An Introduction to Treasury Management Practices
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Treasury Management Practices

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Government Finance Officers Association
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Foreword

While many books have been published on effective treasury management guidelines, little has been written from a practical treasury management point of view on how to implement those guidelines. This publication was developed to share treasury management practices of experienced finance professionals in an effort to synthesize the Government Finance Officers Association's (GFOA) Recommended Practices with the reality of day-to-day treasury management.

Written from a practical standpoint, this publication describes six topics commonly found in the treasury function and discusses the important elements of each topic. Each section includes a definition of the topic area and is followed by a list of self-assessment questions. Government finance officers are encouraged to read the overview and then answer the self-assessment questions. These questions will highlight areas where improvements in internal controls or operational procedures may be necessary. The last section of each topic contains a list of related reference sources.

This publication represents the collective efforts of the GFOA's Committee on Cash Management, and, in particular the Subcommittee on Treasury Management. A special debt of gratitude is owed to Celeste Dunion, former chair of the subcommittee and Director of Finance, Township of Middletown, Delaware County, Pennsylvania, who envisioned this project and kept it going for several years. Dunion was assisted by numerous subcommittee members. A special thanks is extended to the following individuals whose contributions, comments and suggestions enhanced this publication: Robert W. Dulaney, current chair of the subcommittee and Cash and Debt Administrator, City of Dallas, Texas; Charles S. Cox, Director of Finance, City of Farmers Branch, Texas; Robert DeLaCruz, Treasurer, Modesto Irrigation District, Modesto, California; Navdeep Gill, City Treasurer, City of Durham, North Carolina; Denise A. Kautzer, Director of Finance, St. Paul Metro Airports Commission, Minneapolis, Minnesota; Jerry Rogers, Deputy Finance Director/Treasurer, City of Riverside, California; Nathan R. Tubergen, Director of Finance and Administrative Services, City of Billings, Montana; Marc V. Waldman, Treasurer/Collector, Town of Wellesley, Massachusetts; and Lawrence A. Wilson, current chair of the committee and Assistant Treasurer, Cash Management, Connecticut's State Treasurer's Office. We also would like to thank J. Virgil Moon, former chair of the Committee on Cash Management and Director of Finance/Comptroller, Cobb County, Georgia, for his contributions along with John Bergey, Treasury Manager, Cobb County, Georgia, for providing the cash flow forecasting example.

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Jeffrey L. Esser
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Introduction

Over the years, the Government Finance Officers Association (GFOA) has approved a set of recommended practices to be followed by finance officers in their application of the various disciplines involved in public finance, such as accounting, auditing, financial reporting, cash management, budgeting and financial management, debt management, and retirement and benefits administration.¹

The much publicized losses of public funds prove the need to carry the recommended practices in the treasury management area to a higher level. In response, the Subcommittee on Treasury Management, made up of members from GFOA’s Committee on Cash Management, has developed An Introduction to Treasury Management Practices in an effort to further educate finance professionals in the broad arena of treasury management with proper controls.

This publication is intended to serve as an introduction to sound treasury management practices and is divided into six chapters:

- Receipts,
- Disbursements,
- Banking,
- Investments,
- Forecasting and
- Computer Security.

Each chapter consists of a brief overview of the subject matter to acquaint the reader with the topic. The overview is followed by a series of self-assessment questions that were developed to heighten awareness of the topic within a government’s specific organizational structure and set of circumstances. The third part of each chapter lists reference sources for additional information on the topic. To make the most effective use of this publication, readers are encouraged to read the introductory material and then ask themselves the self-assessment questions, noting those areas where their government entity may need improvement. The reference sources act as a guide for those governments needing further information to improve their internal processes.

This publication can be used along with GFOA’s booklet of recommended practices. The GFOA encourages comments and suggestions for additional areas of public finance that could be better served by the development of GFOA recommended practices. They should be sent to the GFOA Federal Liaison Center, 1750 K Street, N.W., Suite 650, Washington, D.C. 20006 for consideration by the relevant GFOA Standing Committee.

¹GFOA’s recommended practices are available from GFOA’s home page at http://www.gfoa.org or for a nominal fee by calling 312/977-9700.
Chapter 1: Receipts

Governments collect many types of revenues in a variety of ways. This chapter describes the types of revenues and methods of collection that are available to governments, and includes a discussion on collecting delinquent revenues and using third-party collectors.

Types of Revenues

A local government receives revenue from various sources to pay for its annual operations. The most common types of revenue are the following:

Property Taxes. A local government can levy property taxes on property located within its jurisdiction. Types of property that generally are subject to taxation include real (land and buildings), personal (motor vehicles), and public utility. Property owners are billed for property taxes and, depending on the jurisdiction, may be required to pay the tax bill in one payment or in installments. Some governments offer a small discount to encourage prompt payment.

Consumption Taxes. Taxes can be levied on products and services as they are consumed. Examples of such taxes include those levied on retail sales, beer and wine, gasoline and hotel/motel services. Consumption taxes can be subject to fluctuations that reflect changes in the economy.

Mercantile, Business Privilege and Occupational Privilege Taxes. When property taxes are the only method supporting the operational functions of a community, the cost of the services may not be evenly spread to all the benefactors of the community. Thus, the mercantile, business privilege and occupations privilege taxes provide a means for more equitable taxation to all the benefactors using the services of the community.

These taxes can employ the use of a business or occupational license fee at a nominal amount and/or the use of a small millage applied to the gross receipts of the commercial accounts. If utilized, it is important that the rolls of those participating be accurate and updated on a regular basis.

Enterprise Revenues. A local government may charge fees for its business enterprises rendered to the public. Those business enterprises may include a provision for water and sewer services, landfill tipping fees and electricity. Recreation programs also may be suitable enterprise revenues. Some governments have found that offering packaged trips through bids to travel agents can be profitable enough to warrant an enterprise fund.

User Fees. User fees became popular as a response to the effects of California’s Proposition 13 in 1978 that marked the beginning of taxpayer revolts against property taxes. Today, many governments are under pressure to either maintain or decrease the property tax
rate. User fee revenue decreases the amount of taxes needed to fund services that are provided to specific users. For example, a jurisdiction may charge fees to recover the costs of particular parks and recreation programs, such as swimming lessons or picnic shelter rentals, to those that use the facilities.

It is important to have detailed documentation to justify the amount established for each user fee charged. That documentation should include the costs associated with providing a particular service and the method for pricing the service (i.e., full cost, incremental or partial).²

**Licenses and Permits.** A local government may charge fees for privilege licenses, such as business and motor vehicle licenses, as well as for regulatory permits, such as those required when building or renovating a structure. Some governments recover the full costs of a regulatory program, such as building inspections, through permit fees.

**City Income Taxes.** Some municipalities have implemented a tax on employees that work in the city but reside outside the corporate limits.

In addition, the following revenues are available to local governments for the provision of capital improvements or multi-year projects:

²For more information, reference the Introduction to the Catalog of Public Fees and Charges (Chicago, IL: Government Finance Officers Association), 1992, p. viii.

**Grants or Loans.** Typically, a grant is received either from the federal or state government to be used for expenditures for a specified purpose and in a specified time frame. The danger with using federal grants as an operating revenue is that the funding for a program is not a reliable source of revenue in the long-term. A recent example of such a federal grant program is the community-oriented police officer grant. This grant funded new police officers for a three-year period, after which time, the local government had to assume the funding.

Loan programs established with federal or state funds are available to fund capital improvements. These loans offer an interest rate that is much lower than can be obtained in the tax-exempt bond market. Some jurisdictions use federal grant programs for capital improvements in blighted areas.

**Impact Fees.** These fees are a one-time charge to developers to offset the costs of providing infrastructure needed to serve new development. The fee can be set to either recover the full or partial amount of a development cost. Impact fees can be levied for street, park, school, water, sewer, drainage and sidewalk construction. Case law governing impact fees indicates that revenue from these fees cannot be used to fund maintenance expenses or other annual operating costs.

In order to ensure that new development receives a benefit for its impact fee payment, the fees must be segregated by type and spent within a specific time frame. As with user fees, it is important to
have detailed justification for the impact fee schedule.

**Special Assessments.** A local government may charge special assessments against a property if any capital improvements are made to benefit the property. Examples of this source of revenue are water, sewer, sidewalk and street improvements.

**Escrow Accounts.** These revenues must be maintained in a separate fund and not commingled with any other accounts since the monies belong to other parties and are held to cover costs associated with the development of specific projects. (The escrow accounts described here are not third-party escrows to be used in case of default.) The expenditures of these funds are covered under the expenditure section of this booklet.

**Methods of Payment and Collections**

Governments of all types and sizes receive payments in a variety of ways from their citizens. The following payment and collection methods are fairly common among governments.

**Cash and Checks.** This is the most common method of collecting revenues from the public. The public can either mail the payment to the jurisdiction or stop by the office to make the payment in person. This method provides interpersonal contact between the local jurisdiction and the public and may speed the collection of delinquent accounts. However, technological advances and staffing issues are causing governments to move away from in-person payment acceptance to other automated applications.

**Night Deposit.** The use of night deposit drop-off sites allows the public to pay their bills after office hours. Night deposit sites should be conveniently located on the outside of a building for easy access.

**Lockbox.** This payment method allows a bank to receive and deposit payments for a government. In some cases, banks also pass payment data to the government electronically. This form of collection can be used for property taxes and enterprise billings. Lockbox collection is most cost effective for high volume billings. Invariably, some form of in-house payment processing must be maintained. The total cost of lockbox processing and in-house processing must be compared to determine which is the most cost-effective collection method.

**Electronic Funds Transfers.** Electronic funds transfers (EFT) represents the future of payments. Under this form of payment, funds are transferred from the payee to the government's bank account electronically. This collection method is cost effective and efficient because it saves staff time and banking costs, and credits the funds to the government’s bank account on a next-day basis. EFT is most effective for the collection of repetitive billings and receiving funds from the federal or state governments.

**Credit Cards.** Accepting credit card payments is efficient for the public and the government. The government is guaranteed the receipt of its funds and
the public avoids any delinquency. The biggest drawback to this payment method is that the government has to bear the burden of credit card processing fees, which reduces the net amount of revenue collected. Current efforts are underway to eliminate this problem.³

Internal Controls for Revenues Received

Generally, it is more efficient to collect all revenues at a central location. If this is not possible, receipts collected at other locations should be deposited daily either directly at the bank or with the treasurer or finance officer. In order to safeguard liquid assets and prevent fraud at the point of collection, staff should use pre-numbered receipt forms. The cashiering function should be segregated from the bank reconciliation function and check preparation function. All receipts should be recorded promptly.

The treasurer or finance officer also should conduct regular audits to insure that pre-numbered receipts are in sequence and should review revenue collections for unusual fluctuations. The treasurer’s report of monies collected should be reconciled to the cash receipts journal on a regular basis. This procedure represents an effective way to ensure that the dollar amounts actually collected by the treasurer or finance officer agree with the amount that has been recorded in the books.

Collection of Delinquent Revenues

Procedures should be in place to review unpaid accounts. Delinquent balances and persistent delinquencies should be addressed. When balances remain unpaid, measures to collect them must be in place. Collecting delinquent taxes can be a difficult task and may require the services of an outside collection agency.

Third-party Collectors

Governments may find it more cost effective to use third-party collectors for taxes, such as mercantile, business privilege, occupational privilege, per capita, amusement, personal income and various other forms of taxes that require verification of outside information. When using third-party collectors, any monies collected should be turned over to the local government as quickly as possible. Annual audits of chosen accounts can be requested to ensure the accuracy of the combined representation of the collection agency and the entity involved.

The following self-assessment questions can be used to evaluate a government’s procedures for the collection of revenues and to identify any potential weaknesses.

³Information regarding the credit card issue can be obtained from GFOA’s Federal Liaison Center, 202/429-2750.
Self-assessment Questions for Receipts

1. Does the government collect revenues at a central location?

2. Are receipts deposited daily?

3. Does the government employ collection methods that can speed up collections, such as:
   - Lockbox?
   - EFT for utility customers and for larger payments?
   - Credit card payments for services?
   - Night drop box?

