



\*\*\*\* PUBLIC NOTICE \*\*\*\*

**NOTICE OF A FINANCE AUDIT COMMITTEE  
OF THE CITY OF CORINTH  
REGULAR SESSION**

**Thursday, December 13, 2018, 4:30 P.M.  
City Hall  
Conference Room - Suite 200  
3300 Corinth Parkway  
Corinth, Texas 76208**

\* Pursuant to Texas Government Code Section 551.002, a quorum of the City Council of Corinth may attend the following meeting and may participate in discussion on the agenda items listed below, but will not take any action.

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**CALL TO ORDER**

**CONSENT AGENDA**

**BUSINESS AGENDA**

1. Appoint a Chairman and Vice-Chairman to the Citizen Finance Audit Committee.
2. Review and discuss the responsibilities of the Citizen Finance Audit Committee.
3. Consider and act on minutes from the April 18, 2018 Regular Session.
4. Discuss and provide staff direction on the annual external audit and the Comprehensive Annual Financial Report (CAFR).
5. Review and approve the Investment Policy for the City of Corinth, Economic Development Corporation and Crime Control & Prevention District.
6. Consider and act on the Fiscal Year 2017-2018 Annual Investment Report
7. Consider and act on the 2018-2019 Authorized Broker/Dealer List for the City of Corinth.
8. Review and discuss the Fiscal Year 2017-2018 Summary of Rebtable Arbitrage.

**CLOSED SESSION**

If, during the course of the meeting, any discussion of any item on the agenda should need to be held in executive or closed session for the Committee to seek advice from the City Attorney as to the posted subject matter of this Committee Meeting, the Committee will convene in such executive or closed session, in accordance with the provisions of the Government Code, Title 5, Subchapter D Chapter 551, to consider one or more matters pursuant to the following:

**Section 551.071.** Private consultation with its attorney to seek advice about pending or contemplated litigation; and/or settlement offer; (2) and/or a matter in which the duty of the attorney to the government body under the Texas Disciplinary Rules of Professional Conduct of the State of Texas clearly conflicts with chapter 551.

**Section 551.072.** To deliberate the purchase, exchange, lease or value of real property if deliberation in an open meeting would have a detrimental effect on the position of the governmental body in negotiations with a third person.

**Section 551.074.** To deliberate the appointment, employment, evaluation, reassignment, duties, discipline, or dismissal of a public officer or employee; or to hear a complaint or charge against an officer or employee.

**Section 551.087.** To deliberate or discuss regarding commercial or financial information that the governmental body has received from a business prospect that the governmental body seeks to have locate, stay, or expand in or near the territory of the governmental body and with which the governmental body is conducting economic development negotiations; or to deliberate the offer of a financial or other incentive to a business prospect.

After discussion of any matters in executive session, any final action or vote taken will be in public by the Committee. The Committee shall have the right at any time to seek legal advice in Executive Session from its Attorney on any agenda item, whether posted for Executive Session or not.

**RECONVENE IN OPEN SESSION TO TAKE ACTION, IF NECESSARY, ON EXECUTIVE SESSION ITEMS.**

**ADJOURN**

Posted this \_\_\_\_ day of \_\_\_\_\_, 2018 at \_\_\_\_ on the bulletin board at Corinth City Hall.

\_\_\_\_\_  
Lee Ann Bunselmeyer, Finance, Communication, and Strategic Services Director  
City of Corinth, Texas

**BUSINESS ITEM 1.**

**Finance Audit Committee Regular Session**

**Meeting Date:** 12/13/2018  
**Title:** Appoint Chairman  
**Submitted For:** Lee Ann Bunselmeyer, Director  
**Submitted By:** Lee Ann Bunselmeyer, Director  
**Finance Review:** N/A  
**City Manager Review:**

**Legal Review:**

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**AGENDA ITEM**

Appoint a Chairman and Vice-Chairman to the Citizen Finance Audit Committee.

**AGENDA ITEM SUMMARY/BACKGROUND**

Section 33.103 of the ordinance establishing the Citizen Finance Audit Committee requires that in June of each year the committee shall elect a Chairman and Vice-Chairman from among its members before proceeding to any other matters of business. The officer shall serve for one year.

An appointment is required as all previous council members of the Citizen Finance Audit Committee are no longer serving.

**RECOMMENDATION**

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**Finance Audit Committee Regular Session**

**Meeting Date:** 12/13/2018  
**Title:** Committee Member Information  
**Submitted For:** Lee Ann Bunselmeyer, Director  
**Submitted By:** Lee Ann Bunselmeyer, Director  
**Finance Review:** N/A **Legal Review:** N/A  
**City Manager Review:**

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**AGENDA ITEM**

Review and discuss the responsibilities of the Citizen Finance Audit Committee.

**AGENDA ITEM SUMMARY/BACKGROUND**

In April 2015, City Council established a Citizen Finance Audit Committee in order to provide the highest level of financial oversight of public funds and transparent financial management. The purpose of the combined Committee is to assist the City Council in meeting its oversight responsibilities for the annual audit process, the development of financial policies and procedures, Investment transactions and reports, and the system of internal controls.

Responsibilities of the Committee consist of the following:

- 1) Advising the City Council and management on the selection of the independent auditor
- 2) Serve as an independent and objective party to monitor the City’s financial and compliance reporting process and internal control system.
- 3) Review and appraise the audit efforts of the City’s independent auditor
- 4) Provide an avenue of communication among the independent auditor, financial and senior management, and the City Council
- 5) Review and provide recommendations on the city’s financial, investment, and budgetary reports, policies and procedures.
- 6) Determine general investment strategies and monitor results.
- 7) Review investment economic outlook, portfolio diversification, maturity structure, potential risk to the City’s funds, authorized brokers and dealers, and the target rate of return on the investment portfolio.

**RECOMMENDATION**

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**Attachments**

An Elected Official's Guide to Audit Committee  
Interpreting Local Government Financial Statements  
Government Code Chapter 2256 - PFIA  
Ordinance Establishing Committee

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# AUDIT COMMITTEES

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Stephen J. Gauthier

*An  
Elected  
Official's  
Guide to*

**AUDIT  
COMMITTEES**

*Stephen J. Gauthier*

*Government Finance Officers Association*

*Copyright 2006 by the  
Government Finance Officers Association  
of the United States and Canada  
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# FOREWORD

Reliable financial reporting is essential if state and local governments are to be fully accountable to the citizens they serve. Therefore, it should come as no surprise that the first recommended practice issued by the Government Finance Officers Association (GFOA) more than two decades ago focused on the need for public-sector entities to conform to the highest standards of accounting, auditing, and financial reporting.

While management is primarily responsible for financial reporting, it is the governing body that ultimately must ensure that management fulfills that responsibility. The audit committee is important because it provides a practical way for governing bodies to do so. For almost a decade, the GFOA has offered advice to state and local governments on the effective use of audit committees. Recently, the GFOA undertook a major initiative to expand and update that guidance to take advantage of the lessons to be learned from private-sector experience in the wake of the federal Sarbanes-Oxley legislation and attendant regulatory guidance. This new publication reflects the fruits of those efforts.

The GFOA wishes to thank Stephen J. Gauthier, Director of the GFOA Technical Services Center, for writing this publication. We hope this booklet, along with others in the *Elected Official's* series, will provide needed guidance to elected officials seeking to improve the financial management of their governments.

Jeffrey L. Esser  
Executive Director/CEO  
Government Finance Officers Association  
August 2006



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# PREFACE

Internal control and financial reporting became the subject of intense public scrutiny in the wake of the Enron and WorldCom scandals that eventually led to the passage of the Sarbanes-Oxley Act of 2002. While that legislation directly affected only publicly traded businesses, it also has had a significant indirect impact on state and local governments. Specifically, in the wake of Sarbanes-Oxley, public-sector managers and governing bodies have raised questions as never before about the adequacy of their own internal control and financial reporting. Such questioning naturally has led to a reexamination of the structure, role, and operation of the audit committee in the public sector.

In 1997, the Government Finance Officers Association (GFOA) first issued a recommended practice on *Audit Committees*. Since that time, substantial changes have taken place in private-sector audit committee practice. In response to those changes, the GFOA Executive Board directed its standing Committee on Accounting, Auditing, and Financial Reporting (CAAFR) to examine how private-sector developments might serve to enrich public-sector practice. This examination focused on 1) the Sarbanes-Oxley Act itself, 2) the Securities and Exchange Commission's regulations on audit committees, and 3) the 1999 Report of the New York Stock Exchange's Special Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees. The final product was a thoroughly revised and much expanded recommended practice issued by the GFOA in 2006, which serves as the foundation for this publication.

For reviewing the manuscript and offering suggestions for improvement, I am grateful to acknowledge Mr. Gregory S. Allison, Assistant Director, University of North Carolina School of Government, Chapel Hill, NC; Stephen Blann, Principal – Government Services, Rehmann Robson, CPAs, Grand Rapids, Michigan; Ms.

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Lena Ellis, Assistant Finance Director, City of San Antonio, Texas; Mr. Patrick F. Hardiman, Partner, Deloitte & Touche LLP; and Mr. Robert B. Scott, Assistant City Manager/CFO, City of Carrollton, Texas. It is also my pleasure to thank Mr. Jake W. Lorentz, Assistant Director, GFOA Technical Services Center, for reviewing the manuscript, as well as Ms. Rebecca Russum, the GFOA's Senior Editor, who oversaw all aspects of production.

Stephen J. Gauthier  
August 2006

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# EXECUTIVE SUMMARY

Sound financial reporting is an essential element of public-sector accountability. The audit committee is an invaluable tool for ensuring that all those responsible in some way for financial reporting—management, independent auditors, and the governing board—fully meet their respective responsibilities in this regard.

The financial statements are simply management's written representations regarding the finances of the entity being managed; therefore, management is *primarily* responsible for them. Management cannot meaningfully assume this responsibility without first having taken steps to ensure that the underlying data are complete and reliable. Accountants describe those steps, in the aggregate, as *internal control*. Management needs nothing less than a *comprehensive integrated framework of internal control* that provides for 1) a favorable *control environment*, 2) the *continuing assessment of risk*, 3) the design, implementation, and maintenance of effective *control-related policies and procedures*, 4) effective *communication* of information, and 5) ongoing *monitoring* of the effectiveness of control-related policies and procedures, as well as the resolution of any problems thus identified.

While management's assumption of responsibility for the financial statements is essential, outside parties also need the assurance of independent auditors that they can reasonably rely upon the financial statements. Furthermore, if management is *primarily* responsible for internal control and financial reporting, it is the governing body<sup>1</sup> that is *ultimately* responsible for both.

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1. For this purpose the term *governing body* is intended to encompass not only the legislative body, but also any other elected officials legally responsible for overseeing internal control and financial reporting (e.g., county auditor, city comptroller). The term also is intended to cover appointed governing boards, such as those commonly established for public employee retirement systems.

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Thus, three parties share responsibility for the quality of financial reporting: management, the independent auditors, and the governing body. Of these three, it is the governing body that must be seen as "first among equals."

An audit committee is a practical tool for ensuring that the governing body periodically considers internal control and financial reporting and deals with both in a timely and appropriate manner. The existence of an audit committee also ensures and facilitates regular, direct communication between the independent auditors and the governing body, which is essential to the effectiveness of the audit process. In addition, an audit committee helps to preserve and enhance the objectivity and independence of the financial statement audit by furnishing a forum in which the independent auditors can candidly discuss audit-related matters with members of the governing board apart from management.

Every governing body, no matter how small the government, should establish an audit committee. The members of an audit committee should *all* be members of the governing body for two principal reasons: 1) oversight of the executive branch is a core responsibility of the legislative branch that cannot be delegated and 2) the inclusion of non-board members on the committee would inherently weaken both its real and perceived authority by creating a gap between ultimate decision-making power (i.e., the board) and the committee. At the same time, no member of the governing body who also exercises financial management responsibilities should serve as a member of the audit committee.

Members of the audit committee should obtain a sufficient understanding of accounting, auditing, financial reporting, and internal control to be able, *with the assistance of a financial expert*, to deliberate meaningfully on the types of issues likely to come before an audit committee. To qualify, members typically should receive some brief formal training on the role of the audit committee, as well as on their personal responsibility as audit committee members.

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There is no single ideal term of service for an audit committee member. Rather, each government must set terms for audit committee service based on its particular circumstances. Terms should be arranged to ensure that there is always at least one experienced member on the committee, preferably the chair.

It is not possible in the public sector to mandate that the financial expert be a member of the audit committee. Therefore, governments should authorize the audit committee to obtain the services of an outside financial expert to assist in the conduct of its work.

To be effective, an audit committee should be 1) *formally established* by the governing body, 2) *adequately funded*, and 3) *properly documented*. In addition, the audit committee should review and reassess the adequacy of its own design and operations no less than once every five years. It also should have no fewer than three members, but not so many as to encumber its efficient functioning or discourage the active engagement of individual committee members.

The documentation that formally establishes the audit committee should expressly state that the independent auditors are to report directly to the audit committee, rather than to management. Also, the audit committee should be afforded access to the internal auditors' annual audit work plan, as well as to individual audit reports.

It is the audit committee's responsibility to provide independent review and oversight of 1) the government's *financial reporting processes*, 2) the government's *internal controls*, and 3) the *independent audit* of the government's financial statements. Specific tasks of the committee include: a) determining the appropriate scope of the independent audit, b) determining the appropriate scope of "nonaudit" services to be performed by the independent auditor, c) managing the audit procurement process, d) selecting the independent auditors, e) reviewing the financial statements, f) reviewing the independent auditor's reports and following up on corrective action, g) reviewing the comprehensive framework of internal control, h) assessing the performance

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of the independent auditors, and i) providing an independent forum for internal auditors to report findings of management abuse or control override.

The audit committee typically should meet no less than once each quarter. There should be at least one meeting per year between the audit committee and the independent auditors that is conducted in private. Likewise, there should be at least one meeting between the audit committee and management that takes place privately. In addition, the audit committee itself needs to deliberate privately, at least once, to facilitate a full and free discussion of its conclusions. Governments are strongly urged to modify "open meetings" or "sunshine" legislation, if needed, to facilitate these private meetings, which are essential to the effective functioning of the audit committee.

The audit committee should conclude its work each year by submitting a written public report to the full governing body on how it has discharged its duties and met its responsibilities.

*Section I*

***BACKGROUND***



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## Question 1:

### *Why are a government's published financial statements important?*

Those who manage financial resources on behalf of others owe them a duty of *accountability* for that stewardship, especially in the public sector.<sup>2</sup> An essential element of accountability is the timely publication of financial statements presented in conformity with nationally recognized accounting standards known as "generally accepted accounting principles" (GAAP).<sup>3</sup>

As in the private sector, *investors and creditors* are among the principal users of public-sector financial statements, which they consult to assess creditworthiness, as well as compliance with finance-related legal and contractual requirements (e.g., bond covenants). *Legislative and oversight bodies* also rely upon the published financial statements of local governments to make informed decisions concerning the allocation of scarce resources and to monitor management's compliance with budgetary and other legal restrictions. *Citizens* too depend upon a government's published financial statements to evaluate the financial stewardship of their elected representatives and other public officials, as well as to obtain the information they need to participate meaningfully in the budget process.<sup>4</sup>

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2. See the Governmental Accounting Standards Board's (GASB) Concepts Statement No. 1, *Objectives of Financial Reporting*, paragraphs 56-57.

3. See the Government Finance Officers Association's (GFOA) recommended practice on *Governmental Accounting, Auditing, and Financial Reporting Practices*. In the United States, the independent standard-setting body GASB is primarily responsible for GAAP for state and local governments.

4. See GASB Concepts Statement No. 1, paragraphs 30-31.

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## Question 2:

### *Who is primarily responsible for a government's published financial statements?*

Published financial statements are simply management's written *representations* (i.e., assertions) regarding the finances of the entity being managed. Thus, it logically follows that management is *primarily* responsible for the published financial statements, just as it is for any of its other assertions. Moreover, even if others assist management in preparing the financial statements (e.g., a public accounting firm), management still remains primarily responsible for their contents. That is to say, management cannot transfer its primary responsibility for financial reporting to someone else.<sup>5</sup>

Management's primary responsibility for the financial statements is underscored by generally accepted auditing standards (GAAS), which *require* that management acknowledge in writing its responsibility for the financial statements.<sup>6</sup> These same standards also require that the independent auditors' report on the fair presentation of the financial statements expressly indicate that management is responsible.<sup>7</sup>

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5. Just as taxpayers ultimately remain primarily responsible for the completeness and accuracy of their tax return even if they engage the services of a paid tax preparer.

6. This acknowledgement is an essential component of the *management representation letter*. See the American Institute of Certified Public Accountants' (AICPA) *Professional Standards*, Section AU 333.06.

7. According to the AICPA's *Professional Standards*, Section AU 508.08c, the independent auditor's report must contain "a statement that the financial statements are the responsibility of the Company's management...."

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### Question 3:

#### *Why is management primarily responsible for internal control?*

It would be both meaningless and irresponsible to make an assertion upon which others might reasonably be expected to rely to their potential detriment without having some reasonable basis for making the assertion (e.g., personal knowledge, direct evidence, indirect evidence). Therefore, management cannot meaningfully assume responsibility for the financial statements without first having taken steps to ensure that the underlying data are, in fact, complete and reliable. Accountants describe those steps, in the aggregate, as *internal control*.

To be effective, the various components of internal control must work together rather than at cross-purposes, so as to function as a single, *integrated framework*. Likewise, that framework must be sufficiently *comprehensive* in nature and scope to provide reasonable assurance regarding every important aspect of financial reporting. Consequently, management needs nothing less than a *comprehensive integrated framework of internal control*.

The Council of Sponsoring Organizations (COSO) of the Treadway Commission identified five essential elements of a comprehensive integrated framework of internal control.<sup>8</sup> Specifically, to be comprehensive, an integrated framework of internal control must provide for 1) a favorable *control environment*, 2) the *continuing assessment of risk*, 3) the design, implementation, and maintenance of effective *control-related policies and procedures*, 4) effective *communication* of information, and 5) on-going *monitoring*

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8. See the COSO's report on *Internal Control—Integrated Framework* (1992).

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of the effectiveness of control-related policies and procedures, as well as the resolution of any problems thus identified.<sup>9</sup>

In short, management can only fully meet its financial reporting responsibility by designing, implementing, and maintaining a comprehensive, integrated framework of internal control. Therefore, it is impossible to separate financial reporting from internal control.

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9. These five elements are discussed in detail in a specifically local government context in the GFOA's publication *Evaluating Internal Control: A Local Government Manager's Guide* (1996).

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#### Question 4:

### *What is the role of the independent auditors?*

As noted previously, published financial statements are simply management's representations concerning the finances of the entity being managed. Because management is only human, it is always possible that the financial statements could contain mistakes despite management's best efforts. It is possible too that management might be tempted to be less than forthcoming with information that reflected unfavorably on its own performance. Therefore, while management's assumption of responsibility for the financial statements is essential, outside parties also need *independent* assurance that they can reasonably rely upon the financial statements. It is the role of the independent auditors to provide such third-party assurance.

Because independent auditors limit themselves to assessing the fairness of management's representations, their role is inherently secondary to that of management.<sup>10</sup> For that reason, the independent auditors can lend support to, but not replace, management's own credibility. If management has seriously compromised that credibility (e.g., high-level fraud), it is likely to be difficult, if not impossible, for the independent auditors to close the credibility gap thus created.<sup>11</sup>

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10. Just as the role of a newspaper fact-checker or editor is secondary to that of the journalist who did the reporting.

11. The AICPA's *Professional Standards*, AU Section 319.28, for example, indicates that "Concerns about the integrity of the entity's management may be so serious as to cause the auditor to conclude that the risk of management misrepresentation in the financial statements is such that an audit cannot be conducted."

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## Question 5:

### *What is the governing body's responsibility for internal control and financial reporting?*

As noted previously, management is primarily responsible for internal control, just as management is primarily responsible for the financial statements. Indeed, long experience has demonstrated that internal control can never be truly effective without strong management support. The fact that management is *primarily* responsible for internal control and financial reporting, however, does not absolve the governing body<sup>12</sup> of its own unique responsibility for internal control and financial reporting. If management is *primarily* responsible for internal control and financial reporting, it is the governing body that is *ultimately* responsible for both. Specifically, it is the responsibility of the governing body to make sure that management fulfills its internal control and financial reporting responsibilities.

One way to grasp the respective responsibilities of management and the governing body is to compare management to pupils and the governing body to parents. It is the pupils' responsibility to complete their homework assignments (no one else can!), but the parents remain responsible for making sure they do so. So too, only management is in a position to ensure sound internal control and financial reporting, but the governing body is still responsible for ensuring that management fulfills these responsibilities.

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12. For this purpose the term *governing body* is intended to encompass not only the legislative body, but also any other elected officials legally responsible for overseeing internal control and financial reporting (e.g., county auditor, city comptroller). The term also is intended to cover appointed governing boards, such as those commonly established for public employee retirement systems.

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To pursue this analogy even further, the independent auditors could be compared to the teacher, whose performance also is a matter of concern to parents. So too, the governing body must satisfy itself as to the quality of the work of the independent auditors.

In short then, three parties share responsibility, each in its own way, for the quality of financial reporting: management (which makes the representations that comprise the financial statements), the independent auditors (who attest to the reliability of the representations made by management), and the governing body (which is responsible for making sure that both management and the independent auditors fulfill their respective responsibilities). Of these three, it is the governing body that must be seen as "first among equals" because of its unique position as the ultimate monitor of the financial reporting process.<sup>13</sup>

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13. See the New York Stock Exchange's *Report and Recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees*, "Background and Overview" (1999).



*Section II*

*NATURE AND PURPOSE*



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## Question 6:

### *What is an audit committee?*

When it comes to internal control and financial reporting, there is a natural tendency to believe that "everything must be okay" until something goes wrong. Unless positive action is taken to counteract this tendency, it is unlikely that a typical governing body will ever focus sustained attention on internal control and financial reporting, especially given the multitude of pressing issues a governing body normally must address.

An *audit committee* avoids this potential trap by institutionalizing ongoing governing-body involvement with internal control and financial reporting. Stated differently, an audit committee is basically a practical tool for ensuring that the whole subject of internal control and financial reporting periodically appears on the governing body's radar screen and is dealt with in a timely and appropriate manner.

The audit committee has three fundamental goals. First, it must satisfy itself that management is maintaining a comprehensive framework of internal control. Second, the audit committee must ensure that management's financial reporting practices are assessed objectively. Third, the committee needs to determine to its own satisfaction that the financial statements are properly audited and that any problems disclosed in the course of the audit are satisfactorily resolved.<sup>14</sup>

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14. See the Securities and Exchange Commission's (SEC) Regulation 33-8220, "Background and Overview of the New Rule and Amendments."

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## Question 7:

### *What are the key benefits of an audit committee?*

An audit committee offers three key benefits. First, as just discussed, an audit committee serves to focus the governing body's attention on its responsibility for internal control and financial reporting, while at the same time providing a practical tool for meeting that responsibility.

Second, the existence of an audit committee ensures and facilitates regular, direct communication between the independent auditors and the governing body, which is essential to the effectiveness of the audit process.<sup>15</sup> An audit committee also provides an appropriate venue for the independent auditors and the governing body to discuss in detail internal control and audit-related matters.

Third, an audit committee helps to preserve and enhance the objectivity and independence of the financial statement audit by furnishing a forum in which the independent auditors can candidly discuss audit-related matters with members of the governing board apart from management.<sup>16</sup>

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15. Note that the AICPA's *Professional Standards*, Section AU380, requires that independent auditors communicate certain types of information directly to the audit committee or its equivalent.

16. SEC Regulation 33-8220 makes this a requirement for publicly traded companies.

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*Question 8:*

*Do smaller governments really need audit committees?*

As part of its basic oversight function, the governing body of any entity, regardless of size, is responsible for ensuring that internal control and financial reporting are reliable. An audit committee, as already explained, is just a practical means for a governing body to meet this responsibility. Thus, audit committees are as important for smaller governments as they are for larger ones. Accordingly, the GFOA urges every governing body,<sup>17</sup> no matter how small the government, to establish an audit committee.<sup>18</sup>

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17. For this purpose, the term *governing body* is intended to encompass not only the legislative body, but also any other elected officials legally responsible for overseeing internal control and financial reporting (e.g., county auditor, city comptroller). The term also is intended to cover appointed governing boards, such as those commonly established for public employee retirement systems.

18. See the GFOA's recommended practice on *Audit Committees*.



*Section III*

*MEMBERSHIP*



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### Question 9:

#### *Who should serve on an audit committee?*

The members of an audit committee should *all* be members of the governing body for two principal reasons. First, one of the core responsibilities of the legislative branch of government is to oversee the executive branch (including its financial management). As a rule, a core responsibility *cannot* be delegated. Second, the credibility of the audit committee (and hence its effectiveness) inevitably will depend on both its *real* and *perceived* authority. The process of delegation inherently weakens both by opening a gap between the audit committee and actual decision makers.<sup>19</sup>

While all members of the audit committee should be members of the governing body, it does *not* follow that any and all members of the governing body automatically should be eligible to serve on the audit committee. As mentioned previously, one of the key benefits of an audit committee is that it should provide a forum in which the independent auditors can candidly discuss audit-related matters with members of the governing body *apart from management*. This benefit would be lost, of course, were someone from management to serve as a member of the audit committee. Therefore, no member of the governing body who exercises financial management responsibilities should serve as a member of the audit committee.<sup>20</sup>

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19. In the private sector, the Sarbanes-Oxley Act requires that all members of the audit committee be members of the governing board as well. (Alternatively, the governing board as a whole could serve as the audit committee.)

20. Likewise it would be inappropriate for the audit committee to delegate responsibilities to such an individual.

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## Question 10:

*What level of expertise is needed to serve as a member of an audit committee?*

While expertise in accounting, auditing, financial reporting, and internal control is highly desirable in an audit committee member, individuals do *not* have to be an expert in any or all of these disciplines to serve. They do, however, need to obtain a sufficient understanding of each to be able to perform their duties as committee members. Specifically, they should be able, *with the assistance of a financial expert*, to deliberate meaningfully on the types of issues likely to come before an audit committee.<sup>21</sup> To qualify, new or prospective audit committee members typically should receive some brief formal training on the role of the audit committee, as well as on their personal responsibility as audit committee members. This training should underscore the duty of committee members to exercise an appropriate degree of *professional skepticism* in dealing with management.<sup>22</sup>

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21. Note that a financial expert only *assists* the audit committee, which has sole authority for decision making.

22. The AICPA's *Professional Standards* describe *professional skepticism* in the context of an audit as "an attitude that includes a questioning mind and a critical assessment of audit evidence" (AU Section 230.07). Those standards go on to elaborate that "the auditor neither assumes that management is dishonest nor assumes unquestioned honesty. In exercising professional skepticism, the auditor should not be satisfied with less than persuasive evidence because of a belief that management is honest" (AU Section 230.09).

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## Question 11:

### *How long should audit committee members serve?*

In determining the appropriate term of service for audit committee members, it is necessary to balance two potentially conflicting goals: *objectivity* and *competence*. The periodic infusion of new perspectives, on the one hand, would tend to favor the goal of objectivity. Competence, on the other hand, normally would benefit from experience and continuity. Thus, a gain for one goal might come at the expense of the other.

Another challenge is the limited pool of potential audit committee members, given that only governing body members should serve on the audit committee. Changing the membership of the committee on a regular basis can be difficult if the governing body itself is small.

