts into categories, a forecast can be done for all receipts. This should increase the accuracy of the forecast. When forecasting receipts it is important to take into account any unusual revenues that would distort the analysis.

Forecasting Disbursements

There are several steps to follow when forecasting disbursements. The first is to evaluate the annual budget. It is also necessary to obtain a report of projected expenditures and a time table for these expenditures from the various departments. A historical analysis of disbursements will identify any patterns that must be considered in the forecast. Finally, after evaluating the information obtained in the steps described above, a disbursement forecast can be created.

Although limits on expenditures can be obtained from the annual budget, predicting the timing of these disbursements, which is crucial to cash forecasting, will require working with the staff of other departments. Both recurring and nonrecurring disbursements should be considered. Some of the types of disbursements to consider include:

- . salaries and wages,
- . payroll taxes,
- . debt service,
- . capital expenditures,
- . materials and supplies,
- . pension and employee benefit plan payments,
- . utility payments, and
- . other expenditures.

As with forecasting receipts, it may be impractical to forecast every type of disbursement. It may be beneficial to combine some disbursements and forecast for the entire category. Any nonrecurring or unusual disbursements should be considered since they could distort the analysis.

Once the historical data is analyzed and all trends are identified, the annual budget will be used to predict future cash flows. Future projections will be compiled in the cash projection report. The cash projection report should be reviewed as actual figures become available with all necessary adjustments made accordingly. Actual data should be compared to projections in order to make investment strategy decisions. It is important to have a safety margin built into the maturity schedule of investments in case unforeseen expenditures arise.

The staff of the LGC has developed basic Excel templates for cash flow projections. Please contact the staff if you wish to obtain a copy.

By periodically reviewing the unit's financial condition, the finance officer may recognize potential problems before they develop. Using the cash flow forecast should provide the finance officer with the necessary information for making informed investment decisions, thus increasing investment earnings for the unit.

CASH DISBURSEMENTS

The major goal of a government's disbursement system should be to slow the payment of funds so that funds are available for investment for the maximum time possible while ensuring that timely payments are made. Finance officers should not pay invoices early or late, but on the due date. Early payment results in the loss of interest income on the funds used to pay the bills, and late payment may result in interest charges or late fees on the amounts owed. An effective disbursement system generally involves two considerations:

- . an analysis of disbursement patterns, and
- . efficient management of disbursements.

Analyzing Disbursement Patterns

An analysis of disbursement patterns can help local governments identify both disbursement float and opportunities for increased investment earnings. By reviewing types of payments and due dates, the cash manager can create a record of due dates. This record can help in determining in-house lead time needed to prepare a disbursement. It also will allow cash managers to match large disbursements with investment maturities. By doing this, funds can remain invested until the disbursement is to be made.

Cash managers may also take advantage of disbursement float in order to earn more investment earnings. An analysis of disbursement patterns can allow a unit to use disbursement

float to its advantage. Disbursement float can be defined as the time that elapses from the moment the governmental unit cuts the check for payment until the time the check clears the banking system. When considering disbursement float, it is important to be cautious in estimating float times, thus reducing the risk of overdrafts due to incorrect estimates.

Managing the Disbursement of Funds

There are several methods that local governments may use to disburse funds. The two most common are by commercial check and wire transfer.

Payment by commercial bank check is probably the most popular disbursement method. A check is simply an order to pay money on demand to the payee from the payor's bank account. It may be advantageous to use a zero-balance account when making specific disbursements by check. Under this system, a concentration account is set up to hold the unit's available funds. Another account or group of accounts containing zero balances are set up to handle disbursements. Funds are transferred electronically from the concentration account to the zero-balance account to cover checks presented for payment. Excess funds remain in the concentration account and often serve as a compensating balance to pay for bank services provided.

Wire transfers move funds between banks electronically. Because wire transfers allow funds to be moved immediately, payments can be made at the last possible minute. This may produce increased investment earnings by allowing funds to remain invested for longer periods. However, wire transfers are costly and are probably not cost-effective for small transactions.