4. Are pre-numbered forms used in the collection process?

5. Are distribution records maintained for all pre-numbered forms?

6. Does the government have written procedures for processing receipts?

7. Are revenue collection procedures reviewed and updated periodically?

8. Are employees that process receipts properly bonded?

9. Does the government offer discounts as an incentive for customers to prepay obligations?

10. Is the treasurer's report of monies collected reconciled to the cash receipts journal daily?

11. Does the government charge a penalty and/or interest for delinquent payments?

12. Does the government require that departments make daily transmittals of remittance information to the treasurer?

13. Is a third-party collector used? If so, is there a written agreement?

14. Are collections from each tax collector and third-party collector promptly deposited to the credit of the government?

15. Are collection instructions supplied to lockbox personnel?

16. Collections by outside agencies (banks, etc.):
   - Are the records prepared by the outside agency adequate in detail, etc.?
   - Are the records reconciled to deposits credited to the accounts?

17. Are adequate records maintained on uncollected revenue?

18. Are written procedures maintained for the collection of delinquent revenues?

19. Are procedures in place to account for all receipts, cash register tapes or other evidences of accountability?

20. Is an inventory of receipt books and forms maintained? If so, are all receipt books and forms signed for by number when issued from inventory?
Reference Sources


Chapter 2: Disbursements

The disbursement process is fairly simple to track as it follows defined steps from placing an order for goods or services to issuing the payment for those goods or services. Internal controls and safeguards can be devised for each of these easily identifiable steps.

Advances in technology have made many disbursement options possible for public cash managers. From a treasury management standpoint, disbursements should be timed so that cash is paid when a bill or obligation becomes due and should be made in the most cost effective way possible. This section will discuss controls that can be implemented to ensure that only authorized requests for payment are granted, common types of disbursements and payment methods.

General Procedures for Disbursement of Monies

Governments make many types of payments. To avoid making unauthorized payments, governments can implement certain procedures to create a check-and-balance system that ensures only authorized personnel request payments, proper account coding is affixed to payment requests, and goods and services being paid have been received.

Purchase Order System. The key to establishing an effective purchase order control system is to require a purchase order number for all purchases over a predetermined dollar amount. The purchase order form should contain sufficient information to provide audit trails for payments and to serve as a legal document to vendors. All purchase orders should be approved prior to payment. No employees should attempt to obtain a purchase order number after the purchase has been made, and no purchases (above the predetermined limit) should be allowed except through the purchase order system.

Invoice Processing Controls. Once a purchase order has been issued, the original purchase order should be mailed to the vendor, copies should be sent to the department requesting the purchase, and a separate copy should be matched to the invoice and check documentation and then filed in a vendor file.

A common procedure for handling disbursements follows: Vendor invoices should be scrutinized for mathematical correctness, validated as received by the party placing the order, and initialed for payment by the department head. Then all items are reviewed by a finance department as part of the "processing for payment" procedure. Each department should agree upon and designate the proper account coding for the charges. Payments should be made directly to the vendor listed on the purchase order. Someone other than the person preparing the checks should do the mailing preparation.
In validating the purchase orders, verification of receipt of goods in acceptable condition and/or to specifications, as well as the consistency of terms, conditions and pricing should be made. Equally important, the purchasing transaction must comply with the government’s provisions of budget and applicable budgetary laws and regulations. Also, there must be adequate appropriations to pay claims. In some cases, payments in excess of a predetermined amount require prior approval by the governing body. In those cases, payment requests must be submitted for approval by the governing body prior to payment. A listing of all payments often is released to the governing body at their regular meetings or on a monthly basis.

**Encumbrances.** Encumbrances are commitments related to unperformed contracts for goods or services and are generally initiated by the issuance of a purchase order. Encumbrances are usually associated with governmental funds, particularly general and special revenue funds.

**Personnel and Payroll System**

Procedures also must be in place for personnel and payroll systems to ensure that unauthorized payments are not made. Below is a description of controls that can help safeguard a government’s cash from unauthorized disbursements.

**Authorization to Pay.** Procedures establishing pay dates and reporting procedures should create a check-and-balance system between the personnel and payroll departments. Important information to track includes: time worked, vacation, sick time, overtime, differential pay, compensatory time and any other listed categories established by the government’s manning table, employee policy handbook or any other governing ordinances.

Forms for reporting information to payroll should establish approvals at the departmental levels prior to being processed for payroll. Pay amounts should be charged to the appropriate fund and function, and should not exceed budgetary restrictions. Payroll deductions often are used for employee benefits and employee savings options. A payroll deduction form authorizing the deductions should be signed by the employee and kept on file.

Whenever possible, employees should be offered direct deposit of payroll, which can be a cost effective option to both employer and employee. Information on how to implement a direct deposit program typically can be obtained from the government’s financial institution. Direct deposit programs are discussed in more detail in Chapter 3: Banking.

**Vacation and Sick Leave.** Governments have varying policies about vacation and sick leave. Records should be maintained on the amount of vacation and sick leave for each employee. Payroll records should agree with personnel records, and a check-and-balance system between the departments should be implemented and maintained on a regular monthly basis. The payroll department should obtain a
copy of the vacation and sick leave policies to ascertain eligibility requirements and procedures for accumulation, utilization, conversion and expiration of unused vacation and sick leave.

Check Processing

When not using electronic payment means, governments should make sure that all disbursements are made by check or warrant (with the exception of petty cash). Control should be maintained over the various check stocks by making sure all checks are pre-numbered and that an inventory is maintained by check number. In addition, a record of all checks, whether issued or voided, should be maintained. All checks and warrants should be pre-printed with the name and address of the government and, if appropriate, the title and name of the issuing officer.

Checks and warrants should only be issued after official approval is obtained and with supporting documentation of that approval. The number of authorized check signatures should be kept to a minimum. If a stamp or check signing machine is used, the signature plate should be kept in a secure area and access to the signature plate should be limited to a few authorized employees. All accounts should be reconciled on a timely basis.

Electronic Funds Transfers

The use of electronic funds transfers (EFT) and electronic data interchange (EDI) is an alternative to issuing paper checks. The Automated Clearing House (ACH) system allows entities to exchange remittance information and funds. This system is an inexpensive alternative to paper checks or Fedwires (the electronic payment system operated by the Federal Reserve banks). There are significant cost savings associated with electronic payments and include: a reduced need for printed check stock, no mailing costs, and no manual processing of checks or check reconciling. One of the main advantages of EFT is the certainty of payment date for both the government issuing payment and the recipient of the payment. EDI provides the means to transfer the information that allows the electronic payment to be identified (issuer’s name, invoice number, etc.).

Contractual Services

Governments should endeavor to obtain as full and open competition as possible on all purchases and sales and to competitively bid on all formal contracts without undue restrictions. Contractual services should comply with all pertinent state and local requirements governing purchasing. The entire process of public purchasing should be conducted in an open, impartial and ethical manner. The government should act to purchase the highest quality supplies or contractual services, at the least expense, consistent with the prevailing economic conditions,
while establishing and maintaining a reputation of fairness and integrity.

**Escrow Payments**

Escrow accounts are cumulative funds within a fund. Separate records on each individual fund within the account as well as specific authority to enter into each account must be maintained. Escrow funds are not third-party escrow accounts to be used in default situations, but rather are funds to be used as needed to offset legal costs, engineering reviews, etc. Using escrows in this way helps the government entity avoid subsidizing a developer for those costs.

Systems should be established to report all costs incurred on each escrow with a valid billing. The funds to cover the billing should be sent to the escrow provider when the bills are paid. Often, the government will pay the bills through their purchase order system and the escrow account will reimburse the general fund. This procedure creates excellent audit trails for all escrow withdrawals. At the same time, the general fund receives the reimbursement as a receipt with an expenditure code, reducing the risk of the government over-reporting its operating expenses. Any refunds of escrow balances should be made timely at the close of the account.

Provisions should be mandated to cover sufficient funds in the escrow accounts. When further development becomes necessary and the escrow is depleted, a policy should establish replacement funds from the developer prior to payment of billings related to the escrow. This method ensures that the government’s operating budget will not be unfavorably affected. It also allocates the cost to the proper source and ensures payments will be made.

**Debt Service Payments**

Debt service funds do not always require sinking funds, particularly debt services created by referendum vote. Debt schedules must be maintained allowing for timely payments. Usually, professional services (bond counsel, bond underwriters and financial advisers) are selected through an open and fair process for the issuance of sizeable debt. The need for such debt generally is for capital projects that cannot be financed from current revenues.

The scheduled maturities of debt should be constantly monitored and should not exceed the useful life of the capital projects or assets financed. A balanced relationship should be maintained between issuing debt and provisions for payment on current debt. It is important to maintain and improve current bond ratings so that access to credit is preserved and borrowing costs are minimized.

When debt is callable and interest rates drop, refunding and advanced refunding should be considered. For the year of the advanced refunding and period thereafter, a full disclosure will present a general description of the transaction (including the debt and related proceeds involved) until the refunded debt is com-
pletely retired. Separate records should be maintained on all existing debt.

**Special Assessment Funds**

Special assessments are levied to finance improvements or services directly for the benefit of identified taxpayers, such as a water district or sewer district. This long-term debt is reported in a special assessment fund; then special assessments are levied against the benefitted taxpayer to pay interest and retire the debt over a period of years. The law usually provides for liens against the property when the assessment billing is not paid. Assessments should not exceed actual costs.

**Pension Costs**

Whether the government has a defined benefit or a defined contribution plan, tracking of all costs should be recorded by the government separate of any third-party administration. Qualified actuaries should calculate the minimum and maximum amounts of normal costs, amortization of past service costs and prior service costs, vested benefits and interest earned equivalents. The government’s own records should provide the actual amounts contributed during each period. Written plans for reduction of any liability should be monitored and updated to reduce the liability as soon as possible. Disclosures should accompany all reporting.

Pension trust funds should report both the pension benefits to retirees and withdrawals to terminated employees.

Any expenses due should be accrued at year-end. The government should either provide the IRS 1099 forms to the retirees or insures that any third-party administering the fund has fulfilled that obligation.

**Interfund Transactions**

Policies on authorization to enter into interfund transactions should be established in order to maintain control and prevent interfund transactions (such as interfund loans that will not be repaid) from being used to conceal possible problems.

**Operating Transfers.** To process and control interfund operating transfers, budgets should accommodate authorized interfund transactions and show a reciprocal relationship between the funds. Interfund payables from one fund must equal interfund receivables in the other fund. All interfund transfers must be reported when they occur and must be validated at year-end. Operating transfers include all transfers other than residual equity transfers.

**Residual Equity Transfers.** Residual equity transfers generally are infrequent, nonrecurring or non-routine in nature. Examples are the transfer of balances of a discontinued fund, contributions or return of contributions from proprietary funds, etc. Disclosure of these funds should be explained in the footnotes of the financial statements or in some other form of disclosure.
Claims, Judgments and Contingent Liabilities

If an uninsured claim or judgment is awarded against a governmental entity, it should be recorded as an expenditure and the related liability classified into current and non-current components. Governmental funds report a currently due and payable claim or judgment as an expenditure and a liability. Balances payable in subsequent years are reported as a liability in a long-term obligation account group.

In a contingent liability (involving a potential loss that may be resolved by one or more future events such as loss or damages from fire, pending or threatened litigation, possible assessments and judgments, etc.), a reasonable estimate may be used and accrued with complete disclosures when the contingent liability is confirmed. Only the difference of the actual and accrued amounts are reported, so that prior period amounts are not restated.

Petty Cash

Petty cash may be used for convenience when it is impractical to go through the normal purchasing procedure for small items. In order to avoid possible abuse, it is important to set a relatively low limit on the amounts of purchases that may be drawn from petty cash and to require receipts or written statements to obtain reimbursement. The funds need to be replenished on a regular basis. These accounts should be closed out and audited at the end of each year.

The following questions can be used to evaluate the adequacy of the process and controls that currently exist or for the planning of a new disbursement system.
Self-assessment Questions for Disbursements

1. Are duties adequately separated (different persons prepare checks/warrants, sign checks/warrants, reconcile bank accounts, and have access to cash receipts)?

