

City of Sultan
Finance Department Report
Council Retreat

Subject: Policy and Procedures for Financial Management

Summary:

The City operates under the guidelines of the BARS (Budget, Accounting and Reporting System) manual provided by the State Auditor's Office. This provides a starting point for the development of internal policies for the financial management of the City. The State Auditor has strongly recommended that the City adopt more formal and written policies for the utility billing system, credit card use, purchasing and travel expenses. It is also good fiscal management to have budget, investment and debt polices in place.

Budget Policy

A good budget policy needs input from staff and the council. The following elements need to be considered:

1. Budget schedule and responsibility
2. Allocation of costs
3. Capital Improvement Plan
4. Debt Service needs
5. Staffing needs
6. Contingency and fund reserve needs
7. Amendments and adjustments
8. Revenue shortfalls and expenditure limitations

Staff has been gathering samples of other budget polices to provide guidelines to develop a policy specific to Sultan. Attached are samples from the City of Kirkland and University Place. The philosophy in all the policies that I reviewed was to provide guidelines for the Council, staff and the citizens on the budget process and the fiscal management of the city.

The City has recently passed Ordinance 940-06 (see page 2) which sets up a General Fund Contingency and Reserve Fund. In the past a resolution as been passed to set spending limitation (see page 3, Resolution 05-33). We have a policy on accounts payables and that is the extent of any written guidelines.

There are several examples of budget policies and I have materials published by the Municipal Finance Officers Association and the Government Finance Officers Association to help us develop a good Budget Policy. At this point, we are looking for Council direction on how you would like us to proceed on the development of budget policy.

Staff recommends that the Council proceed with the development of detailed budget policies

Attachments: A-1 University Place Budget Policy Guidelines
A-2 City of Kirkland Fiscal Policies

**CITY OF SULTAN
ORDINANCE NO. 940-06**

Section 1. Sultan Municipal Code Chapter 3.48 is hereby amended to add an Article III reading as follows:

Article III . General Fund; Contingency Fund; Reserve General Fund

- 3.48.070 General Fund
- 3.48.080 Contingency Fund
- 3.48.090 Reserve General Fund

3.48.070 General Fund. There is hereby established the general fund of the City. Except where otherwise designated, or otherwise required by the provisions of law, all funds of the City shall be deposited into the general fund of the City.

3.48.080 Contingency Fund. There is hereby established in the General Fund a sub-fund entitled the Contingency Fund. For audit purposes the fund shall be numbered Fund 100. Until a total amount equal to the greater of 10% of annual General Fund revenues or \$200,000 is accumulated in the fund, monies shall be deposited to the fund on a periodic basis from the City's retail sales tax revenues when annual proceeds from that tax exceed \$250,000. The previous year's balance in the fund shall become the beginning fund balance in the next annual budget for this sub-fund. Subject to any hearing required by law, amendment of the City's budget as required by law, and compliance with RCW 35A.44.146, monies in the contingency fund shall be used by the City to meet unanticipated revenue short falls or unanticipated expenditures during the City's fiscal year. At no time shall the fund balance exceed the legal limit set forth in RCW 35A.33.145.

3.48.090 Reserve General Fund. There is hereby established in the General Fund a sub-fund entitled the Reserve General Fund. For audit purposes the fund shall be numbered Fund 150. After annual revenues from the City's retail sales tax exceed \$250,000, and after the City's Contingency fund has been fully funded, remaining excess revenues from the City's retail sales tax shall be accumulated in this sub-fund until an amount equal to the greater of 25% of annual General Fund revenues or \$500,000 is in the fund. The previous year's balance in the fund shall become the beginning fund balance in the next annual budget for this sub-fund. Subject to any hearing required by law, and amendment of the City's budget as required by law, and any required compliance with RCW 35A.33.145, monies in the Reserve General Fund shall be used to meet costs associated with emergent and cataclysmic events after a declaration of emergency promulgated by the Mayor. The sum of the monies in this fund and in the Contingency Fund shall not exceed the legal limit set in RCW 35 A.33.145.

RESOLUTION 05-33
A RESOLUTION ADOPTING CITY COUNCIL BUDGET POLICIES
FOR THE ADMINISTRATION OF THE 2006 BUDGET

WHEREAS, the City Council of the City of Sultan has determined that it is in the best interests of the City of Sultan to developed specific Council policies for the Administration of the 2006 Budget to insure that all funds have a Cash Reserve created and maintained to provide a fiscal cushion that meets seasonal cash flow shortfalls, and assists in facing unpredictable economic downturns.

NOW, THEREFORE, BE IT RESOLVED by the City Council of the City of Sultan that the following policies are hereby Adopted for the 2006 Budget:

Policy 1. The following Positions are not funded in the 2006 Budget:

- A. Police Department - Records Clerk, 2 Police Officers
- B. Clerk /Treasurer Department - Deputy/Clerk Treasurer
- C. Public Works - Supervisor
- D. Building Department - Building Inspector
- E. Planning Department - Assistant Planner

Policy 2. Department monthly expenditures, including payroll, shall not exceed 8% of their Fund Budgets. However, monthly expenditures, which are less than the 8% allocation maybe, carried over to the preceding month(s).

Policy 3. All Department requests for monthly expenditures exceeding the monthly 8% allocation shall be reviewed and approved by the Mayor and City Administrator and forwarded to the Finance Committee and City Council for Consideration and Action.

Policy 4. To reduce late fees and finance charges and to provide timely payment on accounts, the Clerk/Treasurer shall be authorized to pay utility bills, phone and pager bills, the credit card bill and any bills that provide discounts subject to the approval of the City Administrator and/or Mayor.

Policy 5. Except for emergency situations acknowledged by the Mayor or City Administrator, overtime hours for non-exempt employees shall **not** be charged to the General Fund.

Policy 6. A monthly payment of \$3,500.00 shall be made from the General Fund to the C.R. Utility Reserve Fund as required by the Promissory Note described in Resolution 03-17, provided funds are available.

Policy 7. All monthly Sales Tax Revenues exceeding the monthly average of \$20,000 shall be deposited in the General Fund Cash Reserve Account.

Policy 8. In order to effectively monitor and administer the 2006 Budget and Policies the City/Clerk Treasurer shall provide monthly financial reports to the City Council and all Departments.

Sample Only

University Place, WA Budget Policy Guidelines

2001-2002 Adopted Biennial Budget
Budget Guide

I. OPERATING BUDGET

A. OVERALL

1. The purpose of budget policies is:
 - a. to ensure the City maintains a financial base sufficient to sustain a consistent level of municipal services;
 - b. to ensure the City is able to withstand local and regional economic variations;
 - c. to adjust to changes in the service requirements of the community, and;
 - d. to maintain a good credit rating in the financial community which assures taxpayers that City government is well managed financially and maintained in sound fiscal condition.
2. The budget should be a performance, financing, and spending plan agreed to by the City Council, City Manager, and Department Directors. It should contain information and data regarding expected revenues, expected expenditures, and expected performance.
3. The City will prepare and annually refine written policies and goals to guide the preparation of performance, financing, and spending plans for the City budget. Adopted budgets will comply with the adopted budget policies and Council priorities.
4. As a comprehensive business plan, the budget should provide the following critical elements recommended by the Government Finance Officers Association: public policies, financial plan, operations guide, and communications device.
5. The City's budget presentation should display the City's service delivery/performance plan in a Council/constituent-friendly format. Therefore, the City will use a department budgeting format to convey the policies and purposes of City operations.
6. Decision making for capital improvements will be coordinated with the operating budget to make effective use of the City's limited resources for operating and maintaining facilities.
7. Under the City Manager's direction, Department Directors have primary responsibility for:
 - a) formulating budget proposals in line with City Council and City Manager priority

A1-1

direction, and b) implementing those proposals once they are approved.

