

# **Treasury Management**

## **November 2006**

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City Auditor's Office

November 3, 2006

Honorable Mayor and City Council,

I am pleased to present the City Auditor's Office's report on the treasury management function at the City of Arlington. The purpose of the audit was to evaluate whether the City's investment activities achieve adequate levels of safety, liquidity, and profitability in accordance with existing mandates.

Management concurs with our audit findings and related recommendations. Management responses to our audit findings and recommendations, as well as target implementation dates and responsibilities, are included in the following report. At a later date, the City Auditor's Office will conduct a follow-up audit and comment on management's implementation of these audit recommendations.

We would like to thank City staff for their cooperation and assistance during this project and we look forward to continuing our efforts to further enhance investment practices.



Patrice Randle, CPA  
City Auditor

c: Jim Holgersson, City Manager  
Fiona Allen, Deputy City Manager  
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# Treasury Management Audit

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# **TREASURY MANAGEMENT AUDIT**



Office of the City Auditor

Patrice Randle, CPA  
City Auditor

Project #06-02

November 3, 2006

## **Executive Summary**

*The City's investment program is in compliance with the Texas Public Funds Investment Act and generally follows GFOA best practices.*

*The City has instituted a system of controls that allows the City to achieve adequate levels of safety, liquidity, and profitability in the investment of its surplus funds.*

## **Opportunities for Improvement**

- *Written procedures*
- *Diversification guidelines*
- *Improved performance measures*

In accordance with the FY 2006 audit plan, the City Auditor's Office has completed an audit of investment activities. The audit was conducted in accordance with generally accepted government auditing standards. The objective of the audit was to evaluate whether the City's investment activities achieve adequate levels of safety, liquidity, and profitability in accordance with existing mandates.

The City's investment program is in conformance with the Texas Public Funds Investment Act and generally follows best practices as recommended by the Government Finance Officers Association (GFOA).

The City has instituted a system of controls that if operating properly is capable of providing reasonable assurance that investment activities achieve adequate levels of safety, liquidity, and profitability in accordance with existing mandates. However, the City Auditor's Office did note the following findings that are summarized below and are presented more thoroughly in the Detailed Audit Findings section of this report:

- A written document describing routine procedures to be used to implement the investment policy does not exist.
- The investment policy does not prescribe the means or guidelines for achieving diversification of the City's portfolio.
- Investment performance measures and reports do not provide an assessment of the quality of investment decisions.

## ***Audit Scope and Methodology***

The City Auditor's Office reviewed investment activity and portfolio structure for FY 2005 and part of FY 2006 (through April 30, 2006). The following methodology was used in completing the audit:

- Reviewed the City's investment policy
- Reviewed the Treasury's administrative procedures for the investment function
- Reviewed the City's banking and investment agreements
- Interviewed Financial Services employees
- Reviewed management reports
- Reviewed relevant state legislation
- Researched best practices for the investment function
- Reviewed and assessed internal controls over investments

## ***Background***

The Texas Public Funds Investment Act<sup>1</sup> regulates the investment of surplus cash by local governments. It requires the City Council to adopt and annually review an investment policy and prescribes the investment policy's content. It requires the City Council to appoint an investment officer to be responsible for the investment function. Security dealers and brokers are required to review the City's investment policy and institute policies and procedures designed to preclude investment transactions unauthorized by the policy and state law. The Act also prescribes the type of investment security instruments local governments are allowed to purchase and sets the investment objectives for local governments as:

1. Preservation and safety of principal
2. Liquidity
3. Yield

In addition, the Act sets requirements for investment officer training, local government reporting requirements, annual review of an authorized brokers list, and an annual audit of internal controls and compliance with the investment policy.

The City has three investment portfolios administered by the Treasury Management Division of the Financial Services Department:

1. Main city portfolio: a pool of City money from the General and other funds including the Self-Insurance, Water and Sewer, and Landfill funds; and an Electric Utility Rate Case Reserve;
2. Trust account for the ballpark construction held for the Arlington Sports Facilities Development Authority (ASFDA). Each year, the city receives \$2 million from the Rangers ticket surcharge to pay off the bonds associated with this account; and,
3. Fund for the construction of the Cowboys stadium.

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<sup>1</sup> Texas Government Code, Chapter 2256.