Consequently, there is no single ideal term of service for an audit committee member. Rather, each government must set terms for audit committee service based on its particular circumstances. In doing so, two factors ought to be borne in mind:

- Continuity is essential for an effective and efficient audit committee. Therefore, whenever possible, the terms of audit committee members should be arranged to ensure that there is always at least one experienced member on the committee, preferably the chair (e.g., staggered terms, with the senior member automatically serving as chair).
- Because newcomers need training, multi-year terms for audit committee members can reduce a government's costs.

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## Question 12:

*Do one or more audit committee members need to be subject-matter experts?*

As already noted, individual audit committee members do not have to be experts in accounting, auditing, financial reporting, and internal control, but they do need to be sufficiently informed about these topics to be able to make informed decisions *with the assistance of a financial expert*. Must then at least one member of the audit committee be in a position to provide the needed expertise?

Members of governing bodies are not necessarily elected or appointed for their specialized expertise in accounting, auditing, financial reporting, and internal control. Therefore, it is quite possible that no member of a given governing body will possess the required level of expertise in any or all of these topics to qualify as a *financial expert*. How then can the needed expertise be obtained if membership on the audit committee is to be limited to governing body members?

In the private sector, it is a relatively straightforward matter to expand the membership of the governing body, if necessary, to include someone with the background needed to serve as a financial expert on the audit committee. Indeed, federal law requires publicly traded companies to do just that.<sup>23</sup> In the public sector, however, where most governing bodies are elected, it typically would *not* be feasible to expand the membership of the governing body to include someone with the qualifications needed to serve as a financial expert. Consequently, it is not possible in the public sector to mandate that the financial ex-

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23. Sarbanes-Oxley Act.

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pert be a member of the audit committee without at the same time relaxing the more fundamental requirement that all members of the audit committee also be members of the governing body. Rather than do that, the GFOA recommends that governments resolve this potential dilemma by authorizing the audit committee to obtain the services of an *outside* financial expert to assist in the conduct of its work.

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### Question 13:

*What qualifications are needed to serve as a financial expert to an audit committee?*

To qualify as a *financial expert*, the GFOA recommends<sup>24</sup> that a given individual possess *all* of the following qualifications:

- *A thorough understanding of GAAP and financial reporting.* GAAP for state and local governments differ significantly from GAAP for other types of entities (e.g., private-sector businesses and non-governmental not-for-profit organizations). Therefore, a background limited to private-sector GAAP and financial reporting, no matter how extensive, is *not* enough for this purpose. Nor is “book knowledge” alone sufficient—this understanding must be the product of *both* education *and* experience;
- *Experience either preparing or auditing the financial statements of similar entities.* The public sector is extremely varied (e.g., general-purpose governments v. special-purpose governments; small governments v. large governments; state level v. local level). It is important, therefore, that a potential financial expert’s experience be relevant to the government being audited. Experience preparing financial statements for small special-purpose governments, for instance, would *not*, of itself, be sufficient to qualify as a financial expert for a large general-purpose government;
- *Experience with the application of GAAP to accounting estimates and accruals.* GAAP require that the effect of events and transactions

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24. See the GFOA’s recommended practice on *Audit Committees*.

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on a government's finances be recognized when the underlying event occurs, *even if related cash inflows and outflows do not occur until some future period*. The process of identifying such future cash flows is known as "accrual." Moreover, the precise amount of many assets and liabilities must be estimated (e.g., how much will eventually be paid out as a result of pending lawsuits?). Needless to say, such estimates and accruals involve a considerable degree of judgment. Accordingly, a potential financial expert must have experience with the proper application of GAAP to both accounting estimates and accruals.

- *Experience with internal accounting control.* As explained earlier, the financial statements are only as reliable as the underlying data they contain, and that reliability, in turn, depends upon the proper functioning of a comprehensive integrated framework of internal control. A financial expert should have experience with the establishment, implementation, and maintenance of a comprehensive integrated framework of internal control, either from the perspective of management or from the perspective of an independent auditor.
- *Understanding the functioning of the audit committee.* The financial expert must have a thorough understanding of how audit committees are supposed to function so as to be able to provide committee members with the guidance they need to fulfill their responsibilities. The individual also should be current with applicable laws and regulations governing the audit committee.<sup>25</sup>

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25. This recommendation substantially reprises the requirements of the Sarbanes-Oxley Act, which states that "in defining the term *financial expert*..., the Commission shall consider whether a person has, through education and experience as a public accountant or auditor or a principal financial officer, comptroller, or principal accounting officer of an issuer, or from a position involving the performance of similar functions—(1) an understanding of generally accepted accounting principles and financial statements; (2) experience in—(A) the preparation or auditing of financial statements of generally comparable issuers; and (B) the application of such principles in connection with the accounting for estimates, accruals, and reserves; (3) experience with internal accounting controls; and (4) an understanding of audit committee function.

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Naturally, the financial expert must be independent of the government, both in fact and appearance (i.e., no potential conflict of interest).

*Section IV*

**STRUCTURE**



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## Question 14:

*How should an audit committee be set up?*

To be effective, an audit committee should be 1) *formally established* by the governing body, 2) *adequately funded*, and 3) *properly documented*.

- *Formally established.* Formal establishment, whether by charter, resolution, or other appropriate means, is necessary to ensure that the audit committee has all of the authority it needs to accomplish its objectives. In particular, the audit committee should be made *directly* responsible for every aspect of the independent audit.<sup>26</sup> Likewise, it should be mandated that the independent auditors report *directly* to the audit committee and that the committee have direct access to internal audit work plans and reports.
- *Adequately funded.* It also is important that the audit committee have adequate funding to accomplish its various tasks. Specifically, the audit committee should have the budgetary authority to obtain the services of a financial expert (as discussed earlier), legal counsel, and other appropriate specialists, as needed.<sup>27</sup>

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<sup>26</sup> This responsibility specifically would include the appointment, compensation, retention, and oversight of the independent auditors. The audit committee also should be made directly responsible for any and all independent audit, review, or attest services beyond the scope of the audit of the financial statements. (See Sarbanes-Oxley Act.) Naturally, the full governing body would retain ultimate authority.

<sup>27</sup> Of course, the full governing body would retain ultimate control over funding.

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- *Properly documented.* Documentation of the audit committee's structure and operations should address, at a minimum, the scope of the committee's responsibilities, as well as its structure, processes, and membership requirements.<sup>28</sup>

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28. See *Report and Recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees.*

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*Question 15:*

*Do the audit committee's structure and operations ever need to be reexamined?*

There is no teacher like experience. It is only to be expected that a conscientious audit committee will, over time, identify ways in which it might improve its own performance. For this reason, private-sector audit committees have been urged to "review and reassess the adequacy of the audit committee charter on an annual basis."<sup>29</sup> The GFOA recommends that public-sector audit committees and governing boards do the same no less than once every five years.<sup>30</sup> Such a reassessment should specifically take into account any changes that may be needed as the result of changes in law, regulation, or professional standards.<sup>31</sup>

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29. *Report and Recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees*, Recommendation 4.

30. See the GFOA's recommended practice on *Audit Committees*.

31. Of course, significant developments may require immediate change and should not be delayed until the next regularly scheduled review process (e.g., every five years).

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*Question 16:*

*How many members should an audit committee have?*

The audit committee's main function is to *deliberate*. As a general rule, the quality of any deliberation tends to benefit from the presence of multiple perspectives. Accordingly, it has been formally recommended in the private sector that an audit committee have no fewer than three members.<sup>32</sup> The GFOA has adopted this same recommendation for local governments.<sup>33</sup>

There are no similar recommendations in either sector regarding the maximum number of members that should serve on an audit committee. All the same, governments naturally will wish to avoid having so many members as to encumber the efficient functioning of the committee or discourage the active engagement of individual committee members.

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32. *Report and Recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees.*

33. See the GFOA's recommended practice on *Audit Committees*.

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*Question 17:*

*What should the relationship be between the independent auditors and the audit committee?*

An important benefit of an audit committee is that it helps to preserve and enhance the objectivity and independence of the financial statement audit by furnishing a forum in which the independent auditors can candidly discuss audit-related matters *apart from management*.<sup>34</sup> Therefore, the documentation that formally establishes the audit committee should expressly state that the independent auditors are to report directly to the audit committee, rather than to management. Likewise, specific provision should be made for the audit committee to meet privately with the independent auditors, as necessary.

If a government is subject to a "sunshine law" or an "open meetings law," it is recommended that such legislation be amended to expressly permit the audit committee to hold private meetings, as necessary (e.g., with the independent auditors). Typically such exemptions already exist for meetings involving personnel-related issues and the discussion of pending litigation.

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34. SEC Regulation 33-8220 makes this a requirement for publicly traded companies.

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*Question 18:*

*What should the relationship be between the audit committee and the internal audit function?*

There are two commonly held and opposing views on the optimal relationship between management and the internal audit function. One school of thought views the relationship between top management and the internal audit function as being essentially similar to the relationship between the governing body and the audit committee, with internal auditors reporting directly to top management. That is, the internal audit function is seen as a practical way for managers to meet their internal control and financial reporting-related responsibilities, just as the audit committee is a practical way for the governing body to meet its responsibilities in regard to internal control and financial reporting.

The opposing position is that the internal audit function should be completely independent of management at all levels. Supporters of this latter position, which is becoming increasingly popular, argue that internal auditors should report directly to the audit committee, or to an elected auditor, to ensure their independence.

Strong arguments can be made in favor of either position. If internal auditors work directly for top management, for instance, they may be in a better position to achieve a high level of cooperation from those whom they audit, either because the latter see no practical choice but to cooperate, or because the internal auditors are perceived as being "on the same team" or acting in the place of top management. Likewise, proponents of this position argue that separating top management from the internal audit function would only reinforce the misguided tendency of

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some managers to try to “pass off” their primary responsibility for internal control and financial reporting to someone else. Conversely, those who support internal auditors reporting directly to the audit committee rather than to top management argue that such direct reporting is essential if internal auditors are to be in a credible position to pursue problems aggressively, no matter where they might lead.

Regardless of how the internal audit function is structured, its functioning is an important consideration in assessing the effectiveness of a government’s control environment, and hence of its comprehensive integrated framework of internal control. Therefore, the audit committee must always be afforded access to the internal auditors’ annual audit work plan, as well as to any and all individual audit reports.<sup>35</sup>

Of course, it may not be practical for smaller governments to establish a formal internal audit function. In that case, GFOA recommends that a government consider either assigning internal audit responsibilities to its regular employees or obtaining internal auditing services from an accounting firm (*other than the independent auditor*).<sup>36</sup>

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35. See the GFOA’s recommended practice on *Audit Committees*.

36. See the GFOA’s recommended practice on *Establishing an Internal Audit Function*.



*Section V*

**TASKS**



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### Question 19:

*What are the basic tasks of an audit committee?*

It is the audit committee's responsibility to provide independent review and oversight of 1) the government's *financial reporting processes*, 2) the government's *internal controls*, and 3) the *independent audit* of the government's financial statements.<sup>37</sup> Specific tasks associated with meeting that responsibility include the following:

- Determining the appropriate scope of the independent audit;
- Determining the appropriate scope of "non-audit" services to be performed by the independent auditor;
- Managing the audit procurement process;
- Selecting the independent auditors;
- Reviewing the financial statements;
- Reviewing the independent auditor's reports;
- Reviewing the comprehensive framework of internal control;
- Assessing the performance of the independent auditors; and
- Providing an independent forum for internal auditors to report findings of management fraud, abuse, or control override.

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37. SEC Regulation 330-8220.

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## Question 20:

*How should the audit committee be involved in determining the appropriate scope of the independent audit?*

There are several considerations involved in auditing the financial statements of a local government beyond those involved in auditing the financial statements of a business enterprise. In particular, three specific issues need to be addressed by local governments:

- *Appropriate auditing standards.* In the private sector, all financial statement audits are performed in accordance with GAAS. In the public sector, GAAS are *complemented* by a related set of standards set forth in the U.S. Governmental Accountability Office's (GAO) publication *Government Auditing Standards*, commonly known simply as the "Yellow Book" or generally accepted *government* auditing standards (GAGAS). In some circumstances, the use of the Yellow Book standards is mandated by federal or state law or regulation (e.g., recipients of more than \$500,000 in federal awards). In other cases, governments *voluntarily* choose to apply GAGAS. The audit committee must determine whether the financial statement audit will be conducted in accordance with *Government Auditing Standards*.
- *Selection of "opinion units."*<sup>38</sup> One of the characteristic features of governmental accounting and financial reporting is the use of *fund accounting*. At a minimum, independent auditors are required to express an opinion on each

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38. Any fund or grouping of funds that is the subject of a separate opinion from the independent auditor is technically referred to as an *opinion unit*.

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separate *major* fund. For nonmajor funds, auditors may either 1) express an opinion on nonmajor funds in the aggregate or 2) express an opinion on each individual nonmajor fund. The latter approach (recommended by the GFOA<sup>39</sup> and sometimes required by regulation, but less frequently encountered in practice) provides a higher level of audit assurance, but may be expected to result in higher audit fees. Again, it is the audit committee that must determine whether nonmajor funds will be treated individually as opinion units.

- *Applicability of "Single Audit."* Governments that receive substantial amounts of federal assistance (either directly or indirectly<sup>40</sup>) are subject to the provisions of the Single Audit Act and related Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Specifically, the auditor is required to use *Government Auditing Standards* and to assume special responsibility for internal controls and compliance for federal awards. The audit committee, once more, is responsible for determining if a Single Audit is required in the government's specific circumstances.

Furthermore, governments sometimes may desire independent auditors to perform work beyond what normally would be required in a financial statement audit regarding matters of special concern (e.g., a program recently subject to media scrutiny). It is the responsibility of the audit committee to determine whether such additional "agreed-upon procedures" should be incorporated into the audit contract.

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39. See the GFOA's recommended practice on *Audit Procurement*.

40. For example, pass-through grants from other governments.

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## Question 21:

*How should the audit committee be involved in determining the appropriate scope of consulting services?*

Public accounting firms frequently are able to offer a broad range of professional services to their clients. Professional auditing standards, however, place strict limits on the type and extent of such consulting (“nonaudit”) services that firms may perform for audit clients to avoid potentially compromising auditor independence in either fact or appearance.<sup>41</sup> Moreover, even in situations where the independent auditors are, in fact, permitted to perform consulting services for a client, certain safeguards often are mandated, including a requirement that any such nonaudit services be approved in advance by the audit committee.<sup>42</sup> Consequently, the audit committee needs to review carefully both the request for proposals for audit services and the resulting audit contract to ensure that any consulting services included within the scope of the anticipated audit engagement fully comply with all applicable limitations. (The GFOA recommends that governments always consider the possibility of someone other than the independent auditors performing any nonaudit services that may be needed.<sup>43</sup>)

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41. For example, independent auditors may *not* design or install new computer software for a client. In some circumstances conflict can be avoided if the extra work is performed using attestation standards rather than auditing standards.

42. A specific requirement for audits performed in conformity with *Government Auditing Standards*.

43. See the GFOA’s recommended practice on *Audit Procurement*.

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## Question 22:

### *How should the audit committee go about managing the audit procurement process?*

As with any professional service, the quality of an audit will depend upon the expertise of the professionals who perform it. Experience has demonstrated a close link between the audit procurement process and the quality of the resulting audit. To be successful, an audit procurement process should possess the following attributes:

- *Competition.* The likelihood of obtaining a high-quality audit at a reasonable price substantially increases with competition. Therefore, the audit procurement process should aim at fostering healthy competition among potential audit firms.<sup>44</sup>
- *Solicitation.* It is important that the document used to solicit potential auditors (i.e., request for proposals – RFP) accomplish two important goals. First the RFP should provide sufficient information about the government to encourage well-qualified candidates to submit a proposal. As a rule, firms are reluctant to incur the often significant costs involved in submitting a proposal unless they have enough information to conclude that they are a reasonably “good match” for a potential engagement.<sup>45</sup> Second, the RFP must solicit enough information from proposers to allow the audit

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44. This consideration naturally does not apply to situations where auditors are assigned to a local government rather than selected by the government itself (e.g., state auditors).

45. Sometimes governments attempt to depoliticize the audit procurement process by including in the RFP a provision that prohibits proposers from contacting the government during the proposal process. Such a provision may interfere with the proposers' own due diligence requirements.

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committee to determine whether they are, in fact, fully qualified to perform the audit.

- *Technical evaluation.* Price is certainly an important consideration in the procurement of audit services, just as it is in the procurement of other types of services. Still, the *primary* focus of the selection process must always be on quality. That is, price should only enter into the equation once it has been determined that a given firm is fully able to perform a high-quality audit. An audit committee that proceeded to select an audit firm based solely or primarily on price (“low bid”) would *not* be fulfilling its audit procurement responsibilities.
- *Written agreement.* It is important that there be a formal audit contract that fully documents all of the understandings reached between the government and the successful proposing audit firm regarding the scope and conduct of the audit. Typically, such a written contract would incorporate by reference the terms of the engagement as set forth in the RFP. (Note that the auditor’s engagement letter is *never* an adequate substitute for a formal audit contract.)<sup>46</sup>

It is the responsibility of the audit committee to design and implement an audit procurement process that incorporates these attributes.

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46. See the GAO’s 1987 study on *CPA Audit Quality: A Framework for Procuring Audit Services*.

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### Question 23:

*What is the appropriate length for an audit contract?*

An audit firm must incur considerable "up-front" costs whenever it takes on a new client. Much of this cost is connected with the auditor's need to obtain a thorough understanding of the comprehensive framework of internal control. Both the federal government and the GFOA recommend that local governments use multi-year audit contracts to reduce audit costs by allowing proposing firms to spread this cost over several years in the bids they submit in response to the RFP. More specifically, both the GAO and the GFOA recommend a five-year audit contract.<sup>47</sup> At the same time, the GFOA discourages any sort of automatic renewal option, recommending instead a complete competitive selection process at the end of each and every contract term.<sup>48</sup>

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47. See the GAO's study on *CPA Audit Quality: A Framework for Procuring Audit Services* (1986), page 28, and the GFOA's recommended practice on *Audit Procurement*.

48. See the GFOA's recommended practice on *Audit Procurement*.

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## Question 24:

### *Should the audit committee mandate auditor rotation?*

Many outside the auditing profession believe that auditor independence is enhanced when the entity to be audited periodically changes audit firms. Accordingly, many businesses and non-profit organizations have set term limits for their auditors, a practice known as “auditor rotation.”

Typically there is no lack of highly qualified public accounting firms able and willing to perform quality audits of businesses and nonprofit organizations. The situation often is quite different, however, for local governments, because of the highly specialized character of governmental accounting, auditing, and financial reporting. Consequently, a policy of mandatory auditor rotation in the public sector could have the unintended and undesirable effect of actually pressuring a government to engage the services of an audit firm that is less than fully qualified. Therefore, the audit committee should refrain from setting a policy of mandatory auditor rotation unless it has first satisfied itself that there is a sufficient number of fully qualified and interested audit firms in the area to ensure that there will always be a viable alternative to the current auditors.

Once again, the GFOA recommends that the audit committee undertake a full-scale audit procurement process at the end of any given audit contract. That is, the GFOA discourages governments from incorporating an automatic renewal provision within the audit contract.<sup>49</sup>

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49. The Sarbanes-Oxley Act, Section 203, does not mandate the rotation of audit firms, but it does require that both the lead partner on an engagement and the partner responsible for reviewing the audit be rotated at least once every five years.

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## *Question 25:*

### *How should the audit committee select the independent auditors?*

Responses to a well-designed RFP should provide the audit committee with all of the information it needs to make a selection among competing audit firms. The objective, of course, is to obtain a high quality audit at a reasonable price. The practical challenge is to avoid focusing on price at the expense of quality (i.e., "just take the low bid").

The first step in the selection process should be to eliminate from consideration firms that clearly are not qualified to perform the engagement because they fail to meet some basic eligibility criterion (e.g., lack of independence, deficient peer reviews, a history of substandard government audits, lack of experience with audits of comparable governmental entities).

The second step is to evaluate the expertise and experience, as well as the proposed audit approach, of the remaining firms. It typically is helpful to subdivide these two broad categories into subcategories, such as the following:

- Expertise and experience
  - Quality of staff to be assigned to the engagement
  - Quality of other staff available to offer assistance
  - Experience with specific grant programs
  - Experience with similar information systems
- Audit approach and capacity
  - Adequacy of proposed staffing plan

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- Adequacy of proposed sampling techniques
  - Adequacy of proposed analytical procedures
  - Adequacy of the proposing firm's resources to meet commitments to all of its clients in a timely manner.
  - Adequacy of proposed methodology for assessing materiality

Once the proposing firms have been evaluated in each of these categories and subcategories, the audit committee could take either of the following approaches:

- *Competitive bid approach.* Under this approach, price is treated as a competitive element in one of two ways:
  - *Relative factor.* Technical qualifications and price are both assigned point values (e.g., 70 points for qualifications, divided among the various categories and subcategories, 30 points for price) and the firm with the highest overall ranking is awarded the audit contract, or
  - *Independent factor.* Firms are determined to be either "fully qualified" or "not fully qualified." The contract is then awarded to the lowest bid received from a fully qualified firm.

To ensure objectivity in the assessment of proposing firms' technical qualifications, it is strongly recommended that bids *not* be opened until the technical assessment has been completed. Governments also may wish to set a price "floor" (e.g., 80 percent of the price of the prior year's audit), which would *not* be disclosed to proposers, so as to reject unrealistically low bids that could be an early warning sign of substandard work to follow.

- *Negotiated bid approach.* Under this approach, each firm judged to be fully qualified is ranked in descending order of qualification. The audit committee then proceeds to negotiate with the highest ranked firm to arrive at a satisfactory price. If that negotiation is unsuccessful, the audit committee then proceeds to negotiate with the second ranked firm, and so forth.

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## Question 26:

*What is the audit committee's responsibility for reviewing the financial statements?*

One important responsibility of the audit committee is to review the financial statements, including the notes. In doing so, the audit committee should be sure to consider all of the following<sup>50</sup>:

- *Accounting policies.* GAAP are not monolithic. Often financial statement preparers can choose from a variety of accounting and financial reporting alternatives, all of which are acceptable (e.g., method used to calculate depreciation expense). The choices ultimately made are described in the *Summary of Significant Accounting Policies*, which normally is presented as the first of the notes to the financial statements. The audit committee, with the assistance of its financial expert, should make its own assessment of the appropriateness of the choices made by management. In doing so, the key factor should be not whether a given choice is merely "permissible," but whether it produces the *best* financial reporting in the government's particular circumstances (with due consideration given to relative costs and benefits). In reviewing accounting policies, the audit committee should pay special attention to 1) changes in accounting policies (Is the new policy truly an improvement?), 2) the application of accounting policies to situations not previously encountered (e.g., participation in a new joint venture), 3) the application of accounting policies in situations where there is only limited authoritative guidance and little consensus in practice, and 4) potentially

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50. AICPA *Professional Standards*, Section AU 380.

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controversial accounting treatments (e.g., off-balance-sheet financings).

- *Accruals and estimates.* As already noted elsewhere, GAAP mandate the use of accruals and estimates, which often require the application of considerable judgment. The audit committee, with the help of its financial expert, should carefully review the methodology and assumptions underlying all significant accruals and estimates.
- *Audit adjustments.* The auditor normally will identify some items in the draft financial statements that are not entirely correct. Frequently these items are corrected by means of an adjusting journal entry. In other cases, management may decline to make an adjustment recommended by the auditor because it does not consider the item to be sufficiently important ("material"). The audit committee should satisfy itself that management has handled adjustments appropriately.
- *Disagreements between the independent auditors and management.* Sometimes significant disagreement will arise between the independent auditors and management. The audit committee should determine that any such disagreements were ultimately resolved to its satisfaction.
- *Consultation with other accountants.* Management may be tempted to engage in "opinion shopping" (i.e., consulting with an accounting firm other than the independent auditor to garner support for a particular accounting treatment favored by management). The audit committee should investigate all contacts between management and other accounting firms to satisfy itself that management was not, in fact, engaged in opinion shopping.<sup>51</sup>

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51. The independent auditors of the financial statements may bring such instances to the attention of the audit committee ("In some cases, management may decide to consult with other accountants about auditing and accounting matters. When the auditor is aware that such consultation has occurred, he should discuss with the audit committee his views about significant matters that were the subject of such consultation." AICPA *Professional Standards*, Section AU 380.14.)

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- *Difficulties encountered in performing the audit.* The audit committee should investigate any obstacles encountered by the independent auditors in performing the engagement caused by management's action or inaction.
  - *Fiscal situation.* Financial statements, of course, provide information that directly bears on the government's current and emerging fiscal situation. The audit committee, with the help of its financial expert, should review the financial statements from this perspective so as to be able to alert the governing body as a whole to any fiscal matters that may require its attention.

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## Question 27:

*What is the audit committee's responsibility for reviewing the independent auditors' reports and following up on corrective action?*

The audit committee will wish to check that the independent auditors have, in fact, rendered an *unqualified* (i.e., "clean") opinion on the fair presentation of the financial statements. If not, the audit committee needs to consider why the auditors' opinion was qualified and how the qualified opinion reflects on management.

In the public sector, *additional* auditors' reports are issued in conjunction with audits performed in conformity with either *Government Auditing Standards* or OMB Circular A-133 (i.e., "Single Audits"). Once again, the audit committee should check all such reports and consider how any qualifications or modifications contained in those reports may reflect on management.

In the private sector, weaknesses uncovered in the course of an audit are communicated to the client in the form of a separate letter to management ("management letter").<sup>52</sup> In the public sector, *significant deficiencies* and *material weaknesses* typically are communicated in the form of published *audit findings* (with management letters being used to communicate deficiencies that are *not* considered to be *significant*). A typical audit finding is composed of up to four separate elements, as follows:

- *Condition*. The auditor describes the facts of the situation.

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52. To be distinguished from the management *representation* letter discussed earlier (see note 5).

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- *Criterion / Criteria.* The auditor explains why the situation constitutes a weakness (e.g., violation of the government's purchasing policy).
  - *Cause.* The auditor explains why the weakness occurred (e.g., appropriate controls were not in place).
  - *Effect.* The auditor describes the impact of the condition (e.g., questioned costs that may ultimately be disallowed by the grantor).

Audit findings often are accompanied by specific recommendations from the auditor on how to alleviate the conditions identified, as well as by management's response.

The audit committee should carefully review all audit findings and satisfy itself that appropriate and timely corrective action has been taken by management to remedy the identified weaknesses. The audit committee also should follow up on corrective action not yet taken.

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*Question 28:*

*What is the audit committee's responsibility for reviewing the comprehensive framework of internal control?*

The audit committee should consider a number of factors in assessing the reliability of the comprehensive framework of internal control used to support financial reporting:

- *Findings of the independent auditors.* The audit committee should examine the audit findings and management letter of the independent auditors from the perspective of how the weaknesses they disclose could reflect on the fundamental integrity of the comprehensive framework of internal control. This examination, of course, should include any findings associated with a government's Single Audit.
- *Audit adjustments.* If audit adjustments were significant, the audit committee should consider whether they may reflect an underlying weakness in the comprehensive framework of internal control that needs to be remedied.
- *Work of internal auditors.* An effective internal audit function is a strong positive factor in the government's control environment (which is the most important of the five elements of a comprehensive integrated framework of internal control). Accordingly, the audit committee will wish to review the annual internal audit work plan to assess the comprehensiveness of the internal audit function. It also will wish to review individual audit reports to assess the effectiveness and objectivity of the internal auditors.