B. FISCAL INTEGRITY

1. The City will maintain the fiscal integrity of its operating, debt service, and capital improvement budgets which provide services and maintain certain public facilities, streets and utilities. It is the City's intent to maximize the level of public goods and services while minimizing the level of debt.
2. Ongoing operating program costs may not exceed the amount of ongoing revenue to finance those costs. The ongoing revenue will be identified along with new program costs. Any available carryover balance may be used to offset one-time or non-recurring costs.
3. Cash balances in excess of the amount required to maintain strategic reserves may be used to fund one-time or non-recurring costs.

C. CONTINGENT ACCOUNTS

1. The City shall annually establish an appropriated Contingency Reserve (RCW 35A.33.145) in order to accommodate unexpected operational changes, legislative impacts, or other economic events affecting the City's operations which could not have been reasonably anticipated at the time the budget was prepared. Funding shall be targeted at three (3) percent of the City's operating expenditures.
2. The City shall establish a Strategic Reserve Fund which shall neither be appropriated nor spent without Council authorization. The purpose of the fund is to provide some fiscal means for the City to respond to potential adversities such as public emergencies, natural disasters, or similarly major, unanticipated events. Funding shall be targeted at not less than five (5) percent of the City's operating expenditures, which may be adjusted annually by the City Council during the biennial budget process.
3. The City shall fund certain asset replacement reserves through depreciation charges paid to the Internal Service Funds.
4. Replacement reserves based on historical value will be established for any equipment, furnishings, and computer software should the need continue beyond the estimated initial useful life, regardless of whether the equipment is acquired via lease, gift, or purchase. An amount equal to the depreciation will be included in the service charges paid by City departments to the various Internal Service funds (Fleet and Equipment, Property Management, Information Technology and Services, and Risk Management). The furnishings reserve may be used for building rehabilitation and will be replenished until cost is fully recovered. This will permit the accumulation of cash to cost-effectively replace these assets and smooth out future budgetary impacts. The City will also maintain a fixed asset system that will identify all city assets and their condition.
5. The strategic reserve should be replenished as soon as possible and always within three subsequent years from the time the reserve is used or falls below the target. Sources to replenish these reserves shall be from undesignated fund balances, deferring non-life safety capital, and operating revenues in this order.

A1.2

D. REVENUES

1. Revenue estimates shall not assume any growth rate in excess of inflation. Real growth that occurs will be recognized through budgetary adjustments only after it takes place. This practice imposes short-term constraint on the level of public goods or services. However, in the event that revenues are less than expected, it minimizes the likelihood of severe cutback actions which may be profoundly disruptive to the goal of providing a consistent level of quality services.
2. Investment income earned through the City's investment pool shall be budgeted based upon the allocation methodology, i.e. the projected average monthly balance of each participating fund.
3. The City will establish and maintain Special Revenue Funds to account for proceeds from specific sources to finance designated activities which are required by statute, ordinance, resolution, or executive order.
4. All fees for services shall be reviewed and adjusted (where necessary) at least every biennium to ensure that fees are equitable and the cover the total cost of service or that percentage of total service cost deemed appropriate by the City.
5. Revenues of a limited or indefinite term should be used for capital projects or one-time operating expenditures to ensure that no ongoing service program is lost when such revenues are reduced or discontinued.
6. Grant applications to fund new service programs with state or federal funds will be reviewed by the City, as they become available, with due consideration being given to whether locally generated revenues will be required to support these programs when outside funding is no longer available.

E. EXPENDITURES

1. Before the City undertakes any agreements that would create fixed ongoing expenditures, the cost implications of such agreements will be fully determined for current and future years with the aid of the City's strategic financial forecast model.
2. Organizations that are not part of the City, but which receive funding from the City, shall not have their appropriation carried forward from year to year unless expressly authorized and directed by the City Council. Annual review and reauthorization of funding is required.

F. MULTI-YEAR FORECAST

1. Each year, the City will update expenditure and revenue forecasts for the next six years. Projections will include estimated operating costs for future capital improvements that are included in the capital budget.
2. These estimates will be presented to elected officials in a form that will facilitate budget decisions and strategic planning, based on a multi-year strategic planning perspective.

G. QUARTERLY REPORT

A1-3

1. The budget will be produced so that it can be directly compared to the actual results of the fiscal year and presented in a timely quarterly report.
2. All budget amendments - both revenues and expenditures - will be noted in the quarterly report.

H. MINIMIZATION OF ADMINISTRATIVE COSTS

1. An appropriate balance will be maintained between resources allocated for direct services to the public and resources allocated to assure sound management, internal controls and legal compliance.

I. CITIZEN INVOLVEMENT

1. Citizen involvement shall be encouraged in the budget decision-making process through public hearings and study sessions.
2. Involvement shall also be facilitated through City boards, task forces, and commissions, which shall serve in advisory capacities to the City Council and/or City Manager.

II. CAPITAL BUDGET

A. FISCAL POLICIES

1. Capital project proposals should include cost estimates that are as complete, reliable, and attainable as possible. Project cost estimates for the Capital Budget should be based upon a thorough analysis of the project and are expected to be as reliable as the level of detail known about the project. Project cost estimates for the Six-Year Capital Improvement Plan will vary in reliability depending on whether they are to be undertaken in the first, third, or sixth year of the Plan.
2. All proposals for the expenditure of capital funds shall be formulated and presented to Council within the framework of a general capital budget and, except in exceptional circumstances, no consideration will be given to the commitment of any capital funds, including reserve funds, in isolation from a general review of all capital budget requirements.
3. Project proposals should indicate the project's impact on the operating budget, including, but not limited to, long-term maintenance costs necessary to support the improvement.
4. The Annual Capital Budget shall include only those projects which can reasonably be accomplished in the time frame indicated. Each budgeted capital project should include a projected schedule.
5. Capital projects which are not encumbered or completed during the fiscal year will be rebudgeted or carried over to the next fiscal year except as reported to and subsequently approved by the City Council. All rebudgeted capital projects should be so noted in the Adopted Capital Budget. Similarly, multi-year projects with unencumbered or unexpended funds will be carried over to the subsequent year(s).

A-1-4

6. Capital projects will not be budgeted unless there are reasonable expectations that revenues will be available to pay for them.

7. Citizen participation in the Capital Improvement Program is a priority for the City. Among the activities which shall be conducted to address this need are the following:

a. The Capital Improvement Plan shall be provided to the City Council in a timely manner to allow time for the Council members to review the proposal with constituents before it is considered for adoption.

b. Council study sessions on the Capital Improvement Plan shall be open to the public and advertised sufficiently in advance of the meetings to allow for the attendance of interested citizens.

c. Prior to the adoption of the Capital Improvement Plan, the City Council shall hold noticed public hearings to provide opportunities for citizens to express their opinions on the proposed plan.

8. All projects included in the Capital Improvement Plan should be consistent with the City's Comprehensive Plan. The goals and policies for services, facilities, and transportation should be followed in the development of the Capital Improvement Plan. The Comprehensive Plan service level goals should be included in the Capital Improvement Plan.

9. Capital projects shall be financed to the greatest extent possible through user fees, grants, and benefit districts when direct benefit to users results from construction of the project.

10. Projects that involve intergovernmental cooperation in planning and funding should be established by an agreement that sets forth the basic responsibilities of the parties involved.

11. The Council will annually review and establish criteria against which capital proposals should be measured. Included among the factors which will be considered for priority-ranking are the following:

a. Projects which have a positive impact on the operating budget (reduced expenditures, increased revenues);

b. Projects which are programmed in the Six-Year Capital Improvement Plan;

c. Projects which can be completed or significantly advanced during the Six-Year Capital Improvement Plan;

d. Projects which can be realistically accomplished during the year they are scheduled; and

e. Projects which implement previous Council-adopted reports and strategies.