2. Are bank account and check/warrant signers authorized, documented and bonded (if required)?

3. Is the responsibility for authorization of disbursements clearly defined and assigned to specific personnel and are authorized check signatures kept to a minimum?

4. Are there current written procedures for disbursements?

5. Have disbursement procedures been reviewed for compliance with all pertinent state and local regulations?

6. Are monthly statements from vendors regularly reconciled to open vouchers or accounts payable?

7. Are accounts payable vouchers approved for payment by the appropriate governmental authority?

8. Are adjustments approved by an authorized employee?

9. Are vouchers audited, authenticated and certified by an authorized employee before they are submitted for approval for payment?

10. Are checks/warrants controlled and accounted for with safeguards over unused, returned or voided checks/warrants?

11. Is physical control of checks/warrants maintained by someone other than the person originating disbursement requests?

12. Is the drawing of checks/warrants to "Cash" or "Bearer" prohibited?

13. Is the signing of blank checks/warrants prohibited or if pre-signed checks are used, are they stored with proper security?

14. Are only original invoices (no photocopies) totaling the amount of the disbursement attached to each voucher before approval for payment?

15. Are spoiled or voided checks/warrants retained and prominently designated as voided?

16. Are procedures and schedules in place for the proper storage, imaging and destruction of cashed checks/warrants?
17. Is the signature plate or signing machine properly safeguarded?

18. Has the use of EFT and EDI been evaluated as a means of reducing disbursement costs?

19. If petty cash accounts are maintained, are there procedures and rules to protect against improper use?

20. Is there a system to accurately record returns and apply vendor credits?

21. Has it been determined that all purchases and resulting disbursements must be tied to a purchase order or that only purchases over a threshold amount would require the use of purchase orders?

22. If a purchase order system is utilized, does the purchase order form contain sufficient information to provide audit trails for payment and satisfy the vendor that it is a legal document committing the purchaser to payment of the bills?

23. If a purchase order system is utilized, can the accounting system properly recognize and liquidate encumbrances?

24. Are multiple invoices and claims from a single vendor paid with as few checks as possible (preferably one)?

25. Are discounts taken when available? If so, is the discount evaluated in terms of savings gained versus interest lost on early payments?

26. Does check stock show the name and address of the governmental unit?

27. Does check stock have a time limit printed (e.g. "This Check Voided After 60 Days")?

28. Are checks pre-numbered?
Reference Sources

Chapter 3: Banking

Public cash managers are challenged to balance the need for cost effective banking services against the financial stability and creditworthiness of institutions offering those services. Because governments have large and fairly stable asset bases, there has always been an ample supply of financial institutions seeking to do business with public-sector entities. Now dramatic changes in the world of banking, such as mergers, regionalization, internationalization and new technologies, have lead to a vast array of new products. The public cash manager must adjust to this new world of banking. These adjustments include being able to understand the changing banks and the technologies they offer. In addition, the manager must evaluate the government's capabilities to implement these technologies while maintaining proper levels of control. Any analysis also must evaluate cost-versus-benefit. When all of this work is done, there is still the concern of whether the bank is going to be there when the government is ready to do business.

The purpose of this section is to assist the public cash manager in making many of these complex decisions. Three banking related issues will be covered: essential areas of controls, particularly in regard to technological changes; selecting and contracting with banks and banking services; and a description of the types of services offered by today's financial institutions.

Control Objectives

Before entering into any relationship for banking services, it is important to fully understand the process of procuring banking services and the risks involved in a banking relationship. Dealing with the public's money requires that all aspects of control be defined and covered in any banking arrangement.

An evaluation of a bank's services must include a review of and written assurances in the areas of data security, confidentiality, accuracy, completeness and timeliness. In today's technologically advanced world of banking, safeguards must be in place to prevent unauthorized access to accounts or release of confidential information. The use of passwords, personal identification numbers (PINs) and call back procedures, as well as physical security preventing access to computer installations are essential. Deterioration of system integrity can be prevented by regularly scheduled backups and off-site data storage. All transaction activity should be supported by logical and sequential documentation of the process. Accuracy and timeliness can be monitored through the use of transaction confirmations. (See Chapter 6: Computer Security.)

The bank should enforce separation of duties to prevent one person from having the ability to perform related functions (e.g., transaction authorization and verification). Banks also should be able to
demonstrate their management controls set up to provide an audit trail to review and test specific transactions and functions for compliance with government regulations and generally accepted accounting principles (GAAP).

Bank security is a factor of a bank’s financial stability. An ongoing process of evaluating a bank’s creditworthiness is a requirement for any cash manager and will be discussed in more detail below. In addition, it is essential that all banks be familiar with the government’s financial policies, legal requirements and, if appropriate, the government’s investment policy.

Collateral agreements are another method of guaranteeing security. Legal requirements for collateralizing public deposits vary from state to state. The key elements of any collateral arrangement are: 1) the process must be governed by a written agreement; 2) the collateral must be held by a third party or a separate trust department; and 3) the value of the collateral must be monitored on a regular basis to assure that it remains on par with the value of the deposit.

Selection and Contracting

The constriction of the banking world through mergers and acquisitions has disrupted many long-standing banking relationships. The potential hardships can be offset by advantages gained through the competitive bidding for banking services through a request for proposal (RFP) process. The introduction of new services, lower costs resulting from competition, alternative methods of compensating banks and additional options for improving cash management are all potential benefits. On the negative side, preparation and evaluation of RFPs can be time consuming. Reviewing RFP documents used by other governments is a good starting point. However, finance officers should avoid using another government’s RFP form verbatim. Rather, the RFP should be tailored to fit the government’s needs. Public cash managers also must realize that there can be political costs associated with the removal of services from a community’s local bank.

Ideas for better banking services generally originate from discussions with colleagues, literature reviews and an awareness of the types of services being provided to the private sector. A competitive bid process begins with a review of the present banking services to determine if any or all services should be bid. The process can bundle all services into a single bid or require separate bids for individual services. Bundling the bid process does not necessarily mean that the entire array of banking services has to be awarded to one vendor. The request for proposal can be as detailed as necessary. This determination depends on whether a government has a specific idea of the desired product or is looking for banks to propose various options.

A copy of the RFP used by the city of Riverside, California is presented in Appendix 1 and serves as an example of the types of questions that might be included in an RFP for banking services.
When evaluating proposals, the finance officer must take into account all of the services to be provided and the quality of that service (including the bank’s ability to satisfy the types of controls discussed above), the cost of services and methods for paying for those services.

In addition, the evaluation process must consider the creditworthiness of all competing banks. Bank credit evaluation should be an ongoing effort for any financial official, but can also play an integral part in the selection process. Whether bank evaluations are performed by internal staff or by an outside rating service, there are five key criteria to examine: Capital adequacy, Asset quality, Management, Earnings and Liquidity, known by the acronym CAMEL. The data can be obtained from the various financial reports that banks file with federal or state chartering agencies or by subscribing to a private rating service.

Another tool for evaluation could be a review of the bank’s Community Reinvestment Act (CRA) rating. This is a federal requirement that measures how well banks meet the credit needs of the communities they serve. Some governments require that all of their banks exceed a specified level of CRA rating.

As with other contractual services, banking services should be governed by written agreements. Whether this is a new arrangement resulting from the RFP process or formalizing existing arrangements, banking service agreements should be used. Agreements need to be specific enough to detail the services being received, yet flexible enough to survive technological changes or the effects of mergers, acquisitions, and downsizing. Banks offer the use of standard service agreements, which in many cases are adequate. However, it is incumbent on the public official to carefully review and if necessary, modify the agreement. There are often agreements to cover general areas of banking services (i.e. checking account services, transfers and collateral). There also may be specific agreements covering services, such as wire transfers, lockbox operations, trust accounts, escrow accounts and safekeeping.

**Banking Services**

Banking services are commonly categorized into four areas: collection services, disbursement services, investment services and credit services. No matter which type of service is being evaluated, it is generally a good practice to consolidate into as few bank accounts as possible. Too many bank accounts can lead to missed opportunities for improved cash management, can prove cumbersome when it is time to reconcile statements and can simply be more expensive. Consolidation does not restrict options as full service banks can apply multiple services to bank accounts.

**Collection Services.** The primary objective of collection services is to accelerate the availability of funds by reducing the time needed to receive, process and deposit payments. This time lag, otherwise known as collection float,
can be reduced by utilizing the following services:

**Wire Transfers.** Wire transfers are the electronic shifting of funds from one bank to another. This is generally reserved for large sums of money since there is often a fixed fee for this service.

**ACH Collection.** ACH collection, otherwise known as direct payment or direct debit, provides for the electronic transfer of a payment, by pre-authorizing the collection of a bill directly from the payer's bank account. This system is most useful for billing systems that operate on a regular schedule, such as utility payments.

**Lockbox Collection Systems.** The use of lockboxes allows banks to collect directly from a post office box, open, verify and process the payment, thus expediting the entire collection process. The verification and processing are generally done on high speed machines. Payment information can be transmitted electronically. The process eliminates the need for making bank deposits and manually posting accounts and can enhance a government's internal controls by keeping checks out of the office.

**Over-the-counter Payments.** Allowing a bank to collect payments over the counter for a government requires an agreement between the government and the bank. This collection method expedites the deposit of funds while reducing the processing workload for the government.

**Credit and Debit Cards.** Credit and debit cards are becoming an accepted payment method by governments. Careful attention must be paid to the issue of the credit card fee and the ability to surcharge credit card users. However, credit cards do assure good funds on a timely basis and are also considered a convenience for the public.

**Coin Processing.** Coin processing has become a specialized service since many banks refuse to accept large volumes of uncounted or loose coins. Armored car companies have developed relationships with banks to collect, count, bag and deposit coins for customers. This can prove to be a cost effective and time-saving means of dealing with large volumes of coins.

**Sweep Accounts.** Sweep accounts are used for both collection and investment purposes. All receipts are deposited into an account and then the daily balance in excess of a target amount is automatically swept into some type of investment vehicle to maximize investment income.

**Disbursement Services.** As discussed in Chapter 2, disbursement services should not be designed to delay payments as long as possible. Although some thought should be given to the financial benefits of disbursement float, it is important to consider the accuracy of the payment process, the need to avoid late payment penalties and the maintenance of good vendor relations. Most governments use checks as the primary method of payment, although advances in tech-
nology will replace this expensive and labor-intensive process.

Some of the services banks offer in the area of disbursements are as follows:

**Wire Transfers.** Wire transfers can be used to control the timing of payments and increase earnings since funds can remain in the investment account up until the day they are due. Again, this is more applicable to large payments since there are fixed charges associated with wire transfers.

**ACH Payments.** ACH payments are primarily associated with direct deposit of payroll. Direct deposit can prove more cost effective than checks and is also considered a benefit to many employees and retirees. ACH payments also may be considered as a method of paying regularly recurring vendor payments. Controls on bank accounts can be set up to prevent unauthorized ACH debits.

**Controlled Disbursement Accounts.** Controlled disbursement accounts provide customers with information in the morning on the value of checks that will clear that day, thereby facilitating the investment of excess bank balances.

**Concentration/Zero Balance Accounts.** Concentration and zero balance accounts (ZBAs) allow checks to be presented for payment against the ZBAs which creates daily overdrafts. The overdrafts are then automatically covered by funds in the concentration account. Multiple ZBAs can be serviced by a single concentration account. Funds that would normally be tied up in checking accounts waiting for checks to clear can be invested up until the moment they are needed and thereby enhance interest earnings.

**Positive Pay Services.** With a positive pay service, a government prepares an electronic file of payable checks sent out and transmits that data to the bank. The bank will only pay those items authorized by the government in advance, thereby increasing protection against unauthorized and altered checks written against the government’s account.

**Check Retention Services.** By offering check retention services, banks can avoid returning paid items to a customer with each account reconcilement. Traditionally, banks microfilmed checks. New imaging technologies can store these records in computer files. Through this service, banks can reduce clerical expenses and avoid postal expenses of returning paid checks, and the government does not incur the expense associated with check storage.