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- *Code of conduct.* Another important factor in a government's control environment is its code of conduct. The audit committee will wish to satisfy itself that the scope of the code of conduct is adequate, that the code of conduct is effectively communicated to employees at all levels, and that all violations are handled appropriately.
  - *Management's involvement with internal control.* Internal control cannot be successful without active management involvement. Thus, a key factor in evaluating the soundness of the comprehensive integrated framework of internal control is to assess the extent of management's involvement with that framework. Specifically, the audit committee will wish to determine whether: 1) management is knowledgeable about internal control, 2) management has documented its control-related policies and procedures, 3) management periodically evaluates the continued functioning and effectiveness of control-related policies and procedures, and 4) management has systematically followed up on the resolution of weaknesses identified by controls.<sup>53</sup>
  - *Special control challenges.* The audit committee will wish to pay special attention to the controls in place to avoid the possibility of managers abusing their position (e.g., policies on the acceptable use of agency vehicles and expense accounts).
  - *Complaints.* Managers are unavoidably in the position of being able to circumvent whatever control-related policies or procedures they implement. Therefore, it is essential that there be some practical means of "getting around" management to communicate any complaints about possible misfeasance or malfeasance on its part. Specifically, the audit committee should establish procedures for the receipt, retention, and treatment of complaints, especially regarding matters related to (or otherwise affecting) accounting, internal control,

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53. See the GFOA's recommended practice on *Enhancing Management Involvement with Internal Control*.

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and auditing. Such procedures should provide for the confidential, anonymous submission by employees of the government of concerns regarding questionable accounting or auditing matters.<sup>54</sup> Naturally, the audit committee will wish to satisfy itself concerning the disposition of all complaints received.

- *Pending accounting and regulatory changes.* All change involves an element of risk that must be mitigated through the comprehensive integrated framework of internal control. Consequently, the audit committee will wish to explore management's plans for dealing with any pending changes, either within or outside the government, that could have an impact on the government's financial reporting, particularly changes affecting accounting standards or finance-related laws and regulations.

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54. See the GFOA's recommended practice on *Audit Committees* and the Sarbanes-Oxley Act, Section 301.

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## Question 29:

*What is the audit committee's responsibility for assessing the performance of the independent auditors?*

In addition to overseeing management's fulfillment of its internal control and audit-related responsibilities, the audit committee also is responsible for overseeing the work of the independent auditors. In assessing the independent auditors' performance, the audit committee will wish to consider a number of factors, including:

- *Contractual performance.* Did the auditors fulfill all of their contractual obligations, including those relating to the number, level, and identity of staff assigned to the engagement?
- *Timeliness.* Did the independent auditors meet all agreed-upon deadlines? Was the auditors' response to unavoidable delays appropriate in the circumstances (e.g., was management informed in a timely fashion)?
- *Coordination.* Did the auditors satisfactorily coordinate their work with the government's staff to minimize disruption and to avoid needless duplication of effort (e.g., did the auditors fully utilize existing documentation and schedules and the work of internal auditors, as appropriate)?
- *Professionalism.* Is the audit committee satisfied with the scope and depth of audit findings? Did the independent auditors make themselves readily available to the audit committee? Were the independent auditors forthcoming with the audit committee in private discussions concerning management?

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*Question 30:*

*What is the audit committee's responsibility for providing an independent forum for internal auditors to report findings of management fraud, abuse, or control override?*

As noted earlier, some internal auditors report directly to the audit committee, whereas others report to top management. In the latter situation, it is important that internal auditors be provided some practical means of dealing with indications of management fraud, abuse, or control override. Specifically, the audit committee should have clear procedures in place that allow internal auditors to approach the committee directly in all such matters.

*Section VI*

**OPERATION AND  
REPORTING**



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*Question 31:*

*When and how often should the audit committee meet?*

The work of the audit committee continues year-round, starting with the process of audit procurement, proceeding through the actual audit itself, and then continuing with follow-up on actions taken by management to correct weaknesses disclosed by both the independent and internal auditors. Accordingly, the audit committee should meet throughout the year, typically no less than once each quarter.<sup>55</sup>

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55. See the "tool kit" on public-sector audit committees available at the AICPA's Web site.

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## Question 32:

### *How should an audit committee arrive at its conclusions?*

As noted previously, one of the key benefits of an audit committee is that it enhances communications between the independent auditors, the governing body, and management. There should be at least one meeting per year between the audit committee and the independent auditors that is conducted in private to ensure a full and frank exchange of views on management's financial reporting practices. Likewise, there should be at least one meeting between the audit committee and management that takes place privately to ensure that management is free to express its true assessment of the degree of coordination and cooperation achieved between the government's staff and the staff of the independent auditors. In addition, the audit committee itself needs to deliberate privately, at least once, to facilitate a full and free discussion of its conclusions. Furthermore, private meetings may be necessary with other parties as well (e.g., chief executive officer, chief financial officer, head of the internal audit function, general counsel, outside counsel, director of financial reporting, or controller), depending upon a government's specific circumstances.<sup>56</sup>

As explained earlier, private meetings of the audit committee may not be permitted under some extant "open meeting" or "sunshine" legislation. In that case, the GFOA strongly encourages that those laws be modified to permit these separate meetings, which are essential to the effective functioning of the audit committee, just as exceptions are routinely made in the case of pending litigation and personnel matters.<sup>57</sup>

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56. See the "tool kit" for public-sector audit committees available at the AICPA's Web site.

57. See the GFOA's recommended practice on *Audit Committees*.

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### Question 33:

#### *How should the audit committee report back to the full governing body?*

The GFOA recommends that the audit committee annually submit a written public report to the full governing body on how it has discharged its duties and met its responsibilities. To allow users of the report to make their own assessment of whether the audit committee has, in fact, done everything it was supposed to do, it is further recommended that the audit committee's annual report be accompanied by the charter, enabling resolution, or other legal documentation that established the committee and laid out its responsibilities.<sup>58</sup>

The GFOA further recommends that the audit committee's annual report contain the following assertions:

- The audit committee has discussed the financial statements with both management and the independent auditors;
- The audit committee met with the independent auditors separately from management;
- The audit committee also met separately from both management and the independent auditors to arrive at its final conclusions;
- Based solely on these conversations, the audit committee reasonably believes that the government's financial reporting is adequate (or was unable to satisfy itself that the government's financial reporting is adequate).

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58. This recommendation was also made in the *Report and Recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees*.



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# Interpreting Local Government Financial Statements

How To Avoid 25  
Common Mistakes

Stephen J. Gauthier



Government Finance Officers Association

*Interpreting Local Government  
Financial Statements:  
How To Avoid 25 Common Mistakes*

Stephen J. Gauthier

Government Finance Officers Association

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# PREFACE

We are all familiar with the notion of *optical illusions*, such as a mirage in the desert or the wheels on a speeding car that appear to be turning backward. So too in local government financial statements, certain items are not always necessarily what they at first appear to be. Such “financial statement illusions” can easily lead to serious misinterpretation and bad decisions. This publication aims to help minimize that risk by examining 25 specific and commonly encountered mistakes of this kind. The goal is not just to serve those who seek to improve their own knowledge of local government financial reporting, but also to assist financial reporting professionals who desire a practical approach for sharing their knowledge with others.

I gratefully acknowledge the contributions of Mr. Stephen Blann, Director of Governmental Audit Quality, Rehmman, Grand Rapids, Michigan; Mr. Michael Genito, Commissioner of Finance, City of White Plains, New York; and Mr. Robert B. Scott, Assistant City Manager/CFO, Carrollton, Texas. Both Mr. Scott and Mr. Genito have served as members of GFOA's Executive Board and as chair of GFOA's standing Committee on Accounting, Auditing, and Financial Reporting. Mr. Blann also has served multiple terms as an advisor to that same committee. I also am grateful to Mr. Todd Buikema and Mr. James Falconer, senior managers in GFOA's Technical Services Center, for their careful and helpful review of the manuscript. It also is my pleasure to thank Natalie Laudadio, Robert Kotchen, and other members of the GFOA who worked with the manuscript at various stages of production.

Stephen J. Gauthier  
March 2016

# FOREWORD

Financial reporting has always played a critical role in public finance. Today, thanks to the Internet, local government financial reports have become readily available to anyone with an interest in a government's finances. As a result, more people than ever now are using local government financial reports, many for the very first time.

In financial reporting, as elsewhere, things are not always necessarily what they might at first appear to be. For example, a large *net pension liability* does not necessarily mean that a government is facing a looming financial crisis; nor has something necessarily gone wrong if user charges for business-type activities only partially recover the cost of providing goods and services to customers. This publication aims to help elected officials and others become better interpreters of local government financial reports by identifying a number of important, but common mistakes to be avoided.

The Government Finance Officers Association (GFOA) is proud of the historic role that it has played in encouraging local governments to prepare and make readily available high quality financial reports. It is our hope that this newest addition to GFOA's Elected Official's Guide series will help users of local government financial reports get the most out of the wealth of information those reports contain.

The Government Finance Officers Association (GFOA) wishes to thank Stephen J. Gauthier, the Director of GFOA's Technical Services Center, for writing this publication. We hope that this booklet, along with others in GFOA's highly popular Elected Official's series, will continue to help bridge the gap between public-sector finance professionals and those they serve.

Jeffrey L. Esser  
Executive Director/CEO  
Government Finance Officers Association  
March 2016

# *Interpreting Local Government Financial Statements: How To Avoid 25 Common Mistakes*

## **1. Government-wide financial statements vs. fund financial statements**

**Misunderstanding:** The government-wide financial statements are the “real” financial statements, whereas the fund financial statements are essentially supporting schedules.

The government-wide financial statements are the first set of financial statements that a reader encounters in a state or local government's financial report. They alone encompass both the primary government and its discretely presented component units. Likewise, some of the government's largest assets and liabilities (capital assets and long-term debt related to general governmental operations) appear only in the government-wide financial statements. Given these facts, it is not surprising that those less familiar with state and local government financial reporting sometimes mistakenly view the government-wide financial statements as the “real” financial statements and look at the fund financial statements that follow them merely as supporting schedules. In truth, however, government-wide financial statements and fund financial statements play very different, but equally important roles. State and local government financial statements are designed to meet two complementary objectives:

- *Operational accountability.* One objective of financial reporting for state and local governments is to provide information that readers can use to assess whether a government is meeting its operating objectives effectively and efficiently and will be able to continue to do so for the foreseeable future. Meeting this objective requires financial statements that are *comprehensive in scope* (all assets and all liabilities) and that have a *long-term focus* (recognizing transactions and events as soon as they occur, even if related cash flows will not take place until well into the future).
- *Fiscal accountability.* The other objective of financial reporting for state and local governments is to provide information that readers can use to assess whether a government has complied during the period with the various limitations placed on the raising and spending of public monies. Meeting this second objective requires financial statements with a *narrower scope* (subgroupings of assets and liabilities dedicated to different purposes) and, in the case of the funds used to account for operations of the general government itself (*governmental funds*), a *near-term focus* (recognizing transactions and events only to the extent they affect near-term cash flows).

Why is a narrower scope needed to demonstrate fiscal accountability? A government's resources cannot be spent for just any purpose: managers in the public sector typically are quite limited in how they can spend public resources. For example, the proceeds of a grant must be spent for the purpose specified by the grantor, just as the proceeds of a bond issuance have to be spent in accordance with the terms of the bond contract (the proceeds of a bond issued to finance bridge construction cannot be used to hire new police officers). Even resources generated by the government itself (property taxes, sales taxes) must be spent in accordance with the annual (or biennial) appropriated budget approved by the legislative body. As a practical matter, separate reporting (*fund accounting*) is necessary to demonstrate that management has, in fact, complied with these various legal and contractual limitations on spending. Likewise, it is useful to segregate different types of business-type activities (transit, water, municipal golf course) to determine the degree to which each is recovering its costs through fees and charges (an objective achieved in the private sector by segment reporting).

Why do governmental funds need to have a near-term focus? Most decisions on the use of general government resources take place in the context of the annual (or biennial) appropriated budget. The goal of governmental funds is to provide information that is relevant from a budgetary perspective, where a key objective is to ensure that the combination of existing and current period inflows of spendable resources will be sufficient to cover expenditures of the period (liquidity). A simple illustration from personal finance may be helpful in understanding this key difference.

Assume that a couple is interested in assessing whether they will be in a good financial position to retire or to send their children through college when the time comes. Clearly the couple would need to take into account: 1) *all* of their assets, both financial (cash on hand, bank accounts, investments, IRAs) and nonfinancial (home, car, vacation home); and 2) *all* of their liabilities, both near-term (current utility bills, annual property tax assessment) and long-term (college loans, mortgage, car note). Now assume instead that the same couple is simply trying to assess whether they “can make ends meet” this current year. Clearly, they cannot “spend” their nonfinancial assets (house or car) to pay bills, nor do they have to be concerned about coming up with money today to liquidate long-term liabilities (mortgage payments due over the next ten years). Thus, information on non-financial assets and long-term liabilities would be distracting, rather than enlightening for making this assessment.

Therefore, the relevance of financial information depends on the question being asked. Is the reader concerned with the government's long-term prospects and sustainability? The government-wide financial statements provide the information needed for this purpose. Is the reader concerned instead with determining whether the government is complying with limitations on the raising and spending of public monies and will be able to pay its bills as they come due? Then, it is the fund financial statements that provide the needed information.

As a practical matter, more people know their checkbook balance (short-term focus) than their net worth (long-term focus). This is because most day-to-day decisions naturally focus

on the former (“you have to get through the short-term to make it to the long-term”). Nonetheless, people undoubtedly would make better day-to-day decisions if they paid more attention to the long-term impact of their short-term choices. So too, decision-making in state and local governments tends to focus heavily on the fund financial statements rather than the government-wide financial statements. All the same, the government-wide financial statements can play an important role for state and local governments by bringing to the fore each year the long-term financial impact of the decisions made that year and in previous years.

### 2. Deferred inflows of resources vs. liabilities

**Misunderstanding:** “Deferred inflows of resources” are equivalent to “liabilities.”

State and local governments distinguish liabilities from *deferred inflows of resources* in their financial statements. Private-sector financial reporting does not make this distinction, nor did state and local governments do so until recently. Indeed, virtually all of the items now reported as deferred inflows of resources in public-sector financial statements previously were reported as liabilities. Perhaps this fact explains why many financial statement users mistakenly assume that liabilities and deferred inflows of resources are more or less equivalent, when in fact they are quite different.

A liability normally represents a government's commitment to make future payments to a third party (bonds payable, pension benefits, claims and judgments). A liability also can reflect a government's commitment to refund resources it has already received should it fail to provide promised goods and services (*unearned revenue*) or should it fail to meet basic eligibility requirements attached to an advance received from a grantor. In either case, a liability is reported to show this *certain or potential reduction of a government's net resources*.

*Deferred inflows of resources*, on the other hand, involve *no reduction of a government's net resources*. To the contrary, deferred inflows of resources normally indicate that an *increase* in net resources has already taken place, but relates to a future period and, therefore, cannot be recognized as revenue until then. One example would be property taxes collected in advance of the budget year they are intended to finance. Another example would be grant proceeds received prior to the period they are intended to finance (assuming all basic eligibility requirements have been met). In both cases, no future reduction of a government's net resources will ever occur.

A second use of *deferred inflows of resources* is to indicate that certain revenues of governmental funds related to the current period cannot be recognized as such because they will not be *available* soon enough after the end of the fiscal year to pay liabilities of the current period (e.g., 60 days). In such cases, once again, no future reduction of a government's net resources will ever occur.

In short, the difference between *liabilities* and *deferred inflows of resources* is nothing less than the difference between resources “going out” (*liability*) and resources “coming in” (*deferred inflow of resources*). Accounting standard-setters in the public sector believe this is a distinction worth making in the financial statements.

### 3. Amount reported for *capital assets* vs. their fair value or replacement cost

**Misunderstanding:** The amount reported for “capital assets” is somehow connected to their current fair value or replacement cost.

Imagine that a government is about to purchase equipment for \$2 million and expects that equipment will provide service for the next 20 years. Normally, the journal entry for an outlay of cash would be:

	DR	CR
Expense	\$2,000,000	
Cash		\$2,000,000

However, it would be misleading to report the full \$2 million as an expense of just the first year, since the equipment will benefit the subsequent 19 years as well. Accordingly, something must be done to delay recognizing the original outlay to purchase equipment as an expense (i.e., *capitalization*):

	DR	CR
Equipment	\$2,000,000	
Cash		\$2,000,000

Thus, the amount reported for *capital assets* in the statement of net position is nothing more than the original cost of purchasing or otherwise acquiring a capital asset, which is then reduced each year by an annual charge to depreciation expense (\$2 million ÷ 20 years = \$100,000/year). Thus, at the end of two years the *carrying value* (amount reported on the face of the financial statements) of the equipment would be \$1.8 million.

Many financial statement users mistakenly think that the amounts reported for *capital assets* either equal or approximate the current fair value or replacement cost of those assets. However, the values reported typically have little relation to either. For example, there is no reason to believe that either the original cost or the carrying value of a building constructed 30 years ago would in any way reflect either its fair value (resale value) today, or what it would cost to replace it today.

### 4. Significance of a *net pension liability* or a *net OPEB liability*

**Misunderstanding:** A large “net pension liability” or a large “net OPEB liability” means that a government must be facing an impending financial crisis.

State and local governments normally provide pension benefits as part of their employee compensation package. In addition, many governments also offer other postemployment benefits (OPEB), such as retirement healthcare. The difference between the value in today's dollars (*present value*) of benefits already earned by employees (*total pension liability* or *total OPEB liability*) and amounts accumulated in trust to pay those benefits (*fiduciary net position*) is reported as a *net pension liability* or a *net OPEB liability*. The amount of these liabilities can be substantial, and may even dwarf the other liabilities reported on the employer's statement of net position.

Financial statement users should always take seriously a large *net pension liability* or a large *net OPEB liability*. That is not to say, however, that a large *net pension liability* or a large *net OPEB liability* indicates that a government is now facing, or will face, serious financial difficulties. An example from personal finance may be helpful in this regard.

Few middle-class parents would deny that financing the cost of a college education for their children constitutes a major financial challenge that must be taken seriously. On the other hand, there is no reason for the parents of a four-year-old to panic just because sufficient resources have not yet been accumulated in the child's college fund to pay in full for tuition and housing. After all, the parents still have another 14 years to accumulate the needed resources! The important thing is that: 1) the parents have a solid plan for accumulating the necessary resources; 2) the plan they have put together is feasible, given the parents' financial circumstances; and 3) the parents faithfully follow that plan by faithfully making their contributions to the college fund in full.

The same considerations hold true for pensions and OPEB. Pension plans and OPEB plans engage the services of professional actuaries to calculate the annual contributions that employers need to make each year to ensure that sufficient resources will be accumulated in time to pay promised benefits. Accordingly, there is no reason for alarm if: 1) the employer intends to make contributions based on an actuarial valuation that uses reasonable assumptions; 2) it is feasible for the employer government to keep making those contributions, given its economic circumstances; and 3) the employer government does, in fact, faithfully pay the full amount of its actuarially determined contribution (ADC) to the pension plan or OPEB plan each year.

To use another analogy from personal finance, the important thing is not so much the size of the mortgage on the house, as the size of the monthly mortgage payments and the homeowner's ability to make those payments given the homeowner's income.

Another key factor in evaluating the significance of an employer's *net pension liability* or *net OPEB liability* is the pension plan's or the OPEB plan's *funded ratio*. As already explained, an employer's net pension/OPEB liability is calculated as follows:

Total pension/OPEB liability	\$100
<u>Fiduciary net position</u>	<u>(85)</u>
Net pension/OPEB liability	\$ 15

These same amounts can also be expressed as a *funded ratio*: \$85 fiduciary net position ÷ \$100 total employer liability = 85% funded. Those interested in the soundness of pension plans and OPEB plans often focus on a plan's funded ratio. In doing so, however, it is important to consider the funded ratio in context. Assume, for instance, the following facts:

	<u>Funded Ratio</u>	
	<u>Pension Plan A</u>	<u>Pension Plan B</u>
2016	80%	85%
2015	79%	87%
2014	77%	90%
2013	74%	92%
2012	71%	93%
2011	70%	95%

If a reader looked only at the current year's funded ratio, Pension Plan B, with 85 percent funding, is clearly in the better funded position. However, an examination of trends over the past five years offers a very different perspective. The funded ratio for Pension Plan B has been steadily *declining* during the five most recent years (even though it is still ahead of Pension Plan A), whereas just the opposite has been happening for Pension Plan A. Consequently, those interested in pension plan or OPEB plan funded ratios normally assess their significance based on trend data. While a plan's funded status today is important, the speed and direction of change are just as important.

All accepted actuarial funding methods will generate actuarially determined employer contribution amounts sufficient to provide all the resources needed to pay promised benefits *if the underlying assumptions hold true* (hence the importance of using reasonable assumptions!). Consequently, *if employer contributions are calculated on an actuarial basis*, an important consideration in determining the adequacy of employer funding is whether the employer has, in fact, been faithfully making its contributions in full each year. For employers in single-employer or agent multiple-employer plans (where employer liabilities are not shared), a schedule is provided as part of Required Supplementary Information (RSI), immediately following the notes to the financial statements, that compares the amount the employer

*should have contributed* in each of the past 10 years with the amount the employer *actually contributed* each year. Such information is invaluable for assessing the employer's commitment to sound funding.

### 5. *Unrestricted net position* vs. “spendable resources”

**Misunderstanding:** All of the resources reflected in “unrestricted net position” are available for spending.

Governmental funds report the difference between assets (+ deferred outflows of resources) and liabilities (+ deferred inflows of resources) as *fund balance*, while government-wide and proprietary fund financial statements report the equivalent amount as *net position*. The *unrestricted* portion of fund balance (*committed fund balance* + *assigned fund balance* + *unassigned fund balance*) reflects resources actually available for spending. The same cannot be said, however, of the amount reported as *unrestricted net position* in the government-wide and proprietary fund financial statements. Why the difference?

The calculation of *unrestricted fund balance* excludes items that are *not* relevant to near-term spending (e.g., long-term receivables and long-term liabilities). In contrast, such items frequently affect the calculation of *unrestricted net position*. For example, the calculation of *unrestricted net position* might include a loan receivable that will not be collected for another three years (which would *not* currently be available for spending) or a liability for vacation leave (which would *not* require the use of resources in the near term). Accordingly, those desiring to know what resources are actually available for spending for general government purposes should look to the unrestricted portion of *fund balance* rather than to the amount reported as *unrestricted net position - governmental activities* in the government-wide financial statements.

## 6. Components of *program revenue*

**Misunderstanding:** “Program revenue” includes taxes dedicated to a specific purpose.

Many government programs partially “pay for themselves” through *charges for services* or program-specific *grants and contributions* from outside parties. For example, governments normally are able to cover a significant portion of the cost of public transportation from farebox revenue (*charges for services*) and transit-related grants (*grants and contributions*). Such amounts are reported in the government-wide statement of activities as *program revenue*, where they are deducted from program expenses to arrive as *net program cost*.

It also is common for governments to dedicate taxes to support a specific program. For example, many governments impose a motor fuel tax subject to the requirement that all the money raised be used to fund road repair or construction. Likewise, it is quite common for a local government to dedicate an increment of its property tax levy to help fund a particular project or program (e.g., park expansion). Like the *program revenue* described earlier (*charges for services; grants and contributions*), dedicated taxes help to cover the cost of a program. However, dedicated taxes differ from *program revenue* in two important ways:

- Unlike *charges for services*, dedicated taxes are *not* actually generated by the program itself; and
- Unlike *grants and contributions*, dedicated taxes do *not* bring in new resources from outside the government's own tax base.

Accordingly, dedicated taxes are never reported as *program revenue*, despite their close association with specific programs; instead, they are reported as part of *general revenue*. Financial statement users who are interested in *all* revenues associated with a given program should bear this fact in mind and consider not only the amounts reported as *program revenue* for a given program, but also related dedicated taxes.

7. Interpreting *net program cost*

**Misunderstandings:** 1) “Program revenue” in excess of expense must mean a program has “paid its own way” in the current period; and 2) “expense” in excess of “program revenue” for a business-type activity must indicate that the program is not meeting its financial objectives.

**“Program revenue” in excess of expense must mean a program has “paid its own way” in the current period.** Assume that a government reports \$100 in program expense and \$110 in program revenue for a given program, as follows:

Program Revenue				
	Expenses	Charges for Services	Grants and Contributions	Net Program Cost
Program A	(\$100)	\$20	\$90	\$10

Based on this information alone, a reader might easily conclude that the program was able to more than cover its program expense in the current year with program revenue. However, not all grants and contributions are available to cover current year program expense. *Capital* grants and contributions, by definition, must be used for capital outlays, which are *not* included in *program expense*, but instead are reported as *capital assets*. That is, a capital grant or contribution is *not* available to cover program expense of the current period. For this reason, governments are required to distinguish operating grants and contributions from capital grants and contributions, as follows:

Program Revenue					
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Net Program Cost
Program A	(\$100)	\$20	\$10	\$80	\$10

This distinction permits financial statement readers to better understand that only \$30 of total program revenue in the example just given was actually available to cover the \$100 of current program expense. That is, from the vantage point of covering program expense, *net program cost* was really -\$70 rather than +\$10, or, stated differently, the program was *not* completely self-financing during the current period. Thus, those interested in assessing the ability of a program to cover its ongoing costs with program revenue should focus exclusively on *charges for services* and operating grants and contributions, since capital grants and contributions are irrelevant to making that assessment.

**“Expense” in excess of “program revenue” for a business-type activity must indicate that the program is not meeting its financial objectives.** Private-sector businesses must either recover the full cost of providing goods and services to their customers or go out of business. Governments, on the other hand, often choose to subsidize certain business-type activities (public transportation), because those activities offer benefit not only to their direct users, but also to the general public (improved air quality, lessened traffic congestion, decreased need for downtown parking, increased access to employment for low-income workers). Thus, a proper financial analysis of a program reported as a business-type activity depends on the government's *specific expectations for that particular program*.

Assume, for example, the following set of circumstances:

Program	Cost Recovery Goal	Expense	Revenue	Net Program Cost	Goal	Variance
Electric utility	100%	\$100	\$105	+\$ 5	\$ 0	+\$ 5
Water utility	80%	\$100	\$ 65	-\$35	-\$20	-\$15
Transit operation	40%	\$100	\$ 50	-\$50	-\$60	+\$10

If *net program cost* were considered independently of the government's specific expectations for each program, it would appear that the electric utility was the most successful in meeting its financial objectives (+\$5), followed by the water utility (-\$35) and the transit operation (-\$50). However, based on the government's subsidy targets, it was actually the transit operation that was most successful in meeting its financial objectives (+\$10), followed by the electric utility (+\$5) and the water utility (-\$15). Accordingly, it is very important that those evaluating the operation of a program reported as a business-type activity take into consideration the government's specific funding goals for that program. Normally *capital* grants and contributions would be irrelevant to this assessment. Likewise, operating grants and contributions would be irrelevant if the target is based exclusively on cost recovery through user charges.

## 8. Components of the line item *interest expense*

**Misunderstandings:** The amount reported as “interest expense” reflects all interest expense, including amounts related to business-type activities.

*Business-type activities* (government-wide financial statements) operate as separate units (*enterprise funds*) within the primary government. For example, a water fund operates separately from a transit fund. Thus, borrowings can be clearly and meaningfully associated with a particular function or program. It is clear, for example, that water bonds are an obligation of the water fund and not of the transit fund. Consequently, interest expense arising from business-type activities is reported as program expense of the program to which it relates.

The same cannot be said of programs of the *general government* (public safety, highways and streets, sanitation, economic development, culture and recreation), because they do *not* operate separately from a financial perspective.

Assume, for example, that a government does not have all the resources it needs to fund capital acquisition for general government programs this year. If it spends the money it does have to buy new police cars, it will have to borrow money to buy a new firetruck. Conversely, if it spends the money it does have to buy a new firetruck, it will have to borrow money to buy new police cars. Thus, assigning financing costs (*interest expense*) to any given function or program within the general government is arbitrary. Consequently, interest expense related to *governmental activities* is reported as a separate line item in the government-wide financial statements, whereas interest expense related to *business-type activities* is not. Stated differently, the line item reported as *interest expense* in the government-wide statement of activities includes only interest expense related to governmental activities, and not interest expense related to business-type activities.