Direct deposit is another way local units can manage funds disbursement. Direct deposit of payroll is the most common example. In this method, a data file is generated by the governmental unit and given to the bank prior to disbursement date. On the designated payment date, the bank will use the Automated Clearing House (ACH) system to move funds from the government account to the recipient's account. Once again, by knowing a specific payment date and leaving funds invested until that date, investment earnings can be increased.

Another method of managing the disbursement of funds is through the use of purchase orders. Under North Carolina law, purchase orders must be signed and approved by the finance officer. This requirement can greatly reduce unnecessary purchases and help to keep inventory levels at a minimum. Because payments are made after the goods or

services are delivered, moneys are in the unit's possession for longer periods and can remain invested longer. In addition, use of the preaudit certificate ensures that there is an appropriation authorizing the purchase. Purchase orders should be prenumbered for internal control purposes. No invoice should be paid unless it is supported by a purchase order bearing a preaudit certificate signed by the finance officer.

Processing Vendor Invoices

When vendor invoices for goods or services are received, several procedures should be performed.

1. The purchase order copy and the receiving report should be obtained and compared to the invoice. The description, quantity, and price of each item on the invoice should agree with the same information on these reports. Any discrepancies should be resolved.
2. The invoice should be checked for accuracy.
3. The code number of accounts to be charged on the invoice should be entered.
4. Corresponding purchase orders, receiving reports, and invoices should be filed in a manner that makes them easily accessible.
5. Cash discounts available for early payment should be taken unless the loss of investment earnings due to early payment is greater than the cash savings from the discount.

Petty Cash Reimbursements

Requests for petty cash reimbursements should be accompanied by petty cash vouchers, supporting receipts, and a summary sheet indicating the code numbers and amounts to be charged to each account. Petty cash vouchers should have authorized approvals. It would be wise to check code numbers on larger items and to run an adding machine tape on the amounts and compare the total to the summary sheet.

Miscellaneous Disbursements

Miscellaneous disbursements are those not usually based on an invoice or other formal request for payment from an outside source. As a result, it is necessary to prepare a check request giving facts and reasons why the payment

should be made. Any justifying documentation should be attached. Examples of such payments with typical documentation are as follows:

- A. REFUNDS - Cash has been received from an outside source in excess of the debt to the unit. The documentation should include date and number of cash receipt, date and number of the invoice or tax bill, and reference to the minutes of the governing board meeting when the refund was authorized.
- B. REFUNDS OF UTILITY DEPOSITS - Documentation includes date and number of cash receipt of original deposit, date and document number for cancellation of service, and clearance from the accounts receivable and billing department that no outstanding bills exist.
- C. PAYMENT OF PAYROLL TAXES AND WITHHELD AMOUNTS - Includes FICA, withheld federal and State income taxes, hospitalization or other insurance, garnishments, or other amounts withheld from employee salaries. Documentation consists of dates and reference numbers of payroll journals, tax or retirement reports, and calculations of the amounts to be paid.
- D. DEBT SERVICE PAYMENTS - Payment of principal and interest. Documentation includes notice of payments due from fiscal agent and/or the Local Government Commission.
- E. PURCHASE OF INVESTMENTS - Documentation includes brokers advices, invoices, and bank memoranda.
- F. PAYMENTS ON CONTRACTS - Paying progress billings and final invoices on large contracts. Documentation includes requests from contractors, necessary legal, architectural, and engineering approvals, memos indicating that special provisions have been fulfilled and any necessary calculations.

Preparation of Checks

All payments to be made on a particular date should be reviewed for proper approval. Payments should be totalled by bank account (if a central depository is used, liabilities should be totalled by fund). Next, it should be determined that cash is available in each fund and each bank account. The payment should be reviewed to see that it was previously encumbered or that a sufficient unencumbered balance remains so that a preaudit certificate can be signed. A voucher check for each payee which includes such information as the invoice number, amount, cash discount taken, and net amount of each item paid should be prepared.

If there is no invoice, a description sufficient to explain the purpose of the payment should be provided. Duplicate copies of the checks should be retained along with any supporting documentation. Original checks and supporting documentation should be submitted to the person(s) authorized to sign checks. It is a good idea to check once again for a signed preaudit certificate. Third copies of the checks can be maintained in numerical order for quick reference.

