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Building Blocks of Cash Management

The Basics of Public Entity Investing

For government organizations, developing a public funds investment program is an essential part of effective financial management — and one that may be overlooked.

Governments have a fiduciary responsibility to manage public funds in a sound and responsible manner. For public entity finance professionals, good stewardship of public funds is a required part of the role. Unfortunately, due to workload, government organizations may relegate investment management to an afterthought.

Investment programs for public entities should be aligned strategically with the cash flow needs and what the entity wants to accomplish from a public policy perspective. They also need to be diversified and cognizant of market activity, compliant, and include the ongoing management and monitoring of investment activity.

KNOWLEDGE GAPS MAY INCREASE RISK

Public entities are required to have an investment program, perform due diligence on their investment partners and perform an annual review.

In practice, however, public entity financial professionals occasionally have knowledge gaps that inhibit the creation of an effective investment program. They may not know what rates they are getting, how much they have in their investment accounts or whether they are exposed to credit risks.

Over the long run, these gaps can negatively impact portfolio performance, but they also can increase risk for public entities in the event of an audit. Just as public entities have best practices in place and established checks and balances around common problem areas such as cash receipt management and expense payments, they require checks and balances around their investment program.

It is important for public entities to recognize that in addition to safety of principal and liquidity, their mandate includes return on investment.

They must manage investments carefully and effectively and in a manner that supports strong financial management and stewardship of public funds. Public accountability requires finance professionals dedicate time to the effort of investing and develop a deliberate process around managing that effort.

What follows is a look at some investment management best practices for public financial professionals who oversee their entity's asset pools.

THERE ARE SPECIFIC FEATURES THAT SHOULD BE INCLUDED IN AN INVESTMENT PROGRAM

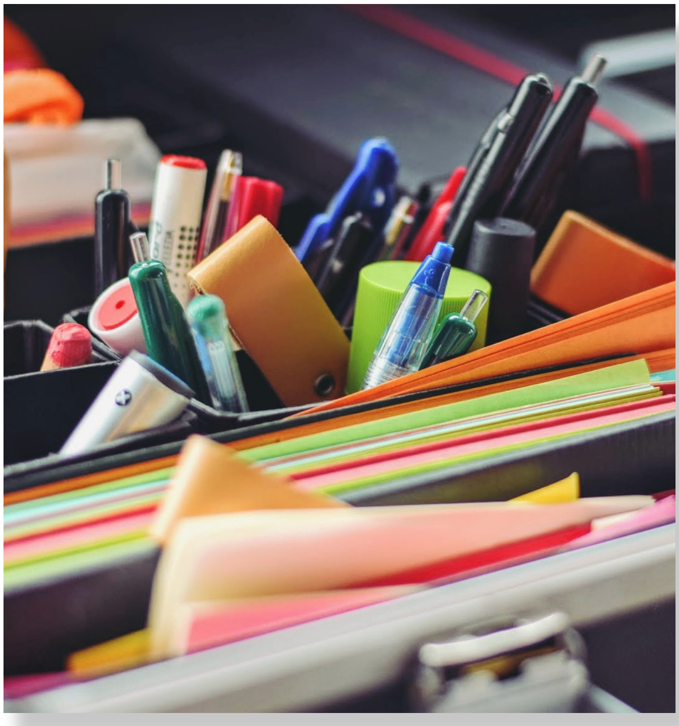
The Government Finance Officers Association (GFOA) recommends that all public entitites establish a public funds investment program by completing the following steps:

- Review all applicable laws and regulations that govern the investing of your funds. It's critical to regularly ensure you're in compliance with those laws and regulations, a step that is sometimes overlooked.
- Establish an investment leadership team. Whether it's internal or external, expertise around managing your entity's cash and investments is a must-have.
- Create a written investment policy to be adopted by the governing body. For public entities, the investment policy statement is not just a required document; it can and should provide a clear outline for your portfolio's objectives, a road map for investing and guideposts for measurement and accountability.
- Determine the portfolio management team (internal or external). The outsourcing of investment management has grown substantially over the years as investors of small and large asset pools continue to realize the benefits of turning to external managers that can add significant resources.
- Establish risk and return objectives. Public entities handle this in substantially different ways depending on their needs, but generally this step includes establishing a risk profile that is consistent with the government's risk tolerance.
- Ensure cash flows are aligned with your portfolio. There are various pools of assets for each public entity, and cash flows for each are unique. Some pools may be investable in a laddered approach out to 5 years or longer while others require daily liquidity. Investing in alignment with these needs may help maximize investment income or return.

DEVOTING TIME TO YOUR INVESTMENT PROGRAM MAY ADD VALUE

Many public finance professionals may feel they don't have the time and resources to focus more attention on their investments. However, in today's landscape where public bodies are being asked to do more with less, adding income or delegating responsibilities to experts may add significant value.

A public entity with a professional partner or strong investment plan will likely have a well-constructed portfolio — whether that's due to an increased focus on how much you have to invest and your cash flow, shopping for the best rates or building relationships with the most effective partners. As a fiduciary of public funds, forming a strong partnership can help ensure you are maximizing potential earnings.