**Investment Services.** Most banks offer some type of investment service in conjunction with their other services. The type and sophistication of these investment services will vary depending on the bank’s size and geographic location. Any investment service should always be evaluated based on the following three criteria: safety or credit risk (the guarantee that the funds will be available for redemption at maturity); liquidity (the ability of an instrument to be converted to cash prior to maturity); and yield (the current rate of return). In
addition to simple account interest, banks may offer the following investment services:

Certificates of Deposit. A certificate of deposit (CD) is a time deposit with the bank for a specific maturity. It can be negotiable or non-negotiable (more common), depending on the size of the bank and the transaction. Non-negotiable CDs lack liquidity and generally carry lower interest rates than money market instruments.

Money Market Instruments. Money market instruments are short-term debt instruments. They can take the form of government-issued debt, such as short-term U.S. Treasury securities or short-term U.S. agency or instrumentality securities. It is always important to check state investment statutes regarding the permissibility of differing money market instruments for public portfolios. (See GFOA Policy Statement on “State and Local Laws Concerning Investment Practices,” 1997.)

Repurchase Agreements. Repurchase agreements (repos) are another form of money market instrument. They involve a bank or dealer simultaneously selling a security (generally U.S. government securities) with an agreement to repurchase it at a future date. Interest is paid on the agreement. Much has been written regarding the risk of these investments and the need for dealing with reputable dealers, having proper written agreements in place and collateralizing the transaction. (See GFOA Recommended Practice on “Repurchase Agreements, Reverse Repurchase Agreements, Leveraging, and Prudent Investment Practices,” 1986 and 1995.)

Reverse Repurchase Agreements. Reverse repurchase agreements involve an agreement where a bank or dealer offers cash for a security in the government’s portfolio. Governments use reverse repos to avoid selling a portion of its portfolio early when additional cash is needed. Because reverse repos can result in imprudent leveraging of investment portfolios, governments should exercise extra caution when entering into reverse repurchase agreements. (See GFOA Recommended Practice on “Repurchase Agreements, Reverse Repurchase Agreements, Leveraging, and Prudent Investment Practices,” 1986 and 1995.)

Custody and Safekeeping Services. These services stem from the days when banks provided safety for bearer instruments. Custody and safekeeping services are still an important safeguard in these days of book-entry securities. Banks will provide these services for securities, whether or not they were involved in the actual transaction. These services also are important for holding securities in collateral arrangements.

Credit Services. Banks offer a variety of services for extending both short- and long-term credit to government agencies. Short-term services, which generally have a duration of less than two years, can be considered as a standard product when soliciting banking services. Long-term credit services should be solicited separately. A number of services to be considered are as follows:
Lines and Letters of Credit. Establishing a line of credit or letters of credit enables a government to borrow money from a bank, up to a pre-determined amount, at any time. Banks will offer this service based on the creditworthiness of the government. This type of service is only advantageous for the frequent borrower. It is also important to determine the permissibility of this practice under state laws.

Municipal Commercial Paper. Some governments issue municipal commercial paper as a borrowing technique for very short-duration loans (generally less than 90 days) requiring a specialized line of credit from a bank. This type of credit vehicle is designed for short-term cash shortfalls, not as an interim financing source for projects that will eventually require long-term borrowing.

Short-term Notes. Governments issue a variety of short-term notes that generally take the form of one of the following: bond anticipation notes (BANs), tax anticipation notes (TANs), or revenue anticipation notes (RANs). These notes generally have a maturity of six months to one year, but can be rolled over.

Leasing. Leasing allows governments to acquire capital equipment and, at the same time, avoid long-term obligations. Leasing also allows governments to keep up with changing technology while avoiding the ownership of outdated equipment.

Other Credit-related Services. Banks offer other credit-related services which can take several forms. Bond and note purchasing is often done by banks, either to hold in their own portfolios or to resell to their customers. This practice is more common now that banks can participate in the mutual fund business.

Many banks act as bond underwriters that purchase new bond issues, either through a competitive or negotiated process, for resale.

Another service that banks offer is bond transfer and registration services that involve the tracking of debt ownership and paying of interest to bondholders.

Compensation Procedures

After all design and evaluation issues are resolved, attention should be turned to compensation. All banking services have a cost, whether they come with a fee or not. "Free" banking services generally involve an opportunity cost or the loss of the ability to do something else with funds the bank requires to be kept on deposit. The key is to determine the compensation method that is in the best interest of the government.

Compensating Balances. The practice of maintaining compensating balances has been the most common method by which governments pay for their banking services. Specified balances are maintained in accounts to compensate banks for services. These account balances are multiplied by an earnings credit rate, a bank-set rate that is often below market rates, to determine the value of the balances. This value is applied to the bank's service charges for the account.
The primary advantage of this payment method is that there is no requirement for an appropriation to pay for banking services. The primary disadvantage is that it requires careful scrutiny to make sure that the loss of interest does not exceed the cost of services.

**Direct Payment.** Direct payment of fees allows banking services to be treated in the same manner as all other services the government purchases. Direct payment of fees, or a combination of direct fees and compensating balances, generally is most financially advantageous to the government. Prices for services are known and can be clearly analyzed. The difficulty comes when costs rise and budgets have to increase to cover the additional costs.

**Account Analysis Statements.** Banks prepare account analysis statements which are informational reports on accounts detailing the account activity, balances and earnings. These reports are usually produced monthly and are the basis for invoicing banking services. They are produced for both compensating balance and direct pay arrangements. The following are some key components of an account analysis statement:

- Average ledger balance is the average amount of money on deposit;

- Average float refers to the number of days checks are in the process of collection or the number of days between deposit and the actual availability of funds;

- Average collected balance is equal to the average ledger balance less average float;

- Reserve requirement is the portion of demand deposits that must be kept on deposit at the Federal Reserve Bank (currently set at 10 percent); and

- Balance available for services is the average collected balance less the reserve requirement and is the amount eligible for monthly earnings credit.
Self-assessment Questions for Banking

1. Are passwords or PINs required for all banking transactions?

2. Does the bank offer the option of callback confirmations on all transactions?

3. Have the bank’s data security practices (i.e., physical security, backups, and off-site storage) been reviewed?

4. Does the bank transmit timely confirmations of all transactions?

5. Are all banking transactions performed through one bank employee or are there multiple contacts at the bank?

6. Have the banking representatives ever reviewed the government’s financial policies and/or investment policy?

7. Is the collateralization of public deposits a legal requirement or is it voluntary to collateralize public deposits? If required, is the process governed by a signed agreement that includes third-party custody and some form of marking-to-market the value of the collateral?

8. When was the last time banking services were bid competitively through the RFP process? If services have not been bid, is it because of lack of competition, inability to draft specifications or political reasons?

9. Has the government recently reviewed any other entity’s banking RFP?

10. Is CAMEL-based credit analysis performed on the banks the government does business with?

11. Have the CRA ratings of the government’s banks been reviewed and do they influence the decision on bank selection?

12. Are written agreements in place to cover the following banking services: general banking services (i.e., checking accounts, interest earnings, transfers, confirmations/authorizations, fees), wire transfers, lockbox services and trust accounts (i.e., custody and safekeeping)?

13. How many bank accounts are maintained? Does each one serve a vital and current need?

14. Are wire transfers used to move large sums of money? Is the cost of wire transfers evaluated against the earnings generated by holding onto the funds longer?

15. Has the use of ACH collection in conjunction with any billing services provided been evaluated?

16. Can any collection operations be improved through the use of lockbox services?
17. Have credit cards been evaluated as a method of payment? How are credit card surcharges handled?

18. If the government’s operation deals with large volumes of coins, have alternatives to manual processing been explored?

19. If a high volume transaction account or multiple transaction accounts for receipts are used, are sweep account arrangements in place to enhance interest earnings?

20. Has the government considered using wire transfers instead of checks for large expenditures?

21. Is direct deposit offered and encouraged as part of the payroll system?

22. If multiple payment accounts are utilized, do they work on a zero-balance basis in conjunction with a concentration account?

23. Has microfilm or microfiche been considered as an alternative to receiving canceled checks with bank statements?

24. Are competitive quotes obtained prior to purchasing CDs or money market instruments for investment?

25. Are repurchase and reverse repurchase agreements covered by a master repurchase agreement?

26. Are all investments held in a third-party safekeeping arrangement? Is this arrangement covered by a written agreement?

27. If banks are utilized frequently to obtain short-term credit, have the costs and benefits of lines of credit vs. municipal commercial paper vs. short term notes been evaluated?

28. Has leasing as an alternative to outright purchase of capital equipment been evaluated?

29. Do the banks the government does business with bid on its bonds and notes?

30. Are there legal requirements that the banks must maintain collateral on all public deposits? If not, has the government considered requiring that all deposits be collateralized?

31. If collateral is utilized, are the terms governed by a written agreement? Is the collateral held in third-party safekeeping? Is the value of the collateral verified on a regular basis?
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Chapter 4: Investments

Many important components of the cash management function need to be in place before an effective investment program can be implemented. Understanding the source and timing of revenues and expenditures along with various aspects of banking relationships and cash flow forecasting are cornerstones of the investment process. While the investment process seems somewhat narrow in scope, the type, volume and sophistication of process and product have exploded in recent years making the public cash manager’s job much more difficult.

The much publicized losses of public funds are testimony to the increased need for education and information in this field. This section will assist the public cash manager in developing an underlying investment philosophy and applying those principles to the day-to-day management of investment responsibilities. Because of the complexity of the investment function, finance officers are strongly encouraged to review GFOA’s publication, Investing Public Funds.

Legal Issues and Constraints

The vast majority of public-sector cash management operations are governed by state laws and provisions that determine the type of investment product and manner in which various governments manage their funds. It is not only important that responsible parties understand in detail the legal framework in which they operate but they also must keep current on any changes to the existing law. Additionally, identifying and understanding non-investment related factors that impact the investment program are also important. An example of this is the recently adopted Governmental Accounting Standards Board Statement #31 that requires “marking to market” certain investments (i.e., verifying the current market value of securities as opposed to simply maintaining the original book value) at fiscal year-end.

It is also important to identify not only the letter of the law but also the purpose of the law. Realizing the law’s strengths and weaknesses will allow the government to place more emphasis in certain policy and training areas.

Developing an Investment Policy

After the legal architecture has been identified, the next logical step is to develop an investment policy that considers the distinct characteristics, risk tolerance, staff expertise and investment opportunities specific to the government entity.

GFOA has published a sample investment policy that specifically details important components of a sound policy.4 An investment policy is the final product of a

4A copy of GFOA’s Sample Investment Policy is available at http://www.gfoa.org (GFOA’s home page) or for a nominal fee by calling 312/977-9700.
significant and ongoing process whose development is as important as the policy itself. Moving through the risk tolerances of the overall organization, developing the ethical and legal framework, identifying staff strengths and weaknesses, establishing procedures and internal controls and, in general, doing a self-critique of the existing system and practices are critical to the cash management process.

While there are many elements that overlay the policy, the core foundation of the policy revolves around three fundamental components: liquidity, diversification and ownership. The cycle of how much (product selection and placement on the yield curve), what (type of product) and how (where securities are held) provides the critical elements to which most of the other components of the policy are intertwined.

The Players

There are many players involved in a government's investment process. Below is a description of who some of these players are and the roles they play in the investment process.

Governing Body/Management. The governing body and management are the investment manager's most important allies. These individuals should be directly involved with policy formation, kept informed about all aspects of the investment program (good and bad) and should be aware of the individual characteristics of the investment portfolio through periodic reporting.

Investment Staff. A government's investment staff, whether it is an individual handling multiple responsibilities or a department dedicated to the investment function, should have the necessary training and expertise to handle all the requirements of the position. It is the governing body's or management's responsibility to determine if the necessary expertise exists or if additional outside resources are required. Ongoing due diligence and assessment of the investment function is needed by elected and appointed officials.

Broker/Dealers. Broker/dealers are an important part of the investment operation. They not only provide access to investment products but also provide valuable market information. Developing trust and confidence in these individuals while still understanding that their compensation is based on selling investments in a very competitive environment is important. Shopping the market to make sure the government is receiving the maximum benefit is a simple concept often overlooked by investment officials.