Cash Disbursements Journal

It is recommended that the Cash Disbursements Journal be formatted to show date, payee, check number, a credit column for each bank account and a debit column for each fund. (See Exhibit F for a sample journal.) If a central depository is used, the Cash Disbursements Journal should be designed to conform to the central depository records. It is intended that the total credits to each Cash on Deposit account will be posted from the Cash Disbursements Journal to the general ledger at the end of the month. However, other charges and other credits should be made to the general ledger from the voucher check copies.

Using the voucher check copy listing, each check should be entered in numerical order. There will be a credit to Cash on Deposit and a debit to expenditures for each fund as appropriate. Amounts credited to each official depository for the day should be summarized and posted to the Daily Cash Balance Report. (If a Central Depository is used, the day's disbursements should be added and crossfooted to ensure that debits equal credits. The balance of the last day should be added to the previous month-to-date total. The amounts should be crossfooted. The total obtained above should be posted to the daily central depository record.) At the end of each page and at the end of the month, the columns should be totalled and crossfooted. If total debits do not equal total credits, errors should be located and corrected.

Interfund Transfers

There are a number of common transactions between funds which must be provided for in the accounting system. These may include contributions to other funds, services provided by an enterprise fund to other funds, functions of the local government unit, and charges between funds of the local unit.

Supporting documents should be reviewed and calculations should be verified for all transfers. A journal voucher should be prepared for each transaction and posted to the

general ledger. Each month after balancing, each receivable should be checked against the equivalent payable. Any differences should be reconciled and necessary journal vouchers prepared to correct any errors.

Each month, all interfund transactions to be settled should be handled according to either of the two following methods:

1. If the funds are in the central depository, a journal voucher should be prepared to transfer the payable balances through the central depository to the fund to be credited.
2. If the funds are not in a central depository on or before the 10th of the month, a check should be drawn on the debtor fund in the exact amount of the interfund balance and deposited to the account of the fund to be credited.

Amounts should be checked to determine that the interfund balances have actually been liquidated in both funds.

BANKING RELATIONS

An essential part of any cash management program is the establishment of positive banking relationships. To obtain the best banking arrangements, a local unit must be aware of the types of services needed by the unit, as well as the types of services available at the financial institutions in the local area. In some cases, it may be necessary to look beyond the local area for desired services. Once desired services are determined, the unit can develop a request for proposal (RFP) and evaluate any bids received. This process should enable the unit to choose the relationship(s) that would be most suited to the local government's needs.

The development of strong banking arrangements should be the result of formal, written policies. Some general points to consider when developing policies for banking arrangements are listed on the next page:

1. The current banking arrangement (or policy) should be examined, noting the reasons why the arrangement exists. An analysis should be performed to determine if the reasons are still valid or if revisions are required.
2. Using the existing resources of the financial institution(s), determine the type of banking arrangement that should be developed. In this

step, the use of a formal bidding process is recommended.

3. A plan for revising the current banking arrangement should be developed in the planned banking arrangement.
4. A consensus of all parties concerned in the decision-making process should be obtained. Generally, this includes the chief executive officer, such as the city or county manager, and key legislative members, such as the mayor or chairperson of the finance committee.
5. A request for proposals for banking services (RFPs) should be prepared according to the plan developed in step 3 above. Services needed by the local government should be incorporated into the RFP.
6. The proposals should be evaluated and the banking services awarded to the financial institution(s) that demonstrate they can handle the business in the most cost-effective manner.
7. The financial institutions that have been awarded the contract should be monitored for compliance with the specifications contained in the RFP, and for any new services that may become available in the banking industry.

Early in the process of developing banking policies, it is necessary to know the range of banking services available. Deregulation in the banking industry has enabled financial institutions to offer a variety of services not previously offered. By knowing the types of services available, the mix of financial services best suited for the unit can be selected. Financial services can be categorized as follows:

- . collection services,
- . disbursement services,
- . investment services, and
- . credit services.