The 2005 Comprehensive Annual Financial Report (CAFR) reports the following values for the City's investments, by fund:

<b>Fund</b>	<b>Book Value</b>	<b>Fair Value</b>	<b>Weighted Average Maturity (days)</b>
General Operating	\$228,787,323	\$228,335,812	153
Cowboys Stadium Complex	\$269,838,308	\$268,773,047	462
Debt Service and Working Capital Reserve	\$6,661,788	\$6,644,193	239
Cowboys Stadium Complex Debt Service Reserve	\$12,525,955	\$12,480,225	579
Self Insurance	\$4,264,785	\$4,252,616	130
<b>Total</b>	<b>\$522,078,159</b>	<b>\$520,485,893</b>	

Source: FY 2005 CAFR

In addition, the component units of the City had the following investments:

Capital Projects Funds	\$946,100	\$946,100	1
Debt Service Sinking Fund	\$9,103,349	\$8,949,738	1,111
<b>Total</b>	<b>\$10,049,449</b>	<b>\$9,895,838</b>	

Source: FY 2005 CAFR

## *Detailed Audit Findings*

### **1. The Treasury Management Division has not documented its routine investment procedures.**

The Treasury Management Division does not have a written document describing its procedures or job descriptions for Treasury personnel. Section V. A. of the City's Investment Policy assigns management responsibility for the investment function to the Chief Financial Officer, who "shall establish written procedures consistent with the policy".

The City's Cash and Debt Administrator made a list of investment procedures communicated to him by management. However, this list was not reviewed, approved, or updated by the Chief Financial Officer. For example, individual security purchases are normally limited to \$5 million, maturities are laddered at 2-week steps, and the City's bank account balance is kept at a minimum of \$250,000. Sound business practice is to document these and other routine procedures such as selecting, purchasing, accounting, and disposing of investments, along with job descriptions for investment officers, in a procedure manual or a similar document.

Documented procedures are an internal control which, if implemented, improve the control environment by eliminating subjectivity and uncertainty in routine operations. It allows for a review and improvement of failed procedures, and provides a source of reference and training for investment officers, managers, and reviewers. In addition, it makes training of new personnel easier and more uniform.

#### ***Recommendation:***

The Director of Financial Services should develop written procedures for the investment function.

#### ***Management's Response:***

*The Cash and Debt Administrator will prepare the written procedures and present them to the Investment Committee for review prior to the November 16, 2006 committee meeting so that the written procedures can be approved on November 16th.*

*Target Date: November 16, 2006*

*Responsibility: Cash and Debt Administrator*

### **2. Diversification guidelines should be revisited.**

Diversification guidelines prevent investment officers from over-concentrating investment resources in any one security type, provide a source of reference for daily operations, and allow for easier review and follow-up. While the City's Investment Policy complies with the Texas Public Funds Investment Act and generally follows GFOA recommendations, there was no document that specified the City's diversification goals and how the goals were to be achieved.

Internal Audit was informed that in practice, the City's strategy is to keep a minimum of 50 percent of the portfolio in investments issued by the U.S. Treasury, ladder maturities, and keep a minimum of 20 percent of the portfolio sufficiently liquid to meet immediate cash needs. Minutes from an August 10, 2000 Regular Investment Committee Meeting indicated that "the Committee discussed the minimum percentage of the City's portfolio (50%) that must be invested in treasury and/or treasury backed repurchase agreements". The August 2000 minutes went on to further state that "if the trend of the federal budget surpluses continues, it may be necessary to reconsider the asset allocation of the City's investment portfolio". Internal Audit observed no reference to the 20% minimum requirement for immediate cash needs and no other reference to the 50% treasuries requirement.

As a part of the investment strategy discussion, the Investment Committee discussed the weighted average maturity at each subsequent quarterly meeting. However, Internal Audit saw no indication that there had been any additional discussion regarding the 50% minimum portfolio requirement that was previously established. By not reconsidering the existing requirements, the City's rate of return on investments may not be maximized. The Cash and Debt Manager indicated that the City could improve its portfolio performance by decreasing the U.S. Treasury requirement. Under current market conditions, Internal Audit noted that yields on other U.S. backed investments (e.g. Fannie Mae) were higher than U.S. Treasuries.

***Recommendation:***

The Director of Financial Services should request that the Investment Committee revisit existing diversification guidelines and incorporate any resulting changes in the investment policy.