B. DEBT POLICIES

1. A debt policy can help the City Council and staff integrate the issuance of debt with other

A-1-5

long-term planning, financial, and management objectives. It also evaluates the impact of each issue on the City's overall financial position. Finally, a debt policy provides guidance to the City Council and staff so as to not exceed acceptable levels of indebtedness.

2. Long-term Borrowing

a. General obligation bonds, or G.O. Bonds, are secured by the full faith and credit of the City. General obligation bonds issued by the City are secured by a pledge of the City's ad valorem taxing power. There are two basic types of general obligation bonds:

i. Limited tax general obligation bonds, also called LTGO bonds or councilmanic bonds, may be issued by a vote of the City Council. General fund revenues are pledged to pay the debt service on councilmanic bonds because the voters have not approved a tax increase to pay for the principal and interest.

ii. Unlimited tax general obligation bonds, also called UTGO bonds or voted debt, must be approved by 60 percent of the voters, with a voter turnout that is at least 40 percent of those voting in the most recent general election. Voters are not only voting for the approval to issue bonds, but they are also voting for an excess levy which raises their property taxes to fund debt service payments.

b. Certificates of Participation are used to acquire real or personal property with tax-exempt financing using a lease-purchase agreement. The City would make annual installment payments to a third party investor over time, acquiring the property at the end of the lease period for a nominal payment.

c. Revenue bonds are issued to finance facilities that have a definable user or revenue base, usually a City enterprise that is self-supporting. These debt instruments are secured by a specific source of funds, either from the operations of the project being financed or from a dedicated revenue stream, rather than the general taxing powers of the City. Generally, no election is required prior to the issuance or validation of revenue bonds.

d. Special assessment bonds or local improvement districts (LIDs) are obligations payable from special assessment revenue. These bonds are issued to finance improvements that benefit a specific area. Because the benefit is largely enjoyed by a limited segment of the community, a special assessment to pay debt service is levied only on properties or households benefiting from the project. Property owners may petition the City to form an LID, or the City Council may adopt a resolution of intent to form an LID. An LID initiated by Council Resolution may be blocked if the property owners who would be paying at least 60 percent of the costs protest. LIDs are commonly used for projects such as street improvements, street lights, sidewalks, and water and sewer systems.

e. Utility local improvement districts (ULIDs) may be formed in a manner similar to LIDs for the purpose of providing water systems, sewer and storm drainage systems, and parking garages. The primary difference between the two kinds of districts is that revenue bonds must be issued for ULIDs, assessments must be deposited in a fund to pay off the revenue bonds, and the bonds are backed both by assessments and by

A-16

utility revenue.

3. Short-term Borrowing

- a. Notes, such as bond anticipation notes (BANs) or tax anticipation notes (TANs), is a written short-term promise of the City to repay a specified principal amount on a certain date, together with interest at a stated rate, or according to a formula for determining that rate, payable from a defined source of anticipated revenue such as bonds, anticipated taxes, or some other anticipated revenue source expected to be received at a future date.
 - b. Lines of credit are another short-term borrowing option that provides an alternative to anticipation notes. A bank and the City agree on the maximum amount that will be available under the line of credit. The City provides a note to the bank that is backed by the full faith and credit of the City.
4. City Council approval is required prior to the issuance of debt. In addition, an analytical review shall be conducted prior to the issuance of debt to determine if there are reasonable alternatives and to reduce the cost of borrowing.
 5. The City will use the services of a legally certified and credible bond counsel in the preparation of all bond representations.
 6. A Financial Advisor may be used to assist in the issuance of the City's debt. The Financial Advisor provides the City with objective advice and analysis on debt issuance. This includes, but is not limited to, monitoring market opportunities, structuring and pricing debt, and preparing official statements of disclosure.
 7. An Underwriter(s) will be used for all debt issued in a negotiated or private placement sale method. The Underwriter is responsible for purchasing negotiated or private placement debt and reselling the debt to investors.
 8. A Fiscal Agent will be used to provide accurate and timely securities processing and timely payment to bondholders. In accordance with RCW 43.80, the City will use the Fiscal Agent that is appointed by the State.
 9. Short-term lines of credit, tax or Revenue Anticipation Notes may be used only when the City's ability to implement approved programs and projects is seriously hampered by temporary cash flow shortages. In general, these Notes will be avoided. No other form of debt will be used to finance ongoing operational costs.
 10. Whenever possible, the City shall identify alternative sources of funding and shall examine the availability of those sources in order to minimize the level of debt.
 11. Whenever possible, the City shall use special assessment, revenue, or other self-supporting bonds instead of general obligation debt.
 12. Long-term general obligation debt will be incurred when necessary to acquire land or fixed assets, based upon the ability of the City to pay. This debt shall be limited to those capital improvements that cannot be financed from existing revenues and when there is an

A-1.7

existing or near-term need for the project. The project should also be integrated with the City's long-term financial plan and Capital Improvement Plan.

13. The maturity date for any debt will not exceed the reasonable expected useful life of the project so financed.

14. The City shall encourage and maintain good relations with financial and bond rating agencies, and will follow a policy of full and open disclosure on every financial report and bond prospectus.

15. The City shall establish affordability guidelines in order to preserve credit quality.

16. Long-term borrowing will only be used for capital improvements that cannot be financed from current revenues.

17. Short-term borrowing will only be used to meet the immediate financing needs of a project for which long-term financing has been secured, but not yet received.

18. DEBT MANAGEMENT POLICY

The City Council adopted Resolution No. 100, setting forth its debt management policy, on May 6, 1996. The resolution provides, in general, that:

- The maturity date for any debt will not exceed the reasonable expected useful life of the project so financed.
- Long term debt will not be used to finance ongoing current operations and maintenance.
- The City shall attempt to maintain a cash reserve of eight percent (8%) of its operating budget, the approximate equivalent of one month's operating requirement.
- The City shall attempt to maintain a balanced relationship between issuing debt and using pay-as-you-go financing.
- In determining which type of debt to issue, the following factors should be considered:
 - A significantly larger portion of the citizens should benefit from projects financed by general obligation bonds.
 - Whenever possible, the City shall identify alternative sources of funding and shall examine the availability of those sources in order to minimize the level of debt.
 - The project should be integrated with the City's long-term financial plan and Capital Improvement Plan.
 - The City shall encourage and maintain good relations with financial and bond rating agencies, and will follow a policy of full and open disclosure on every financial report and bond prospectus. The City shall also establish affordability guidelines in order to preserve credit quality.

BASIS OF ACCOUNTING AND BUDGETING

A-18

Accounting

Accounting records for the City are maintained in accordance with methods prescribed by the State Auditor under the authority of Washington State law, Chapter 43.09 R.C.W., and in compliance with generally accepted accounting principles as set forth by the Governmental Accounting Standards Board.

Basis of Presentation - Fund Accounting

The accounts of the City are organized on the basis of funds and account groups. Each fund is a separate accounting entity with a self-balancing set of accounts. The account groups are financial reporting devices used to provide accounting control for certain assets and liabilities not recorded in the funds because they do not directly affect net expendable available financial resources. Under the current governmental accounting model, there are three broad fund categories, seven generic fund types within those categories and two account groups. A purpose and description of the fund is provided on the fund pages in the Budget by Fund section of this budget document. A description of the three fund categories and the generic fund types included in each category is provided below.

Governmental Funds Types

Governmental funds are used to account for activities typically associated with state and local government operations. All governmental fund types are accounted for on a spending or "financial flows" measurement focus, which means that typically only current assets and current liabilities are included on related balance sheets. The operating statements of governmental funds measure changes in financial position, rather than net income. They present increases (revenues and other financing sources) and decreases (expenditures and other financing uses) in net current assets. The four generic fund types in this category are described in the following paragraphs.

The **General Fund** is the general operating fund of the City and accounts for all activities not required to be accounted for in some other fund.