Each category has several services offered. (See Exhibit I for a list of services by category.) This list of services should be reviewed to identify any that may be used by your unit.

Negotiating for Banking Services

As more services have become available, competitive bidding in selecting financial institutions has become widely used

by governmental units. The benefits associated with competitive bidding include:

- . additional services are available with no increase in service charges or compensating balances,
- . reduced service charges or compensating balances as a result of competition,
- . additional interest earnings due to increased amount of moneys available for investment, and
- . an overall increase in efficiency of cash management operations.

Once it has been determined which banking services the unit desires, it is time to begin the request for proposals process. In developing a RFP, it is necessary to incorporate the desired services into the proposal. Although each unit's RFP will be tailored to meet the needs of that unit, some common variables which should be defined in the RFP include:

- . terms of the contract, with specified provisions for renewal and for selected cost increases,
- . availability schedules,
- . formula for setting the daily repurchase (sweep) agreement for investing idle funds,
- . provisions to handle interest reimbursement on failed wire transfers,
- . defining the reserve requirement to be used in the compensating balance formula, and
- . defining the earnings allowance to be used in the compensating balance formula.

There are several topics that should be covered in the RFP. The RFP should contain a section detailing some general information that is pertinent to the proposal. This general information should include:

- . background information,
- . objectives of the bidding process,
- . bidding instructions,
- . bid evaluation/selection criteria,
- . length of contract period, and

. terms and conditions of the contract.

It is also the responsibility of the local unit to provide statistical information relating to monthly volume. This information will be helpful when institutions are pricing services.

The next section of the proposal should include a list of desired services. The RFP should briefly describe how the service should operate. Any deadlines or time constraints for receiving specified services should be indicated. It is also a good idea to obtain a cost per unit figure in this section of the proposal.

Because of the recent financial concerns surrounding banks and savings institutions, evaluating the financial soundness of bidding institutions has become increasingly important. Public funds should only be placed with financially-sound institutions. Therefore, it is necessary to evaluate the financial strengths of institutions with whom the unit is considering doing business. Because of the importance of this evaluation, cash managers should commit an adequate amount of time and resources to the evaluation process. Evaluating the soundness of financial institutions can entail studying trend analysis and ratio analysis. It is also necessary to evaluate how the institution is pricing the services provided. This analysis could show a specific method that may save bank processing costs.

It is a good idea to contact other local governments or corporate customers of the financial institutions being considered during the evaluation process. They could be good sources for determining if the institution can actually deliver what is promised. After all the requests for proposals have been received and evaluated, the contract is awarded.

MONITORING AND REPORTING ON THE PLAN

Developing and implementing cash management policies is only an initial step toward effective cash management. In order for the policies and practices to be effective, there should be some formal review of adherence to the plan with results of the review reported on a timely basis. Establishing a system of internal controls will allow the system to be monitored on a continuing basis with necessary adjustments

made as soon as applicable. Performance reporting is a vehicle for monitoring compliance with investment policies and statutory requirements.

The reporting system should address the following areas of concern:

- . Does the portfolio only include investments authorized by law and by the written policies of the unit?
- . Has the unit obtained an adequate level of return without jeopardizing safety and liquidity (market risk)?
- . Has the unit ensured that all deposits and investments are adequately insured or collateralized according to the law (credit risk)?
- . Has the unit structured investments in a way to ensure that maturities meet cash flow needs (liquidity risk)?

The answers to these questions should be yes if the cash management policy is in place and operating efficiently.

Developing a Performance Report

In order to evaluate and report on the effectiveness of investment performance, it is necessary to establish a benchmark for comparison. The benchmark chosen should be readily available, reliable, and readily comparable to the unit's permitted investments. It should behave consistently throughout a market cycle, thus indicating it is representative of that sector of the market. Using a benchmark for comparison will allow both the cash manager and the report users to evaluate the effectiveness of the cash management system.