Custodial/Safekeeping Agents. Custodial and safekeeping activities are often the most overlooked activity in the investment process. Ownership and the right to control the assets purchased by a government is a simple and inexpensive way to ensure the integrity of the portfolio. Custodial/safekeeping agents acting at the direction of the government along with proper collateralization of repurchase agreements are critical program elements to reduce risk and ensure that the government keeps control of its securities.
INVESTMENT PROCESS FLOWCHART

GFOA’s recommended cash management practices for state and local governments detail many specifics related to sound investment management. The investment policy provides the ideal framework to itemize each allowable investment alternative, to detail the benefits and risks of these alternatives, and to recommend the maximum percentage allocation, the selection process, the risk framework and the allowable maturities of the investment alternatives.

Investment Alternatives

Many state statutes establish and, in many cases, limit what types of investment instruments can be used. Finance officers should remember that just because an investment is legal does not make it advisable or prudent. The only instruments that should be included in an investment policy are those investments that the staff and responsible individuals understand and are trained to handle.

Process of Investing

After the framework is established, purchasing a security is relatively simple. The Investment Process Flowchart above details the relationship of events and functions.

Notice much investment activity is preparatory, taking place before a broker/dealer is contacted to purchase an investment. Once the security is purchased and settled the job is not finished. Reporting and specifically

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3As mentioned earlier, GFOA’s recommended practices are available from GFOA’s home page at http://www.gfoa.org or for a nominal fee by calling 312/977-9700.
monitoring all investments is a function of due diligence, basically bringing the process back to its origin as an investment matures or is sold.

Risks of Investing

The main focus of investment management is controlling risk. Market risk, liquidity risk, credit risk, yield curve risk, regulatory risk, and opportunity risk illustrate some of the exposure an investment professional is subjected to and must try to constantly control.

While it is important to identify the investment risks that impact a program, a good cash management program attempts to control, not eliminate, risk exposure. Fear of risk can paralyze. Just as there are many risks associated with purchasing an inappropriate investment, there are also risks associated with doing nothing.

Diversification is the key to better controlling risk. Basics such as diversification by asset classification, by market sector, by credit rating, and by maturity or duration are important to understand but the single most important reason to diversify is to ensure that liquidity is never threatened.

Risk can be controlled further by fully understanding the structure of every investment purchased, by the timing of market entry, by structuring a screening process for broker/dealers, and by talking to and reading other professionals’ points of view. Remember, investing is done in an efficient market. An investment officer may be right 55 percent of the time but may not be right the other 45 percent.

Money market mutual funds and local government investment pools can be effective mechanisms for obtaining same-day liquidity, diversified portfolios and competitive yields, particularly for jurisdictions with relatively small amounts of funds to invest or for finance officers with insufficient time to devote to investment activities.

In many instances, a good question and a well thought-out answer can be much more effective than pages of written material. The following questions have been developed around the core of sound investment practices. They are intended to move one through the thought process of developing an investment policy and trigger other important questions and ideas specific to the government entity.
Self-assessment Questions for Investments

1. Have all laws regarding investments been reviewed by the investment staff?

2. Were there any past investment problems? Has a plan been developed to make sure that they are not repeated?

3. Is there a written investment policy? When was it written? Is it followed?

4. Is there a written investment strategy in place? Has it been approved? Is it followed?

5. Are written investment procedures in place? Are they updated regularly?

6. Has a treasurer or cash manager been designated to manage the investment function? By formal action?

7. Determine the total scope of investment management responsibilities. Do they include cash with fiscal agents, joint power agreements, deferred compensation and pension plans?

8. Has every staff person involved with any aspect of the investment process been identified?

9. Who can initiate investment transactions? Wire transfers? Is it the same person(s)?

10. Is there adequate separation of duties? Are staff vacations required?

11. Is investment-related training budgeted?

12. Are there external managers involved with the investment process?

13. Are the investment and accounting functions separate?

14. Are investments being properly accounted for?

15. How often are investments marked-to-market? Formally? Informally?

16. Are investment reports produced regularly? Are they required by law? Are the reports adequate?

17. Is there an established written benchmark? Does it make sense?

18. Is there adequate technology in place to support the investment operation?

19. How often is the credit quality of each security reviewed?

20. Is a formal cash flow forecast prepared? Is it tied to the investment function?

21. Is all money (funds) pooled for investment purposes? Which are not?
22. How is the banking relationship viewed? How is the banking function involved in the investment function?

23. Are sweep accounts utilized? Is the product understood by the investment staff?

24. Are money market accounts or local government investment pools utilized? Has all necessary information about the account been provided to the investment staff for review?

25. Are investment contracts utilized? Are they collateralized?

26. If repurchase agreements are used, is there a master repurchase agreement in place?

27. Are all investment transactions handled on a delivery vs. payment (DVP) basis?
Reference Sources


Sample Investment Policy, Government Finance Officers Association, Chicago, IL, August 1997.
Chapter 5: Forecasting

To forecast is to "estimate or calculate beforehand." In an attempt to plan for the future, every organization must forecast. The differences among governments are evident in many ways, including the degree of formalization of the forecasting process. However, many similarities also exist. This chapter defines the process to follow in creating a forecast that will provide useful information to management. While many cash managers may only be involved in cash flow forecasting, the techniques described below can apply to a variety of forecasting needs.

Identification of Management Requirements

Whatever the size of the entity, the purpose of forecasting remains the same: to improve decision making. In the cash management function, accurately forecasting cash inflows and outflows allows a government to maximize its potential for investment earnings by limiting the need to sell investments before maturity to meet unexpected cash demands and to lengthen investment maturities in a normal yield curve environment to increase interest income.

Needs of each manager. An individual forecast may become a tool for multiple managers or be used for yet another forecast. For example, a detailed expenditure and revenue forecast would be essential for an interest earnings forecast. The needs of each area which will use the forecast must be taken into account when developing the forecast model.

Management's Participation. The needs of management must be taken into account when deciding which variables to forecast and the type of forecasting required. Sensitive variables should receive the greatest attention to detail and accuracy so that differences between forecasted and actual results are minor and explainable.

Accuracy of Data. Preparing the forecasting database is usually accomplished by exporting a file of historical records (such as cash receipts and cash disbursements) from the entity's database and formatting it for input into a forecasting or spreadsheet software package. For a reliable outcome, the data used for the forecasting model must be accurate.

Choosing a Forecasting Technique

Most software packages offer a variety of forecasting techniques to accommodate different types of data. The methods most useful for business applications include: moving averages, exponential smoothing models and Box-Jenkins for univariate forecasting (univariate techniques forecast based solely upon the past history of the forecast variable); and dynamic regression for multivariate forecasting (multivariate techniques forecast based on the historical relationships among several variables).
Moving Averages. The moving average is an extremely simple forecasting technique that averages the values of the variable's recent history and is the most widely used technique for preparing cash flow forecasts. For example, to prepare a forecast for next month’s cash requirements for accounts payable using a three-month moving average, add together the cash requirement figures for the most recent three months and divide by three. The next month’s moving average will then drop the first month’s data and calculate an average using months two, three and four. Note that moving averages are incapable of forecasting trends or seasonal patterns and should only be used when the data are extremely short or extremely volatile.

Exponential Smoothing. Exponential smoothing models are widely used statistical models and are found in most forecasting software. They work by identifying features found in the historical data, such as trends and seasonal patterns, and projecting them into the future. The ability to adapt to change and to smooth over volatile data makes them ideal for most univariate product-oriented forecasting.

Dynamic Regression. Dynamic regression allows the forecaster to model relationships between the variable to be forecasted (the dependent variable) and explanatory variables such as staff size, pay rates, deductions and overtime (independent variables). Dynamic regression produces an equation that captures the behavioral relationship of a dependent variable to its own past and that of the explanatory variables. Dynamic regression should be used only when (1) the data are long and stable enough to support a correlational model, (2) reliable forecasts for the explanatory variables(s) are available and (3) the model outperforms univariate techniques.

Regression Analysis. Internal data are often supplemented by external data on trends, financial markets and national economic trends. Often, the goal is to find some external variable whose movements foreshadow changes in an internal variable, i.e., to identify a "leading indicator." For instance, statistics on new business location and population growth may imply a coming increase in retail activity and sales tax collection. The statistical basis for this kind of forecasting is known as regression analysis.

Steps in Creating a Forecast

Preparing statistically based forecasts requires that the forecaster execute the following four steps:

1. Collect a database of historic values for the item to be forecast.
2. Identify the form of a statistical model that is likely to fit the data.
3. Fit the parameters of the model to the historical data.
4. Use the equations of the fitted statistical model to extrapolate (forecast) from the historical data.

Forecasting software packages vary greatly in the forecasting techniques they provide and the amount to which the user is responsible for performing the above steps. Formulas for the various forecasting methods discussed above are
included in forecasting software packages.

**Analyze Financial Conditions**

In preparing a forecast, many factors must be analyzed. The following is a discussion of those factors.

**Environmental Factors.** A comprehensive forecast must take a variety of factors into account. These environmental factors exist both within and outside the organization.

**Community Needs and Resources.** When taxpayer dollars are concerned, chances are there will be community input. For example, a bond program includes the voter-approved propositions for the various improvements. Therefore, a forecast of capital expenditures needs to incorporate those voter-approved projects, including dollar amounts and a timetable. The community’s desires will also be an integral part of any forecasts related to Community Development Block Grant programs and should be considered in all grant applications and spending plans and related forecasts.

**External Economic Conditions.** National, state and local economic conditions affect everyone and must be considered when forecasting. Statistics such as the Consumer Price Index (CPI), retail sales and office vacancy rates are useful when projecting revenues such as ad valorem tax and sales tax. Sources for this type of information include the federal government agencies, such as the Bureau of Labor Statistics, state governments and other regional sources, such as local research firms, newsletters, chambers of commerce, and convention and visitor’s bureaus.

**Internal Governmental Constraints.** The usual constraints, such as resources, both human and other, time and policies, must be addressed when an organization decides what to forecast and how to approach the task. If the organization has capable staff, they would be enlisted to develop the appropriate forecasting models. There are many software packages available for those models requiring complicated algorithms and other sophisticated mathematical modeling.

**Political Culture.** Politics affect everything we do and forecasting is no exception. Once policy is set, determine what forecasts need to be done to implement those policies, assign responsibility and get to work. Make certain that forecasts address a service implementation issue, are well prepared and extremely well documented, use reliable sources, are easily explained and generate a useable result.

**Other External Factors.** Other external factors include federal, state and local law, mandates and actions of other governmental entities in the jurisdiction, such as counties, school districts, and other boards and commissions. The actions of competitors (e.g., other cities and towns in the immediate area) are an important external factor that must be considered. If outside actions will have an effect on the forecasting process, those effects should be factored in.
Organizational Factors. The policies ordained by the governing body should be the starting point from which the organization develops procedures used to implement those policies. Policies dictated by law become the starting point for an organization to strategically plan and forecast its future.

Management Practices. Those responsible for forecasting in the organization must be aware of management's short- and long-term goals and the forecasts required to meet these goals. Additional management practices involving forecast scheduling, preparation, and communication should be clear and understood so deadlines are met and useful information is available when needed.

Financial Factors. Accurate financial forecasting is critical for an organization responsible for providing services and taxing citizens to pay for them. Other factors also must be considered to prevent over taxation.

Revenues. For many entities, ad valorem taxes constitute the largest source of revenue. Accurate forecasting of this and other significant revenue sources is critical for determining revenues for budget and long-range forecasting purposes. Regression analysis is useful in forecasting this type of revenue source.

Expenditures. This component of a forecast is equally important. If expenditures are understated, an over-budget situation will occur causing hiring freezes and layoffs. If expenditures are overstated, a surplus will result and the entity appears to have overtaxed its citizens. Historical analysis and regression can be used to forecast expenditures.

Operating Position. The operating position of the entity must include positive fund balances and cash balances. A completed forecast of revenues and expenditures and cash flow can be used to forecast the operating position. This position will be of significant interest to auditors and rating agencies.

Debt Structure. Forecasts of debt outstanding and future debt issuance are also critical to the decision on how much to tax. Is the debt structured to be paid off aggressively? Are principal payments level? What is the government's debt capacity both legally and considering its ability to pay?