Special Revenue Funds account for the proceeds of specific revenue sources - other than expendable trusts or revenues designated for major capital projects - that are legally restricted to expenditures for specific purposes.

Debt Service Funds account for the accumulation of resources for and the payment of general long-term debt, principal, interest, and related costs.

Capital Projects Funds account for the acquisition or construction of major capital facilities except those financed by proprietary funds and trust funds.

Proprietary Funds are used to account for activities similar to those found in the private sector where the intent of the governing body is to finance the full cost of providing services, including depreciation, primarily through user charges. The measurement focus for these funds is based on the commercial model which uses a flow of economic resources approach. Under this approach, the operating statements for the proprietary funds focus on a measurement of net income (revenues and expenses) and both current and non-current assets and liabilities are reported on related balance sheets. Their reported fund equity (net total assets) is segregated into contributed capital and retained earnings components. As described below, there are two generic fund types in this category.

Enterprise Funds account for operations that are financed and operated in a manner similar to private

A-19

business enterprises where the intent of the City is to finance or recover, primarily through user charges, the costs of providing goods or services to the general public on a continuing basis.

Internal Services Funds account for business-like activities where related goods or services are primarily provided to other departments or funds of the City on a cost-reimbursed basis.

Fiduciary Funds are used to account for assets held by the City in a trustee capacity or as an agent for individuals, private organizations, other governments, or other funds. These funds share characteristics with both the governmental and proprietary funds and therefore, as described below, use the measurements focus and basis of accounting most appropriate to their specific operations. This fund category includes expendable trust, nonexpendable trust, pension trust, and agency funds. The City uses funds in two of these subclassifications to account for its current financial activities: 1) two expendable trust funds, where both the principal and revenues earned on that principal may be expended for purposes designated by the trust agreement; and 2) one agency fund which accounts for assets that the City holds for other funds, governments, or individuals.

Expendable Trust Funds are accounted for in essentially the same manner as governmental funds, having a flow of current financial resources measurement focus and using the modified accrual basis of accounting. Agency funds are custodial in nature (assets equal liabilities) and do not measure the results of operations.

Account Groups

To facilitate the measurement of the sources and uses of current financial resources in the governmental funds, separate account groups are used to account for related non-current or non-financial resources, such as general fixed assets and unmatured general long-term debt. On this basis, the City uses the following account groups to establish accounting control over related assets and liabilities not recorded in the governmental funds.

The **General Fixed Assets Account Group** accounts for all fixed assets of the City other than those assets accounted for in the proprietary funds.

The **General Long-term Debt Account Group** accounts for all long-term debt of the city other than debt accounted for in the proprietary funds.

Basis of Accounting

Basis of accounting refers to when revenues and expenditures or expenses are recognized and reported in the financial statement.

The **accrual basis** of accounting is used by proprietary fund types, pension trust funds, and nonexpendable trust funds. Under this method, revenues are recognized when earned, and expenses are recognized when incurred.

The **modified accrual** basis of accounting is used by governmental, expendable trust, and agency funds. Revenues and other financial resources are recognized when they become susceptible to accrual, i.e., when the related funds become both measurable and available to finance expenditures of the current period. To be considered "available", revenue must be collected during the current period or soon enough thereafter to pay current liabilities.

A-1-10

Budgets and Budgetary Accounting

Scope of Budget - Annual appropriated budgets are adopted for the general, special revenue, debt service, and proprietary funds on the modified accrual basis of accounting. Certain special revenue and capital project funds, however, are budgeted on a project-length basis. For governmental funds, there are no differences between the budgetary basis and generally accepted accounting principles. Budgets for project/grant related special revenue funds and capital project funds are adopted at the level of the individual project and for fiscal periods that correspond to the lives of projects.

Legal budgetary control is established at the fund level, i.e., expenditures for a fund may not exceed the total appropriation amount. Any unexpended appropriation balances for annually budgeted funds lapse at the end of the year. Appropriations for other special purpose funds that are non-operating in nature are adopted on a "project-length" basis. Therefore, these appropriations are carried forward from year to year without reappropriation until authorized amounts are fully expended or the designated purpose of the fund has been accomplished.

The individual funds within each fund type which are included in the City's annual operating budget are listed below:

Funds Budgeted on an Annual Basis

General Fund is used to account for all financial resources except those required to be accounted for in another Fund.

Special Revenue Funds are established to account for proceed of specific revenue sources that are legally restricted to expenditures for specified purpose.

- Street Fund
- Arterial Street Fund
- Real Estate Excise Tax Fund
- Path and Trails Reserve Fund
- Surface Water Management Fund
- Strategic Reserve Fund
- Donations and Gifts to University Place Fund

Debt Service Fund is to account for the accumulation of resources for, and the payment of, general long-term debt principal and interest.

Enterprise Fund accounts for operations that are normally financed and operated in a manner similar to a private business enterprise where the intent of the governing body is that the costs of providing goods and services to the general publicly on a continuing basis be financed or recovered primarily through user charges. The City currently doe not operate an Enterprise Fund.

Internal Service Funds are established to account for the financing of goods ad services provided by one department of the governmental unit on a cost reimbursement basis.

- Fleet and Equipment Fund
- Information Technology & Services Fund
- Risk Management Fund
- Property Management Fund

Funds Budgeted on a Multi-Year Basis

A-1 11

Special Revenue Fund - This fund is established to account for proceeds of specific revenue sources that are legally restricted to expenditures for specific purposes.

Capital Project Funds account for financial resources to be used for the acquisition or construction of major capital facilities.

- Parks CIP Fund
- Public Works CIP Fund
- Municipal Facilities CIP Fund

A-1 12

Sample Only

Kirkland, WA Fiscal Policies

Background and Purpose

The stewardship of public funds is one of the greatest responsibilities given to the officials and managers of the City of Kirkland. Therefore, the establishment and maintenance of wise fiscal policies enables City officials to protect public interests and ensure public trust.

This document incorporates past financial practices in defining the current policies to be used by the City to meet its obligations and operate in a financially prudent manner. These policies have been established to provide general fiscal guidelines and are intended to provide sound direction in the management of the City's financial affairs.

General Financial Philosophy

The financial policy of the City of Kirkland is to provide a sufficient financial base and the resources necessary to sustain a high level of municipal services to ensure public safety, to maintain the physical infrastructure and surroundings of the City, and to promote the social well-being of the citizens of Kirkland.

It shall be the goal of the City to achieve a strong financial condition with the ability to:

- Withstand local and regional economic impacts;
- Adjust efficiently to the community's changing service requirements;
- Effectively maintain and improve the City's infrastructure;
- Prudently plan, coordinate, review and implement responsible community development and growth;
- Provide a high level of police, fire, and other protective services to assure public health and safety.

Operating Budget Policies

The Municipal Budget is the central financial planning document which embodies all operating revenue and expenditure decisions. It establishes the level of services to be provided by each department within the confines of anticipated municipal revenues.

The City Council will establish municipal service levels and priorities for the ensuing year prior to and during the development of the preliminary budget.

The City Manager shall incorporate the Council's priorities in the formulation of the preliminary and final budget proposal.

Adequate maintenance and replacement of the City's capital plant and equipment will be provided for in the annual budget.

A-2 1

The current fiscal year budget will be balanced with current year revenues.

Revenue and Expenditure Policies

Annual revenues are conservatively estimated as a basis for preparation of the annual budget and City service programs.

Expenditures approved by the City Council in the annual budget define the City's spending limits for the upcoming fiscal year. Beyond the requirements of law, the City will maintain an operating philosophy of cost control and responsible financial management.

The City will maintain revenue and expenditure categories according to state statute and administrative regulation.

Current revenues will be sufficient to support current expenditures.

All revenue forecasts will be performed utilizing accepted analytical techniques.

All fees for services shall be reviewed and adjusted (where necessary) at least every five years to ensure that rates are equitable and cover the total cost of service or that percentage of total service cost deemed appropriate by the City.