An example of a benchmark that might be selected is the treasury bill rate. This data is continuously available, reliable, and representative of the market. The cash manager has the option of deriving the benchmark from a single instrument (e.g. the 90-day rate) or from a weighted basis of several rates (e.g., 50% on a 30-day rate, 50% on a 90-day rate). Generally, single rate benchmarks are used for portfolios of shorter average maturities (e.g. 90 days or less), while a blended rate benchmark is used for portfolios of longer average maturities. In the portfolios with longer maturities, interest rate movement has an increased importance in evaluating yield performance.

The selection of a benchmark should not become a barrier. It is important to remember that the purpose of the benchmark is to have a basis with which to compare investment performance and to determine if adjustments are necessary. For most units, a simple benchmark consistently applied and reported will be adequate.

The performance report should be straightforward and organized so the reader can go from a general overview to detailed documentation. Presenting this information to the governing board on a periodic basis can show that the cash management policy is indeed in place and functioning as was intended by the board. It also will identify any weaknesses that need to be addressed.

The report should include a brief narrative statement of results for the reporting period. This statement could address such topics as the impact of cash flows, changes in market conditions, and actions taken by the cash manager. Any key figures which provide a quick picture of results also could be included. In addition, a table describing allocations by investment categories and earning results should be included. The amount of detail needed in this section will be determined by the cash manager. To be useful in evaluating the effectiveness of the unit's cash management policies, the report should be informative and easy to understand. There is no set method of presenting this information; therefore, the performance report should be tailored to fit the needs of the unit.

"Report of Deposits and Investments" (LGC 203) and " Notification of Public Deposits" (Form INV-91)

In addition to periodically reporting to the board, there are several instances in which the finance officer is required to report to the Local Government Commission. G.S. 159-33 and 33.1 require the finance officer to submit semiannually the LGC-203, Report of Deposits and Investments, to the Secretary of the Local Government Commission. (Note: School systems also are required to submit the LGC 203 S for individual schools.) This is a report on the status of deposits and investments held by the unit as of June 30 or December 31. This information, with explanations as required, should be reported to the manager and/or governing board at the next scheduled meeting after each report has been submitted. In addition, as of June 30 every year, each unit is required to submit a completed "Notification of Public Deposit" (Form INV-90) to the Investment and Banking Division in the Department of State Treasurer. This report identifies public deposits and the depositories in which they are held. This report should be completed in triplicate with one copy going to the depository and one copy going to the State Treasurer. One copy should be retained by the unit.

DEPARTMENT OF STATE TREASURER POLICIES MANUAL
 CASH MANAGEMENT
 SECTION 30 PAGE – 37

CITY, TOWN, COUNTY OF _____
 Daily Collection Report

EXHIBIT A

<u>Code No.</u>	<u>GENERAL FUND</u>		<u>Today</u>	<u>Month to Date</u>
10 31XX 110	Taxes, Ad Valorem (Current Year)	Cr.	1100	
10 31XX 110	Taxes, Ad Valorem (1st Prior Year)	Cr.		
10 31XX 110	Taxes, Ad Valorem (2nd Prior Year)	Cr.		
10 31XX 110	Taxes, Ad Valorem (3rd Prior Year)	Cr.		
10 31XX 110	Taxes, Ad Valorem (4th & All Prior Years)	Cr.	100	
10 31XX 190	Discounts Allowed on Taxes	Dr.		
10 3260 110	Privilege Licenses	Cr.	300	
10 3280 110	Motor Vehicle Licenses	Cr.		
10 3323 330	Court Costs, Fees and Charges	Cr.		
10 3343 330	Building Permits	Cr.		
10 3740 330	Refuse Collection Fees	Cr.		
10 3831 491	Interest Earned on Investments	Cr.		
10 3832 610	Special Assessments Collected	Cr.		
	Other Receipts - detail below:			
	_____	Cr.		
	_____	Cr.		
	_____	Cr.		
10 2610 110	Taxes Collected in Advance	Cr.		
10 1101 000	Total Deposit, General Fund	Dr.	2000	
	<u>DEBT SERVICE FUND</u>			
30 31XX 110	Taxes, Ad Valorem (Current Year)	Cr.	3000	
30 31XX 110	Taxes, Ad Valorem (1st Prior Year)	Cr.		
30 31XX 110	Taxes, Ad Valorem (2nd Prior Year)	Cr.		
30 31XX 110	Taxes, Ad Valorem (3rd Prior Year)	Cr.		
30 3831 495	Interest Earned on Investments	Cr.		