## 9. *Special items vs. extraordinary items*

**Misunderstanding:** The sole difference between “special items” and “extraordinary items” is that special items have to meet only one of the two criteria required for classification as an extraordinary item.

It is difficult to evaluate the significance of financial data for the current year without some point of reference. Typically, users of financial statements look to comparable data from prior years for that purpose. However, significant transactions and events that are both *unusual in nature* (highly abnormal and unrelated to an entity's typical activities) and *infrequent in occurrence* (not reasonably expected to recur in the foreseeable future) compromise the comparability of financial data from one year to the next. Therefore, such transactions and events are reported on a separate line in the financial statements as *extraordinary items*.

Some significant transactions and events meet one, but not both, of the criteria just described. They, too, potentially could compromise the comparability of financial data from year to year. Accordingly, these *special items* also are reported on a separate line in the financial statements, *but only if they are subject to management control*.

In short, a transaction or event must always meet two criteria to be classified as either an *extraordinary item* or a *special item*, as follows:

	Extraordinary Item	Special Item
Criterion 1	Unusual in nature	Unusual in nature <i>or</i> Infrequent in occurrence
Criterion 2	Infrequent in occurrence	Subject to management control

A practical illustration may be helpful. A hurricane is certainly *unusual in nature*; whether it is *infrequent in occurrence*, however, depends entirely on location. A hurricane in Massachusetts, for instance, would be infrequent in occurrence, whereas a hurricane in Florida would not. At this point it might be tempting to classify the hurricane in Massachusetts as an *extraordinary item* (because it was *both* unusual in nature *and* infrequent in occurrence) and to classify the hurricane in Florida as a *special item* (because it met one of the two criteria for an extraordinary item, but not the other). However, the second criterion for classification as a *special item* is that the transaction or event *be subject to management control*, which certainly would *not* be the case for a hurricane anywhere.

In summary, a *special item* is not simply a transaction or event that meets just one of the two criteria for classification as an *extraordinary item* (unusual in nature *or* infrequent in occurrence), but also one that is subject to management control. Thus, transactions and events that meet one or the other criterion for classification as an *extraordinary item* do *not* necessarily qualify for reporting as *special items*.

### 10. *Fund balance* as a measure of financial well-being

**Misunderstanding:** “Fund balance,” by itself, is an adequate measure of financial well-being.

Financial statement users typically focus more attention on *fund balance* than on any other number in a state or local government's financial statements. While it is true that low levels of *fund balance* or a deficit in *fund balance* normally are symptomatic of financial difficulties, it is *not* necessarily true that a high level of fund balance means a government is in good financial shape.

Governmental funds focus on *liquidity*; that is, they provide information useful in assessing whether existing and current period inflows of spendable resources are sufficient to cover expenditures of the current period. Liquidity, however, as just described, is *not* always an indicator of overall financial well-being. An example from personal finance may help to underscore this point.

At first glance, a homeowner with a high checking account balance and a high savings account balance after all bills had been paid would appear to be in good financial shape. However, that first impression would probably change if it turned out that the high balance in both accounts was the product of a second mortgage that the homeowner recently had to take out because regular household income was proving inadequate to meet monthly expenses. So too, a high level of fund balance that resulted from a borrowing would *not* necessarily be indicative of financial well-being.

Similarly, the ability to pay *today's* bills is not necessarily an indication of the ability to pay *tomorrow's* bills. Once again, to use an example from personal finance, a couple that has been doing quite well meeting its current obligations over the years may face serious financial challenges when they have to start to pay college bills for their children. So too, governments that have not been systematically accumulating resources in advance to meet certain long-term obligations (e.g., pensions and OPEB), may face significant financial challenges when payments ultimately have to be made.

### 11. Determining the appropriate level of *fund balance*

**Misunderstandings:** 1) Readers of financial statements should focus on the total amount of “fund balance” in the general fund; and 2) there is a single “right answer” to the question of how much “fund balance” is enough.

**Readers of financial statements should focus on the total amount of “fund balance” in the general fund.** Governments need to maintain a healthy financial “cushion” to ensure they are prepared to meet unexpected contingencies, just as individuals strive in their personal finances to maintain a minimum level of readily available cash for emergencies. Typically financial statement users rightly look to *fund balance* in the general fund to determine whether a government's financial “cushion” is adequate. It is a mistake, however, to use total fund balance in the general fund for this purpose.

To be sure, governmental funds do focus on liquidity; however, that does *not* mean that all resources in the general fund are equally available for spending if an unexpected contingency occurs. One portion of total *fund balance* represents resources that are *not* in spendable form, such as inventories and the long-term portion of receivables (*nonspendable fund balance*). Another portion of *fund balance* represents resources whose use is subject to externally enforceable legal limitations (*restricted fund balance*), and thus would *not* be available for spending in the event of an unexpected contingency. Consequently, it is only the remaining portion of *fund balance* (*committed fund balance* + *assigned fund balance* + *unassigned fund* = *unrestricted fund balance*) that is relevant for assessing whether sufficient resources have been accumulated for contingencies. Indeed, a more conservative approach would focus exclusively on the combination of *assigned fund balance* and *unassigned fund balance*, or on just *unassigned fund balance*.

**There is a single “right answer” to the question of how much “fund balance” is enough.** There are two possible points of reference for assessing the adequacy of *unrestricted fund balance*: regular operating revenues and regular operating expenditures. Typically, governments choose whichever of the two is more predictable in their particular circumstances. For example, a local government that relies primarily on property tax, which is highly predictable, would likely use regular operating revenues as its point of reference. Conversely, a government that relies primarily on sales tax, which is a much less predictable revenue source than property tax, would likely use regular operating expenditures. As a general rule, the Government Finance Officers Association (GFOA) recommends that *unrestricted fund balance* be no less than two months of whichever is chosen as a point of reference.

In personal finance, certain general rules of thumb often are applied to assess how much an individual should maintain as a “rainy day fund.” Ultimately, however, the right amount will depend on an individual's specific circumstances. For example, a worker in an industry where periodic layoffs are common likely would desire to maintain more resources in a “rainy day fund” than would a worker in an industry less subject to layoffs. So too, GFOA recommends that governments subject to higher than ordinary levels of volatility in their revenues or expenditures maintain a higher minimum level of *unrestricted fund balance* than the two months of regular operating revenues/expenditures described earlier.

What is unpredictable for an individual is often predictable for a group. For example, a driver has no way of knowing whether he or she will be involved in an automobile accident in a given year, but an insurance company that insures millions of drivers is able to predict with a relatively high degree of reliability how many accidents will occur among the drivers it insures in a given year. So too, very large governments, by virtue of their size, often are much better able to predict contingencies than are smaller governments. Consequently, very large governments may be able to establish an acceptable level of *unrestricted fund balance* that is significantly less than the two months of regular operating revenues/expenditures normally recommended.

## 12. Interpreting *assigned fund balance*

**Misunderstanding:** “Assigned fund balance” always represents the full amount of fund resources that a government has formally “earmarked.”

Governments often formally set aside or “earmark” resources for a specific purpose. For example, a city council might decide to set aside a portion of a surplus in the general fund to finance the purchase of new police vehicles. Such earmarked resources are properly reflected in *assigned fund balance*. Logically speaking, however, there is an inherent “ceiling” to the amount that can be reported as *assigned fund balance*. Assume, for example, the following situation:

Total fund balance	\$100
Nonspendable fund balance	(5)
Restricted fund balance	(40)
<u>Committed fund balance</u>	<u>(30)</u>
Remaining portion	\$ 25

Further assume that the government has earmarked \$30 for a special project. In these circumstances, reporting the full \$30 that was earmarked as *assigned fund balance* would produce a \$5 deficit in *unassigned fund balance*:

Total fund balance	\$100
Nonspendable fund balance	(5)
Restricted fund balance	(40)
Committed fund balance	(30)
Assigned fund balance	(30)
Unassigned fund balance	(5)

However, a government cannot meaningfully “earmark” resources that it does not have! Consequently, the amount reported as *assigned fund balance* could never exceed the amount of *total fund balance* that remains after deducting *nonspendable fund balance*, *restricted fund balance*, and *committed fund balance*. Stated differently, it is impossible to report positive *assigned fund balance* and negative *unassigned fund balance* simultaneously. Thus, in the circumstances just described, the correct reporting would instead be as follows:

Total fund balance	\$100
Nonspendable fund balance	(5)
Restricted fund balance	(40)
Committed fund balance	(30)
Assigned fund balance	(25)
Unassigned fund balance	0

Thus, financial statement readers must bear in mind that the amount reported for earmarked resources in *assigned fund balance* reflects only net resources actually accumulated at the end of the fiscal year, which could be *less* than the amount intended to be earmarked.

### 13. Revenue in government-wide financial statements vs. revenue in governmental fund financial statements

**Misunderstanding:** Government-wide financial statements and governmental fund financial statements use different terms for outflows (“expense” vs. “expenditures”), but the same term for inflows (“revenues”); therefore, “revenues” must be the same for both.

As explained earlier, government-wide financial statements take a long-term perspective. Accordingly, they report inflows and outflows of resources as soon as the underlying event has occurred, regardless of the timing of related cash flows. Thus, *revenue* is recognized in government-wide financial statements as soon as it is earned or, in the case of grants, as soon as all eligibility requirements have been met, *even if collection will not actually occur until much later*. Accountants describe this approach to revenue recognition, which deliberately ignores the timing of related cash flows, as the *accrual* basis of accounting.

Governmental funds, as also explained earlier, focus on near-term inflows and outflows of resources, consistent with the operating budget. As a practical matter, resources that will not be collected until well into the following year, or even later, cannot be used to liquidate liabilities of the current year, and so are irrelevant to this near-term focus. Accordingly, it is not enough that earning has occurred or that eligibility requirements have been met to recognize *revenue* in governmental funds; *in addition*, collection must occur during the current year, or soon enough thereafter, to be *available* to liquidate liabilities of the current period. This approach is known as the *modified accrual* basis of accounting.

Put simply, *accrual* accounting has one criterion for revenue recognition, whereas *modified accrual* accounting has two:

Accrual:	Earning/Eligibility
Modified accrual:	Earning/Eligibility + Availability

Moreover, these *unavailable* amounts are ultimately recognized as *revenue* in governmental funds when they do eventually become *available*. Thus, governmental funds report both:

- The available portion of total current-year revenue; *and*
- Prior-year revenue that first became available in the current year.

Assume, for example, the following information:

Year 1	Total revenue - accrual basis	\$100
	Less: amount available	<u>95</u>
	Amount unavailable	\$ 5*
<i>*All collected during Year 2</i>		
Year 2:	Total revenue - accrual basis	\$110
	Less: amount available	<u>108</u>
	Amount unavailable	\$ 2

Based on these assumptions, the amount of revenue reported in the government-wide and governmental fund financial statements for Year 2 would be as follows:

Government-wide financial statements:	\$110
Governmental fund financial statements:	\$113*
<i>* Available revenue – current year</i>	<i>\$108</i>
<i>Newly available revenue – prior year</i>	<u><i>5</i></u>
	<i>\$113</i>

Thus, despite the use of the same terminology, the *revenue* reported for governmental activities in the government-wide financial statements is *not* the same as the *revenue* reported in the governmental fund financial statements.

## 14. Expenditures vs. disbursements

**Misunderstanding:** An “expenditure” is the same thing as a “disbursement.”

As explained earlier, an *expense* is recognized in government-wide financial statements as soon as the underlying event occurs, regardless of the timing of related cash flows. Conversely, both *expenditures* (which are reported in governmental fund financial statements) and *disbursements* are affected by the timing of related cash flows, although not in the same way.

A *disbursement* represents a cash payment. For example, a bill that is *payable* at the end of Year 1, but not *paid* until Year 2, would be a *disbursement* of Year 2. *Disbursements* are reported in financial statements prepared using the *cash basis* of accounting, which is *not* appropriate for financial statements prepared in accordance with generally accepted accounting principles (GAAP).

Governmental funds, which use the *modified accrual basis of accounting* (rather than the cash basis of accounting) report *expenditures* rather than *disbursements*. The key difference between the two is that *expenditures* are not limited to just cash payments, but also include amounts that *normally* would be paid from financial resources of the current period, regardless of when payment actually was made. For example, if a government received goods from a vendor during the current year, but did not pay for those goods until the following year, it would still recognize an *expenditure* in the current period, because governments normally pay their vendors for services rendered in the current period with current period financial resources.

## 15. Interpreting the line item *capital outlay*

**Misunderstanding:** The amount reported as “capital outlay” represents the total amount of governmental fund expenditures that was capitalized during the period.

State and local governments typically report a single line for *capital outlay* expenditures in their governmental fund financial statements. This line, however, usually does not represent the total amount expended in governmental funds for capital assets. Why so?

One key conceptual difference between *capital outlay expenditures* and regular ongoing *current expenditures* is that the former offer value not just to the current period, but to future periods as well. A firefighter's salary, for instance, offers value only for the current year, whereas the purchase of a new fire truck offers value each year the fire truck remains in use. Thus, accounting standards direct financial statement preparers to take this fact into account by reporting separate *character classifications* for *current expenditures* and *capital outlay expenditures*.

Many, if not most, financial statement users are primarily concerned with the functional or programmatic purpose for which money was spent (e.g., public safety, parks and recreation). However, if all capital outlays are reported indiscriminately on a single *capital outlay* expenditures line, it is impossible to discern how much was spent in total (operational + capital) for a given function or program. Assume, for example, the following spending for the police and fire function and for the Parks and Recreation function:

Police and fire:		
Operations	\$100	
New patrol cars	50	
		\$150
Parks and recreation:		
Operations	\$ 25	
New soccer field	5	
		\$ 30

If all capital outlay is reported on a separate line, the result would be as follows:

Current Expenditures:	
Police and fire	\$100
Parks and recreation	25
Capital Outlay Expenditures:	55

To avoid losing information on the total cost of each function or program, most governments combine operating expenditures and capital outlay expenditures in the appropriate functional line within *current expenditures*, as follows:

<b>Current Expenditures:</b>	
Police and fire	\$150
Parks and recreation	30

A few governments try to accomplish both goals by reporting separate functional or programmatic lines within *capital outlay expenditures*, just as they do within *current expenditures*:

<b>Current Expenditures:</b>	
Police and fire	\$100
Parks and recreation	25

<b>Capital Outlay Expenditures:</b>	
Police and fire	\$ 50
Parks and recreation	5

Unfortunately, this approach requires adding additional lines to an already crowded statement of revenues, expenditures, and changes in fund balances. Consequently, most governments elect *not* to distinguish capital outlay expenditures associated with general government functions, but instead reserve the use of the *capital outlay expenditures* line for expenditures reported in capital projects funds.

## 16. Treatment of the sale of a capital asset in the government-wide financial statements vs. treatment of that same sale in the governmental fund financial statements

**Misunderstanding:** “Gains” on the sale of capital assets (government-wide financial statements) and “other financing sources” resulting from the sale of capital assets (governmental fund financial statements) are essentially the same thing.

Government-wide financial statements focus on the *economic* impact of transactions and events, whereas governmental funds focus on their effect on *near-term liquidity*. This difference in focus results in very different treatments of the sale of assets.

From an *economic* vantage point, the effect of the sale of an asset is the difference between the carrying value of the asset and the proceeds of the sale:

	DR	CR
Cash	\$100	
Land		\$40
Gain on sale		60

Conversely, from a *near-term liquidity* stand point, the exchange of a nonspendable asset (land) for a spendable asset (cash) increases liquidity by the full amount of the proceeds received. To avoid creating the false impression that a government is *economically* better off as a result, the increase in liquidity just described is reported in a governmental fund as an *other financing source* rather than as *revenue*:

	DR	CR
Cash	\$100	
Other financing source		\$100

This same treatment applies to insurance recoveries associated with losses of capital assets, which are equivalent to an involuntary sale.

### 17. Source of *actual* amounts presented in budgetary comparisons

**Misunderstanding:** “Actual” amounts are drawn from the governmental fund statement of revenues, expenditures, and changes in fund balances.

Governments are required to present a budgetary comparison for their general fund and major special revenue funds, either as a basic financial statement or as Required Supplementary Information (RSI). In addition, a government that prepares a comprehensive annual financial report (CAFR) is required to present budgetary comparisons for each individual governmental fund with a legally adopted annual (or biennial) budget. In both cases, the budgetary statement or schedule compares *actual* expenditures to *budgeted* appropriations.

Governmental fund financial statements are prepared using the modified accrual basis of accounting. While many budgets are prepared on this same basis, it is quite common for budgets to use a different *budgetary basis of accounting* for budgetary purposes. For example, for budgetary purposes, money typically is considered to be “spent” as soon as a purchase order is issued (*encumbrance*), whereas under the modified accrual basis of accounting, an expenditure is not recognized until goods or services are actually received.

Assume, for instance, that a government spent \$100 for goods and services that were, in fact, received, and also issued an additional \$10 of purchase orders. Assume as well that the government’s *budgetary basis of accounting* treats both purchases for which goods and services have been received and encumbrances as expenditures. In that case, *expenditures* would be as follows:

Governmental fund financial statements: \$100  
Budgetary basis: \$110

Now further assume that the government authorized (*appropriated*) \$105 to be spent. If the amount reported in the governmental fund financial statements was used as the *actual* amount for the budgetary comparison, it would appear the government had complied with the budget:

	<u>Budget</u>	<u>Actual</u>	<u>Variance</u>
Expenditures	\$105	\$100	\$5

However, from the vantage point of the budget, as *legally defined*, overspending occurred:

	<u>Budget</u>	<u>Actual</u>	<u>Variance</u>
Expenditures	\$105	\$110	(\$5)

Accordingly, the amounts reported for *actual* expenditures in budgetary comparisons always reflect the *budgetary basis of accounting*, meaning those amounts may not be the same as the amounts reported in the governmental fund statement of revenues, expenditures, and changes in fund balances.

### 18. Legal compliance and budgetary comparisons

**Misunderstanding:** If no line item is overspent on the budgetary comparison, then actual spending must have complied with the budget.

Governments are required to present budgetary comparisons for the general fund and major special revenue funds, either as a basic financial statement, or as Required Supplementary Information (RSI). This comparison must be presented in no less detail than the governmental fund statement of revenues, expenditures, and changes in fund balances, which typically reports expenditures by function or program.

Governing bodies normally allow management a certain degree of flexibility in how appropriations are applied. Assume, for example, the following information concerning budgetary appropriations for the public safety function:

Police:			
	Program A:	\$100	
	Program B:	90	
	Program C:	<u>30</u>	
	Total		\$220
Fire			
	Program A:	\$125	
	Program B:	25	
	Program C:	<u>15</u>	
	Total		<u>\$165</u>
Total			\$385

One possibility would be that the governing body permitted management to reassign appropriations within the public safety function, so long as total expenditures did not exceed \$385. Another possibility would be that management was permitted to reassign appropriations within either department, but not between them. That is, spending for police could not exceed \$220 and spending for fire could not exceed \$165. The level at which management is *not* free to reassign appropriations without prior approval from the governing body is described as the *legal level of budgetary control*. In the first case, the legal level of budgetary control was *by function*. In the second case, the legal level of budgetary control was *by department*.

Now assume that the government presents its mandated budgetary comparison for the general fund and major special revenue funds by function, but that its legal level of budgetary control is by department. In that case, overspending at the legal level of budgetary control might be invisible in the budgetary comparison.

Assume, for example, that actual police spending (\$225) exceeded appropriations (\$220); whereas, actual fire spending (\$150) was less than the appropriated amount (\$165). If so, the underspending for fire would mask the overspending for police, as follows:

	<u>Budget</u>	<u>Actual</u>	<u>Variance</u>
Public safety	\$385	\$375	\$10

Accordingly, governments that prepare a comprehensive annual financial report (CAFR) are required to present a budgetary comparison for the general fund and major special revenue funds at the legal level of budgetary control somewhere in the CAFR, either by providing the necessary detail on the face of the mandated budgetary comparison itself, or by reporting a separate, more detailed budgetary comparison elsewhere in the CAFR, as follows:

	<u>Budget</u>	<u>Actual</u>	<u>Variance</u>
Police	\$220	\$225	(\$ 5)
Fire	\$165	\$150	\$15

### 19. Interpreting variance between budgeted expenditures and actual expenditures

**Misunderstanding:** Actual expenditures well below budgeted levels is always a desirable outcome.

A key difference between the public and private sectors is that business enterprises provide services to generate revenue, whereas governments generate revenue to provide services. Accordingly, the success of a government cannot be divorced from the scope and quality of the services it provides.

Assume, for example, that a government authorized \$150 to be spent for a given program, but that only \$70 was actually spent. The result would be a “positive” or “favorable” variance of \$80, which would be good news, of course, if the government had, in fact, been able to provide the scope and quality of service it originally intended at a reduced cost. However, it would *not* be a “positive” or “favorable” outcome if the “savings” resulted from a delay in getting the program up and operating. After all, if saving money by not providing service is a “positive” or “favorable” outcome, why not simply shut the government down altogether and “save” the entire budget?!

Accordingly, it is important to consider the scope and quality of services provided in assessing the true significance of a “positive” or “favorable” budgetary variance. Indeed, the Government Finance Officers Association (GFOA) discourages local governments from using the terms “positive” or “favorable” to describe budgetary variances in a budgetary comparison.

### 20. *Enterprise funds vs. internal service funds*

**Misunderstanding:** The only real difference between enterprise funds and internal service funds is the identity of their customers.

Proprietary fund financial statements report both *enterprise funds* and *internal service funds*. Those two fund types follow essentially the same accounting and financial reporting as do private-sector businesses.

One obvious difference between *enterprise funds* and *internal service funds* is the identity of the customers they serve: internal service funds normally provide service to departments *within* the government itself (for example, a motor pool); whereas, enterprise funds primarily or exclusively serve parties outside the government (for example, a water utility). However, there is an even more important distinction between the two fund types.

Internal service funds operate on a cost-reimbursement basis. That is to say, the expectation is that an internal service fund will charge its customers the amount needed to cover the cost of providing goods and services to them – no more, no less. In that sense, an internal service fund might be compared to diners “splitting a check” at a restaurant. If there is money left over after paying the bill and tip, it would mean the diners were overcharged; if there was not enough money to pay the bill and tip, it would mean the diners did not each pay their full share. While the match between revenue and expense in an internal service fund need not be exact in any given year (often customer charges are based on estimates, which can lead to variances), a significant ongoing surplus or deficit would indicate that internal service fund customers were being overcharged or undercharged, which would be inconsistent with the cost-reimbursement focus of an internal service fund.

In contrast, there is no reason to expect that revenues in enterprise funds will match the cost of goods sold or service provided. Indeed, many activities reported in enterprise funds are subsidized (e.g., public transit), meaning that the government seeks only to partially recover its costs through charges to customers. Accordingly, an ongoing surplus or deficit in an enterprise fund would *not* be inconsistent with the use of the enterprise fund type.

## 21. Interpreting *depreciation expense*

**Misunderstandings:** 1) Depreciation expense is a good measure of the amount that needs to be put aside to fund the replacement of capital assets; and 2) lower program cost that results from lower levels of depreciation expense is evidence of efficiency.

**Depreciation expense is a good measure of the amount that needs to be put aside to fund the replacement of capital assets.** Depreciation expense is simply the allocation of the historic cost of a capital asset over its estimated useful life. For example, if a government paid \$50,000 to construct a building with an estimated useful life of 50 years, it would recognize \$1,000 of depreciation expense each year during that 50-year period.

If prices did not change over time, setting aside an amount equal to depreciation expense each year would be one way of accumulating the resources needed to replace a capital asset at the end of its useful life. However, prices do change over time, often significantly, especially in the case of long-lived assets. For example, a building built for \$50,000 in the current year may well cost \$300,000 to build a half-century later. Thus, accumulating \$50,000 to replace the asset based on depreciation expense would leave the government far short of the amount actually needed to do so (\$300,000 replacement cost - \$50,000 accumulated resources = \$250,000 shortfall). Therefore, governments should accumulate the resources they will need to replace existing capital assets based on their estimated *future* replacement cost, rather than on their past historical cost (as reflected in depreciation expense).

**Lower program cost that results from lower levels of depreciation expense is evidence of efficiency.** Depreciation expense is based on the historical cost of capital assets. Consequently, all things being equal, older assets result in lower levels of depreciation expense than do newer assets. This fact must be taken into account when comparing the costs of similar operations.

Assume, for example, two separate water districts that are essentially identical, except that District A installed its water mains 50 years ago, while District B replaced its old water mains with new ones just a decade ago. In both cases, the water lines are estimated to have a 60 year useful life. It cost District A \$60,000 to put in its water mains 50 years ago, while it cost District B \$240,000 to do the same thing 10 years ago. In those circumstances, annual depreciation expense for District A would be only \$1,000 per year ( $\$60,000 \div 60 \text{ years} = \$1,000/\text{year}$ ), while annual depreciation expense for District B would be four times that amount ( $\$240,000 \div 60 = \$4,000/\text{year}$ ). Consequently, District A would report only a quarter of the annual depreciation expense reported by District B, which could make District A look more efficient

than District B. Such an analysis, however, would ignore the important fact that District A is still using old pipes that will soon have to be replaced, while District B is set for the next half-century.

Accordingly, it may be desirable to remove depreciation expense from other expenses when making cost comparisons between similar operations, as the amounts reported are not necessarily comparable. In the case of operations reported as part of governmental activities in the government-wide financial statements (where depreciation expense is not reported separately), the notes to the financial statements disclose the amount of depreciation expense included in program expense for each function.

## 22. Cash flows from operating activities: public sector vs. private sector

**Misunderstanding:** Cash flows from operating activities are the same in both the public sector and private sector.

The statement of resource flows for proprietary funds (*statement of revenues, expenses, and changes in net position*) and private-sector businesses (*operating statement*) is careful to distinguish operating revenue and expenses (revenues from customers and expenses associated with providing goods and services to them) from nonoperating items, such as gains and losses and interest revenue/expense, as follows:

Operating revenues and expenses:	
Revenues	\$1,000
Expenses	<u>990</u>
Operating income	\$ 10
Nonoperating items:	
Gains/losses	(2)
Interest revenue/expense	<u>8</u>
Nonoperating	6
Net change	\$ 16

The statement of cash flows in the private sector uses the term *cash flows from operating activities* to describe a cash flow related to any item that appears anywhere in the statement of resource flows (including nonoperating items, such as interest revenue and expense). In contrast, the public-sector statement of cash flows, for the most part, limits *cash flows from operating activities* to cash flows related to items that appear within the operating income subsection of the statement of resource flows. Thus, interest revenue and expense are *always* reported as *cash flows from operating activities* in the private sector, but rarely so in the public sector.

## 23. Cash flows from investing activities: public sector vs. private sector

**Misunderstanding:** Cash flows from investing activities include cash flows related to capital outlays.

A public-sector statement of cash flows, like its private-sector counterpart, distinguishes *financing activities* from *investing activities*. Unfortunately, the similar terminology can be misleading because *financing activities* and *investing activities* are defined quite differently in the public and private sectors.

In the private sector, disbursements to construct or otherwise obtain capital assets are considered to be an “investment” in the business's capital assets; therefore, related cash flows are reported in a private-sector statement of cash flows as *cash flows from investing activities*. In contrast, a public-sector statement of cash flows distinguishes *cash flows from noncapital financing activities* from *cash flows from capital and related financing activities* and includes cash flows related to capital acquisition in the latter category (*cash flows from capital and related financing activities*). Accordingly, users of state and local government financial reports should avoid the mistake of looking to *cash flows from investing activities* for information on capital disbursements during the period, but rather should turn instead to the *cash flows from capital and related financing activities* category for the information they need.