Revenues of a limited or indefinite term will be used for capital projects or one-time operating expenditures to ensure that no ongoing service program is lost when such revenues are reduced or discontinued.

Grant applications to fund new service programs with state or federal fund will be reviewed by the City, as they become available, with due consideration being given to whether locally generated revenues will be required to support these programs when outside funding is no longer available.

The City of Kirkland will establish and maintain Special Revenue Funds which will be used to account for proceeds from specific revenue sources to finance designated activities which are required by statute, ordinance, resolution or executive order.

Annual expenditures will be maintained within the limitations of annual revenues. The City will not use short-term borrowing to finance current operating needs without full financial analysis and prior approval of the City Council

In order to ensure the continuity of services, the City will budget no more sales tax revenue than was received in the prior year as a hedge against possible future economic events.

Interest income revenue will be used to finance one-time capital or time-limited goods or services.

All authorized positions will be budgeted for a full year and with the maximum allowable benefit rate unless specifically designated by the City Council as a partial-year position.

Enterprise Fund Policies

The City will establish enterprise funds for City services when 1) the intent of the City is that all costs of providing the service should be financed primarily through user charges; and/or 2) the City Council

A23

determines that it is appropriate to conduct a periodic review of net income for capital maintenance, accountability, or other public policy purposes.

Enterprise funds will be established for City-operated utility services.

Enterprise fund expenditures will be established at a level sufficient to properly maintain the fund's infrastructure and provide for necessary capital development.

Each enterprise fund will maintain an adequate rate structure to cover the costs of all operations, including maintenance, depreciation, capital and debt service requirements, reserves (as established by fiscal policy or bond covenant), and any other cost deemed necessary.

Rates may be offset from available fund cash after requirements are met for cash flow and scheduled reserve contributions.

Enterprise fund services will establish and maintain reserves for general contingency and capital purposes consistent with those maintained for general governmental services.

Revenue bonds shall be issued only when projected operating revenues are insufficient for the enterprise's capital financing needs.

The City will insure that net operating revenues of the enterprise constitute a minimum of 1.5 times the annual debt service requirements.

The City will limit the maturities of all utility revenue bond issues to 25 years or less.

Cash Management and Investment Policies

Careful financial control of the City's daily operations is an important part of Kirkland's overall fiscal management program. Achieving adequate cash management and investment control requires sound financial planning to ensure that sufficient revenues are available to meet the current expenditures of any one operating period. Once steps are taken to ensure that the City maintains a protected cash position in its daily operations, it is to the municipality's advantage to prudently invest idle funds until such time as they are required to make expenditures.

The City's idle cash will be invested on a continuous basis in accordance with the City's adopted investment policies.

The City will maintain a formal investment policy which is reviewed and endorsed by state and national professional organizations.

The City will invest all funds (in excess of current requirements) based upon the following order of priority: 1) legality; 2) safety; 3) liquidity and yield.

Investments with City funds shall not be made for purposes of speculation.

The City is prohibited from investing in derivative financial instruments for the City's managed investment portfolio.

Proper security measures will be taken to safeguard investments. The City's designated banking

A-2 3

institution will provide adequate collateral to insure City funds.

The City's investment portfolio will be reviewed every two years by a qualified portfolio valuation service to assess the portfolio's degree of risk and compliance with the adopted investment policies.

An analysis of the City's cash position will be prepared at regular intervals throughout the fiscal year.

The City Council will be provided with quarterly reports on the City's investment strategy and performance.

Sufficient cash shall be maintained to provide adequate funds for current operating expenditures.

Where permitted, the City will pool its cash resources from various funds ("Treasurer's Cash") for investment purposes.

Investment income from Treasurer's Cash will be allocated in accordance with RCW 5.24.060 considering 1) minimum cash balance needs as determined by the Finance Director; 2) average cash balance of the participating fund; and 3) administrative costs with first priority given to the Current Expense Fund revenue requirements.

The City of Kirkland will select its official banking institution through a formal bidding process in order to provide the City with the most comprehensive, flexible, and cost-effective banking services available.

The City will issue warrants for all budgetary expenditures to provide greater financial control and investment flexibility.

Accounting, Financial Reporting, and Auditing Policies

The City of Kirkland will establish and maintain a high standard of accounting practices. Accounting and budgetary systems will, at all times, conform to Generally Accepted Accounting Principles, the State of Washington Budgeting Accounting Reporting System (B.A.R.S.) and local regulations.

A comprehensive accounting system will be maintained to provide all financial information necessary to effectively operate the City.

The City will meet the financial reporting standards set by the Governmental Accounting Standards Board.

Full disclosure will be provided in all City financial reports and bond representations.

An annual audit will be performed by the State Auditor's Office and include the issuance of a financial opinion.

Reserve Fund Policies

Adequate reserve levels are a necessary component of the City's overall financial management strategy and a key factor in external agencies' measurement of the City's financial strength.

City and State regulations have been established to allow the City of Kirkland to create and maintain specific reserve funds. Prudent use of reserve funds enable the City to defray future costs, take

A-2 4

advantage of matching funds, and beneficial (but limited) opportunities. Reserve funds provide the City with the ability to exercise flexible financial planning in developing future capital projects. Reserve funds are necessary to enable the City to deal with unforeseen emergencies or changes in condition.

A Contingency Reserve Fund shall be maintained in accordance with RCW 35A.33.145 to meet any municipal expense, the necessity or extent of which could not have been reasonably foreseen at the time of adopting the annual budget. Annual contributions to the Contingency Fund will be budgeted from Current Expense Fund resources.

All expenditures from the Contingency Reserve shall have the prior approval of the City Council.

The City will maintain a General Operating Reserve to serve as a "Rainy Day Fund" to address temporary revenue shortfalls in an amount equivalent to twelve percent of the operating budget, less proprietary funds and interfund operating transfers. Annual contributions will be budgeted from Current Expense Fund resources as available to attain and maintain an established reserve level.

The City will maintain a General Capital Reserve to address unforeseen project expenditures or external revenue shortfalls in an amount equivalent to ten percent of the funded six-year CIP, less proprietary fund projects. Contributions will be made from Current Expense Fund resources as they are available.

Special reserve accounts may be created within the Park and Municipal Reserve Fund to account for monies for future known expenditures, special projects, or other specific purposes.

The City will maintain a Capital Improvement Project Grant Match Reserve as a means of assuring the availability of cash resources to leverage external funding when the opportunity arises. Contributions will be made from Current Expense Fund resources as they are available.

All expenditures drawn from reserve accounts shall require prior Council approval unless previously authorized by the City Council for expenditure in the annual budget.

Debt Management Policies

The amount of debt issued by the City is an important factor in measuring its financial performance and condition. Proper use and management of borrowing can yield significant advantages. From a policy perspective, the City of Kirkland uses debt in two ways: (1) As a mechanism to equalize the costs of needed improvements to both present and future citizens; and (2) As a mechanism to reduce the costs of substantial public improvements.

City Council approval is required prior to the issuance of debt.

An analytical review shall be conducted prior to the issuance of debt.

The City will use the services of a legally certified and credible bond counsel in the preparation of all bond representations.

The City of Kirkland will not use long-term debt to support current operations.

Long-term borrowing will only be used for capital improvements that cannot be financed from current revenues.

A-2 5

Short-term borrowing will only be used to meet the immediate financing needs of a project for which long-term financing has been secured but not yet received.

The issuance of bonds shall be financed for a period not to exceed a conservative estimate of the asset's useful life.

Noncapital furnishings, supplies, and personnel will not be financed from bond proceeds.

The City will use refunding bonds where appropriate, when restructuring its current outstanding debt.

Reserves, interest costs, operating costs, and/or maintenance expenses will be capitalized only for enterprise activities; capitalized operating expenses will be strictly limited to those expenses incurred prior to actual operation of the facilities.