A fiduciary acts in your best interest, not theirs.

Another benefit to dedicating more resources to investment management is less tangible in the near-term, but no less important. Public entities have a fiduciary responsibility to manage these funds, and a reputable registered investment adviser (RIA) stands alongside you as a fiduciary. Not all investment firms are RIAs or fiduciaries, so this is an important distinction. A fiduciary acts in your best interest, not theirs. A fiduciary partner may provide another layer of protection to help verify that your investment program's goal of good stewardship is being met.

Finally, though many budget-constrained public entities have legitimate cost concerns about outsourcing investment management, outside assistance with the process may be a value-added service. Investment professionals are in the market each day. They provide knowledge and insights on portfolio structure, market movements and outlook, investment types, the competitive yields, cash flow alignment, board reporting, and many other needs. Professional, expert investment management has the potential to pay for itself through increased income or returns on the portfolio.

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REGULAR REVIEWS AND DUE DILIGENCE ARE VITAL

Public bodies are required to maintain an investment program, which includes regular review. It is important that the review process does not become an end-of-the-year rubber stamp, quickly approved on the agenda, rather than undergoing a careful review.

The GFOA recommends public entities undergo a comprehensive annual review of their investment policy statement to help stay abreast of changes, update controls and portfolio objectives, and incorporate any changes in cash-flow forecasts and risk profile.

The investment policy should be reviewed and updated annually and should include statements on the following:

- Scope And Investment Objectives.
- Roles, Responsibilities And Standards Of Care.
- Suitable And Authorized Investments.
- Investment Diversification.
- Safekeeping, Custody And Internal Controls.
- Authorized Financial Institutions, Depositories And Broker-Dealers.
- Risk And Performance Standards.
- Reporting And Disclosure Standards.

The same careful review should be performed on all investment options and partners as well. The markets change quickly, as do an entity's needs. Verifying that investment partners have met your performance standards, remain creditworthy, and have added value over the relationship is critical.

CONCLUSION

Developing a robust investment plan, either internally or with outside help, can help you ensure your investments are delivering for you and also help you re-allocate resources toward more strategic efforts.

If your organization is not sure where it stands in its investment program, the enclosed self-assessment questionnaire is an excellent place to start.

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GOVERNMENT ENTITY SELF-ASSESSMENT QUESTIONNAIRE

1. Who is responsible for supervising the day-to-day investment activities of your entity?

   ____

2. Has that authority been officially delegated by your governing board annually, as required?
   YES ☐ NO ☐

3. How would you rate your oversight procedures?
   Comprehensive ☐ Moderate ☐ Very Few ☐ None ☐

4. Do you know your agency's investment policy statement (IPS)? YES ☐ NO ☐

5. Does your governing body review the IPS annually as required? YES ☐ NO ☐

6. Do you receive monthly or quarterly investment reports (including performance and yield information)? YES ☐ NO ☐

7. Does your governing body review regular investment reports? YES ☐ NO ☐

8. If your investments are managed by a third party, do the reports show a lot of transactions (purchases and sales)? YES ☐ NO ☐

9. If yes, do you know why the trading is so frequent given public entities are typically buy and hold investors? YES ☐ NO ☐

10. Do you know the yield or total return that your portfolio or individual investments are earning? YES ☐ NO ☐

11. Are your investments diversified or concentrated in just a few holdings?
    Widely Diversified ☐ Somewhat Diversified ☐ Only a Few Holdings ☐ Not Sure ☐

12. Are any of your bank holdings over the FDIC insurance limit? YES ☐ NO ☐

13. Do you know the creditworthiness of the financial institutions holding your deposits? YES ☐ NO ☐

14. Have you compared investment rates within the last 6 months? YES ☐ NO ☐

15. How comfortable are you that the investment portfolio is aligned appropriately with your cash flows?
    Very Comfortable ☐ Somewhat ☐ Slightly ☐ Not Comfortable ☐

16. What metrics do you use to assess the creditworthiness and safety of your investments?
    Credit Quality ☐ Duration ☐ Standard Deviation ☐ Other ☐ Not Sure ☐

17. Have you assessed the creditworthiness of your brokers or custodial banks annually? YES ☐ NO ☐

18. Do you invest with a broker, a bank and/or credit union, an investment manager, or all of the above?
    Broker ☐ Bank and/or Credit Union ☐ Investment Manager ☐ Not Sure ☐

19. Have you performed other due diligence on your investment partners in the last three years? YES ☐ NO ☐

20. Do you know what fees you are paying including hard dollar and/or fees netted out of the return? YES ☐ NO ☐

21. Does your investment partner provide additional services you need and / or present to your governing body on a regular or annual basis? YES ☐ NO ☐

If you have answered No or Not Sure to multiple questions, we would be happy to help you evaluate your current investment effort and identify steps to moving forward. Please contact us for a free consultation today!

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