### 24. Why do pension trust funds and OPEB trust funds always report positive net position even if a plan is underfunded?

**Misunderstanding:** Positive net position in a pension trust fund or an OPEB trust fund is evidence that the plan is fully funded.

Financial statement users are sometimes surprised to discover that a pension plan they know to be seriously underfunded reports a large positive balance of net position. How can that be?! they ask. An analogy from personal finance may be helpful in understanding why this situation occurs.

Assume that parents are saving to provide for their children's college education and estimate that the cost of that education will be \$500,000. Further assume that the parents have set up a special bank account to serve as a college fund and have managed to accumulate \$100,000 in that account. From the vantage point of the parents, they still have a long way to go to fund their children's college education (\$500,000 needed - \$100,000 accumulated = \$400,000 shortfall). The bank, however, has no obligation beyond the \$100,000 it has received. So too, the promise to pay pension benefits and OPEB benefits to employees is a liability of the employer that made the promise (parents), but not of the pension plan or OPEB plan that manages the assets (bank). Thus, only employers report a *net pension liability* or *net OPEB liability* for their unfunded promises, whereas pension plans and OPEB plans simply report the assets they manage (and a liability for any amounts *currently* due and payable to beneficiaries, but not yet paid).

Thus, it is important that those interested primarily in a government employer's financial well-being focus on the *net pension liability* or *net OPEB liability* reported by the government employer, rather than on the financial statements of the pension plan or OPEB plan.

### 25. Why do trust fund financial statements report *additions* and *deductions* rather than *revenues* and *expenses*?

**Misunderstanding:** Additions and deductions are basically the same thing as revenues and expenses.

Individuals are used to depositing funds in their bank account and later withdrawing those funds. From the bank's vantage point, receiving money that continues to belong to the depositor is not *revenue*, nor is the return of that money *expense*. Instead, banks report a liability for deposits and a reduction of that liability for the return of deposited amounts. As a result, these transactions are invisible in the bank's operating statement.

Technically, the same approach could be taken to report resources placed in trust. However, the objective of trust fund reporting is to demonstrate accountability, which is easier to demonstrate when contributions to the trust and subsequent disbursements are reported as inflows and outflows in the statement of changes. Nor is there any practical need to report a liability, as such, given that all of the resources of a trust fund, by definition, are being held on behalf of the beneficiaries of the trust. Accordingly, anything that increases or decreases the net position of a trust fund is reported as an *addition* or *deduction*.

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## GOVERNMENT CODE

## TITLE 10. GENERAL GOVERNMENT

## SUBTITLE F. STATE AND LOCAL CONTRACTS AND FUND MANAGEMENT

## CHAPTER 2256. PUBLIC FUNDS INVESTMENT

## SUBCHAPTER A. AUTHORIZED INVESTMENTS FOR GOVERNMENTAL ENTITIES

Sec. 2256.001. SHORT TITLE. This chapter may be cited as the Public Funds Investment Act.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995.

Sec. 2256.002. DEFINITIONS. In this chapter:

(1) "Bond proceeds" means the proceeds from the sale of bonds, notes, and other obligations issued by an entity, and reserves and funds maintained by an entity for debt service purposes.

(2) "Book value" means the original acquisition cost of an investment plus or minus the accrued amortization or accretion.

(3) "Funds" means public funds in the custody of a state agency or local government that:

(A) are not required by law to be deposited in the state treasury; and

(B) the investing entity has authority to invest.

(4) "Institution of higher education" has the meaning assigned by Section 61.003, Education Code.

(5) "Investing entity" and "entity" mean an entity subject to this chapter and described by Section 2256.003.

(6) "Investment pool" means an entity created under this code to invest public funds jointly on behalf of the entities that participate in the pool and whose investment objectives in order of priority are:

(A) preservation and safety of principal;

(B) liquidity; and

(C) yield.

(7) "Local government" means a municipality, a county, a school district, a district or authority created under Section 52(b)(1) or (2), Article III, or Section 59, Article XVI, Texas Constitution, a fresh water supply district, a hospital district, and any political subdivision, authority, public corporation, body politic, or instrumentality of the State of Texas, and any nonprofit corporation acting on behalf of any of those entities.

(8) "Market value" means the current face or par value of an investment multiplied by the net selling price of the security as quoted by a recognized market pricing source quoted on the valuation date.

(9) "Pooled fund group" means an internally created fund of an investing entity in which one or more institutional accounts of the investing entity are invested.

(10) "Qualified representative" means a person who holds a position with a business organization, who is authorized to act on behalf of the business organization, and who is one of the following:

(A) for a business organization doing business that is regulated by or registered with a securities commission, a person who is registered under the rules of the National Association of Securities Dealers;

(B) for a state or federal bank, a savings bank, or a state or federal credit union, a member of the loan committee for the bank or branch of the bank or a person authorized by corporate resolution to act on behalf of and bind the banking institution;

(C) for an investment pool, the person authorized by the elected official or board with authority to administer the activities of the investment pool to sign the written instrument on behalf of the investment pool; or

(D) for an investment management firm registered under the Investment Advisers Act of 1940 (15 U.S.C. Section 80b-1 et seq.) or, if not subject to registration under that Act, registered with the State Securities Board, a person who is an officer or principal of the investment management firm.

(11) "School district" means a public school district.

(12) "Separately invested asset" means an account or fund of a state agency or local government that is not invested in a pooled fund group.

(13) "State agency" means an office, department, commission, board, or other agency that is part of any branch of state government, an institution of higher education, and any nonprofit corporation acting on behalf of any of those entities.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995; Acts 1997, 75th Leg., ch. 1421, Sec. 1, eff. Sept. 1, 1997; Acts 1999, 76th Leg., ch. 1454, Sec. 1, eff. Sept. 1, 1999.

Sec. 2256.003. AUTHORITY TO INVEST FUNDS; ENTITIES SUBJECT TO THIS CHAPTER. (a) Each governing body of the following entities may purchase, sell, and invest its funds and funds under its control in investments authorized under this subchapter in compliance with

investment policies approved by the governing body and according to the standard of care prescribed by Section [2256.006](#):

- (1) a local government;
- (2) a state agency;
- (3) a nonprofit corporation acting on behalf of a local government or a state agency; or
- (4) an investment pool acting on behalf of two or more local governments, state agencies, or a combination of those entities.

(b) In the exercise of its powers under Subsection (a), the governing body of an investing entity may contract with an investment management firm registered under the Investment Advisers Act of 1940 (15 U.S.C. Section 80b-1 et seq.) or with the State Securities Board to provide for the investment and management of its public funds or other funds under its control. A contract made under authority of this subsection may not be for a term longer than two years. A renewal or extension of the contract must be made by the governing body of the investing entity by order, ordinance, or resolution.

(c) This chapter does not prohibit an investing entity or investment officer from using the entity's employees or the services of a contractor of the entity to aid the investment officer in the execution of the officer's duties under this chapter.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995; Acts 1999, 76th Leg., ch. 1454, Sec. 2, eff. Sept. 1, 1999.

Sec. 2256.004. APPLICABILITY. (a) This subchapter does not apply to:

- (1) a public retirement system as defined by Section [802.001](#);
- (2) state funds invested as authorized by Section [404.024](#);
- (3) an institution of higher education having total endowments of at least \$150 million in book value on September 1, 2017;
- (4) funds invested by the Veterans' Land Board as authorized by Chapter [161](#), [162](#), or [164](#), Natural Resources Code;
- (5) registry funds deposited with the county or district clerk under Chapter [117](#), Local Government Code; or
- (6) a deferred compensation plan that qualifies under either Section 401(k) or 457 of the Internal Revenue Code of 1986 (26 U.S.C. Section 1 et seq.), as amended.

(b) This subchapter does not apply to an investment donated to an investing entity for a particular purpose or under terms of use specified by the donor.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995; Acts 1997, 75th Leg., ch. 505, Sec. 24, eff. Sept. 1, 1997; Acts 1997,

75th Leg., ch. 1421, Sec. 2, eff. Sept. 1, 1997; Acts 1999, 76th Leg., ch. 62, Sec. 8.21, eff. Sept. 1, 1999; Acts 1999, 76th Leg., ch. 1454, Sec. 3, eff. Sept. 1, 1999.

Amended by:

Acts 2017, 85th Leg., R.S., Ch. 773 (H.B. 1003), Sec. 1, eff. June 14, 2017.

Sec. 2256.005. INVESTMENT POLICIES; INVESTMENT STRATEGIES; INVESTMENT OFFICER. (a) The governing body of an investing entity shall adopt by rule, order, ordinance, or resolution, as appropriate, a written investment policy regarding the investment of its funds and funds under its control.

(b) The investment policies must:

- (1) be written;
- (2) primarily emphasize safety of principal and liquidity;
- (3) address investment diversification, yield, and maturity and the quality and capability of investment management; and
- (4) include:
  - (A) a list of the types of authorized investments in which the investing entity's funds may be invested;
  - (B) the maximum allowable stated maturity of any individual investment owned by the entity;
  - (C) for pooled fund groups, the maximum dollar-weighted average maturity allowed based on the stated maturity date for the portfolio;
  - (D) methods to monitor the market price of investments acquired with public funds;
  - (E) a requirement for settlement of all transactions, except investment pool funds and mutual funds, on a delivery versus payment basis; and
  - (F) procedures to monitor rating changes in investments acquired with public funds and the liquidation of such investments consistent with the provisions of Section 2256.021.

(c) The investment policies may provide that bids for certificates of deposit be solicited:

- (1) orally;
- (2) in writing;
- (3) electronically; or
- (4) in any combination of those methods.

(d) As an integral part of an investment policy, the governing body shall adopt a separate written investment strategy for each of the funds or group of funds under its control. Each investment strategy must

describe the investment objectives for the particular fund using the following priorities in order of importance:

- (1) understanding of the suitability of the investment to the financial requirements of the entity;
- (2) preservation and safety of principal;
- (3) liquidity;
- (4) marketability of the investment if the need arises to liquidate the investment before maturity;
- (5) diversification of the investment portfolio; and
- (6) yield.

(e) The governing body of an investing entity shall review its investment policy and investment strategies not less than annually. The governing body shall adopt a written instrument by rule, order, ordinance, or resolution stating that it has reviewed the investment policy and investment strategies and that the written instrument so adopted shall record any changes made to either the investment policy or investment strategies.

(f) Each investing entity shall designate, by rule, order, ordinance, or resolution, as appropriate, one or more officers or employees of the state agency, local government, or investment pool as investment officer to be responsible for the investment of its funds consistent with the investment policy adopted by the entity. If the governing body of an investing entity has contracted with another investing entity to invest its funds, the investment officer of the other investing entity is considered to be the investment officer of the first investing entity for purposes of this chapter. Authority granted to a person to invest an entity's funds is effective until rescinded by the investing entity, until the expiration of the officer's term or the termination of the person's employment by the investing entity, or if an investment management firm, until the expiration of the contract with the investing entity. In the administration of the duties of an investment officer, the person designated as investment officer shall exercise the judgment and care, under prevailing circumstances, that a prudent person would exercise in the management of the person's own affairs, but the governing body of the investing entity retains ultimate responsibility as fiduciaries of the assets of the entity. Unless authorized by law, a person may not deposit, withdraw, transfer, or manage in any other manner the funds of the investing entity.

(g) Subsection (f) does not apply to a state agency, local government, or investment pool for which an officer of the entity is assigned by law the function of investing its funds.

Text of subsec. (h) as amended by Acts 1997, 75th Leg., ch. 685, Sec. 1

(h) An officer or employee of a commission created under Chapter 391, Local Government Code, is ineligible to be an investment officer for the commission under Subsection (f) if the officer or employee is an investment officer designated under Subsection (f) for another local government.

Text of subsec. (h) as amended by Acts 1997, 75th Leg., ch. 1421, Sec. 3

(h) An officer or employee of a commission created under Chapter 391, Local Government Code, is ineligible to be designated as an investment officer under Subsection (f) for any investing entity other than for that commission.

(i) An investment officer of an entity who has a personal business relationship with a business organization offering to engage in an investment transaction with the entity shall file a statement disclosing that personal business interest. An investment officer who is related within the second degree by affinity or consanguinity, as determined under Chapter 573, to an individual seeking to sell an investment to the investment officer's entity shall file a statement disclosing that relationship. A statement required under this subsection must be filed with the Texas Ethics Commission and the governing body of the entity. For purposes of this subsection, an investment officer has a personal business relationship with a business organization if:

(1) the investment officer owns 10 percent or more of the voting stock or shares of the business organization or owns \$5,000 or more of the fair market value of the business organization;

(2) funds received by the investment officer from the business organization exceed 10 percent of the investment officer's gross income for the previous year; or

(3) the investment officer has acquired from the business organization during the previous year investments with a book value of \$2,500 or more for the personal account of the investment officer.

(j) The governing body of an investing entity may specify in its investment policy that any investment authorized by this chapter is not suitable.

(k) A written copy of the investment policy shall be presented to any business organization offering to engage in an investment transaction with an investing entity. For purposes of this subsection and Subsection (l), "business organization" means an investment pool or investment management firm under contract with an investing entity to invest or manage the entity's investment portfolio that has accepted authority granted by the entity under the contract to exercise investment

discretion in regard to the investing entity's funds. Nothing in this subsection relieves the investing entity of the responsibility for monitoring the investments made by the investing entity to determine that they are in compliance with the investment policy. The qualified representative of the business organization offering to engage in an investment transaction with an investing entity shall execute a written instrument in a form acceptable to the investing entity and the business organization substantially to the effect that the business organization has:

- (1) received and reviewed the investment policy of the entity;
- and
- (2) acknowledged that the business organization has implemented reasonable procedures and controls in an effort to preclude investment transactions conducted between the entity and the organization that are not authorized by the entity's investment policy, except to the extent that this authorization:
    - (A) is dependent on an analysis of the makeup of the entity's entire portfolio;
    - (B) requires an interpretation of subjective investment standards; or
    - (C) relates to investment transactions of the entity that are not made through accounts or other contractual arrangements over which the business organization has accepted discretionary investment authority.

(l) The investment officer of an entity may not acquire or otherwise obtain any authorized investment described in the investment policy of the investing entity from a business organization that has not delivered to the entity the instrument required by Subsection (k).

(m) An investing entity other than a state agency, in conjunction with its annual financial audit, shall perform a compliance audit of management controls on investments and adherence to the entity's established investment policies.

(n) Except as provided by Subsection (o), at least once every two years a state agency shall arrange for a compliance audit of management controls on investments and adherence to the agency's established investment policies. The compliance audit shall be performed by the agency's internal auditor or by a private auditor employed in the manner provided by Section [321.020](#). Not later than January 1 of each even-numbered year a state agency shall report the results of the most recent audit performed under this subsection to the state auditor. Subject to a risk assessment and to the legislative audit committee's approval of including a review by the state auditor in the audit plan under Section [321.013](#), the state auditor may review information provided under this

section. If review by the state auditor is approved by the legislative audit committee, the state auditor may, based on its review, require a state agency to also report to the state auditor other information the state auditor determines necessary to assess compliance with laws and policies applicable to state agency investments. A report under this subsection shall be prepared in a manner the state auditor prescribes.

(o) The audit requirements of Subsection (n) do not apply to assets of a state agency that are invested by the comptroller under Section [404.024](#).

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995; Acts 1997, 75th Leg., ch. 685, Sec. 1, eff. Sept. 1, 1997; Acts 1997, 75th Leg., ch. 1421, Sec. 3, eff. Sept. 1, 1997; Acts 1999, 76th Leg., ch. 1454, Sec. 4, eff. Sept. 1, 1999; Acts 2003, 78th Leg., ch. 785, Sec. 41, eff. Sept. 1, 2003.

Amended by:

Acts 2011, 82nd Leg., R.S., Ch. 1004 (H.B. [2226](#)), Sec. 1, eff. June 17, 2011.

Acts 2017, 85th Leg., R.S., Ch. 149 (H.B. [1701](#)), Sec. 1, eff. September 1, 2017.

Sec. 2256.006. STANDARD OF CARE. (a) Investments shall be made with judgment and care, under prevailing circumstances, that a person of prudence, discretion, and intelligence would exercise in the management of the person's own affairs, not for speculation, but for investment, considering the probable safety of capital and the probable income to be derived. Investment of funds shall be governed by the following investment objectives, in order of priority:

- (1) preservation and safety of principal;
- (2) liquidity; and
- (3) yield.

(b) In determining whether an investment officer has exercised prudence with respect to an investment decision, the determination shall be made taking into consideration:

- (1) the investment of all funds, or funds under the entity's control, over which the officer had responsibility rather than a consideration as to the prudence of a single investment; and
- (2) whether the investment decision was consistent with the written investment policy of the entity.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995.

Sec. 2256.007. INVESTMENT TRAINING; STATE AGENCY BOARD MEMBERS AND OFFICERS. (a) Each member of the governing board of a state agency and its investment officer shall attend at least one training session relating to the person's responsibilities under this chapter within six months after taking office or assuming duties.

(b) The Texas Higher Education Coordinating Board shall provide the training under this section.

(c) Training under this section must include education in investment controls, security risks, strategy risks, market risks, diversification of investment portfolio, and compliance with this chapter.

(d) An investment officer shall attend a training session not less than once each state fiscal biennium and may receive training from any independent source approved by the governing body of the state agency. The investment officer shall prepare a report on this subchapter and deliver the report to the governing body of the state agency not later than the 180th day after the last day of each regular session of the legislature.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995; Acts 1997, 75th Leg., ch. 73, Sec. 1, eff. May 9, 1997; Acts 1997, 75th Leg., ch. 1421, Sec. 4, eff. Sept. 1, 1997; Acts 1999, 76th Leg., ch. 1454, Sec. 5, eff. Sept. 1, 1999.

Amended by:

Acts 2011, 82nd Leg., R.S., Ch. 1004 (H.B. [2226](#)), Sec. 2, eff. June 17, 2011.

Sec. 2256.008. INVESTMENT TRAINING; LOCAL GOVERNMENTS.

(a) Except as provided by Subsections (a-1), (b), (b-1), (e), and (f), the treasurer, the chief financial officer if the treasurer is not the chief financial officer, and the investment officer of a local government shall:

(1) attend at least one training session from an independent source approved by the governing body of the local government or a designated investment committee advising the investment officer as provided for in the investment policy of the local government and containing at least 10 hours of instruction relating to the treasurer's or officer's responsibilities under this subchapter within 12 months after taking office or assuming duties; and

(2) attend an investment training session not less than once in a two-year period that begins on the first day of that local government's fiscal year and consists of the two consecutive fiscal years after that date, and receive not less than 10 hours of instruction relating to

investment responsibilities under this subchapter from an independent source approved by the governing body of the local government or a designated investment committee advising the investment officer as provided for in the investment policy of the local government.

(a-1) In addition to the requirements of Subsection (a)(1), the treasurer, or the chief financial officer if the treasurer is not the chief financial officer, and the investment officer of a school district or a municipality shall attend an investment training session not less than once in a two-year period that begins on the first day of the school district's or municipality's fiscal year and consists of the two consecutive fiscal years after that date, and receive not less than eight hours of instruction relating to investment responsibilities under this subchapter from an independent source approved by the governing body of the school district or municipality, or by a designated investment committee advising the investment officer as provided for in the investment policy of the school district or municipality.

(b) An investing entity created under authority of Section 52(b), Article III, or Section 59, Article XVI, Texas Constitution, that has contracted with an investment management firm under Section 2256.003(b) and has fewer than five full-time employees or an investing entity that has contracted with another investing entity to invest the entity's funds may satisfy the training requirement provided by Subsection (a)(2) by having an officer of the governing body attend four hours of appropriate instruction in a two-year period that begins on the first day of that local government's fiscal year and consists of the two consecutive fiscal years after that date. The treasurer or chief financial officer of an investing entity created under authority of Section 52(b), Article III, or Section 59, Article XVI, Texas Constitution, and that has fewer than five full-time employees is not required to attend training required by this section unless the person is also the investment officer of the entity.

(b-1) A housing authority created under Chapter 392, Local Government Code, may satisfy the training requirement provided by Subsection (a)(2) by requiring the following person to attend, in each two-year period that begins on the first day of that housing authority's fiscal year and consists of the two consecutive fiscal years after that date, at least five hours of appropriate instruction:

(1) the treasurer, or the chief financial officer if the treasurer is not the chief financial officer, or the investment officer;  
or

(2) if the authority does not have an officer described by Subdivision (1), another officer of the authority.

(c) Training under this section must include education in investment controls, security risks, strategy risks, market risks, diversification of investment portfolio, and compliance with this chapter.

(d) Not later than December 31 each year, each individual, association, business, organization, governmental entity, or other person that provides training under this section shall report to the comptroller a list of the governmental entities for which the person provided required training under this section during that calendar year. An individual's reporting requirements under this subsection are satisfied by a report of the individual's employer or the sponsoring or organizing entity of a training program or seminar.

(e) This section does not apply to a district governed by Chapter 36 or 49, Water Code.

(f) Subsection (a)(2) does not apply to an officer of a municipality or housing authority if the municipality or housing authority:

(1) does not invest municipal or housing authority funds, as applicable; or

(2) only deposits those funds in:

(A) interest-bearing deposit accounts; or

(B) certificates of deposit as authorized by Section 2256.010.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995; Acts 1997, 75th Leg., ch. 1421, Sec. 5, eff. Sept. 1, 1997; Acts 1999, 76th Leg., ch. 1454, Sec. 6, eff. Sept. 1, 1999; Acts 2001, 77th Leg., ch. 69, Sec. 4, eff. May 14, 2001.

Amended by:

Acts 2011, 82nd Leg., R.S., Ch. 1004 (H.B. 2226), Sec. 3, eff. June 17, 2011.

Acts 2015, 84th Leg., R.S., Ch. 222 (H.B. 1148), Sec. 1, eff. September 1, 2015.

Acts 2015, 84th Leg., R.S., Ch. 1248 (H.B. 870), Sec. 1, eff. September 1, 2015.

Acts 2017, 85th Leg., R.S., Ch. 324 (S.B. 1488), Sec. 8.015, eff. September 1, 2017.

Acts 2017, 85th Leg., R.S., Ch. 1000 (H.B. 1238), Sec. 1, eff. September 1, 2017.

Acts 2017, 85th Leg., R.S., Ch. 1000 (H.B. 1238), Sec. 2, eff. September 1, 2017.

Sec. 2256.009. AUTHORIZED INVESTMENTS: OBLIGATIONS OF, OR GUARANTEED BY GOVERNMENTAL ENTITIES. (a) Except as provided by Subsection (b), the following are authorized investments under this subchapter:

(1) obligations, including letters of credit, of the United States or its agencies and instrumentalities, including the Federal Home Loan Banks;

(2) direct obligations of this state or its agencies and instrumentalities;

(3) collateralized mortgage obligations directly issued by a federal agency or instrumentality of the United States, the underlying security for which is guaranteed by an agency or instrumentality of the United States;

(4) other obligations, the principal and interest of which are unconditionally guaranteed or insured by, or backed by the full faith and credit of, this state or the United States or their respective agencies and instrumentalities, including obligations that are fully guaranteed or insured by the Federal Deposit Insurance Corporation or by the explicit full faith and credit of the United States;

(5) obligations of states, agencies, counties, cities, and other political subdivisions of any state rated as to investment quality by a nationally recognized investment rating firm not less than A or its equivalent;

(6) bonds issued, assumed, or guaranteed by the State of Israel;

(7) interest-bearing banking deposits that are guaranteed or insured by:

(A) the Federal Deposit Insurance Corporation or its successor; or

(B) the National Credit Union Share Insurance Fund or its successor; and

(8) interest-bearing banking deposits other than those described by Subdivision (7) if:

(A) the funds invested in the banking deposits are invested through:

(i) a broker with a main office or branch office in this state that the investing entity selects from a list the governing body or designated investment committee of the entity adopts as required by Section [2256.025](#); or

(ii) a depository institution with a main office or branch office in this state that the investing entity selects;

(B) the broker or depository institution selected as described by Paragraph (A) arranges for the deposit of the funds in the

banking deposits in one or more federally insured depository institutions, regardless of where located, for the investing entity's account;

(C) the full amount of the principal and accrued interest of the banking deposits is insured by the United States or an instrumentality of the United States; and

(D) the investing entity appoints as the entity's custodian of the banking deposits issued for the entity's account:

(i) the depository institution selected as described by Paragraph (A);

(ii) an entity described by Section [2257.041\(d\)](#); or

(iii) a clearing broker dealer registered with the Securities and Exchange Commission and operating under Securities and Exchange Commission Rule 15c3-3 (17 C.F.R. Section 240.15c3-3).

(b) The following are not authorized investments under this section:

(1) obligations whose payment represents the coupon payments on the outstanding principal balance of the underlying mortgage-backed security collateral and pays no principal;

(2) obligations whose payment represents the principal stream of cash flow from the underlying mortgage-backed security collateral and bears no interest;

(3) collateralized mortgage obligations that have a stated final maturity date of greater than 10 years; and

(4) collateralized mortgage obligations the interest rate of which is determined by an index that adjusts opposite to the changes in a market index.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995; Acts 1999, 76th Leg., ch. 1454, Sec. 7, eff. Sept. 1, 1999; Acts 2001, 77th Leg., ch. 558, Sec. 1, eff. Sept. 1, 2001.

Amended by:

Acts 2011, 82nd Leg., R.S., Ch. 1004 (H.B. [2226](#)), Sec. 4, eff. June 17, 2011.

Acts 2017, 85th Leg., R.S., Ch. 773 (H.B. [1003](#)), Sec. 2, eff. June 14, 2017.

Acts 2017, 85th Leg., R.S., Ch. 863 (H.B. [2647](#)), Sec. 1, eff. June 15, 2017.

Acts 2017, 85th Leg., R.S., Ch. 874 (H.B. [2928](#)), Sec. 1, eff. September 1, 2017.

Sec. 2256.010. AUTHORIZED INVESTMENTS: CERTIFICATES OF DEPOSIT AND SHARE CERTIFICATES. (a) A certificate of deposit or share certificate

is an authorized investment under this subchapter if the certificate is issued by a depository institution that has its main office or a branch office in this state and is:

(1) guaranteed or insured by the Federal Deposit Insurance Corporation or its successor or the National Credit Union Share Insurance Fund or its successor;

(2) secured by obligations that are described by Section 2256.009(a), including mortgage backed securities directly issued by a federal agency or instrumentality that have a market value of not less than the principal amount of the certificates, but excluding those mortgage backed securities of the nature described by Section 2256.009(b); or

(3) secured in accordance with Chapter 2257 or in any other manner and amount provided by law for deposits of the investing entity.

(b) In addition to the authority to invest funds in certificates of deposit under Subsection (a), an investment in certificates of deposit made in accordance with the following conditions is an authorized investment under this subchapter:

(1) the funds are invested by an investing entity through:

(A) a broker that has its main office or a branch office in this state and is selected from a list adopted by the investing entity as required by Section 2256.025; or

(B) a depository institution that has its main office or a branch office in this state and that is selected by the investing entity;

(2) the broker or the depository institution selected by the investing entity under Subdivision (1) arranges for the deposit of the funds in certificates of deposit in one or more federally insured depository institutions, wherever located, for the account of the investing entity;

(3) the full amount of the principal and accrued interest of each of the certificates of deposit is insured by the United States or an instrumentality of the United States; and

(4) the investing entity appoints the depository institution selected by the investing entity under Subdivision (1), an entity described by Section 2257.041(d), or a clearing broker-dealer registered with the Securities and Exchange Commission and operating pursuant to Securities and Exchange Commission Rule 15c3-3 (17 C.F.R. Section 240.15c3-3) as custodian for the investing entity with respect to the certificates of deposit issued for the account of the investing entity.