The City will maintain a good credit rating at all times.

Assessment bonds will be issued in place of general obligation bonds, where possible, to assure the greatest degree of public equity.

Under most circumstances, the maturity of all assessment bonds shall not exceed 12 years.

General Obligation bonds will be issued with maturities of 20 years or less.

The voter approved general obligation debt of Kirkland will not exceed an aggregated total of 7.5% of the assessed valuation of the taxable property within the City.

The following individual percentages shall not be exceeded in any specific debt category:

- General Debt - 2.5% of assessed valuation
- Utility Debt - 2.5% of assessed valuation
- Open Space and Park Facilities - 2.5% of assessed valuation

Limited-tax general obligation bonds will not exceed one and one-half percent of the City's current assessed property valuation.

Limited-tax general obligation bonds will be issued only if:

- A project in progress requires funding not available from alternative sources;
- Matching fund monies are available which may be lost if not applied for a timely manner; or
- Emergency conditions exist.

Capital Improvement Policies

Kirkland's city government is accountable for a considerable investment in buildings, parks, roads, sewers, equipment and other capital investments. The preservation, maintenance, and future improvement of these facilities are a primary responsibility of the City. Planning and implementing sound capital improvement policies and programs today will help the City avoid emergencies and major costs in the future therefore:

The City will establish and implement a comprehensive multiyear-year Capital Improvement Program.

A 2 6

The Capital Improvement Program will be prepared and updated annually.

The City Council will designate annual ongoing funding levels for each of the major project categories within the Capital Improvement Program.

Financial analysis of funding sources will be conducted for all proposed capital improvement projects.

Financial analysis of funding sources will be conducted for all proposed capital improvement projects.

An annual Capital Improvement Budget will be developed and adopted by the City Council as part of the annual budget.

The Capital Improvement Program will be consistent with the Capital Facilities Element of the Comprehensive Plan.

A 27

Investment Policy:

Attached is a draft Investment Policy for the City. This was drafted based on guidelines and a sample policy from the Washington Municipal Treasurers Association and the Municipal Treasurer' Association of the United States and Canada. This policy provides objectives and guidelines for investing.

Currently the distribution of interest is based on a resolution that is several years old (1992). I have attached an interest distribution report from the 3rd quarter of 2006 and as you can see, interest is distributed differently than the resolution. Special revenue and bond/debt service funds receive interest based on their current fund balance. The General fund receives all interest that is not specifically designated. The General fund receives interest generate by the Water, Sewer and Garbage Utility funds and reserves held in the clearing funds and treasurers trust account.

The council needs to update the interest resolution and make a policy decision on how moneys will be allocated.

Staff recommends that the Council adopt the Investment Policy and update the resolution to provide for interest distribution by fund.

Attachments: B-1 Draft Investment Policy
 B-2 Resolution 92-11
 B-3 Interest Distribution Report
 B-4 BARS Manual information on investments

CITY OF SULTAN
RESOLUTION 92-11

A RESOLUTION OF THE CITY OF SULTAN PROVIDING FOR THE
DISBURSEMENT OF INVESTMENT INTEREST

WHEREAS, the Revised Code of Washington Chapter 35.39, section 35.30.034 provides for the disbursement of investment interest earnings, and

WHEREAS, section 35.39.034 further provides for commingling of funds within one investment portfolio, and

WHEREAS, section 35.39.034 also provides that any excess funds on hand may be invested by the City Treasurer for the benefit of the general or current expense fund,

NOW, THEREFORE, BE IT RESOLVED BY THE CITY COUNCIL OF THE CITY OF SULTAN that the fund principle investment appointment and interest distribution be established as follows:

| <u>FUND (PRINCIPLE)</u> | <u>FUND (INTEREST) (RECIPIENT)</u> | <u>PERCENT</u> |
|------------------------------------|--|----------------|
| Arterial Street | Arterial Street | 100% |
| Drug Enforcement | Drug Enforcement | 100% |
| General Obligation (Fire Truck) | General Obligation (Fire Truck) | 100% |
| Community Improvement | Community Improvement | 100% |
| Capital Improvement | Capital Improvement | 100% |
| Water/Sewer Revenue Bond | Water/Sewer Revenue Bond | 100% |
| Cemetery Trust | Cemetery | 100% |
| Excess Cash | Current Expense | 100% |

REGULARLY ADOPTED this 24 day of November, 1992.


JOHN WALKER

MAYOR

Attest:


Laura J Koenig Clerk/Treasurer

CITY OF SULTAN INVESTMENT POLICY

Policy:

It is the policy of the City of Sultan to invest public funds in a manner which will provide maximum security with the highest investment return while meeting the daily cash flow demands and conforming to all state and local statutes governing the investment of public funds.

Scope:

This investment policy applies to all financial assets of the City of Sultan. These funds are accounted for in the City's annual report and include:

1. General Fund
2. Special Revenue Funds
3. Capital Project Funds
4. Enterprise Funds
5. Trust and Agency Funds
6. Any new fund created by City ordinance, unless specifically exempted.

Prudence:

Investments shall be made with judgment and care to the degree which persons of prudence, discretion and intelligence would exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived.

The standard of prudence to be used by investment officials shall be the "prudent person" standard and shall be applied in the context of managing an overall portfolio. The investment officers acting in accordance with this policy and exercising due diligence shall be relieved of personal responsibility for an individual security's credit risk or market price changes, provided deviations from expectations are reported in a timely manner and appropriate action is taken to control adverse development.

Objective:

The primary objectives, in priority order, of the City's investment activities shall be:

Safety: Safety of the principal is the foremost objective of the investment program. Investments of the City of Sultan shall be undertaken in a manner that seeks to ensure the preservation of capital in the overall portfolio. To obtain this objective, diversification is required in order that potential losses on individual securities do not exceed the income generated from the remainder of the portfolio.

Liquidity: The City's investment portfolio will remain sufficiently liquid to enable the City to meet all operating requirements which might be reasonably anticipated.

Yield: The City's investment portfolio will be designed with the objective of attaining a market rate of return throughout the budgetary and economic cycles, taking into account the City's investment risk constraints and the cash flow characteristics of the portfolio. Investment of tax exempt borrowing proceeds and of any debt service funds will comply with the arbitrage restrictions of section 148 of the IRS Code of 1986.

Delegation of Authority:

Management responsibility for the investment program is delegated to the Finance Director who shall establish written procedures for the operation of the investment program consistent with this investment policy. The Finance Director shall be responsible for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate officials.

Ethics and Conflicts of Interest:

Officers and employees involved in the investment process shall refrain from personal business activity that would conflict with proper execution of the investment program, or which could impair their ability to make impartial investment decisions. Employees and investment officials shall disclose to the Council any material financial interest in financial institutions that conduct business with the City. They shall further disclose any large personal financial/investment positions that could be related to the performance of the City's portfolio. Employees and officers shall subordinate their personal investment transactions to those of the City of Sultan, particularly with regard to the timing and purchases and sales.

Authorized Financial Dealers and Institutions:

The Finance Director is authorized to conduct investment transactions with several competing, reputable investment securities broker/dealers and financial institutions. Security dealers and financial institutions may include primary or regional dealers that qualify under Securities and Exchange Commission Rule 15C3-1 and investment departments of local banks on the list of Qualified Public Depositories approved by the Washington Public Deposit Protection Commission as authorized to provide investment services under RCW 39.58.080.

Authorized Investments:

The City is empowered to invest in the following types of securities:

- Certificates, notes, bonds or other obligations of the United States
- Obligations of the U.S. agencies or of any corporation wholly owned by the government of the United States.
- State of Washington Investment Pool
- Any investment authorized by law for the treasurer of the State of Washington or any local government of the State of Washington but, except as provided in Chapter 39.58 RCW, such investments shall not include certificates of deposit (CD) of banks or bank branches not located in the State of Washington.