Unfunded Liabilities. Legal issues, pension contributions and landfill maintenance and closures are examples of unfunded liabilities that should be forecasted and disclosed. External auditors should be consulted regarding which liabilities to disclose and methodologies for forecasting them.

Condition of Capital Plant. The capital plant consists of all owned infrastructures such as power and treatment plants, roads and bridges, and buildings and land. All infrastructures require maintenance, repair and eventual replacement. A detailed annual forecast helps to plan for the work and budget for the expense of this annual maintenance.
Data Considerations

When developing a forecast, information must be obtained from various sources. The type of information available and the format in which the information can be found will determine how complete and accurate the overall forecast will be.

Data Availability. The data needed for the forecast will be found both internally and externally. The challenge is to locate it in a useable format which can be easily introduced into the forecasting model. Government agencies, government and private publications, the local library and the Internet are just a few sources of reliable data.

Data Consistency. Since many forecasts must be updated at some point, it is important to obtain data from a source that is reliable and that will be available when the forecast needs to be revised. A detailed formulation description that outlines how the model was constructed, references sources for all information, and describes the various sections of the model and what they do is useful, especially if the model is not revisited frequently. This outline also helps the next person in the job to understand how the model was developed, how it works and its intended purpose.

Error Measurement. Statistically speaking, every forecast should include a measure of its accuracy. Practically speaking, this is an unlikely accomplishment unless a trained statistician or regression analysis software is available.

Communicating the Forecast

One of the most difficult aspects of preparing a forecast is communication. Some governments may be required by law to prepare a forecast, while other entities prepare a forecast as a management tool. Whatever the reason for the forecast, the challenge is to gather accurate, complete information and then format that information into a useable document that will help the entity make sound financial decisions.

Requirement to Prepare Forecasts. A council, board or commission may require certain annual forecasts be prepared. Or another entity may expect an update twice a year, monthly or weekly. Whatever the requirement, the need has been communicated and a forecast is needed.

Management must be aware of requests for forecasts found in a variety of written documents the organization produces, such as resolutions, directives, policies and procedures.

Communications to Management. Executive summaries of forecasts are useful whether the forecast is communicated in a formal briefing or via memorandum, and are necessary regardless of the complexity of the forecast.

Comparison of Actual Results to Forecast Results. If a forecast provides a monthly output, then a monthly summary of projected amounts compared to actual amounts is appropriate. This feed-
back should clearly show variances and reasons for them.

A copy of a cash flow forecast for the General Fund and Fire District Special Revenue Fund for Cobb County, Georgia, is presented in Appendix 2.
<table>
<thead>
<tr>
<th>Self-assessment Questions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. What various forecasts are prepared within the organization? Why are they prepared?</td>
</tr>
<tr>
<td>2. Are the procedures to prepare the forecasts formalized? Are there written procedures?</td>
</tr>
<tr>
<td>3. Is management aware of these forecasts and procedures?</td>
</tr>
<tr>
<td>4. Are the needs of management and the divisions which will use the forecast taken into account in the preparation of the forecast?</td>
</tr>
<tr>
<td>5. Is the source of information for the forecasting database reliable?</td>
</tr>
<tr>
<td>6. What internal and external factors and information is required?</td>
</tr>
<tr>
<td>7. Which forecasting method is most appropriate?</td>
</tr>
<tr>
<td>8. Can the forecasting model be developed internally, or should a statistical software package be considered?</td>
</tr>
<tr>
<td>9. What is the goal of the forecasting model?</td>
</tr>
<tr>
<td>10. What internal and external environmental factors will affect the forecast?</td>
</tr>
<tr>
<td>11. Have the needs and resources of the community been taken into account?</td>
</tr>
<tr>
<td>12. Have economic factors been taken into account?</td>
</tr>
<tr>
<td>13. Have the various issues which put limits on the ability of the entity to participate in the preparation of the forecast and respond to the outcome been considered?</td>
</tr>
<tr>
<td>14. Has the effect of the political culture been taken into account?</td>
</tr>
<tr>
<td>15. What effect will existing and proposed legislation have on the forecast?</td>
</tr>
<tr>
<td>16. What effect will existing management practices have on the forecast?</td>
</tr>
<tr>
<td>17. What financial factors exist which will affect the forecast?</td>
</tr>
<tr>
<td>18. What variables should be considered when forecasting cash balances and operating position?</td>
</tr>
<tr>
<td>19. What variables should be considered when forecasting an entity’s debt structure?</td>
</tr>
<tr>
<td>20. What variables should be considered when forecasting unfunded liabilities?</td>
</tr>
<tr>
<td>21. What variables should be considered when forecasting the condition of the capital plant?</td>
</tr>
</tbody>
</table>
22. What sources of data will be considered? What formats is it available in? Are these formats compatible to the forecast format?

23. Is the chosen source reliable? How long has the data been available from this source? Is it reasonable to assume the source will be there for the foreseeable future?

24. Is there a forecast manual or outline which describes the methodology, sources of data, and uses and users of the forecast?

25. Has error measurement been incorporated into the forecast, and if so, have the error statistics for the chosen forecast model been reviewed?

26. Have forecast requirements been communicated to the appropriate staff?

27. Are procedures in place regarding the appropriate format of the forecast and how it should be communicated to management?

28. Are forecasts used to formulate policy?

29. Are forecasts used for service/operations planning?

30. Are forecasts used for financial planning?

31. Is there a feedback mechanism associated with the forecast so projections may be compared with actual results?

32. Have benchmarks been identified which can be used to evaluate the forecast?
Reference Sources


Chapter 6: Computer Security

Public-sector officials live in an age of information. The modern computer has sparked an information revolution and has become an indispensable tool for building the information age. Today, information is one of the most important assets of an organization. Survival of the organization is often dependent on the quality, adequacy and integrity of its information. Protecting information and the infrastructure that processes and maintains information becomes critical to the continuity of operations. The health of an organization is often directly influenced by the health of its information; thus the need for “protection” or “security” must embrace basic health (adequacy, integrity, quality, accessibility, etc.) as well as responding to and averting threats. Security of information resources must include controls and safeguards to offset possible threats as well as controls to ensure timeliness, availability, integrity and other measures of robustness or “health.”

Computer security may be defined as (1) control to ensure the continuity of adequate information and (2) protection of computing assets from loss or damage. As a natural extension, the avoidance of loss or damage to other assets through information inadequacy or through abuse or misuse of computer facilities is also within the scope of this topic.

Protection encompasses prevention, detection, recovery and insurance. Computing assets may be defined to include hardware, physical facilities, application programs, software programs, information or data files and personnel. Loss or damage must be considered from any source, whether accidental or intentional, and for various consequences.

The emergence of computer security as a major problem has been caused by the relative success of the computer and its proliferation. There is widespread use of data processing by all large organizations as well as most medium-sized and many small ones. Quite significantly, data processing usually involves a concentration of vital facilities and assets. The rapid growth and acceptance of computer technology has not been accompanied by a parallel growth in the management of this technology. The management lag gives rise to an exposure that can be detrimental to the very existence of an organization.

All organizations, of course, are not equally affected by this exposure to loss. In certain government computer installations, matters of national security are at stake, and the measures required to protect such facilities are elaborate and costly. At the other end of the spectrum, computers may be used exclusively for non-confidential word processing, requiring few security precautions except for file backup. Proper computer security requires a balance of adequate security with cost effectiveness and common sense.
Computer Security Objectives

There are four objectives to keep in mind when analyzing the security of a government's computer system. These include integrity, availability, control and auditability and are discussed below.

Integrity. The ability of a system to ensure accuracy, reliability and confidentiality is a basic building block. The collective system (hardware, software, communications) must be able to maintain and process data correctly and move traffic (transactions, inquiries, commands, etc.) from its origins to the intended destinations without unauthorized modification or disclosure. Reliable performance is essential. Any failures should be and reported to permit timely corrective action. Suspicious user activity should be detectable. The network and its data should be protected from contamination or outside interference.

Availability. The system must provide efficient response and adequate capacity in order to support acceptable performance. It should be able to recover quickly from either short-term or long-term disruptions. Backup measures, including data backup and equipment backup, and tested contingency plans should be in place. Prevention is of primary importance. Single points of failure should be avoided. In other words,

- avoid dependence on single equipment devices or single communication pathways,
- avoid overloading the network at peak activity periods and
- provide environmental backup (redundant power, air conditioning, heating and other support systems, limited equipment access, etc.) to reduce other exposures.

Control. Management should have the capability to limit who can access the system, how much capacity can be used for each purpose or function, what purposes are allowed, what data is accessible and transmittable for each user, and what connection can be made. Administrative and technical controls should be utilized. Administrative measures include:

- Publication of policies, standards and guidelines,
- Screening of personnel,
- Security awareness training and
- System change control procedures, including security criteria in system design, and monitoring of system activity and quality.

Technical measures include:

- Access control (system access, resource restrictions),
- Log on and password control,
- Alternative identification methods (personal tokens, digital signatures),
- Call-back connections,
- Network isolation (from public networks),
- Fire walls and
- Physical security of system components.

Auditability. Management should use the audit function as an independent arbiter to measure compliance with policies, standards and guidelines as well as to
assess the adequacy of technical protection. The system and its network should preserve and display evidence of use, behavior and content. Events of use and variances from anticipated use should be recorded.

**Summary of Protective Measures**

There are a number of protective measures that can be taken to enhance the security of the government’s computer system.

**Location and Site Preparation.** Computer security ideally starts with site selection and site preparation. The location of a computer facility should be chosen to avoid, or at least to minimize, any physical hazards.

**Fire Protection.** Protection from the physical hazard of fire is common for computer facilities.

**Water Damage.** Good drainage is essential to minimize water hazards.

**Power Loss.** Full protection from loss of power for a large computer installation can be costly; however, lesser degrees of protection can be realized at a modest cost.

**Vandalism.** In addition to the maintenance of a low profile (avoiding overt pointers or signs that disclose the high-value nature of the facility), physical access security is important.

**Equipment and Software Malfunction.** Computer system redundancy should be established where the cost of a lengthy equipment breakdown is high. Comprehensive testing procedures and quality control can reduce the incidence of errors during software development and subsequent use.

**Human Errors.** Operating procedures should be designed to minimize the risk of deliberate or inadvertent alteration, manipulation or destruction of programs, data files or hardware by operators, programmers, engineers or others.

**Misuse of Data.** Dishonesty is a continuous threat to computer operations, as it is in all other activities. It is, of course, possible to use the computer to manipulate large masses of records to accomplish fraud, but the computer itself also may be used to detect dishonesty (or error) involving computerized records. The computer, when misused, can improve the economics of fraud, because it facilitates the mass manipulation of detailed records. These dangers are closely intertwined with programming, since perpetration presumes that the system logic must first be altered.

The countermeasures required to protect against dishonesty and fraud remain the same whether or not a computer is involved: separation of responsibility and adequate independent control. “How much separation?” and “What constitutes adequate control?” are the questions that each organization must answer for itself. Some of the precautions to be considered include:

- The presence of audit trails throughout various levels of application systems;
• Independent audit and testing of application controls;
• Authorization requirements for program changes;
• Separation of programming and computer operations;
• Separation of clerical control and data control from computer operations;
• Rotation of assignments: programmers switch applications, operators change shifts, etc.;
• Dual control of computer operations, with two operators always on duty so that collusion would be necessary to perpetrate a fraud;
• Separation of program development and program testing;
• Controlled access to program documentation and source code for operational programs;
• Restricted access to data files or file copies; and
• Insurance coverage and bonding of personnel.

Loss of Data. Information loss or corruption represents the most probable and most common threat that every data processing installation faces. Data files, computer programs, and associated supporting material, such as source documents, output records, program documentation, and procedure descriptions, are all part of the information resource that is the life blood of data processing. Some common measures of protection include:

• Saving of files, using the minimum three-generation (grandfather, father, son) principal whereby the oldest file is not destroyed until after the current and previous files have been backed up and validated;
• Duplication of information, on a similar or different physical medium;
• Off-site storage of backup file copies with limited access to the off-site facility;
• Up-to-date record retention schedules covering all protected data files and documents;
• Off-premises storage of vital reports on microfilm or other medium for emergency reconstruction;
• An up-to-date emergency reconstruction plan for major disasters; and
• Development and periodic testing of backup computer programs to reconstruct data files.