Amended by Acts 1995, 74th Leg., ch. 32, Sec. 1, eff. April 28, 1995; Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995; Acts 1997, 75th Leg., ch. 1421, Sec. 6, eff. Sept. 1, 1997.

Amended by:

Acts 2005, 79th Leg., Ch. 128 (H.B. 256), Sec. 1, eff. September 1, 2005.

Acts 2011, 82nd Leg., R.S., Ch. 1004 (H.B. 2226), Sec. 5, eff. June 17, 2011.

Acts 2017, 85th Leg., R.S., Ch. 874 (H.B. 2928), Sec. 2, eff. September 1, 2017.

Sec. 2256.011. AUTHORIZED INVESTMENTS: REPURCHASE AGREEMENTS. (a) A fully collateralized repurchase agreement is an authorized investment under this subchapter if the repurchase agreement:

- (1) has a defined termination date;
- (2) is secured by a combination of cash and obligations described by Section 2256.009(a)(1); and
- (3) requires the securities being purchased by the entity or cash held by the entity to be pledged to the entity, held in the entity's name, and deposited at the time the investment is made with the entity or with a third party selected and approved by the entity; and
- (4) is placed through a primary government securities dealer, as defined by the Federal Reserve, or a financial institution doing business in this state.

(b) In this section, "repurchase agreement" means a simultaneous agreement to buy, hold for a specified time, and sell back at a future date obligations described by Section 2256.009(a)(1), at a market value at the time the funds are disbursed of not less than the principal amount of the funds disbursed. The term includes a direct security repurchase agreement and a reverse security repurchase agreement.

(c) Notwithstanding any other law, the term of any reverse security repurchase agreement may not exceed 90 days after the date the reverse security repurchase agreement is delivered.

(d) Money received by an entity under the terms of a reverse security repurchase agreement shall be used to acquire additional authorized investments, but the term of the authorized investments acquired must mature not later than the expiration date stated in the reverse security repurchase agreement.

(e) Section 1371.059(c) applies to the execution of a repurchase agreement by an investing entity.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995.

Amended by:

Acts 2011, 82nd Leg., R.S., Ch. 1004 (H.B. 2226), Sec. 6, eff. June 17, 2011.

Acts 2017, 85th Leg., R.S., Ch. 773 (H.B. 1003), Sec. 3, eff. June 14, 2017.

Sec. 2256.0115. AUTHORIZED INVESTMENTS: SECURITIES LENDING PROGRAM. (a) A securities lending program is an authorized investment under this subchapter if it meets the conditions provided by this section.

(b) To qualify as an authorized investment under this subchapter:

(1) the value of securities loaned under the program must be not less than 100 percent collateralized, including accrued income;

(2) a loan made under the program must allow for termination at any time;

(3) a loan made under the program must be secured by:

(A) pledged securities described by Section 2256.009;

(B) pledged irrevocable letters of credit issued by a bank that is:

(i) organized and existing under the laws of the United States or any other state; and

(ii) continuously rated by at least one nationally recognized investment rating firm at not less than A or its equivalent; or

(C) cash invested in accordance with Section:

(i) 2256.009;

(ii) 2256.013;

(iii) 2256.014; or

(iv) 2256.016;

(4) the terms of a loan made under the program must require that the securities being held as collateral be:

(A) pledged to the investing entity;

(B) held in the investing entity's name; and

(C) deposited at the time the investment is made with the entity or with a third party selected by or approved by the investing entity;

(5) a loan made under the program must be placed through:

(A) a primary government securities dealer, as defined by 5 C.F.R. Section 6801.102(f), as that regulation existed on September 1, 2003; or

(B) a financial institution doing business in this state;

and

(6) an agreement to lend securities that is executed under this section must have a term of one year or less.

Added by Acts 2003, 78th Leg., ch. 1227, Sec. 1, eff. Sept. 1, 2003.

Sec. 2256.012. AUTHORIZED INVESTMENTS: BANKER'S ACCEPTANCES. A bankers' acceptance is an authorized investment under this subchapter if the bankers' acceptance:

- (1) has a stated maturity of 270 days or fewer from the date of its issuance;
- (2) will be, in accordance with its terms, liquidated in full at maturity;
- (3) is eligible for collateral for borrowing from a Federal Reserve Bank; and
- (4) is accepted by a bank organized and existing under the laws of the United States or any state, if the short-term obligations of the bank, or of a bank holding company of which the bank is the largest subsidiary, are rated not less than A-1 or P-1 or an equivalent rating by at least one nationally recognized credit rating agency.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995.

Sec. 2256.013. AUTHORIZED INVESTMENTS: COMMERCIAL PAPER. Commercial paper is an authorized investment under this subchapter if the commercial paper:

- (1) has a stated maturity of 270 days or fewer from the date of its issuance; and
- (2) is rated not less than A-1 or P-1 or an equivalent rating by at least:
  - (A) two nationally recognized credit rating agencies; or
  - (B) one nationally recognized credit rating agency and is fully secured by an irrevocable letter of credit issued by a bank organized and existing under the laws of the United States or any state.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995.

Sec. 2256.014. AUTHORIZED INVESTMENTS: MUTUAL FUNDS.

(a) A no-load money market mutual fund is an authorized investment under this subchapter if the mutual fund:

- (1) is registered with and regulated by the Securities and Exchange Commission;
- (2) provides the investing entity with a prospectus and other information required by the Securities Exchange Act of 1934 (15 U.S.C. Section 78a et seq.) or the Investment Company Act of 1940 (15 U.S.C. Section 80a-1 et seq.); and
- (3) complies with federal Securities and Exchange Commission Rule 2a-7 (17 C.F.R. Section 270.2a-7), promulgated under the Investment Company Act of 1940 (15 U.S.C. Section 80a-1 et seq.).

(b) In addition to a no-load money market mutual fund permitted as an authorized investment in Subsection (a), a no-load mutual fund is an authorized investment under this subchapter if the mutual fund:

- (1) is registered with the Securities and Exchange Commission;
- (2) has an average weighted maturity of less than two years;

and

- (3) either:

(A) has a duration of one year or more and is invested exclusively in obligations approved by this subchapter; or

(B) has a duration of less than one year and the investment portfolio is limited to investment grade securities, excluding asset-backed securities.

(c) An entity is not authorized by this section to:

(1) invest in the aggregate more than 15 percent of its monthly average fund balance, excluding bond proceeds and reserves and other funds held for debt service, in mutual funds described in Subsection (b);

(2) invest any portion of bond proceeds, reserves and funds held for debt service, in mutual funds described in Subsection (b); or

(3) invest its funds or funds under its control, including bond proceeds and reserves and other funds held for debt service, in any one mutual fund described in Subsection (a) or (b) in an amount that exceeds 10 percent of the total assets of the mutual fund.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995; Acts 1997, 75th Leg., ch. 1421, Sec. 7, eff. Sept. 1, 1997; Acts 1999, 76th Leg., ch. 1454, Sec. 8, eff. Sept. 1, 1999.

Amended by:

Acts 2017, 85th Leg., R.S., Ch. 773 (H.B. 1003), Sec. 4, eff. June 14, 2017.

Sec. 2256.015. AUTHORIZED INVESTMENTS: GUARANTEED INVESTMENT CONTRACTS. (a) A guaranteed investment contract is an authorized investment for bond proceeds under this subchapter if the guaranteed investment contract:

- (1) has a defined termination date;

(2) is secured by obligations described by Section 2256.009(a)(1), excluding those obligations described by Section 2256.009(b), in an amount at least equal to the amount of bond proceeds invested under the contract; and

(3) is pledged to the entity and deposited with the entity or with a third party selected and approved by the entity.

(b) Bond proceeds, other than bond proceeds representing reserves and funds maintained for debt service purposes, may not be invested under

this subchapter in a guaranteed investment contract with a term of longer than five years from the date of issuance of the bonds.

(c) To be eligible as an authorized investment:

(1) the governing body of the entity must specifically authorize guaranteed investment contracts as an eligible investment in the order, ordinance, or resolution authorizing the issuance of bonds;

(2) the entity must receive bids from at least three separate providers with no material financial interest in the bonds from which proceeds were received;

(3) the entity must purchase the highest yielding guaranteed investment contract for which a qualifying bid is received;

(4) the price of the guaranteed investment contract must take into account the reasonably expected drawdown schedule for the bond proceeds to be invested; and

(5) the provider must certify the administrative costs reasonably expected to be paid to third parties in connection with the guaranteed investment contract.

(d) Section 1371.059(c) applies to the execution of a guaranteed investment contract by an investing entity.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995; Acts 1997, 75th Leg., ch. 1421, Sec. 8, eff. Sept. 1, 1997; Acts 1999, 76th Leg., ch. 1454, Sec. 9, 10, eff. Sept. 1, 1999.

Amended by:

Acts 2017, 85th Leg., R.S., Ch. 773 (H.B. 1003), Sec. 5, eff. June 14, 2017.

Sec. 2256.016. AUTHORIZED INVESTMENTS: INVESTMENT POOLS. (a) An entity may invest its funds and funds under its control through an eligible investment pool if the governing body of the entity by rule, order, ordinance, or resolution, as appropriate, authorizes investment in the particular pool. An investment pool shall invest the funds it receives from entities in authorized investments permitted by this subchapter. An investment pool may invest its funds in money market mutual funds to the extent permitted by and consistent with this subchapter and the investment policies and objectives adopted by the investment pool.

(b) To be eligible to receive funds from and invest funds on behalf of an entity under this chapter, an investment pool must furnish to the investment officer or other authorized representative of the entity an offering circular or other similar disclosure instrument that contains, at a minimum, the following information:

- (1) the types of investments in which money is allowed to be invested;
- (2) the maximum average dollar-weighted maturity allowed, based on the stated maturity date, of the pool;
- (3) the maximum stated maturity date any investment security within the portfolio has;
- (4) the objectives of the pool;
- (5) the size of the pool;
- (6) the names of the members of the advisory board of the pool and the dates their terms expire;
- (7) the custodian bank that will safekeep the pool's assets;
- (8) whether the intent of the pool is to maintain a net asset value of one dollar and the risk of market price fluctuation;
- (9) whether the only source of payment is the assets of the pool at market value or whether there is a secondary source of payment, such as insurance or guarantees, and a description of the secondary source of payment;
- (10) the name and address of the independent auditor of the pool;
- (11) the requirements to be satisfied for an entity to deposit funds in and withdraw funds from the pool and any deadlines or other operating policies required for the entity to invest funds in and withdraw funds from the pool;
- (12) the performance history of the pool, including yield, average dollar-weighted maturities, and expense ratios; and
- (13) the pool's policy regarding holding deposits in cash.

(c) To maintain eligibility to receive funds from and invest funds on behalf of an entity under this chapter, an investment pool must furnish to the investment officer or other authorized representative of the entity:

- (1) investment transaction confirmations; and
- (2) a monthly report that contains, at a minimum, the following information:
  - (A) the types and percentage breakdown of securities in which the pool is invested;
  - (B) the current average dollar-weighted maturity, based on the stated maturity date, of the pool;
  - (C) the current percentage of the pool's portfolio in investments that have stated maturities of more than one year;
  - (D) the book value versus the market value of the pool's portfolio, using amortized cost valuation;
  - (E) the size of the pool;
  - (F) the number of participants in the pool;

(G) the custodian bank that is safekeeping the assets of the pool;

(H) a listing of daily transaction activity of the entity participating in the pool;

(I) the yield and expense ratio of the pool, including a statement regarding how yield is calculated;

(J) the portfolio managers of the pool; and

(K) any changes or addenda to the offering circular.

(d) An entity by contract may delegate to an investment pool the authority to hold legal title as custodian of investments purchased with its local funds.

(e) In this section, "yield" shall be calculated in accordance with regulations governing the registration of open-end management investment companies under the Investment Company Act of 1940, as promulgated from time to time by the federal Securities and Exchange Commission.

(f) To be eligible to receive funds from and invest funds on behalf of an entity under this chapter, a public funds investment pool that uses amortized cost or fair value accounting must mark its portfolio to market daily, and, to the extent reasonably possible, stabilize at a \$1.00 net asset value, when rounded and expressed to two decimal places. If the ratio of the market value of the portfolio divided by the book value of the portfolio is less than 0.995 or greater than 1.005, the governing body of the public funds investment pool shall take action as the body determines necessary to eliminate or reduce to the extent reasonably practicable any dilution or unfair result to existing participants, including a sale of portfolio holdings to attempt to maintain the ratio between 0.995 and 1.005. In addition to the requirements of its investment policy and any other forms of reporting, a public funds investment pool that uses amortized cost shall report yield to its investors in accordance with regulations of the federal Securities and Exchange Commission applicable to reporting by money market funds.

(g) To be eligible to receive funds from and invest funds on behalf of an entity under this chapter, a public funds investment pool must have an advisory board composed:

(1) equally of participants in the pool and other persons who do not have a business relationship with the pool and are qualified to advise the pool, for a public funds investment pool created under Chapter 791 and managed by a state agency; or

(2) of participants in the pool and other persons who do not have a business relationship with the pool and are qualified to advise the pool, for other investment pools.

(h) To maintain eligibility to receive funds from and invest funds on behalf of an entity under this chapter, an investment pool must be

continuously rated no lower than AAA or AAA-m or at an equivalent rating by at least one nationally recognized rating service.

(i) If the investment pool operates an Internet website, the information in a disclosure instrument or report described in Subsections (b), (c) (2), and (f) must be posted on the website.

(j) To maintain eligibility to receive funds from and invest funds on behalf of an entity under this chapter, an investment pool must make available to the entity an annual audited financial statement of the investment pool in which the entity has funds invested.

(k) If an investment pool offers fee breakpoints based on fund balances invested, the investment pool in advertising investment rates must include either all levels of return based on the breakpoints provided or state the lowest possible level of return based on the smallest level of funds invested.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995; Acts 1997, 75th Leg., ch. 1421, Sec. 9, eff. Sept. 1, 1997.

Amended by:

Acts 2011, 82nd Leg., R.S., Ch. 1004 (H.B. 2226), Sec. 7, eff. June 17, 2011.

Acts 2017, 85th Leg., R.S., Ch. 773 (H.B. 1003), Sec. 6, eff. June 14, 2017.

Sec. 2256.017. EXISTING INVESTMENTS. Except as provided by Chapter 2270, an entity is not required to liquidate investments that were authorized investments at the time of purchase.

Added by Acts 1995, 74th Leg., ch. 76, Sec. 5.46(a), eff. Sept. 1, 1995; Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995. Amended by Acts 1997, 75th Leg., ch. 1421, Sec. 10, eff. Sept. 1, 1997.

Amended by:

Acts 2017, 85th Leg., R.S., Ch. 96 (S.B. 253), Sec. 2, eff. May 23, 2017.

Sec. 2256.019. RATING OF CERTAIN INVESTMENT POOLS. A public funds investment pool must be continuously rated no lower than AAA or AAA-m or at an equivalent rating by at least one nationally recognized rating service.

Added by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995.

Amended by Acts 1997, 75th Leg., ch. 1421, Sec. 11, eff. Sept. 1, 1997.

Amended by:

Acts 2011, 82nd Leg., R.S., Ch. 1004 (H.B. 2226), Sec. 8, eff. June 17, 2011.

Sec. 2256.020. AUTHORIZED INVESTMENTS: INSTITUTIONS OF HIGHER EDUCATION. In addition to the authorized investments permitted by this subchapter, an institution of higher education may purchase, sell, and invest its funds and funds under its control in the following:

(1) cash management and fixed income funds sponsored by organizations exempt from federal income taxation under Section 501(f), Internal Revenue Code of 1986 (26 U.S.C. Section 501(f));

(2) negotiable certificates of deposit issued by a bank that has a certificate of deposit rating of at least 1 or the equivalent by a nationally recognized credit rating agency or that is associated with a holding company having a commercial paper rating of at least A-1, P-1, or the equivalent by a nationally recognized credit rating agency; and

(3) corporate bonds, debentures, or similar debt obligations rated by a nationally recognized investment rating firm in one of the two highest long-term rating categories, without regard to gradations within those categories.

Added by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995.

Sec. 2256.0201. AUTHORIZED INVESTMENTS; MUNICIPAL UTILITY. (a) A municipality that owns a municipal electric utility that is engaged in the distribution and sale of electric energy or natural gas to the public may enter into a hedging contract and related security and insurance agreements in relation to fuel oil, natural gas, coal, nuclear fuel, and electric energy to protect against loss due to price fluctuations. A hedging transaction must comply with the regulations of the Commodity Futures Trading Commission and the Securities and Exchange Commission. If there is a conflict between the municipal charter of the municipality and this chapter, this chapter prevails.

(b) A payment by a municipally owned electric or gas utility under a hedging contract or related agreement in relation to fuel supplies or fuel reserves is a fuel expense, and the utility may credit any amounts it receives under the contract or agreement against fuel expenses.

(c) The governing body of a municipally owned electric or gas utility or the body vested with power to manage and operate the municipally owned electric or gas utility may set policy regarding hedging transactions.

(d) In this section, "hedging" means the buying and selling of fuel oil, natural gas, coal, nuclear fuel, and electric energy futures or options or similar contracts on those commodities and related transportation costs as a protection against loss due to price fluctuation.

Added by Acts 1999, 76th Leg., ch. 405, Sec. 48, eff. Sept. 1, 1999.

Amended by:

Acts 2007, 80th Leg., R.S., Ch. 7 (S.B. 495), Sec. 1, eff. April 13, 2007.

Sec. 2256.0202. AUTHORIZED INVESTMENTS: MUNICIPAL FUNDS FROM MANAGEMENT AND DEVELOPMENT OF MINERAL RIGHTS. (a) In addition to other investments authorized under this subchapter, a municipality may invest funds received by the municipality from a lease or contract for the management and development of land owned by the municipality and leased for oil, gas, or other mineral development in any investment authorized to be made by a trustee under Subtitle B, Title 9, Property Code (Texas Trust Code).

(b) Funds invested by a municipality under this section shall be segregated and accounted for separately from other funds of the municipality.

Added by Acts 2009, 81st Leg., R.S., Ch. 1371 (S.B. 894), Sec. 1, eff. September 1, 2009.

Sec. 2256.0203. AUTHORIZED INVESTMENTS: PORTS AND NAVIGATION DISTRICTS. (a) In this section, "district" means a navigation district organized under Section 52, Article III, or Section 59, Article XVI, Texas Constitution.

(b) In addition to the authorized investments permitted by this subchapter, a port or district may purchase, sell, and invest its funds and funds under its control in negotiable certificates of deposit issued by a bank that has a certificate of deposit rating of at least 1 or the equivalent by a nationally recognized credit rating agency or that is associated with a holding company having a commercial paper rating of at least A-1, P-1, or the equivalent by a nationally recognized credit rating agency.

Added by Acts 2011, 82nd Leg., R.S., Ch. 804 (H.B. 2346), Sec. 1, eff. September 1, 2011.

Sec. 2256.0204. AUTHORIZED INVESTMENTS: INDEPENDENT SCHOOL DISTRICTS. (a) In this section, "corporate bond" means a senior secured debt obligation issued by a domestic business entity and rated not lower than "AA-" or the equivalent by a nationally recognized investment rating firm. The term does not include a debt obligation that:

(1) on conversion, would result in the holder becoming a stockholder or shareholder in the entity, or any affiliate or subsidiary

of the entity, that issued the debt obligation; or

(2) is an unsecured debt obligation.

(b) This section applies only to an independent school district that qualifies as an issuer as defined by Section 1371.001.

(c) In addition to authorized investments permitted by this subchapter, an independent school district subject to this section may purchase, sell, and invest its funds and funds under its control in corporate bonds that, at the time of purchase, are rated by a nationally recognized investment rating firm "AA-" or the equivalent and have a stated final maturity that is not later than the third anniversary of the date the corporate bonds were purchased.

(d) An independent school district subject to this section is not authorized by this section to:

(1) invest in the aggregate more than 15 percent of its monthly average fund balance, excluding bond proceeds, reserves, and other funds held for the payment of debt service, in corporate bonds; or

(2) invest more than 25 percent of the funds invested in corporate bonds in any one domestic business entity, including subsidiaries and affiliates of the entity.

(e) An independent school district subject to this section may purchase, sell, and invest its funds and funds under its control in corporate bonds if the governing body of the district:

(1) amends its investment policy to authorize corporate bonds as an eligible investment;

(2) adopts procedures to provide for:

(A) monitoring rating changes in corporate bonds acquired with public funds; and

(B) liquidating the investment in corporate bonds; and

(3) identifies the funds eligible to be invested in corporate bonds.

(f) The investment officer of an independent school district, acting on behalf of the district, shall sell corporate bonds in which the district has invested its funds not later than the seventh day after the date a nationally recognized investment rating firm:

(1) issues a release that places the corporate bonds or the domestic business entity that issued the corporate bonds on negative credit watch or the equivalent, if the corporate bonds are rated "AA-" or the equivalent at the time the release is issued; or

(2) changes the rating on the corporate bonds to a rating lower than "AA-" or the equivalent.

(g) Corporate bonds are not an eligible investment for a public funds investment pool.

Added by Acts 2011, 82nd Leg., R.S., Ch. 1347 (S.B. [1543](#)), Sec. 1, eff. June 17, 2011.

Sec. 2256.0205. AUTHORIZED INVESTMENTS; DECOMMISSIONING TRUST. (a)  
In this section:

(1) "Decommissioning trust" means a trust created to provide the Nuclear Regulatory Commission assurance that funds will be available for decommissioning purposes as required under 10 C.F.R. Part 50 or other similar regulation.

(2) "Funds" includes any money held in a decommissioning trust regardless of whether the money is considered to be public funds under this subchapter.

(b) In addition to other investments authorized under this subchapter, a municipality that owns a municipal electric utility that is engaged in the distribution and sale of electric energy or natural gas to the public may invest funds held in a decommissioning trust in any investment authorized by Subtitle B, Title 9, Property Code.

Added by Acts 2005, 79th Leg., Ch. 121 (S.B. [1464](#)), Sec. 1, eff. September 1, 2005.

Text of section as added by Acts 2017, 85th Leg., R.S., Ch. 773 (H.B. [1003](#)), Sec. 7

For text of section as added by Acts 2017, 85th Leg., R.S., Ch. 344 (H.B. [1472](#)), Sec. 1, see other Sec. 2256.0206.

Sec. 2256.0206. AUTHORIZED INVESTMENTS: HEDGING TRANSACTIONS. (a)  
In this section:

(1) "Eligible entity" means a political subdivision that has:  
(A) a principal amount of at least \$250 million in:  
(i) outstanding long-term indebtedness;  
(ii) long-term indebtedness proposed to be issued; or  
(iii) a combination of outstanding long-term indebtedness and long-term indebtedness proposed to be issued; and

(B) outstanding long-term indebtedness that is rated in one of the four highest rating categories for long-term debt instruments by a nationally recognized rating agency for municipal securities, without regard to the effect of any credit agreement or other form of credit enhancement entered into in connection with the obligation.

(2) "Eligible project" has the meaning assigned by Section [1371.001](#).

(3) "Hedging" means acting to protect against economic loss due to price fluctuation of a commodity or related investment by entering

into an offsetting position or using a financial agreement or producer price agreement in a correlated security, index, or other commodity.

(b) This section prevails to the extent of any conflict between this section and:

- (1) another law; or
- (2) an eligible entity's municipal charter, if applicable.

(c) The governing body of an eligible entity shall establish the entity's policy regarding hedging transactions.

(d) An eligible entity may enter into hedging transactions, including hedging contracts, and related security, credit, and insurance agreements in connection with commodities used by an eligible entity in the entity's general operations, with the acquisition or construction of a capital project, or with an eligible project. A hedging transaction must comply with the regulations of the federal Commodity Futures Trading Commission and the federal Securities and Exchange Commission.

(e) An eligible entity may pledge as security for and to the payment of a hedging contract or a security, credit, or insurance agreement any general or special revenues or funds the entity is authorized by law to pledge to the payment of any other obligation.

(f) Section 1371.059(c) applies to the execution by an eligible entity of a hedging contract and any related security, credit, or insurance agreement.

(g) An eligible entity may credit any amount the entity receives under a hedging contract against expenses associated with a commodity purchase.

(h) An eligible entity's cost of or payment under a hedging contract or agreement may be considered:

- (1) an operation and maintenance expense of the eligible entity;
- (2) an acquisition expense of the eligible entity;
- (3) a project cost of an eligible project; or
- (4) a construction expense of the eligible entity.

Added by Acts 2017, 85th Leg., R.S., Ch. 773 (H.B. 1003), Sec. 7, eff. June 14, 2017.

Text of section as added by Acts 2017, 85th Leg., R.S., Ch. 344 (H.B. 1472), Sec. 1

For text of section as added by Acts 2017, 85th Leg., R.S., Ch. 773 (H.B. 1003), Sec. 7, see other Sec. 2256.0206.

Sec. 2256.0206. AUTHORIZED INVESTMENTS: PUBLIC JUNIOR COLLEGE DISTRICT FUNDS FROM MANAGEMENT AND DEVELOPMENT OF MINERAL RIGHTS. (a)

In addition to other investments authorized under this subchapter, the governing board of a public junior college district may invest funds received by the district from a lease or contract for the management and development of land owned by the district and leased for oil, gas, or other mineral development in any investment authorized to be made by a trustee under Subtitle B, Title 9, Property Code (Texas Trust Code).

(b) Funds invested by the governing board of a public junior college district under this section shall be segregated and accounted for separately from other funds of the district.

Added by Acts 2017, 85th Leg., R.S., Ch. 344 (H.B. 1472), Sec. 1, eff. September 1, 2017.

Sec. 2256.021. EFFECT OF LOSS OF REQUIRED RATING. An investment that requires a minimum rating under this subchapter does not qualify as an authorized investment during the period the investment does not have the minimum rating. An entity shall take all prudent measures that are consistent with its investment policy to liquidate an investment that does not have the minimum rating.

Added by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995.

Sec. 2256.022. EXPANSION OF INVESTMENT AUTHORITY. Expansion of investment authority granted by this chapter shall require a risk assessment by the state auditor or performed at the direction of the state auditor, subject to the legislative audit committee's approval of including the review in the audit plan under Section 321.013.

Added by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995.

Amended by Acts 2003, 78th Leg., ch. 785, Sec. 42, eff. Sept. 1, 2003.

Sec. 2256.023. INTERNAL MANAGEMENT REPORTS. (a) Not less than quarterly, the investment officer shall prepare and submit to the governing body of the entity a written report of investment transactions for all funds covered by this chapter for the preceding reporting period.

(b) The report must:

(1) describe in detail the investment position of the entity on the date of the report;

(2) be prepared jointly by all investment officers of the entity;

(3) be signed by each investment officer of the entity;

(4) contain a summary statement of each pooled fund group that states the:

(A) beginning market value for the reporting period;

(B) ending market value for the period; and

(C) fully accrued interest for the reporting period;

(5) state the book value and market value of each separately invested asset at the end of the reporting period by the type of asset and fund type invested;

(6) state the maturity date of each separately invested asset that has a maturity date;

(7) state the account or fund or pooled group fund in the state agency or local government for which each individual investment was acquired; and

(8) state the compliance of the investment portfolio of the state agency or local government as it relates to:

(A) the investment strategy expressed in the agency's or local government's investment policy; and

(B) relevant provisions of this chapter.

(c) The report shall be presented not less than quarterly to the governing body and the chief executive officer of the entity within a reasonable time after the end of the period.