30 1101 000	Total Deposit, Debt Service Fund	Dr.	3000	
	<u>WATER AND SEWER FUND</u>			
61 3713 510	Water Charges	Cr.	2000	
61 6714 510	Sewer Charges	Cr.	1000	
61 3715 520	Water and Sewer Taps	Cr.	600	
61 3716 520	Reconnection Fees	Cr.	400	
61 3831 497	Interest Earned on Investments	Cr.		
	_____	Cr.		
	_____	Cr.		
61 1101 000	Total Deposit, Water and Sewer Fund	Dr.	4000	
	<u>CENTRAL DEPOSITORY</u>			
01 1100 000	Cash on Deposit-Central Depository	Dr.	9000	
01 1101 000	Due to General Fund	Cr.		2000
01 1101 000	Due to Debt Service Fund	Cr.		4000
01 1101 000	Due to Water and Sewer Fund	Cr.		3000

Prepared By _____ Approved By _____ Posted By _____
 Date _____ Date _____

EXHIBIT B

 Unit

Daily Cash Balance Report For _____ (Bank)

	<u>Fund</u>	<u>Fund</u>	<u>Total for Bank</u>
1 Previous Day's Closing Balance	\$ _____	\$ _____	\$ _____
2 Add: Deposits Made	_____	_____	_____
3 Adjustments Increasing Cash	_____	_____	_____
4 Subtotal:	_____	_____	_____
5 Deduct: Checks Issued	_____	_____	_____
6 Adjustments Decreasing Cash	_____	_____	_____
7 Today's Closing Balance	\$ _____ =====	\$ _____ =====	\$ _____ =====
8 Today's Closing Balance of Time Deposits	\$ _____ =====	\$ _____ =====	\$ _____ =====
9 Total Balance for Bank	\$ _____ =====	\$ _____ =====	\$ _____ =====

CENTRAL DEPOSITORY RECORDS

DATE	DESCRIPTION	INVESTMENTS		DUE TO: Equity in Central Depository					WATER & SEWER DR(CR) 01-1101-000
		CHECKING ACCT. DR (CR) 01-1100-000	BANK A DR (CR) 01-1140-001	BANK B DR(CR) 01-1140-002	BANK C DR(CR) 01-1140-003	GENERAL DR(CR) 01-1101-000	DEBT SERVICE DR(CR) 01-1101-000		
	Balance	78500.00	25000.00	11500.00	20000.00	80000.00	(20000.00)	(35000.00)	
12/1	Receipts	9000.00				(2000.00)	(3000.00)	(4000.00)	
	Disbursements	(15800.00)				1200.00	1100.00	13500	
	(Daily receipts and disbursements)								
	Balance	71700.00	25000.00	11500.00	20000.00	80800.00	(21900.00)	(25500.00)	
	(Normal Daily Entry)								
12/10	Disbursements	(50000.00)	50000.00						
	(Transfer from checking to investment account)								
	Balance	21700.00	75000.00	11500.00	20000.00	80800.00	(21900.00)	(25500.00)	
12/31	Receipts	880.00				(521.48)	(130.37)	(228.15)	
	(Receipt and allocation of interest earned)								
	Balance	22580.00	75000.00	11500.00	20000.00	81321.48	(22030.37)	(25728.15)	

Note: This ledger shows daily entries being made to the central checking account and the investment accounts, with corresponding entries being made to the individual funds in the central depository. The amounts in the checking account and the investment accounts should equal the combined amounts of the individual funds.