Safekeeping and Custody:

All security transactions, including collateral for repurchase agreements, entered into by the City of Sultan shall be conducted on a delivery-vs-payment (DVP) basis. Securities purchased by the City will be delivered against payment and held in a custodial safekeeping account with the trust department of the bank. The trust department of a bank, a third party custodian, will be designated by the Finance Director and all transactions will be evidenced by safekeeping receipts.

Diversification:

The City will diversify the investment portfolio to the extent necessary to maximize the return on investment while minimizing the risk of loss and to retain sufficient liquidity to meet cash flow obligations. With the exception of U.S. Treasury securities and authorized pools, no more than percent of the city's total investment portfolio will be invested in a single security type or with a single financial institution. Nothing herein should be construed as a mandate to place investments with any specified number or firms or financial institutions or to distribute investments among firms or financial institutions based on a ratio or total funds to be invested. Safety, liquidity and return should be the determining factors, along with each of working with a given broker/dealer or financial institution, in placement of investment funds.

Maximum Maturates:

To the extent possible, the City will attempt to match its investments with anticipated cash flow requirements. Unless matched to a specific cash flow, the City will not directly invest in securities maturing more than five years from the date of purchase.

Internal Controls:

The Finance Director shall establish a process of independent review by an external auditor. This review will provide internal control by assuring that policies and procedures are being followed.

Performance Standards:

The investment portfolio will be designed to obtain a average rate of return during budgetary and economic cycles which meets or exceed the average rate of return of the Local Government Investment Pool of the State of Washington. This performance standard shall take into account the City's investment risk constraints and cash flow needs.

Reporting:

The Finance Director will provide the City Council with a quarterly report of investment holdings and activity.

Investment Policy Adoption:

The City's investment policy shall be adopted by resolution of the City Council. The policy shall be reviewed on an annual basis by the approving authority and any modifications must be approved by the City Council.

| JULY THRU SEPTEMBER 2006 | | | |
|---------------------------------|--------------------|-------------------------|-----------------|
| | | INTEREST EARNED: | 41957.09 |
| FUND | FUND | FUND | INTEREST |
| | | BALANCE | DIST |
| 001 | General | | 13768.16 |
| 101 | Street | 26301.21 | 235.65 |
| 103 | Cemetery | | 872.04 |
| 107 | Drug Enf | 5273.91 | 47.25 |
| 108 | Impact Fees | 71829.30 | 643.56 |
| 109 | Community Imp | 940.65 | 8.43 |
| 110 | Police Bonds Oper | 310230.24 | 2779.52 |
| 203 | Limited Tax Bonds | 81080.84 | 726.45 |
| 205 | Police Bonds | 23982.89 | 214.88 |
| 207 | LID Bonds | 412886.57 | 3699.27 |
| 301 | Capital Imp Fund | 285535.23 | 2558.26 |
| 303 | Street Imp Fund | 0.00 | 0.00 |
| 307 | LID Project | 129330.80 | 1158.74 |
| 403 | Water/Sewer Bonds | 82970.05 | 743.37 |
| 405 | CR Utility Reserve | 1057529.90 | 9474.98 |
| 407 | Sewer Imp Fund | 182221.62 | 1632.62 |
| 409 | Water Imp Fund | 82006.28 | 734.74 |
| 412 | Water Debt Fund | 296797.00 | 2659.16 |
| 413 | Sewe Debt Fund | 0.00 | 0.00 |
| 621 | Cemetery Trust | 97330.57 | |
| 634 | Excess Cash | 1536704.01 | |
| | | 4682951.07 | 41957.09 |
| | | | |
| | | | |
| | | | |

INVESTING REQUIREMENTS

Each municipal corporation should, by action of its governing body, authorize investment of any moneys which are not required for immediate expense and which are in the custody of the county treasurer or other municipal corporation treasurer.

If the governing body has not taken any action pertaining to the investment of any such moneys, the county finance committee should direct the county treasurer to invest, to the maximum prudent extent, such moneys or any portion thereof in any of the securities mentioned below (RCW 36.29.020).

INVESTMENT VEHICLES

All local governments (counties, cities, towns, special purpose districts, political subdivisions, municipal corporations, or quasi-municipal corporations, including any public corporation, authority, or other instrumentality created by such an entity) in Washington State are empowered by statute to invest moneys, which are eligible for investment¹, in the following types of securities. (The enabling legislation is contained in Chapter 39.59 RCW.²)

- Certificates, notes, bonds or other obligations of the United States or its agencies, or of any corporation wholly owned by the government of the United States:
 - Treasury bills
 - Treasury bonds
 - Government National Mortgage Association bonds.
 - Small Business Administration bonds (see caution 3). (RCW 36.29.020, 43.84.080)
- State, county, municipal, or school district bonds, or warrants of taxing districts of the state. Such bonds and warrants should be only those found to be within the limit of indebtedness prescribed by law for the taxing district issuing them and to be general obligations. (RCW 36.29.020, 43.84.080)
- Motor vehicle fund warrants when authorized by agreement between the state treasurer and the Department of Transportation requiring repayment of invested funds from any moneys in the motor vehicle fund available for state highway construction. (RCW 36.29.020, 43.84.080)
- Federal Home Loan Bank notes and bonds. (RCW 36.29.020, 43.84.080)
- Federal Land Bank bonds. (RCW 36.29.020, 43.84.080)

¹ Not all available money is eligible for investment as allowed by Chapter 39.59 RCW. The Attorney General (AG) Opinion No. 132 (1961-62) states that the county general (current expense) fund's money must be in the form of cash or "that which is redeemable in cash upon demand, as a matter of fixed right." The AG Memorandum to the State Auditor dated March 20, 1989, reaffirms this opinion. Warrants are not demand instruments. They are not considered to be the equivalent of cash, redeemable upon demand, as matter of right, therefore county general (current expense) fund's money cannot be invested in them.

² Chapter 39.59 RCW expands the investment authority of local governments by allowing them to invest in "any investments authorized by law for the treasurer of the state of Washington or any local government of the state of Washington other than a metropolitan municipal corporation . . ." (RCW 39.59.020(4)). The AG memorandum to the State Auditor dated November 30, 1989, clarifies the scope of this increased authority. It states that if a certain type of investment authority did not exist for local governments prior to the enactment of RCW 39.59.020, but was authorized by section (4) of that statute, the restrictions contained in sections (1), (2), and (3) of the statute do not apply to those newly granted powers of investment. Therefore, local governments may choose the least restrictive investments from the above list of authorized investments. (See caution 4.)

- Money market funds with portfolios consisting of only bonds of states and local governments or other issuers authorized by law for investment by local governments, which bonds have at the time of investment one of the two highest credit ratings of a nationally recognized rating agency;
- Money market funds with portfolios consisting of securities otherwise authorized by law for investment by local governments. (See caution 4.) (RCW 39.59.030)
- Notes or bonds secured by mortgage (insured or with a commitment to insure in obligations of national mortgage associations) by the Federal Housing Administrator. (RCW 39.60.010)
- Debentures issued by the Federal Housing Administrator. (RCW 39.60.010)
- Bonds of the Home Owner's Loan Corporation or any other corporation which is or may be created by the United States as a governmental agency or instrumentality. (RCW 39.60.010)
- Notes, bonds, or debentures of savings and loan associations, banks, mutual savings banks, savings and loan service corporations operating with approval of the Federal Home Loan Bank, and corporate mortgage companies that are rated not less than "A" by a nationally recognized rating agency, or are insured or guaranteed and backed as required by the statute. (RCW 39.60.050)
- Bonds or warrants of the state of Washington. (RCW 35.39.030)
- General obligation or utility revenue bonds or warrants of any city or town in the state of Washington. (RCW 35.39.030)
- Bonds or warrants (RCW 35.39.030) or installment notes (RCW 35.45.150) of a city's or town's own local improvement district which are within the protection of the local improvement guaranty fund law.
- Interim financing warrants of a local improvement district which is within the protection of the local improvement guaranty fund law for the benefit of the general (current expense) fund. (RCW 35.39.034)
- Bonds or other obligations issued by a metropolitan municipal corporation pursuant to Chapter 35.58 RCW. (RCW 35.58.510)
- Outstanding warrants of the county tax refund fund in the same county as the government making the investment subject to the provisions of RCW 36.33.070.
- Bonds or other obligations issued by a housing authority pursuant to the housing authorities law of this state or issued by any public housing authority or agency in the United States. (RCW 35.82.220)

NOTE: Per an Attorney General Memorandum dated February 8, 1991, cities and towns have the authority to invest in out-of-state CDs via RCW 35.39.030(6) and RCW 43.84.080(6). Restrictions on investments contained in RCW 39.59.020 do not apply to investment authority existing prior to the enactment of that statute (1988). Accordingly, local governments other than cities or towns would be restricted to investment in in-state CDs since they did not possess this authority prior to the enactment of RCW 39.59.020(4).