(d) If an entity invests in other than money market mutual funds, investment pools or accounts offered by its depository bank in the form of certificates of deposit, or money market accounts or similar accounts, the reports prepared by the investment officers under this section shall be formally reviewed at least annually by an independent auditor, and the result of the review shall be reported to the governing body by that auditor.

Added by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995.

Amended by Acts 1997, 75th Leg., ch. 1421, Sec. 12, eff. Sept. 1, 1997.

Amended by:

Acts 2011, 82nd Leg., R.S., Ch. 1004 (H.B. [2226](#)), Sec. 9, eff. June 17, 2011.

Sec. 2256.024. SUBCHAPTER CUMULATIVE. (a) The authority granted by this subchapter is in addition to that granted by other law. Except as provided by Subsection (b) and Section [2256.017](#), this subchapter does not:

(1) prohibit an investment specifically authorized by other law; or

(2) authorize an investment specifically prohibited by other law.

(b) Except with respect to those investing entities described in Subsection (c), a security described in Section [2256.009](#)(b) is not an authorized investment for a state agency, a local government, or another

investing entity, notwithstanding any other provision of this chapter or other law to the contrary.

(c) Mortgage pass-through certificates and individual mortgage loans that may constitute an investment described in Section 2256.009(b) are authorized investments with respect to the housing bond programs operated by:

- (1) the Texas Department of Housing and Community Affairs or a nonprofit corporation created to act on its behalf;
  - (2) an entity created under Chapter 392, Local Government Code;
- or
- (3) an entity created under Chapter 394, Local Government Code.

Added by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995.

Amended by:

Acts 2017, 85th Leg., R.S., Ch. 96 (S.B. 253), Sec. 3, eff. May 23, 2017.

Sec. 2256.025. SELECTION OF AUTHORIZED BROKERS. The governing body of an entity subject to this subchapter or the designated investment committee of the entity shall, at least annually, review, revise, and adopt a list of qualified brokers that are authorized to engage in investment transactions with the entity.

Added by Acts 1997, 75th Leg., ch. 1421, Sec. 13, eff. Sept. 1, 1997.

Sec. 2256.026. STATUTORY COMPLIANCE. All investments made by entities must comply with this subchapter and all federal, state, and local statutes, rules, or regulations.

Added by Acts 1997, 75th Leg., ch. 1421, Sec. 13, eff. Sept. 1, 1997.

#### SUBCHAPTER B. MISCELLANEOUS PROVISIONS

Sec. 2256.051. ELECTRONIC FUNDS TRANSFER. Any local government may use electronic means to transfer or invest all funds collected or controlled by the local government.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995.

Sec. 2256.052. PRIVATE AUDITOR. Notwithstanding any other law, a state agency shall employ a private auditor if authorized by the legislative audit committee either on the committee's initiative or on request of the governing body of the agency.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995.

Sec. 2256.053. PAYMENT FOR SECURITIES PURCHASED BY STATE. The comptroller or the disbursing officer of an agency that has the power to invest assets directly may pay for authorized securities purchased from or through a member in good standing of the National Association of Securities Dealers or from or through a national or state bank on receiving an invoice from the seller of the securities showing that the securities have been purchased by the board or agency and that the amount to be paid for the securities is just, due, and unpaid. A purchase of securities may not be made at a price that exceeds the existing market value of the securities.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995; Acts 1997, 75th Leg., ch. 1423, Sec. 8.67, eff. Sept. 1, 1997.

Sec. 2256.054. DELIVERY OF SECURITIES PURCHASED BY STATE. A security purchased under this chapter may be delivered to the comptroller, a bank, or the board or agency investing its funds. The delivery shall be made under normal and recognized practices in the securities and banking industries, including the book entry procedure of the Federal Reserve Bank.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995; Acts 1997, 75th Leg., ch. 1423, Sec. 8.68, eff. Sept. 1, 1997.

Sec. 2256.055. DEPOSIT OF SECURITIES PURCHASED BY STATE. At the direction of the comptroller or the agency, a security purchased under this chapter may be deposited in trust with a bank or federal reserve bank or branch designated by the comptroller, whether in or outside the state. The deposit shall be held in the entity's name as evidenced by a trust receipt of the bank with which the securities are deposited.

Amended by Acts 1995, 74th Leg., ch. 402, Sec. 1, eff. Sept. 1, 1995; Acts 1997, 75th Leg., ch. 1423, Sec. 8.69, eff. Sept. 1, 1997.

ORDINANCE NO. 18-10-04-33

**AN ORDINANCE OF THE CITY OF CORINTH, TEXAS, AMENDING CHAPTER 33 OF THE CORINTH CODE OF ORDINANCES, ESTABLISHING THE FINANCE AUDIT COMMITTEE, MERGING THE DUTIES, RESPONSIBILITIES, AND MEMBERSHIP OF THE INVESTMENT COMMITTEE WITH THOSE OF THE AUDIT COMMITTEE; ESTABLISHING ITS MEMBERSHIP, PROCEDURES AND TERMS OF OFFICE; AND PROVIDING AN EFFECTIVE DATE.**

**WHEREAS**, the City of Corinth is a home rule city acting under its charter adopted by the electorate pursuant to Article XI, Section 5 of the Texas Constitution and Chapter 9 of the Local Government Code; and

**WHEREAS**, the City Council has determined it is in the best interest of the citizens of Corinth to merge the Investment Committee and the Audit Committee and to include members of the community in furtherance of its goal of providing transparency;

**NOW, THEREFORE, BE IT ORDAINED BY THE CITY COUNCIL OF THE CITY OF CORINTH:**

**SECTION I.**

That Title III of Chapter 33 of the Code of Ordinances of the City of Corinth, Texas, is amended to add a new article, to be entitled "Finance Audit Committee", which article shall hereafter be and read as follows:

***"FINANCE AUDIT COMMITTEE"***

**§ 33.100 CREATION**

There is hereby created the Finance Audit Committee as an advisory committee of the City.

**“§ 33.101 PURPOSE AND DUTIES**

The purpose of the Committee is to assist the City Council in fulfilling its oversight responsibilities for the annual audit process, the development of financial policies and procedures, Investment transactions and reports, and the system of internal controls. The Committee shall have the following responsibilities:

- 1) Advise the City Council and management on the selection of the independent auditor.
- 2) Serve as an independent and objective party to monitor the City's financial and compliance reporting process and internal control system.
- 3) Review and appraise the audit efforts of the City's independent auditor.

- 4) Provide an avenue of communication among the independent auditor, financial and senior management, and the City Council.
- 5) Review and provide recommendations on the City's financial, investment, and budgetary policies, reports, and procedures.
- 6) Recommend general investment strategies and monitor results.
- 7) Review investment economic outlook, portfolio diversification, maturity structure, potential risk to the City's funds, authorized brokers and dealers, and the target rate of return on the investment portfolio.
- 8) Adopt the list of authorized brokers and dealers of government securities.

### **§ 33.102 MEMBERSHIP; TERM OF OFFICE**

(A) The Committee shall be comprised of five members. The Mayor shall serve on the Committee as a permanent member. The other four members shall be nominated and approved by the City Council. Two members shall be members of the City Council and two members shall be representatives from the community. The committee members from the community must be registered voters of the City, who, to the extent possible, shall be finance professionals such as accountants, Certified Public Accountants, auditors or shall have equivalent experience.

(B) The term of each Committee member shall be two (2) years. The Committee members from the community shall serve no more than two (2) successive terms, provided, however, that a Committee member appointed to complete the term of another Committee member shall, at the completion of such term, be eligible for appointment for another full term.

### **§ 33.103 MEETINGS; OFFICERS**

The Committee shall hold an organizational meeting in June of each year and shall elect a Chairman and Vice-Chairman from among its members before proceeding to any other matters of business. The officers shall serve for one year. The Committee shall meet not less than once per calendar quarter and shall designate the time and place of its meetings.

### **§ 33.104 QUORUM; RULES**

(A) A majority of the members of the Committee shall constitute a quorum for the conduct of business. The members of the Committee shall regularly attend meetings and shall serve without compensation except for reimbursement of authorized expenses attendant to the performance of their duties.

(B) The Committee shall utilize and abide by the Rules of Procedure and Policies as set forth in Resolution 09-05-01-11, as amended, and the Charter of the City of Corinth. Newly appointed members shall be installed at the first meeting after their appointments. Minutes shall be kept of the Committee's meetings.

(C) The City Councilmembers and the Mayor shall be voting members of the Committee.

The Community Representative members shall be non-voting members of the Committee.

**SECTION II.**

Section V of the City of Corinth Investment Policy, is amended to read as follows:

**V. INVESTMENT COMMITTEE**

There shall be an Investment Committee appointed by the City Council with the duties and responsibilities as set forth in Chapter 30 of the City of Corinth Code of Ordinances.

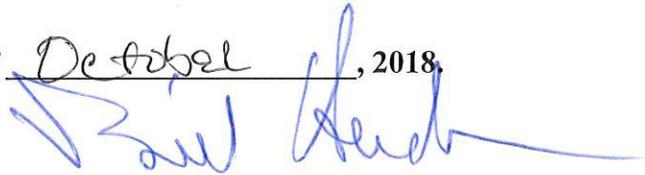
**SECTION III.**

This Ordinance shall be cumulative of all provisions of all existing ordinances and resolutions and of the Code of Ordinances of the City of Corinth, Texas, as amended, except where the provisions of this ordinance are in direct conflict with the provisions of such existing ordinances, resolutions, and code, in which event the conflicting provisions of such ordinances and Code are hereby repealed.

**SECTION IV.**

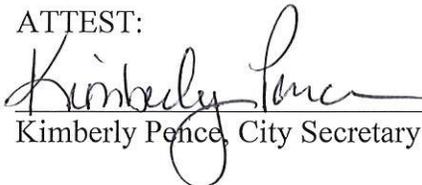
This Ordinance shall take effect on the 4 day of October, 2018.

PASSED AND APPROVED this 4 day of October, 2018.

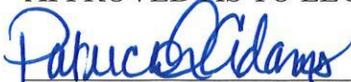


Bill Heidemann, Mayor

ATTEST:

  
Kimberly Pence, City Secretary

APPROVED AS TO LEGAL FORM:

  
Patrice Adams  
City Attorney



**CONSENT ITEM 3.**

**Finance Audit Committee Regular Session**

**Meeting Date:** 12/13/2018  
**Title:** April 18, 2018 Regular Session Minutes  
**Submitted For:** Lee Ann Bunselmeyer, Director  
**Submitted By:** Chris Rodriguez, Financial Services Manager  
**Finance Review:** N/A **Legal Review:** N/A  
**City Manager Review: Approval:** Bob Hart, City Manager

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**AGENDA ITEM**

Consider and act on minutes from the April 18, 2018 Regular Session.

**AGENDA ITEM SUMMARY/BACKGROUND**

Attached are minutes from the April 18, 2018 Regular Session. The minutes are in draft form and are not considered official until formally approved by the Finance Audit Committee.

**RECOMMENDATION**

Staff recommends approval of the April 18, 2018 Regular Session minutes.

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**Attachments**

April Minutes

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**STATE OF TEXAS  
COUNTY OF DENTON  
CITY OF CORINTH**

On this the 18th day of April 2018 the Finance Audit Committee of the City of Corinth, Texas met in a Regular Meeting at 4:30 P.M. at the Corinth City Hall, located at 3300 Corinth Parkway, Corinth, Texas. The meeting date, time, place and purposes as required by Title 5, Subchapter A, Chapter 551, Subchapter C, Section 551.041, Government Code, with the following members to wit:

**Councilmembers Present:**

Councilmember Lowell Johnson  
Councilmember Joe Harrison

**Citizen Members Present:**

Dick Baker  
Mike Taylor

**Staff Committee Members Present:**

Bob Hart, City Manager  
Lee Ann Bunselmeyer, Director of Finance, Communication & Strategic Services

**Staff Members Present:**

Chris Rodriguez, Financial Services Manager

**CALL TO ORDER**

Councilmember Johnson called the meeting to order at 4:30 pm

**CONSENT AGENDA**

All matters listed under the Consent Agenda are considered to be routine and will be enacted in one motion. Should the Chairman, a Board Member, or a citizen desire discussion of any item, that item will be removed from the Consent Agenda and will be considered separately.

- 1) Consider and act on minutes from the February 21, 2018 Regular Session.

**MOTION** made by Councilmember Lowell Johnson to approve the Consent Agenda as presented.  
Passed by acclamation.

**AYES:**

**NOES:**

**MOTION CARRIED**

**BUSINESS AGENDA**

- 2) Consider and act on February 2018 Monthly Financials.

**MOTION** made by Councilmember Joe Harrison to approve February 21, 2018 Monthly Financials. Seconded by Lowell Johnson.

**AYES:** Harrison, Johnson, Hart

**NOES:** None

**MOTION CARRIED**

3) Discuss and approve the Fiscal Year 2017-2018 Second Quarter Investment Report.

**MOTION** made by Councilmember Harrison to approve the FY 2017-2018 Second Quarter Investment Report.  
Seconded by City Manager Bob Hart.

**AYES:** Harrison, Johnson, Hart

**NOES:** None

**MOTION CARRIED**

4) Receive a report, hold a discussion and provide staff direction on the bank depository agreement.

Committee agreed to a one year renewal and recommended including the Lake Cities area when doing the RFP for banking services in December.

**No Action Taken.**

**ADJOURN THE REGULAR MEETING**

Councilmember Johnson adjourned the Regular Meeting at 5:20 pm.

**Finance Audit Committee Regular Session**

**Meeting Date:** 12/13/2018  
**Title:** Annual Audit and Comprehensive Annual Report Discussion  
**Submitted For:** Lee Ann Bunselmeyer, Director  
**Submitted By:** Chris Rodriguez, Financial Services Manager  
**Finance Review:** N/A **Legal Review:** N/A

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**AGENDA ITEM**

Discuss and provide staff direction on the annual external audit and the Comprehensive Annual Financial Report (CAFR).

**AGENDA ITEM SUMMARY/BACKGROUND**

The City of Corinth's Home Rule Charter, Section 9.12, states that at the close of the fiscal year an independent audit must be made on all accounts of the City by a certified public accountant. Davis Kinard & Co, in their third year as the City's independent audit firm, will perform the audit for fiscal year 2017-2018 which ends on September 30, 2018.

The tentative audit timeline is listed below:

September 10, 2018	Auditors begin Interim Fieldwork
September 30, 2018	City's fiscal year end
October-December 6, 2018	City staff analyze the financials, make year end entries and prepare the CAFR.
December 7, 2018	City staff close the books and provide a trial balance to the auditors
December 10, 2018	Auditors begin fieldwork
December 13, 2018	Preliminary Audit discussions with Finance Audit Committee
February 20, 2018	Post-Audit meeting with Finance Audit Committee and presentation of CAFR
March 21, 2018	Presentation of CAFR to City Council

**RECOMMENDATION**

No action to be taken on this item.

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**Finance Audit Committee Regular Session**

**Meeting Date:** 12/13/2018  
**Title:** FY 2018-2019 Investment Policies  
**Submitted For:** Lee Ann Bunselmeyer, Director  
**Submitted By:** Chris Rodriguez, Financial Services Manager  
**Finance Review:** N/A **Legal Review:** N/A

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**AGENDA ITEM**

Review and approve the Investment Policy for the City of Corinth, Economic Development Corporation and Crime Control & Prevention District.

**AGENDA ITEM SUMMARY/BACKGROUND**

In accordance with Public Funds Investment Act, Chapter 2256 of the Texas Government Code, the city is required to annually adopt a formal written Investment Policy for the investment of public funds. The policy establishes investment parameters and guidelines for the investment program in order to achieve the goals of safety, liquidity, diversification, rate-of-return, and public trust, and designates the authorized investment officer responsible for the daily investment activity by the City.

As part of the annual process, staff reviews the policy and may recommend revisions to the existing policy, if needed. Therecommended revisions to the investment policies reflect the changes that the City Council made to the structure of the Finance Audit Committee in September of 2018. the recommended revisions are summarized below.

Section V. finance Audit Committee (A) Members:

There is hereby created a Finance Audit Committee consisting of the ~~City Manager, Director of Finance, a secondary Investment Officer designated by the Director of Finance,~~ Mayor, two members of the City Council and two citizens appointed by the City Council ~~by majority vote.~~ The Mayor will be a permanent member of the Committee. The other four members of the Committee will be appointed by the City Council to serve a two-year term and shall not exceed two successive terms. The Mayor and the two members of the City Council shall be voting members of the Committee. The Community Representative members shall be non-voting member of the Committee.

Section V. Finance Audit Committee (B) Scope:

The Finance Audit Committee shall meet at least once per calendar quarter ~~annually~~ to determine general strategies and to monitor results.

Section V. Finance Audit Committee (C) Procedures:

The Finance Audit Committee shall provide minutes of its meetings. Any two members of the Finance Audit Committee may request a special meeting, and a majority of the members shall constitute a quorum. ~~The Finance Audit Committee shall establish its own rules of procedure.~~ The Finance Audit Committee shall abide by the Rules of Procedure and Policies as set forth in Resolution 09-05-01-11, as amended, and the Charter of the City of Corinth.

**RECOMMENDATION**

Staff recommends approval of the Investment Policies.

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## **Attachments**

Crime Control Investment Policy

Corinth Investment Policy

EDC Investment Policy

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**CORINTH, TEXAS  
CORINTH CRIME CONTROL AND PREVENTION DISTRICT  
INVESTMENT POLICY**

**PREFACE**

It is the policy of the City of Corinth (the "City") and the Corinth Crime Control and Prevention District (the "DISTRICT") that after allowing for the anticipated cash flow requirements and giving due consideration to the safety and risks of investments, all available funds shall be invested in conformance with these legal and administrative guidelines to obtain a market rate-of-return.

Effective cash management is recognized as essential to good fiscal management. An active cash management and investment policy will be pursued to take advantage of investment interest as a viable and material source of revenue for DISTRICT funds. The DISTRICT's portfolio shall be designed and managed in a manner responsive to the public trust and shall be invested in conformance with State and Federal Regulations, applicable Bond Resolution requirements, and adopted investment policy. The DISTRICT will invest public funds in a manner which will provide the maximum security and a market rate-of-return while meeting the daily cash flow demands of the DISTRICT.

Pursuant to Subchapter E of Chapter 363 of the Local Government Code, the DISTRICT designates the City of Corinth to invest its funds in accordance with the provisions and requirements of this policy and § 363.206(c) of the Texas Local Gov't Code.

## I. PURPOSE

The purpose of this investment policy (the “policy”) is to set forth specific investment policy and strategy guidelines for the DISTRICT in order to achieve the goals of safety, liquidity, rate-of-return, and public trust for all investment activities.

## II. SCOPE

The investment policy shall govern the investment of all financial assets considered to be part of the DISTRICT and includes the following separately invested funds or fund types: Operating, Reserve, and Bond Funds, although the DISTRICT has only operating funds. This policy does not include funds governed by approved trust agreements, or assets administered for the benefit of the DISTRICT by outside agencies under retirement or deferred compensation programs. The City shall and will maintain responsibility for these funds to the extent required by: Federal and State law; the City Charter; and donor stipulations.

## III. INVESTMENT OBJECTIVES

Funds of the DISTRICT shall be invested in accordance with all applicable Texas statutes, this policy and any other approved, written administrative procedures. The five objectives of the DISTRICT’s investment activities shall be as follows (in the order of priority):

- A. Safety – Preservation and safety of Principal. Safety of principal invested is the foremost objective in the investment decisions of the DISTRICT. Each investment transaction shall seek to ensure the preservation of capital in the overall portfolio. The risk of loss shall be controlled by investing only in authorized securities as defined in this policy, by qualifying the financial institutions with which the DISTRICT will transact, and by portfolio diversification. Safety is defined as the undiminished return of the principal on the DISTRICT’s investments
- B. Liquidity -The investment portfolio shall be managed to maintain liquidity to ensure that funds will be available to meet the DISTRICT’s cash flow requirements and by investing in securities with active secondary markets. Investments shall be structured in such a manner as to provide liquidity necessary to pay obligations as they become due. A security may be liquidated prior to its stated maturity to meet unanticipated cash requirements or to otherwise favorably adjust the DISTRICT’s portfolio.
- C. Diversification - Investment maturities shall be staggered throughout the budget cycle to provide cash flow based on the anticipated needs of the DISTRICT. Diversifying the appropriate maturity structure will reduce market cycle risk.
- D. Market Rate-of-Return (Yield) - The DISTRICT’s investment portfolio shall be designed to optimize a market rate-of-return on investments consistent with risk constraints and cash flow requirements of the portfolio. The investment portfolio shall be managed in a manner which seeks to attain a market rate-of-return throughout budgetary and economic cycles. The DISTRICT will not attempt to consistently attain an unrealistic above market rate-of-return as this objective will subject the overall portfolio to greater risk. Therefore, the DISTRICT’s rate-of-return objective is secondary to those of safety and liquidity. Rate-of-return (yield) is defined as the annual income returned on an investment, expressed as a percentage.

- E. Public Trust - The Investment Officer(s) shall avoid any transactions that might impair public confidence in the DISTRICT's ability to govern effectively. The governing body recognizes that in diversifying the portfolio, occasional measured losses due to market volatility are inevitable, and must be considered within the context of the overall portfolio's investment return, provided that adequate diversification has been implemented. The prudence of the investment decision shall be measured in accordance with the tests set forth in Section 2256.006(b) of the Act.

#### IV. INVESTMENT STRATEGY

The City maintains a comprehensive and proactive cash management program which is designed to monitor and control all DISTRICT funds to ensure maximum utilization and yield a market rate-of-return. The basic and underlying strategy of this program is that all of the DISTRICT's funds are earning interest. It is the responsibility and obligation of the City to maintain a flexible approach and be prepared to modify the investment strategy as market conditions dictate. The investment strategy described is predicated on conditions as they now exist and are subject to change. The investment strategy emphasizes low credit risk, diversification, and the management of maturities. The strategy also considers the expertise and time constraints of the Investment Officers. The allowable investments as defined in Section VII of this policy reflect the avoidance of credit risk. Diversification refers to dividing investments among a variety of securities offering independent returns. This strategy uses local government investment pools to achieve diversification. The active management of maturities refers to structuring the maturity dates of the direct investments so that, while funds are initially invested for a longer period of time, some investments mature as cash needs require. The strategies for the DISTRICT's investment activities shall be as follows:

##### **Strategy No. 1**

Diversifying the DISTRICT's investment opportunities through the use of local government investment pools and money market mutual funds as authorized by the City Council. An investment pool is a professionally managed portfolio of shared assets created to invest public funds jointly on behalf of the governmental entities that participate in the pool and whose investment objectives in order of priority match those objectives of the DISTRICT. Fund withdrawals are usually available from investment pools on a same-day basis, meaning the pools have a high degree of liquidity. Because of the size and expertise of their staff, investment pools are able to prudently invest in a variety of the investment types allowed by state law. In this manner, investment pools achieve desired diversification. The strategy of the DISTRICT calls for the use of investment pools as a primary source of diversification and a supplemental source of liquidity. Funds that may be needed on a short-term basis but are in excess of the amount maintained at the depository bank are available for deposit in investment pools.

##### **Strategy No. 2**

Building a ladder of authorized securities with staggered maturities for all or part of the longer-term investable funds. The benefits of this ladder approach include the following:

- A. It is straight-forward and easily understood;
- B. It will assure the DISTRICT that it will capture a reasonable portion of the yield curve; and,
- C. It provides predictable cash flow with scheduled maturities and reinvestment opportunities.

**Strategy No. 3**

Utilizing the services of a Professional Investment Advisor in order to maximize investment earnings and realize market opportunities when they become available. Other responsibilities of the Investment Advisor include, but are not limited to broker compliance, security selection, competitive bidding, investment reporting, and security documentation. The Investment Advisor must be registered with the Securities and Exchange Commission (SEC) under the Investment Advisor's Act of 1940 as well as with the Texas State Securities Board and shall adhere to the spirit and philosophy of this policy and avoid recommending or suggesting transactions outside the "Standard of Care" under this policy.

**Strategy No. 4**

The DISTRICT will utilize a general investment strategy designed to address the unique characteristics of specific fund-types (detailed strategies are presented in Attachment A):

- A. Investment strategies for operating funds and pooled funds containing operating funds have as their primary objective to assure that anticipated cash flows are matched with adequate investment liquidity. The secondary objective is to create a portfolio which will experience minimal volatility during economic cycles.
- B. Investment strategies for reserve funds shall have as the primary objective the ability to generate a dependable revenue stream to the appropriate reserve fund.
- C. Investment strategies for special projects and capital projects funds will have as their primary objective to assure that anticipated cash flows are matched with adequate investment liquidity.
- D. The investment maturity of bond proceeds (excluding reserve and debt service funds) shall generally be limited to the anticipated cash flow requirement or the "temporary period," as defined by Federal tax law. During the temporary period, bond proceeds may be invested at an unrestricted yield. After the expiration of the temporary period, bond proceeds subject to yield restriction shall be invested considering the anticipated cash flow requirements of the funds and market conditions to achieve compliance with the applicable regulations.

**Strategy No. 5**

The DISTRICT generally intends to hold all of its securities until they mature and will accomplish this by maintaining sufficient liquidity in its portfolio so that it does not need to sell a security early. Should it become necessary to sell a security prior to maturity, where the sale proceeds are less than the current book value, the prior written consent of the City Manager must be obtained. Securities may be sold prior to maturity by the Director of Finance at or above their book value at any time, without the consent of the City Manager.

### **Strategy No. 6**

All demand deposits of the DISTRICT will be concentrated with one central depository. The City's depository procedure will maximize the DISTRICT's ability to pool cash for investment purposes, and provide more manageable banking relationships. In addition, depositories not holding demand deposits of the DISTRICT may be eligible to bid on DISTRICT investments.

### **Strategy No. 7**

This policy shall further seek to maintain good depository bank relationships while minimizing the cost of banking services. The City will seek to maintain a depository contract which will be managed to a level that minimizes the cost of the banking relationship to the DISTRICT, while allowing the DISTRICT to earn an appropriate return on idle demand deposits.

### **Strategy No. 8**

A single pooled fund group, as defined in this policy, may be utilized at the discretion of the Investment Officer. However, earnings from investments will be allocated on a pro-rata cash basis to the individual funds and used in a manner that will best service the interests of the DISTRICT.

### **Strategy No. 9**

Procedures shall be established and implemented in order to maximize investable cash by decreasing the time between the actual collection and the deposit of receipts, and by the controlling of disbursements.

## **V. FINANCE AUDIT COMMITTEE**

- A. Members** - There is hereby created a Finance Audit Committee consisting of the ~~City Manager, Director of Finance, a secondary Investment Officer designated by the Director of Finance, Mayor,~~ two members of the City Council and two citizens appointed by the City Council ~~by majority vote.~~ The Mayor will be a permanent member of the Committee. The other four members of the Committee will be appointed by the City Council to serve a two-year term and shall not exceed two successive terms. The Mayor and the two members of the City Council shall be voting members of the committee. The Community Representative members shall be non-voting members of the Committee
- B. Scope** - The Finance Audit Committee shall meet at least once per calendar quarter annually to determine general strategies and to monitor results. Included in its deliberations will be such topics as: economic outlook, portfolio diversification, maturity structure, potential risk to the DISTRICT's funds, authorized brokers and dealers, and the target rate-of-return on the investment portfolio.
- C. Procedures** - The Finance Audit Committee shall provide minutes of its meetings. Any two members of the Finance Audit Committee may request a special meeting, and a majority of the members shall constitute a quorum. The Finance Audit Committee shall establish its own rules of procedures. The Finance Audit Committee shall abide by the Rules of Procedure and Policies as set forth in Resolution 09-05-01-11, as amended, and the Charter of the City of Corinth.