CASH DISBURSEMENTS JOURNAL

DATE	PAYEE	CHECK NUMBER	CASH ON DEPOSIT (CENT. DEP.) CREDIT 01-1100-000	ACCOUNT CODE	CENTRAL DEPOSITORY CODE 01	GENERAL FUND CODE 10	DEBT SERVICE FUND CODE 30	WATER & SEWER FUND CODE 61	OTHER FUNDS FUND CODE X
12/1	A. Commission	1	100.00	10-4110-121		100.00			
	B. National Bank	2	1100.00	30-4130-750			1100.00		
	C. Water Services, Inc.	3	13500.00	61-7110-721				13500.00	
	D. Finance	4	800.00	10-4130-191		800.00			
	E. Supply Co.	5	300.00	10-4260-331		300.00			
	Total for Day		15800.00			1200.00	1100.00	13500.00	
	Total Month to Date		15800.00			1200.00	1100.00	13500.00	
12/10	Bank A	28	50000.00	01-1140-001	50000.00				
	(Transfer from checking to investment account)								
	Total for Day		50000.00		50000.00				
	Total Month to Date		65800.00		50000.00	1200.00	1100.00	13500.00	

Note: this journal shows the payments to vendors being recorded in the central depository and the corresponding individual funds.

ALLOCATING INVESTMENT EARNINGS

In order to allocate investment earnings, a ration must be established. This ratio method is used when using a central depository system. Below is an example of how to calculate this ratio:

	<u>Equity Amount</u>	<u>Percent to Total</u>
General Fund	\$ 21,422.42	\$ 56.66
Water Fund	\$ 9,445.10	\$ 24.98
Debt Service Fund	<u>\$ 6,940.47</u>	<u>\$ 18.36</u>
Total	<u><u>\$ 37,807.99</u></u>	<u><u>\$ 100.00</u></u>

Example:

General Fund	21,422.42 = 56.66
	37,807.99
Water Fund	9,455.10 = 24.98
	37,807.99
Debt Service Fund	6,940.47 = 18.36
	37,807.99

If investment earnings for the month totaled \$5,000, the allocation would be as follows:

General Fund	5,000 x .5666 = 2,833
Water Fund	5,000 x .2498 = 1,249
Debt Service Fund	5,000 x .1836 = 918

The new equity amount in each fund is as follows:

General Fund	21,422.42 + 2,833 = 24,255.42
Water Fund	9,445.10 + 1,249 = 10,694.10
Debt Service Fund	6,940.47 + 918 = 7,858.47

EXHIBIT H

ELIGIBLE COLLATERAL SECURITIES PURSUANT TO 20 NCAC 7

The following types of investment securities are eligible for pledging as security provided that the securities are currently eligible for investment by the depository and can be included at full value in the reserves of the depository:

- (1) Obligations of the United State of America;
- (2) Obligations of any agency or instrumentality of the United States of America if the payment of such obligations is fully guaranteed by the United States of America;
- (3) Obligations of the State of North Carolina, the N.C. Medical Care Commission, the N.C. Housing Finance Agency, the N.C. State Education Assistance Authority and the component institutions of the University of North Carolina;
- (4) Bonds or notes of any North Carolina local government or public authority issued with the approval of the Local Government Commission and not currently in default on payment of interest or principal of any of its bonds or notes;
- (5) General obligations bonds of other states whose full faith and credit are pledged to the payment of principal and interest thereof;
- (6) Bonds, notes and other direct obligations of the Federal Financing Bank, the Farm Credit System, the Federal Land Banks, the Federal Home Loan Banks, the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association, the Government National Mortgage Association, the Federal Housing Administration, the Farmers Home Administration, the United States Postal Service, the Export-Import Bank, the International Bank for Reconstruction and Development, the International Finance Corporation, the Inter-America Development Bank, the Asian Development Bank, the African Development Bank, and the Student Loan Marketing Association;
- (7) Bonds or notes of a housing authority established or to be established pursuant to Article 1, Chapter 157 of the General Statutes of North Carolina or issued by any public housing authority or agency in the United States, when such bonds and notes are secured by a pledge of an annual contribution to be paid by the United States government or any agency thereof, or bonds or notes which may be issued by a not-for-profit corporate agency of a housing authority secured by rentals payable pursuant to Section 23 of the United States Housing Acts of 1937, as amended;
- (8) Pre-refunded bonds and bonds escrowed to maturity - the issuer shall have applied for and received a re-rating of "AAA" by at least one nationally recognized rating service by reason of U.S. Government securities being escrowed with the trustee;
- (9) Special obligation bonds - if they were originally rated "AAA" by reason of U.S. Government securities being escrowed with the trustee;
- (10) Prime quality commercial paper bearing the highest rating of at least one nationally recognized rating service and not bearing a rating below the highest by any nationally recognized rating service which rates the particular obligation;
- (11) Bills of exchange or time drafts drawn on and accepted by a commercial bank and eligible for use as collateral by member banks in borrowing from a federal reserve bank, provided that the accepting bank or its holding company either:
 - (a) is incorporated in the State of North Carolina; or
 - (b) has outstanding publicly held obligations bearing the highest rating of at least one nationally recognized rating service and not bearing a rating below the highest by any nationally recognized rating service which rates the particular obligations.