In addition to the securities listed above, municipalities may invest excess moneys in the Washington State Treasurer's Investment Pool (Chapter 43.250 RCW). The governing body of the municipality must authorize participation by passing an ordinance or resolution.

Municipalities may also invest in repurchase and reverse repurchase agreements. However, the underlying securities must be legal investments for public funds as defined in this section. For additional requirements for these repurchase and reverse repurchase agreements see Cautious, Note 8.

| | | | | | | | |
|-----------------|-------------------|-------------------|---------------------|------------|-----------|-----------|-------------|
| <u>EFF DATE</u> | <u>SUPERSEDES</u> | <u>CATEGORY 2</u> | <u>BARS MANUAL:</u> | <u>VOL</u> | <u>PT</u> | <u>CH</u> | <u>PAGE</u> |
| 1-1-05 | 1-1-97 | | | 1 | 3 | 6 | 3 |

B4 3

- a. Determine the net deposit liability of the defaulting institution after FDIC coverage.
- b. Make assessments against all bank depositories or all thrift depositories, depending on whether the defaulting institution was a bank or a thrift institution:
 - First, against the defaulting institution to the full extent of securities pledged as collateral.
 - Second, against all other bank or thrift depositories, for their proportionate share of the loss, up to a maximum of 10 percent of each institution's public deposits. (RCW 39.58.060(3); 39.58.010(6).)
- c. Represent all public treasurers for liquidation of the defaulting institution's assets to recover the remaining net deposit liability, if any exists after assessments against all bank or thrift depositories.

Treasurers should be aware that in the event of a default of a qualified depository, the funds in that institution could be tied up until deposit balances are certified and assessments are collected (see RCW 29.58.060). Diversification of investments among various bank and thrift institutions could help alleviate potential cash flow problems.

6. Properly Name Accounts For Insurance Coverage

In order to maximize insurance coverage from FDIC, care should be exercised to properly name deposit accounts so that ownership of such accounts is clear.

7. Consult Your Bond Counsel For Guidance On Arbitrage Restriction

The Tax Reform Act of 1986 placed tighter restrictions on tax-exempt bonds. Penalties for noncompliance include fines and, possibly, retroactive taxation on the bonds.

8. Repurchase Agreements Require Proper Procedures to Avoid Loss

Recent losses suffered by local governments indicate the need for treasurers to participate in repurchase agreements (repos) with adequate procedures and knowledge of the mechanics of repo transactions.

a. Treasurer Must Have Control Of Securities In Repos

Each repo must be structured so that one of the following events occurs for the period of time that the repo is effective:

- (1) Either of the procedures called DVP (delivery versus payment) whereby:
 - a) The treasurer obtains physical delivery of the underlying securities; OR
 - b) The underlying securities are delivered to a third party, such as a safekeeping bank acting as an agent for the public treasurer; OR
- (2) The underlying securities are delivered to a bank's trust division (not within its operating division) for the account of the public treasury, when the repo is being done with the same institution.

This delivery may be made either physically or by book entry. Book entry is a system of handling securities. The Federal Reserve Bank's system is a securities safekeeping arrangement between the Fed and its customers. All US government agencies' issues exist only in book entry form, in computerized files, rather than in definitive (engraved paper) form. Under the system, book entry securities are transferred electronically between accounts based on input from the depository institution transferring securities from its account.

b. Do Not Invest In "Pooled" Or "Master" Repos

Some dealers offer repos where a treasurer invests in a pool of securities held by a trustee. Statements from the trustee list the securities; however, no "owner" is listed on the statement. The statements only reference a pool number. Treasurers have no way to assure themselves that the dealer has not oversold the securities. In the event of a dealer's default, the treasurer may discover the pool does not cover all of the claims of its investors. Where securities involved in repos are being held by trustees or a bank's trust division, the treasurer must require that the securities be held in his/her name.

c. Market Value Of Securities Should Cover The Investment

Treasurers should assure themselves that they are adequately protected from a sudden decline in the market value of the securities they have purchased. Some authorities recommend that the market value of the underlying securities exceed the amount to be received at the end of the agreement, thus protecting principal and interest. It is common practice in the industry for an excess of market value over the cash paid, called a market or "haircut", to be built into the agreement to protect against declines in the market value of the underlying securities.

The local treasurer should review (reprice) the market value of the underlying securities periodically to make sure it has not fallen below an acceptable level, placing part of the entity's principal and earnings at risk. Should such a decline in value occur, additional securities should be obtained or part of the entity's principal should be recovered. The size of the margin built into the agreement should reflect the price volatility of the underlying securities, the frequency of repricing, and the length of the repo.

d. Evaluate Financial Position Of Security Dealers

Treasurers should screen and evaluate the integrity of dealers from whom they will purchase securities. Many dealers are unregulated. Many authorities recommend that treasurers deal only with the primary security dealers. Dealers of money market or mutual funds must have bonds posted with the Risk Management Office of the Department of General Administration per RCW 39.59.010.

e. Obtain Written Contracts

Local governments should establish their rights in repos through written contracts. A written contract will specify, among other things, the right of the local government to liquidate the underlying securities in the event of default by the dealer and directions for the delivery of the underlying securities. This written contract may take the form of a master agreement covering all future transactions or a transaction agreement covering a single transaction.

Local governments should also have a written contract with a custodial agent, usually a bank, specifying the responsibilities of that third party. Such a written contract, called a custodial agreement ensures that the entity's custodian is an independent third party to the repo transaction. Among the custodial responsibilities that may be specified in a written contract are:

- 1) The custodian's responsibility to disburse cash for repos only on delivery of the underlying securities;
- 2) The custodian's responsibility to obtain additional securities if the required margin on the repo agreement is not maintained;
- 3) The custodian's responsibility for periodic reporting to the entity on the market value of the securities.

f. Beware Of Pitfalls

No treasurer should participate in repos without a thorough knowledge and understanding of what repos are and how they work. Every treasurer should be aware of the pitfalls and why other governments have suffered losses.

9. Investments Not Eligible For Public Funds

Absent statutes specifically authorizing a local government to make an investment in a certain investment type, the following investments are not eligible for investment of public funds.

- Corporate Stocks
- Corporate Bonds
- Foreign government Obligations
- Futures Contracts
- Investment in Commodities
- Real Estate
- Limited Partnerships
- Negotiable Certificates of Deposit

NOTE: The BARS material on investments is intended to inform local treasurers of the State Auditor's current audit standards and to provide information on current legal authority questions and on prudent investment standards. This material does not constitute a legal opinion on the validity of any particular investment. The State Auditor does not intend to imply that a treasurer who follows the standards set forth in these materials will thereby avoid any possibility of a loss of public funds. Each treasurer must exercise his or her best professional judgment in selecting particular investments, relying where appropriate on legal and other professional assistance.