Summary

Computer security is necessary in today’s environment because data processing represents a concentration of valuable assets in the form of information, equipment and personnel. Dependence on data processing services creates a unique vulnerability for many organizations. Centralized facilities increase the need for protection but also afford the opportunity for better control and uniform protection. The movement toward decentralization and the rising popularity of personal computers create new exposures and present special needs for security awareness.

Management involvement is essential to a computer security program. Capital expenditures alone cannot accomplish security. Management concern and effort are needed to plan, guide, motivate and
control an effective computer security program. A balanced program, with proper concern for practicality and human values, will enhance the overall effectiveness of the information processing function.
Self-assessment Questions for Computer Security

1. Is there a formal definition of objectives and a formal policy statement on computer and information security? Are these policies and objectives communicated throughout the organization?

2. Are computer operators restricted from data and program information not necessary for operating the computers?

3. Do operators rotate duties periodically?

4. Do programmers rotate duties periodically?

5. Are the duties of data processing personnel separate from input of data and changes to master files?

6. Is there an internal or external audit and review of the system?

7. Is there a systems and procedures manual?

8. Is programming documentation kept up to date?

9. Are backups maintained off-site?

10. Are backups conducted at frequent intervals?

11. Is system security maintained? Are passwords required? Are new users authorized in writing? Are former users deleted from system security?

12. Are alternative facilities available in the event of loss?

13. Do terminals automatically log-off after no usage for several minutes?

14. Are terminals located in a physically secure area?
Reference Sources

Information Systems Audit & Control Association  
3701 Algonquin Road - Suite 1010  
Rolling Meadows, IL 60008  

Information Systems Security Association  
4350 DiPaolo Center, Suite C  
Glenview, IL 60025  

Institute of Internal Auditors  
249 Maitland Ave.  
Altamonte Springs, FL 32701  


Weekly and monthly technical magazines (such as Computer World, Information Week,  
InfoSecurity, Datamation, Network World, Security Advantage, PC Week, PC Magazine, etc.)  
only often provide critiques and comparisons of security products and can identify security  
weaknesses or vulnerabilities in other hardware and software.
CITY OF RIVERSIDE
CALIFORNIA

PROPOSAL SPECIFICATIONS FOR BANKING SERVICES

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Attachment 1

GENERAL INFORMATION

About the City of Riverside

The City of Riverside is a full service Charter City with approximately 250,000 residents. The City operates under a charter adopted on November 17, 1891 which currently provides for a seven-member elected City Council and an elected Mayor. There are no other elected officials. The Council appoints the City Manager, City Attorney and the City Clerk to carry out its adopted policies. The major municipal services provided by the City include administration, police, fire, electric, water, library, recreation and public works such as sewer treatment, refuse collection and general maintenance. The City has approximately 2,400 permanent employees.

About the Request for Proposal

The Treasurer of the City of Riverside seeks proposals from banks interested in providing banking services for the City. The objective of requesting proposals is for the City to determine which bank can offer the highest quality of service at the most reasonable cost. Services currently provided by Bank of America are satisfactory, but the City has a policy that requires a request for proposal process every five years. This process also provides the City the opportunity to explore alternative procedural methods with various technological advances that could improve its banking, cash management and customer service capabilities.
We encourage you to be creative and educational in your responses. While your format must be consistent with the requirements of the RFP, if you believe that your proposed solution or services would be beneficial to the City, we invite you to offer them.

The investment activities of the City will in no way be affected by the appointment of a banking institution to handle the City's banking requirements. All investment activities are handled at the direction of the City Treasurer and are not included as a component of this Request for Proposal.

The City intends to establish a five-year contract, reviewed on a yearly basis. The conditions of the proposal must remain valid for a minimum contract term of five years. As a matter of policy the City will conduct a Request for Proposal for Banking Services at the end of the five year term. Either party can cancel the contract for any reason with 90 days written notice.

**PROPOSAL PROCESS**

The City has made every effort to include enough information within this proposal request for a bank to prepare a responsive proposal. The City encourages banks to submit the most comprehensive and competitive proposal possible. If additional information would be of benefit the City will be willing to respond to questions from bank representatives. In order to achieve an equitable dissemination of information, a pre-proposal conference will be held to allow all interested bank representatives to ask questions of City staff for the mutual benefit of all involved. The timing of the proposal process is as follows:

a. Distribution of Request for Proposals. Proposals will be mailed on **October 20, 1995**.

b. Pre-proposal Conference. City staff will meet collectively with bank representatives seeking additional information about the proposal process and the City's banking needs. The conference is scheduled for **November 8, 1995 beginning at 10:00 a.m.** in the sixth floor conference room at 3900 Main Street, Riverside, CA 92522. Due to space limitations, we must limit the attendance to two representatives from each interested bank. The City requests that the bank advise the City of the bank's attendees by contacting Patti Sanchez at (909) 782-5884 by **November 3, 1995**.

c. Proposal Submission. Proposals must be delivered directly to the Finance Department no later than **5:00 pm, December 1, 1995**. Late submissions after December 1, 1995 or faxed transmitted proposals will not be accepted. A total of three identical copies must be submitted to the following address:

   City of Riverside Finance Department  
   3900 Main Street, 6th Floor
Riverside, CA 92522  
Ref: Banking Services Proposal  
Attn: Jerry Rogers, Deputy Finance Director

d. Proposal Review. The review committee will evaluate each proposal submitted. It is anticipated that the review process will be completed by December 15, 1995 and specific recommendations will be presented to the City’s Finance Committee and City Council.

e. Notification. The City anticipates sending written notification to all banks regarding the outcome of the review and contract award process by January 23, 1996 or sooner.

f. Conversion Activities. The approved firm will be required to coordinate with City staff all the activities necessary to ensure a smooth transition. Conversion activities will begin upon notification and are projected to be completed by March 31, 1996.

g. Contract Effectiveness. The Banking Services contract will become effective on the conversion date for a five year term. The contract shall provide that the City reserves the right to cancel this contract at any time with 90 days written notice.

The City will make every effort to administer the proposal process in accordance with the terms and dates discussed in the request for proposal. However, the City reserves the right to modify the proposal process and dates as deemed necessary.

MINIMUM QUALIFICATIONS

To be considered for selection, proposing banks must have at least the following qualifications:

a. Be a federally or State of California chartered financial institution.
b. Be member of the Federal Reserve System and have access to all services.
c. Be a full service bank in good standing among other comparable banks.
d. Be capable of providing the services sought by the City.
e. Have established offices within the City of Riverside.
f. Have experience in providing banking services for other large organizations, preferably to other municipalities.
g. Be in compliance and good standing with the Community Reinvestment Act.
h. Be sufficiently capitalized to accommodate the City’s cash management needs.
i. Agree to assign personnel who are committed and capable of serving the City’s accounts.
j. Be a qualified depository for public funds.
ACCOUNT DESCRIPTION

The City of Riverside cashiers in excess of $2 billion annually through its demand accounts. Approximately $400 million represents normal City business and $1.5 billion represents investment transactions. The City issues payroll in excess of $70 million and accounts payable checks in excess of $200 million.

The City’s general business requires three (3) demand accounts:

* General Account
* Payroll Account
* Workers’ Compensation Account

There are additional minor account requirements which perform as subsidiary zero-balance accounts to the general account.

* Parking Citation Account
* Swimming Pool Revenue Accounts
* Animal Shelter Account
* Various Small Deposit Accounts (additional accounts may added as needed)

The General Account is used for all cashiering, investment, disbursement and money transfer activities. The Payroll and Worker’s Compensation are non zero-balance accounts established for the disbursement activity only. All accounts are concentrated and rolled into one analysis statement for fee calculation purposes.

Statistical Information:

The majority of the relationship activity takes place in three accounts. The General, Payroll and Workers’ Compensation accounts have been combined to produce the following statistical information regarding volume of combined account activity.

<table>
<thead>
<tr>
<th>Description</th>
<th>Annual Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Items Deposited</td>
<td>1,020,000</td>
</tr>
<tr>
<td>Checks Paid</td>
<td>60,000</td>
</tr>
<tr>
<td>Returned Items</td>
<td>6,000</td>
</tr>
<tr>
<td>Recleared Items</td>
<td>9,000</td>
</tr>
<tr>
<td>Stop Payments</td>
<td>120</td>
</tr>
<tr>
<td>Wires-Incoming</td>
<td>120</td>
</tr>
<tr>
<td>Wires-Outgoing</td>
<td>150</td>
</tr>
<tr>
<td>Coin Deposited (in dollars)</td>
<td>60,000</td>
</tr>
<tr>
<td>Currency Deposited (bill count)</td>
<td>105,000</td>
</tr>
</tbody>
</table>

54
<table>
<thead>
<tr>
<th>Description</th>
<th>Estimated Amount*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average Daily Ledger Balance</td>
<td>$2,900,000</td>
</tr>
<tr>
<td>Average Daily Float</td>
<td>940,000</td>
</tr>
<tr>
<td>Average Positive Collected Balance</td>
<td>1,960,000</td>
</tr>
<tr>
<td>Average Daily Deposits of</td>
<td></td>
</tr>
<tr>
<td>Currency / Coin</td>
<td>50,000</td>
</tr>
</tbody>
</table>

* based on August 1995 analysis report

Deposits

In addition to over-the-counter and mail receipts, the general account will be utilized as the designated depository for electronic transfer deposits. Coin and currency deposited are rolled and bundled by denomination. All deposit items (checks) are fully encoded. The service bank must give immediate ledger credit for deposit items received during the regularly scheduled banking hours whether or not the deposit items can be fully processed by the bank on the day of receipt.

Deposit items returned for non-sufficient funds must be automatically redeposited. If an item is returned a second time, it should be presented to the City for reimbursement.

Disbursements

Most disbursement of funds in the custody of the City, except for investments, direct deposit of payroll and authorized wire transfers are made through the issuance of checks. The City will furnish check stock suitable to the bank’s processing standards. Imprinted on the checks are the bank clearing number, name of the bank, MICR encoding for the bank ABA number, check number and any other required information.

The City currently pays for banking services on an indirect “soft dollar” cost basis. We wish to pay for future banking services on a direct “hard dollar” basis and desire that all responses be proposed in that manner.

SERVICES REQUIRED

The services required to accommodate the City’s current and anticipated banking needs are extensive and major service categories are outlined as follows:

1. Account Reconciliation for Various Checking Accounts. The City wants all disbursement accounts placed on full account reconciliation with positive pay
capabilities. Weekly hard copy reporting and monthly computer media reporting are required.

2. Electronic Reporting/File Transmission. The bank must have an electronic communication/file transmission system to allow the City to receive, by 7 a.m. Pacific Standard Time (PST), previous day balance and transaction information for each designated account. The City will use a personal computer and modem to obtain a balance report each morning for use in connection with its cash management functions. This system must have wire transfer capability.

3. Federal Tax Payments. The City deposits various employee tax payments with the bank.

4. Cash Vault Services. The bank should have a centralized cash vault operation that can accommodate the security, deposit volume and change order demands associated with accounts as large as the City’s. The City currently contracts with the Bank for armored transport services for three distinct cashiering sites within the City.

5. Electronic Payment/Deposit Services. The bank must have the capability to accommodate a wide range of electronic payment and deposit services currently used by the City in connection with investment transactions and Federal and State transfers of funds to the City. The City utilizes direct deposit services for its bi-weekly payroll. Approximately 1,600 employees take advantage of the payment mechanism.

6. Money Transfer Services. The bank must have the capability to accommodate incoming and outgoing electronic money transfers. The bank should also provide the City with a money transfer service that allows the City to initiate wire transfers with the use of a personal computer and modem.

7. Reporting Services. The bank must provide monthly account reconciliation reports, bank statements, account analysis statements, confirmation tickets and other report related features normally associated with large corporate accounts. The banks must be able to provide various reports and statements in a computer media designated by the City and also provide specialized reports, where feasible, as needed.