***Management's Response:***

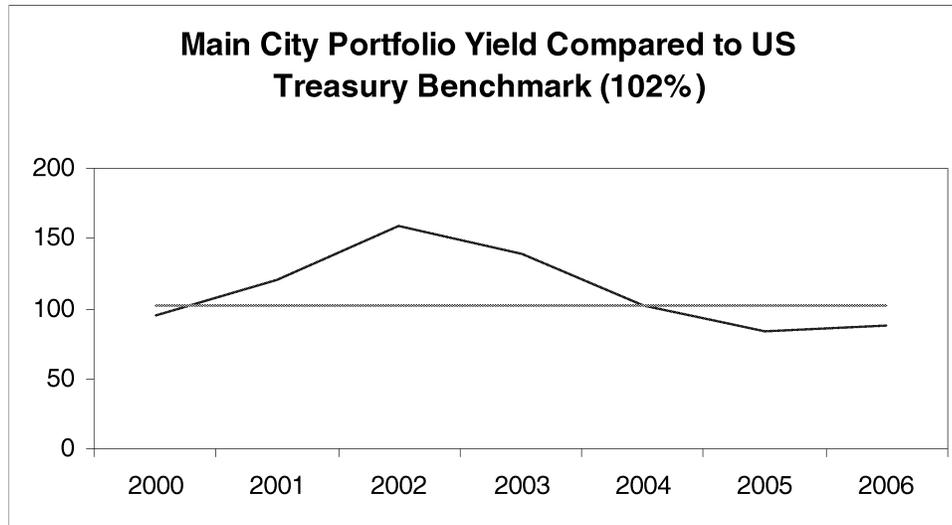
*The Cash and Debt Administrator will re-examine the current practices relating to the diversification of the portfolio; develop a written policy defining maximum percentages of any type of investment instead of the current practice which defines minimum investment levels and present the recommendations for codification into the Investment Policy to the Investment Committee prior to the November 16, 2006 meeting for review and adoption on that date. Revisions to the Investment Policy will be presented to the City Council for adoption.*

*Target Date: November 16, 2006*

*Responsibility: Cash and Debt Administrator*

**3. Performance measures for the investment function can be improved.**

The City's investment policy states the investment goal as exceeding by 1.02 times the average rate of return of the U.S. Treasury yield curve. The Treasury Management Division has met its performance goal in four of the last six years. However, in the last two fiscal years, the City's portfolio yield did not exceed the average U.S. Treasury yield, as shown in the graph on the following page:



Source: FY 2000-2006 Performance Management Reports

Different municipalities use different benchmarks for measuring their performance. Municipalities compare the performance of their portfolios to indexes, a combination of indexes, or yields reported by privately run funds based on the similarity of underlying securities and whether or not the benchmark data are readily available. Some municipalities compare the performance of their portfolio to that of peer cities. The City's benchmark is based on the current yield rate, which is not comparable to a portfolio based on investments purchased over time. The result is an inaccurate performance measure, evidenced by the performance variability shown in the graph above.

The City's investment policy also states a separate goal for the investment of tax-exempt debt proceeds, for which the Treasury Management Division has not been tracking or reporting as a separate performance measure. The goal is to achieve an average rate of return equal to at least the arbitrage yield limit on the debt. Treasury Management staff indicated that since the City no longer establishes a new portfolio each time bonds are sold, the separate performance measure of tax-exempt bonds is no longer necessary. The Treasury Division, therefore, includes tax-exempt investments in the performance of the overall portfolio that is compared to the yields from U.S. Treasury securities.

***Recommendation:***

The Director of Financial Services should revise the investment performance measures to more effectively evaluate the City's practice.

***Management's Response:***

*The Cash and Debt Administrator will re-examine the investment portfolio performance measures and revise as necessary to more effectively evaluate the City's actual performance. The recommended changes to the Investment Policy will be distributed the Investment Committee prior to the November 16, 2006 meeting for their consideration and adoption on that date. Any changes to the Investment Policy will be presented to the City Council for adoption.*

*Target Date:* November 16, 2006  
*Responsibility:* Cash and Debt Administrator

***Recommendation:***

The Director of Financial Services should exclude the performance measure for tax-exempt investment from the City's investment policy.

***Management's Response:***

*The exclusion will be presented to the Investment Committee for review and approval at the November 16, 2006 Investment Committee meeting, and subsequently presented to the City Council for approval.*

*Target Date:* November 16, 2006  
*Responsibility:* Cash and Debt Administrator