In case of questions, it is the responsibility of the depository to demonstrate that the security pledged does fulfill the requirements of this Rule.

EXHIBIT I

Bank Services

Collection Services

Wire Transfer
ACH Collections
Pre-Authorized Checks
Lock Box Systems
Depository Transfer Checks
Over-the-Counter Payment Systems
Armored Car Services
Night Depository Services
Coin Counting Services

Investment Services

Money Market Instruments
Custodial Arrangements for Repurchase
Agreements
Investment Advice
Retirement Plan Services

Disbursement Services

Wire Transfers Services
Payable-Through-Drafts (PTDs)
ACH Payments
Concentration/Zero Balance Accounts
Controlled Disbursements
Account Reconciliation Services
Check Truncation
Disbursement Float Summary
Serial Check Float
Microfilm Checks
Computer Services
Balance Reporting

Credit Services

Lines of Credit
Municipal Commercial Paper
Short-Term Notes
Bond Purchases
Bond Underwriter
Bond Transfer and Registration Services
Lending Activities Related to Community
And Economic Development Projects
Leasing

EXHIBIT C

CASH RECEIPTS JOURNAL
 MONTH OF _____ 19 _____

ACCOUNT	CODE	1	31	TOTAL
<u>General Fund</u>				
Dr. Cash on Deposit	10-1101-000	2000.00	521.48	2521.48
Cr. Taxes, Ad Valorem	10-31xx-110	(1100.00)		(1100.00)
Tax Penalties	10-31xx-170	(100.00)		(100.00)
Privilege Licenses	10-3260-110	(300.00)		(300.00)
Building Permits	10-3343-330	(500.00)		(500.00)
Interest Earned	10-3831-491		(521.48)	(521.48)
<u>Debt Service Fund</u>				
Dr. Cash on Deposit	30-1101-000	3000.00	130.37	3130.37
Cr. Taxes, Ad Valorem	30-31xx-110	(3000.00)		(3000.00)
Interest Earned	30-3831-495		(130.37)	(130.37)
<u>Water & Sewer Fund</u>				
Dr. Cash on Deposit	61-1101-000	4000	228.15	4228.15
Cr. Water Charges	61-3713-510	(2000.00)		(2000.00)
Sewer Charges	61-3714-510	(1000.00)		(1000.00)
Water & Sewer Taps	61-3715-520	(600.00)		(600.00)
Reconnection Fees	61-3716-520	(400.00)		(400.00)
Interest Earned	61-3831-497		(228.15)	(228.15)
<u>Central Depository</u>				
Dr. Cash on Deposit	01-1100-000	9000.00	880.00	9880.00
Cr. Due to General Fund	01-1101-000	(2000.00)	(521.48)	(2521.48)
Due to Debt Service Fund	01-1101-000	(4000.00)	(130.37)	(4130.37)
Due to Water & Sewer Fund	01-1101-000	(3000.00)	(228.15)	(3228.15)

Note: This journal is only a sample. It only includes the first and last day of the month. A complete journal would include all days of the month. The entries on the first day represent receipt of moneys into each fund and the central depository. The entries on the last day represent the recording of interest income to each fund and the central depository.