8. Flash Fund. The bank must provide with 24 hours notice on a confidential basis, up to $100,000 in currency of $20.00, $50.00 and $100.00 denominations to be used by the Police Department in connection with its law enforcement activities. Such deposits and withdrawals should be exempt from federal and state cash deposit reporting. Usual withdrawals range from $10,000 to $25,000 and are usually returned (deposited) within 48 hours of withdrawal.
9. Credit Card Services. The City currently does not accept debit or credit cards for payments of services. However, the bank must be able to provide an electronic system which will accommodate credit card authorizations, automatically deposit funds into a designated City checking account and account for any fees or discount charges with a separate monthly billing.

10. Training Services. The bank must provide on-site training to City personnel for the operation and use of the bank’s services and automated systems for all areas of service. Training, operating manuals, and on-going support are to be supplied by the bank for all services provided.

12. Messenger Services. The bank must provide a messenger between the City and the bank to deliver large checks for same day deposit, magnetic tapes and various reports.

13. Daylight Overdraft Protection. The bank must provide a minimum $25,000,000 Daylight Overdraft Line of Credit subject to credit review by the bank.

14. Processing of returned checks a second time if the item is initially dishonored due to “non sufficient funds” or “refer to maker”. The City receives approximately 6,000 return items per year.

15. Custody & Investment Services. Custody & investment services for the City’s $250 million investment portfolio are not a part of this banking services request for proposal.

16. Other Services. There are many other services too detailed to mention that are customarily provided to corporations and governmental entities. These services will also be generally assessed by the City in reviewing the information provided in the proposal. The City reserves the right to add other services, at a reasonable cost, during the term of the contract.

Proposing banks should have prior experience in providing these services for large corporate organizations and preferably for other governmental entities. More importantly, banks should have the capitalization necessary to accommodate the City’s depository, collateral and cash flow needs.

Demand Account Services

a. The bank must have an operation center or a correspondent bank in the City of Riverside with an operations center in the State of California., be a member of the Federal Reserve System, and meet all California government codes pertaining to depository requirements.
b. The City will compensate the bank for all charges on a direct fee basis. Attachment 1 lists the estimated monthly activity for this relationship.

c. The City, for major service requirements, needs the following account set-ups

1. General Account (Main Sweep Account)
   Monthly statement adapted to City’s accounting month
   Monthly media transmission of all disbursements in prescribed format
   Automated account detail on a daily basis
   Encoded deposit slips

2. Payroll Account
   Monthly statement adapted to City’s accounting month
   Monthly media transmission of all disbursements in prescribed format
   Automated account detail on a daily basis

3. Workers’ Compensation Account
   Monthly statement adapted to City’s accounting month
   Monthly media transmission of all disbursements in prescribed format
   Automated account detail on a daily basis

4. Various Zero Balance Accounts (subsidary to General Account)
   Monthly statement(s) adapted to City’s accounting month
   Automated account detail on a daily basis

**FORMAT AND CONTENT OF PROPOSAL**

In order for City staff to adequately compare and evaluate proposals objectively, all proposals **MUST** be submitted in accordance with this format. The proposal should be prepared simply and economically, providing straight-forward and concise information as requested. Each proposal should be placed in one book format and separated by section and tabbed in conjunction with the proposal specifications. The proposal sections and format **MUST** be organized as follows:

**Title Page/Cover.** *One printed page maximum.* Show the name of the proposing bank, its principal business address and the branch address that would serve the City, the name of the proposer, a bank contact for questions by the City and the date that the proposal was submitted.

**Tab 1. Table of Contents.** *One printed page maximum.*

**Tab 2. Transmittal Letter.** *Two printed pages maximum.* The letter should briefly address the bank’s willingness and commitment, if selected, to provide the services, why the
bank believes it should be selected and any exceptions to the services requested by the City.

Tab 3. Bank and Staff Profile. Five printed pages maximum. Respond to the following underlined text sections:

A. Describe the Bank. Briefly describe the historical evolvement of the bank in the Riverside area including the number of branches within the City limits. Identify the branch or correspondent bank branch in Riverside that would act as the lead banking facility.

B. Describe the bank’s experience in providing similar services. Summarize the services provided for no more than two of the bank’s most comparable corporate or municipal customers. Include a brief description of the services provided, how long such services have been provided and a contact person for each client described.

C. Identify the personnel to be assigned. Describe the role and responsibility of each person assigned a major role in this banking relationship briefly detailing credential and related banking experience.

D. Exceptions. List any services required by the City which are not included in the bank’s proposal.

Tab 4. Deposit Processing. Three printed pages maximum. Describe how the bank would accommodate the volume associated with an account as large and complex as the City’s. For example, indicate if the bank intends to process deposits through the a retail branch or a cash vault center. Recommendations to improve current deposit practices could also be included in this section.

Tab 5. Account Reconcilement. Three printed pages maximum. Describe the account reconciliation services offered by the bank. Describe the media specifications for the bank. Include a description of any electronic or software features available that could be used by the City to interface with the bank to determine a daily or weekly outstanding check balances. Also describe your check truncation services that would be available and its merits.


Tab 8. Balance Reporting. *One printed page maximum.* Describe the balance reporting services offered by the bank.

Tab 9. Payroll Tax Processing. *One printed page maximum.* Describe the services available from the bank to accommodate the City’s payment and reporting of payroll taxes.

Tab 10. Credit Card Processing. *Two printed pages maximum.* Describe the electronic system(s) available to the City for processing credit card transactions.

Tab 11. Controlled Disbursement. *One printed page maximum.* Describe the controlled disbursement program offered by the bank.

Tab 12. Sweep Account Facility. *One printed page maximum.* The City may require the bank to provide a sweep feature to the general account to be used at the option of the City in order to permit excess collected balances remaining in the accounts to be automatically invested in a government qualified money market fund or collateralized repurchase agreement on an overnight basis. Describe the sweep account option offered by the bank.

Tab 13. Interest Allowance/Earnings (where applicable). *One printed page maximum.* Describe the methodology that would be used to give credit to the City for bank balances.

Tab 14. Collected Balances. *Two printed pages maximum.* Specify the bank’s procedures for the calculation of collected balances, calculation of charges for funds advanced, and an explanation of how deposit float will be calculated.

Tab 15. Daylight Overdraft Protection. *One printed page maximum.* Describe any issues, concerns or charges associated with the use of a daylight overdraft facility.

Tab 16. Pricing. *Three printed pages maximum.* Describe, using *attachment 1* as a guide, the pricing for services and supplies that the bank proposes. Include a pro forma detailed monthly billing statement as part of this section (not to be included as part of the page maximum for this section). Indicate if the bank will cap or propose a flat monthly service fee based on information provided by the City in this RFP.

Tab 17. Pricing Adjustments. *One printed page maximum.* Prices are to remain constant for the first two years of the contract. For subsequent years, indicate what process the bank proposes for price increases, if any. Banks may propose an annual adjustment to prices either on a fixed percentage basis or on a variable percentage based on the increase in a nationally recognized index. Indicate if there is there a maximum percentage increase applicable.
Tab 18. Conversion Plan. Two printed pages maximum. Describe the overall plan your bank would coordinate to ensure a smooth transition from the current provider. Indicate what direct costs the City would be responsible for in the conversion. Indicate what conversion costs, if any, would be absorbed by the bank as start up costs. The current provider should discuss any issues that may be different from the existing services. Also discuss the training program for City staff that the bank would provide.

Tab 19. Service Enhancements. Three printed pages maximum. Based upon information about the City’s banking needs and goals learned during the course of this proposal process, describe any enhancements, technological or otherwise, that the City should consider to improve operational or cash management efficiencies.

Tab 20. Community Reinvestment Act. Three printed pages maximum. Describe the bank’s Community Reinvestment Act program established in the Riverside area. Summarize the disclosure data for the last three years for the City of Riverside.

Tab 21. Authorization to Contract. Two printed pages maximum. Provide either a Corporate Resolution, Certificate of Secretary, or correspondence from the Chief Executive Officer or Chairperson attesting that the individual signing the proposal has the authority to make binding representations on behalf of the bank.

Tab 22. Draft Contract. As necessary. Provide a draft contract or agreement for Banking Services that is specific to the services, terms and conditions represented in this request for proposal.

Tab 23. Financial Statements and Ratings. As necessary. Provide the most recent audited financial statements for the bank; and at least two (Standard & Poors, Moody’s and Fitch) credit ratings for the past three years.


Tab 25. Other Information. Three printed pages maximum. Briefly describe any other information not previously mentioned that the bank believes should be given consideration by the City.

EVALUATION OF PROPOSALS

The proposals will be evaluated by a committee comprised of City staff that are directly and indirectly responsible for administering the City’s banking activities. The City at its sole discretion, will determine whether to hold discussions with the Proposers who are in a “competitive range” or to recommend that the Contract be awarded without
discussion on the basis of the proposal submitted. The evaluation criteria will include the following:

A. **Proper Submission of Proposal.** The proposal must be submitted, received by the City Finance Department or postmarked, by the due date outlined in this proposal. It is the responsibility of the bank to ensure proper and timely delivery of all required material. Late submissions will not be considered or evaluated.

B. **Comprehensiveness of Services Provided:** The City’s evaluation of the overall capabilities of the bank to meet the required service levels described in this RFP.

C. **Related Experience.** The bank’s related experience in providing services comparable to the City’s needs.

D. **Firm Stability.** The bank’s financial standing among it peers and the associated credit quality ratings.

E. **Prior City Experience.** The City’s prior experience with the bank.

F. **Assigned Individuals.** The credentials and experience of the person(s) assigned to the City’s accounts.

G. **Account Analysis.** The quality of the bank’s standard account analysis statement.

H. **Conversion Plan.** The thoroughness of the conversion plan to ensure a smooth transition.

I. **Charges for Services.** The amount of the standard charges, proposed pricing increases in subsequent years and the concession pricing structure being proposed.

J. **Service Enhancements.** The bank’s efforts to understand the City’s banking needs and goals and the creativity the bank shows in introducing new technologies and efficiencies to the City to improve current practices and procedures.

K. **Other Factors.** Any other factors that the City believes would be in the best interest of the City to consider which were not previously described.

**FINAL COMMENTS**

The City reserves the right to reject any and all proposals, cancel all or part of this RFP, waive any minor irregularities and to request additional information from proposing banks. By requesting proposals, the City is in no way obligated to award a contract or
pay expenses of the proposing banks in connection with the preparation or submission of a proposal.

The City's decision to award a contract will be based on many factors including but not limited to service, cost, financial strength and innovation. No single factor, such as cost, will determine the final decision to award.

The successful Proposer will be required to secure and maintain appropriate insurance coverage. Proof of such coverage, in the form of a broker-issued certificate, must be received by the City prior to the beginning contract date.

The City truly appreciates the effort all the banks and their respective staffs have put forth in responding to the Banking Services Request for Proposal for the City of Riverside.
ATTACHMENT 1

ESTIMATED BANKING ACTIVITY
UNIT COST ANALYSIS

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<th>UNIT COST</th>
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Automated Reporting Systems
Account reconcilement Charges
Messenger Services
Armored Car (three sites)

Other Costs:____________________________________
________________________________________________
________________________________________________
________________________________________________

TOTAL ESTIMATED YEARLY COST $_____________

Briefly describe the anticipated methodology for service pricing increases, if any. Will the increases be based on the banks standard pricing schedule or an index such as the Consumer Price Index (CPI)?
### Ending Balance

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### Notes
- **Note Proceeds**: Other (int'l., & misc.)
- **Revenue & Permits**: Licenses & Permits
- **Administrative**: Other
- **Other Revenues**: Licenses & Permits
- **Property Taxes**: Other Revenues
- **Use Taxes**: Licenses & Permits
- **Other Revenue**: Licenses & Permits
- **Commissions & Fees**: Other Revenues

### Receipts:
- **Beginning Balance**: $44,829
- **Calendar Year**: 1997
- **General Fund & Special District Special Revenue Fund Estimated Cash Receipts & Disbursements**
- **Appendix 2**

### Appendix 2
- **Calendar Year 1997

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