## VI. RESPONSIBILITY AND STANDARD OF CARE

- A. The responsibility for the daily operation and management of the DISTRICT's investments shall be outlined within this section.
1. Delegation of Authority - Management responsibility for the investment program is hereby delegated to the Director of Finance, who shall be authorized to deposit, withdraw, invest, transfer or manage the funds of the DISTRICT and shall establish written procedures for the operation of the investment program, consistent with this policy. Such procedures shall include explicit delegation of authority to other persons responsible for investment transactions. All persons involved in investment activities will be referred to in this policy as "Investment Officers." No persons may engage in investment transactions, except as provided under the terms of this policy and the procedures established by the Director of Finance.
  2. The Director of Finance shall assume responsibility for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate Investment Officers. The system of controls shall be designed to provide reasonable assurance that ensures the assets of the DISTRICT are protected from loss, theft or misuse. The concept of reasonable assurance recognizes that:
    - a. The cost of control should not exceed the benefits likely to be derived; and,
    - b. The valuation of costs and benefits requires estimates and judgments by management.
  3. The Director of Finance shall be designated as the primary Investment Officer for the DISTRICT and shall be responsible for investment decisions and activities under the direction of the City Manager. The Director of Finance may delegate any phase of the investment program to a secondary Investment Officer. Both the Director of Finance and the designated secondary Investment Officer are responsible for daily investment decisions and activities. However, ultimate responsibility for investment decisions will rest with the Director of Finance.
- B. Prudence - The standard of prudence to be applied by the Investment Official shall be the "prudent investor" rule, which states, "investments shall be made with judgment and care, under prevailing circumstances, that a person of prudence, discretion and intelligence would exercise in the management of the person's own affairs, not for speculation, but for investment, considering the probable safety of capital and the probable income to be derived." In determining whether the Investment Officer has exercised prudence with respect to an investment decision, the determination shall be made taking into consideration the following:
1. The investment of all funds over which the Investment Officer had responsibility rather than a consideration as to the prudence of a single investment; and
  2. The investment decision was consistent with the written investment policy and procedures of the DISTRICT.
- C. Due Diligence - The Director of Finance, designated secondary Investment Officer, Mayor, City Council, City Manager, other Finance employees and citizen committee

members acting in accordance with written policies and procedures and exercising due diligence, shall not be held personally responsible for a specific security's credit risk or market price changes, provided that these deviations are reported in a timely manner and that appropriate action is taken to control adverse developments.

**D. Ethical Standards and Conflicts of Interest**

1. All DISTRICT Investment Officers having a direct or indirect role in the investment of DISTRICT funds shall act as custodians of the public trust avoiding any transaction which might involve a conflict of interest, the appearance of a conflict of interest, or any activity which might otherwise discourage public confidence. Officers and employees involved in the investment process shall refrain from personal business activity that could conflict with proper execution of the investment program, or which could impair the ability to make impartial investment decisions.
2. An Investment Officer who has a personal business relationship with the depository bank or with any entity seeking to sell an investment to the DISTRICT shall file a statement disclosing that personal business interest.
3. An Investment Officer has a personal business relationship with a business organization if:
  - a. The Investment Officer or one related to the Investment Officer within the second degree of affinity or consanguinity owns 10% or more of the voting stock or shares of the business organization or owns \$5,000 or more of the fair market value of the business organization;
  - b. Funds received by the Investment Officer or one related to the Investment Officer within the second degree of affinity or consanguinity from the business organization exceed 10% of the Investment Official's gross income for the prior year; or
  - c. The Investment Officer or one related to the Investment Officer within the second degree of affinity or consanguinity has acquired from the business organization during the prior year investments with a book value of \$2,500 or more for the personal account of the Investment Officer.
  - d. An Investment Officer who is related within the second degree of affinity or consanguinity to an individual seeking to sell an investment to the DISTRICT shall file a statement disclosing that relationship. A statement required under this subsection must be filed with the Texas Ethics Commission and the City Council.

- E. Training** - The City shall provide periodic training in investments for the investment personnel through courses and seminars offered by professional organizations and associations in order to ensure the quality and capability of the DISTRICT'S investment personnel making investment decisions in compliance with the Public Funds Investment Act (PFIA). The Investment Officials and the Finance Audit Committee members shall attend at least one training session containing at least 10 hours of instruction relating to the officer's responsibility under the PFIA within 12

months after assuming duties, and thereafter shall attend at least 8 hours of additional investment training in subsequent two-year periods which begin on the first day of the fiscal year and consist of the two consecutive fiscal years after that date. The Government Finance Officers Association of Texas, the Government Treasurers Organization of Texas, the Texas Municipal League, or the North Central Texas Council of Governments are approved as independent training sources by the City Council.

## VII. AUTHORIZED INVESTMENTS

- A. Generally - Safety of principal is the primary objective in investing public funds and can be accomplished by limiting credit risk and interest rate risk. Credit risk is the risk associated with the failure of a security issuer or backer to pay back principal and interest on a timely basis. Interest rate risk is the risk that the value of a portfolio will decline due to an increase in the general level of interest rates. In order to provide for safety of principal as the DISTRICT's primary objective, only certain investments are authorized as acceptable investments for the DISTRICT. The following list of authorized investments for the DISTRICT intentionally excludes some investments authorized by state law. These restrictions are intended to limit possible risk and provide the maximum measure of safety to DISTRICT funds. In the event an authorized investment loses its required minimum credit rating, all prudent measures will be taken to liquidate said investment. Additionally, the DISTRICT is not required to liquidate investments that were authorized at the time of purchase.
- B. Authorized and Acceptable Investments - The authorized list of investment instruments is as follows:
1. Obligations of the United States or its agencies and instrumentalities or any obligation fully guaranteed or insured by the Federal Deposit Insurance Corporation (FDIC), *excluding mortgage-backed securities*.
  2. Direct obligations of the State of Texas, or its agencies and instrumentalities Other obligations, the principal of and interest on which are unconditionally guaranteed or insured by, or backed by the full faith and credit of, the State of Texas or the United States or their respective agencies and instrumentalities, excluding mortgage-related securities.
- C. Certificates of Deposit – A certificate of deposit issued by a depository institution that has its main office or branch office in this state, and is secured in accordance with the specific collateralization requirements contained in section XI.B of this policy. In addition, an investment in “bundled” or “shared” CDs made in accordance with the following conditions is permitted:
1. The funds are invested through a broker that has its main office or a branch office in this state selected from a list adopted by the City as required by Section 2256.025; or through a depository institution that has its main office or a branch office in this state and that is selected by the City;
  2. The selected broker or depository institution arranges for the deposit of the funds in certificates of deposit in one or more federally insured depository institutions, wherever located, for the account of the City.

3. The full amount of the principal and accrued interest of each of the CD is insured by the United States or an instrumentality of the United States; and
  4. The City appoints the depository institution, a clearing broker-dealer registered with the Securities and Exchange Commission and operating pursuant to SEC Rule 15c3-3, or an entity described in the Public Funds Collateral Act, Section 2257.041(d), as custodian for the City with respect to those CDs issued for the City's account.
- D. Eligible Local Government Investment Pools – AAA-rated public funds investment pools, with a weighted average maturity of 60 days or less, individually approved by formal Council resolution, which invest in instruments and follow practices allowed by the current law as defined by Section 2256.016 of the Texas Government Code. The pool must be continuously rated no lower than AAA or AAA-m or at an equivalent rating by at least one nationally recognized rating service. A public funds investment pool created to function as a money market mutual fund must mark to market daily and stabilize at a \$1 net asset value.
- E. Repurchase Agreements – Fully collateralized repurchase agreements having a defined termination date, placed through a primary government securities dealer or a financial institution doing business in the State of Texas, and fully secured by cash and obligations of the United States or its agencies and instrumentalities. This collateral must be pledged to the DISTRICT and held in safekeeping with a third-party custodian approved by the City. All collateral must be maintained at a market value of no less than the principal amount of the outstanding funds disbursed. All transactions shall be governed by signed Security Industry and Financial Markets Association, (SIFMA) Master Repurchase Agreement. Repurchase agreements must also be collateralized in accordance with State law as described in Section XI of this policy. Authorization under this section includes flexible repurchase agreements which may be used for specific investment of bond proceeds *but shall not include reverse repurchase agreements*.
- F. Bankers' Acceptances and Commercial Paper (LIMITED USE) – These investments are authorized for the DISTRICT to the extent that they are contained in the portfolios of approved public funds investment pools or money market funds in which the DISTRICT invests.
- G. AAA-rated SEC-Regulated 2a7 No-Load Money Market Mutual Funds – An SEC-registered, no load money market mutual fund which has a dollar weighted average stated maturity of 60 days or less whose assets consist exclusively of the assets described in section VII.A and whose investment objectives includes the maintenance of a stable net asset value of \$1 for each share: furthermore, it provides the DISTRICT with a prospectus and other information required by the SEC act of 1934 or the Investment Advisor Act of 1940 and which provides the DISTRICT with a prospectus and other information required by the Securities Exchange Act of 1934 (15 USC Section 78a et. Seq.) of the Investment Company Act of 1990 (15 USC Section 80a-1 et. Seq.).
- H. Unauthorized Securities – State law specifically prohibits investment in the following securities:

1. An obligation whose payment represents the coupon payments on the outstanding principal balance of the underlying mortgage-backed security and pays no principal.
2. An obligation whose payment represents the principal stream of cash flow from the underlying mortgage-backed security and bears no interest.
3. Collateralized mortgage obligations that have a stated final maturity date of greater than 10 years.
4. Collateralized mortgage obligations, the interest rate of which is determined by an index that adjusts opposite to the changes in a market index.

**VIII. DIVERSIFICATION**

**A. Generally** - Diversification of investment instruments shall be utilized to avoid incurring unreasonable risks resulting from over-concentration of investments in a specific maturity, a specific issue, or a specific class of securities. With the exception of U.S. Government securities (debt obligations issued by the U. S. Government, its agencies, or instrumentalities) as authorized in this policy, and authorized local government investment pools, no more than forty percent (40%) of the total investment portfolio will be invested in any one security type or with a single financial institution. Diversification of the portfolio considers diversification by maturity dates and diversification by investment instrument.

**B. Diversification by Maturities** - The longer the maturity of investments, the greater their price volatility. Therefore, it is the DISTRICT's policy to concentrate its investment portfolio in shorter-term securities in order to limit principal risks caused by change in interest rates. The DISTRICT will attempt to match its investments with anticipated cash flow requirements. Unless matched to a specific cash flow (including the anticipated cash flow requirements of bond proceeds within the temporary period), the DISTRICT will not directly invest in securities maturing more than two (2) years from the date of purchase. However, the above described obligations, certificates, or agreements may be collateralized using longer date instruments. The DISTRICT shall diversify the use of investment instruments to avoid incurring unreasonable risks inherent in over-investing in specific instruments, individual financial institutions or maturities. Maturity scheduling shall be managed by the Investment Officer so that maturities of investments shall be timed to coincide with projected cash flow needs.

The entire DISTRICT portfolio, or single pooled fund group if utilized, shall maintain a maximum average dollar-weighted maturity, based on the stated maturity date, of less than two hundred seventy (270) days. Investment maturities for debt service interest and sinking funds and/or other types of reserve funds, whose use is never anticipated, shall maintain a maximum average dollar-weighted maturity, based on the stated maturity date, of less than three hundred sixty-five (365) days.

**C. Diversification by Investment Instrument** - Diversification by investment instrument shall not exceed the following guidelines for each type of instrument:

Maximum %  
of Portfolio

U.S. Treasury Obligations	100%
U.S. Government Agency Securities and Instrumentalities	100%
Authorized Local Government Investment Pool	100%
Local Government Obligations	10%
Fully Collateralized Certificates of Deposit	50%
Fully Collateralized Repurchase Agreements	25%
SEC-Regulated No-Load Money Market Mutual Fund	100%
U.S. Treasury & Agency Callables	30%

## **IX. SECURITY SWAPS**

Security swaps may be considered as an investment option for the DISTRICT. A swap out of one instrument into another is acceptable to increase yield, realign for disbursement dates, extend or shorten maturity dates and improve market sector diversification. Swaps may be initiated by brokers/dealers who are on the City's approved list. A horizon analysis is required for each swap proving benefit to the DISTRICT before the trade decision is made, which will accompany the investment file for record keeping.

## **X. AUTHORIZED FINANCIAL DEALERS AND INSTITUTIONS.**

- A.** The Director of Finance will maintain a list of financial institutions authorized to provide investment services to the City. In addition, a list will also be maintained of approved broker/dealers authorized to provide investment services in the State of Texas. These will include financial institutions that qualify under Securities & Exchange Commission Rule 15-C3-1 (uniform net capital rule). No public deposit shall be made except in a qualified public depository as established by state laws.
- B.** All financial institutions and broker/dealers who desire to become qualified bidders for investment transactions must supply the Director of Finance with the following, as appropriate: audited financial statements, proof of Financial Industry Regulatory Authority certification, trading resolution, proof of State registration, completed broker/dealer questionnaire and certification of having read the DISTRICT's investment policy.
- C.** The Finance Audit Committee shall be responsible for adopting the list of brokers and dealers of government securities. Their selection shall be among only primary government securities dealers that report directly to the New York Federal Reserve Bank, unless a comprehensive credit and capitalization analysis reveals that other firms are adequately financed to conduct public business. The Finance Audit Committee shall base its evaluation of security dealers and financial institutions upon:
1. Financial conditions, strength and capability to fulfill commitments;
  2. Overall reputation with other dealers or investors;
  3. Regulatory status of the dealer;
  4. Background and expertise of the individual representatives.
- D.** Investment Officers shall only conduct business with securities dealers approved by the Finance Audit Committee and will not purchase investments from any financial

organization until the organization's registered principal has executed a written instrument stating that he or she has thoroughly reviewed the DISTRICT's investment policy and acknowledges that reasonable procedures and controls have been implemented to preclude imprudent investment activities arising out of transactions between the organization and the DISTRICT, except to the extent that this authorization is dependent on an analysis of the makeup of the DISTRICT's entire portfolio or requires an interpretation of subjective investment standards.

- E. To guard against default possibilities under these conditions, and to assure diversification of bidders, business with any one issuer, or investment broker, should be limited to forty percent (40%) of the total portfolio at any point in time. In this way, bankruptcy, receivership or legal action would not immobilize the DISTRICT's ability to meet payroll or other expenses.
- F. All investment (governments or bank C.D.'s) will be solicited on a competitive basis with at least three (3) institutions. The Finance Audit Committee can approve exceptions on a case by case basis or on a general basis in the form of guidelines. These guidelines shall take into consideration the investment type maturity date, amount, and potential disruptiveness to the DISTRICT's investment strategy. The investment will be made with the broker/dealer offering the best yield/quality to the DISTRICT. The quotes may be accepted orally, in writing, electronically, or any combination of these methods.
- G. An annual review of the financial condition and registration of qualified financial organizations will be conducted by the Director of Finance.
- H. A current audited financial statement is required to be on file for each financial institution and broker/dealer in which the DISTRICT invests.
- I. If the City has contracted with a Registered Investment Advisor for the management of its funds, the advisor shall be responsible for performing due diligence on and maintaining a list of broker/dealers with which it shall transact business on behalf of the DISTRICT. The advisor shall determine selection criteria and shall annually present a list of its authorized broker/dealers to the CITY for review and likewise shall execute the aforementioned written instrument stating that the advisor has reviewed the DISTRICT's investment policy and has implemented reasonable procedures and controls in an effort to preclude imprudent investment activities with the DISTRICT. The advisor shall obtain and document competitive bids and offers on all transactions and present these to the City as part of its standard trade documentation.
- J. It is the policy of the City that all security transactions entered into with the DISTRICT shall be conducted on a "Delivery-versus-Payment basis through the Federal Reserve System. By doing this, DISTRICT funds are not released until the City has received, through the Federal Reserve wire, the securities purchased. The City shall authorize the release of funds only after receiving notification from the safekeeping bank that a purchased security has been received in the safekeeping account of the DISTRICT. The notification may be oral, but shall be confirmed in writing.
  - 1. Financial conditions, strength and capability to fulfill commitments;
  - 2. Overall reputation with other dealers or investors;

3. Regulatory status of the dealer;
4. Background and expertise of the individual representatives.

## **XI. SAFEKEEPING AND COLLATERALIZATION**

- A. Safekeeping** - All securities owned by the DISTRICT shall be held by a third-party safekeeping agent selected by the City. The collateral for bank deposits will be held in the City's name in the bank's trust department, in a Federal Reserve Bank account in the City's name, or third-party financial institutions doing business in the state of Texas, in accordance with state law. Original safekeeping receipts shall be obtained and held by the City. The City shall contract with a bank or banks for the safekeeping of securities either owned by the City as part of its investment portfolio or held as collateral to secure time deposits.
- B. Collateralization** - Consistent with the requirements of the Public Funds Collateral Act, it is the policy of the City to require full collateralization of all City funds on deposit with a depository bank. The market value of the investments securing the deposit of funds shall be at least equal to 102% of the amount of the deposits of funds reduced to the extent that the deposits are insured by the Federal Deposit Insurance Corporation (FDIC). Securities pledged as collateral shall be held by an independent third party with whom the City has a current custodial agreement. The agreement is to specify the acceptable investment securities as collateral, including provisions relating to possession of the collateral, the substitution or release of investment securities, ownership of securities, and the method of valuation of securities. The safekeeping agreement must clearly state that the safekeeping bank is instructed to release purchased and collateral securities to the City in the event the City has determined that the depository bank has failed to pay on any matured investments in certificates of deposit, or has determined that the funds of the City are in jeopardy for whatever reason, including involuntary closure or change of ownership. A clearly marked evidence of ownership, e.g., safekeeping receipt, must be supplied to the City and retained by the City.
1. The City may accept the following to insure or collateralize bank deposits:
    - a. Guaranteed or insured by the Federal Deposit Insurance Corporation or its successor or the National Credit Union Share Insurance Fund or its successor;
    - b. United States Treasuries & Agencies
    - c. Other securities as approved by the Finance Audit Committee
  2. For certificates of deposit and other evidences of deposit, collateral shall be at 102% of market value. The market value of collateral will always equal or exceed 102% of the principal plus accrued interest of deposits at financial institutions.
  3. Financial institutions with which the City invests or maintains other deposits shall provide monthly, and as requested by the Investment Officer, a listing of the collateral pledged to the City, marked to current market prices. The listing shall include total pledged securities itemized by name, type, description, par value, current market value, maturity date, and Moody's or Standard & Poor's rating, if

applicable. The City and the financial institution shall jointly assume the responsibility for ensuring that the collateral is sufficient.

**C. Collateralized Deposits** - Consistent with the requirements of State law, the City requires all bank deposits to be federally insured or collateralized with eligible securities. Financial institutions serving as City depositories will be required to sign a "Depository Agreement" with the City and the City's safekeeping agent. The collateralized deposit portion of the Agreement shall define the City's rights to the collateral in the event of default, bankruptcy, or closing and shall establish a perfected security interest in compliance with Federal and State regulations, including:

1. Agreement must be in writing;
2. Agreement has to be executed by the Depository and the City contemporaneously with the acquisition of the asset;
3. Agreement must be approved by the Board of Directors or designated committee of the Depository and a copy of the meeting minutes must be delivered to the City; and
4. Agreement must be part of the Depository's "official record" continuously since its execution.

## **XII. INTERNAL CONTROL**

The Investment Officer shall establish a system of written internal controls, which shall be reviewed annually by independent auditors. The controls shall be designed to prevent loss of public funds due to fraud, error, misrepresentation, unanticipated market changes, or imprudent actions. The internal controls are to be reviewed annually in conjunction with an external independent audit. This review will provide assurance of compliance with policies and procedures as specified by this policy. The City, in conjunction with its annual financial audit, shall perform a compliance audit of management controls and adherence to the DISTRICT's established investment policy.

## **XIII. PERFORMANCE**

The DISTRICT's investment portfolio shall be designed to obtain a market rate-of-return on investments consistent with risk constraints and cash flow requirements of the DISTRICT. This investment policy establishes "weighted average yield to maturity" as the standard portfolio performance measurement.

## **XIV. REPORTING**

**A. Quarterly** - The Director of Finance shall prepare and submit a signed quarterly investment report to the Corinth Crime Control and Prevention District Board and the Finance Audit Committee that summarizes current market conditions, economic developments, and anticipated investment conditions. The report shall summarize investment strategies employed in the most recent quarter and describe the portfolio in terms of investment securities, maturities, risk characteristics, and shall explain the total investment return for the quarter. The City shall also monitor the credit ratings on securities that require minimum ratings. This may be accomplished through staff

research, or with the assistance of broker-dealers, investment advisors, banks or safekeeping agents.

- B. Annual Report** - Within 180 days of the end of the fiscal year, the Director of Finance shall present an annual report on the investment program and investment activity. This report may be presented as a component of the fourth quarter report to the Corinth Crime Control and Prevention District Board, City Manager and the City Council. The quarterly reports prepared by the Director of Finance shall be formally reviewed at least annually by an independent auditor, and the result of the review shall be reported to the City Council by that auditor.
- C. Methods** - The quarterly and annual investment reports shall include a succinct management summary that provides a clear picture of the status of the current investment portfolio and transactions made over the past quarter. This management summary will be prepared in a manner which will allow the DISTRICT to ascertain whether investment activities during the reporting period have conformed to the investment policy. The report will be prepared in compliance with generally accepted accounting principles. The report will include the following:
1. A listing of individual securities held at the end of the reporting period. This list will include the name of the fund or pooled group fund for which each individual investment was acquired;
  2. Unrealized gains or losses resulting from appreciation or depreciation by listing the beginning and ending book and market value of securities for the period. Market values shall be obtained from financial institutions or portfolio reporting services independent from the broker/dealer from which the security was purchased;
  3. Additions and changes to the market value during the period;
  4. Fully accrued interest for the reporting period;
  5. Average weighted yield to maturity of portfolio on entity investments as compared to applicable benchmarks;
  6. Listing of investments by maturity date;
  7. The percentage of the total portfolio which each type of investment represents; and
  8. Statement of compliance of the DISTRICT's investment portfolio with State Law and the investment strategy and policy approved by the City Council.
  9. Market yield benchmark comparison of the average 90-day U. S. Treasury Bill auction yield during the reporting period.
  10. The guidelines of retaining records for seven years as recommended in the *Texas State Library Municipal Records Manual* should be followed. The Director of Finance shall oversee the filing and/or storing of investment records.

**XV. INVESTMENT POLICY ADOPTION AND AMENDMENT**

The DISTRICT's investment policy shall be reviewed by the Corinth Crime Control and Prevention District and formally adopted and amended by resolution by the City Council. The CITY's written policies and procedures for investments are subject to review not less than annually to stay current with changing laws, regulations and needs of the CITY. The City Council, not less than annually, shall adopt a written instrument stating that it has reviewed the investment policy and investment strategies and that the written instrument so adopted shall record any changes made to either the policy or strategies.

## **Attachment A**

CITY OF CORINTH, TEXAS  
Corinth Crime Control and Prevention District  
Investment Strategy Statement

### **Operating Funds**

1. Suitability - Any investment eligible in the investment policy is suitable for Operating Funds.
2. Safety of Principal - All investments shall be of high quality securities with no perceived default risk. Market price fluctuations will occur. However, by managing the weighted average days to maturity for the Operating Fund's portfolio to less than 270 days and restricting the maximum allowable maturity to two years, the price volatility of the overall portfolio will be minimized.
3. Marketability - Securities with active and efficient secondary markets are necessary in the event of an unanticipated cash flow requirement. Historical market "spreads" between the bid and offer prices of a particular security-type of less than a quarter of a percentage point will define an efficient secondary market.
4. Liquidity - The Operating Fund requires the greatest short-term liquidity of any of the Fund types. Short-term investment pools and money market mutual funds will provide daily liquidity and may be utilized as a competitive yield alternative to fixed maturity investments.
5. Diversification - Investment maturities should be staggered throughout the budget cycle to provide cash flow based on the anticipated operating needs of the DISTRICT. Market cycle risk will be reduced by diversifying the appropriate maturity structure out through two years.
6. Yield - Attaining a competitive market yield for comparable security-types and portfolio restrictions is the desired objective. The yield of an equally weighted, rolling three-month treasury-bill portfolio will be the minimum yield objective.

### **Reserve Funds**

1. Suitability - Any investment eligible in the investment policy is suitable for Debt Service Reserve Funds. Bond resolution and loan documentation constraints and insurance company restrictions may create specific considerations in addition to the investment policy.
2. Safety of Principal - All investments shall be of high quality securities with no perceived default risk. Market price fluctuations will occur. However, managing Debt Service Reserve Fund maturities to not exceed the call provisions of the borrowing reduces the investment's market risk if the DISTRICT debt is redeemed and the Reserve Fund liquidated. The fund shall maintain a maximum average dollar-weighted maturity, based on the stated maturity date, of less than three hundred sixty-five (365) days. No stated final investment maturity shall exceed the shorter of the final maturity of the

borrowing or two years. Annual mark-to-market requirements or specific maturity and average life limitations within the borrowing's documentation will influence the attractiveness of market risk and reduce the opportunity for maturity extension.

3. Marketability - Securities with less active and efficient secondary markets are acceptable for Debt Service Reserve Funds.
4. Liquidity – Debt Service Reserve Funds have no anticipated expenditures. The Funds are deposited to provide annual debt service payment protection to the DISTRICT's debt holders. The funds are "returned" to the DISTRICT at the final debt service payment. Market conditions and arbitrage regulation compliance determine the advantage of security diversification and liquidity. Generally, if investment rates exceed the cost of borrowing, the DISTRICT is best served by locking in investment maturities and reducing liquidity. If the borrowing cost cannot be exceeded, then concurrent market conditions will determine the attractiveness of locking in maturities or investing shorter and anticipating future increased yields.
5. Diversification - Market conditions and the arbitrage regulations influence the attractiveness of staggering the maturity of fixed rate investments for Debt Service Reserve Funds. At no time shall the final debt service payment date of the bond issue be exceeded in an attempt to bolster yield.
6. Yield - Achieving a positive spread to the applicable borrowing cost is the desired objective. Debt Service Reserve Fund portfolio management shall at all times operate within the limits of the investment policy's risk constraints.

### **Bond Funds**

1. Suitability - Any investment eligible in the investment policy is suitable for Bond Funds.
2. Safety of Principal - All investments will be of high quality securities with no perceived default risk. Market price fluctuations will occur. However, by managing Bond Funds to not exceed the shorter of two years or the anticipated expenditure schedule and maintaining a maximum average dollar-weighted maturity, based on the stated maturity date, of less than three hundred sixty-five (365) days the market risk of the overall portfolio will be minimized.
3. Marketability - Securities with active and efficient secondary markets are necessary in the event of an unanticipated cash flow requirement. Historical market "spreads" between the bid and offer prices of a particular security-type of less than a quarter of a percentage point will define an efficient secondary market.
4. Liquidity – Bond Funds used for capital improvements programs have reasonably predictable draw down schedules. Therefore investment maturities should generally follow the anticipated cash flow requirements. Investment pools and money market mutual funds will provide readily available funds generally equal to one month's anticipated cash flow needs, or a competitive yield alternative for short term fixed maturity investments. A singular repurchase agreement may be utilized if disbursements are allowed in the amount necessary to satisfy any expenditure request. This investment structure is commonly referred to as a flexible repurchase agreement.

5. Diversification - Market conditions and arbitrage regulations influence the attractiveness of staggering the maturity of fixed rate investments for construction, loan and bond proceeds. Generally, when investment rates exceed the applicable cost of borrowing, the DISTRICT is best served by locking in most investments. If the cost of borrowing cannot be exceeded, then concurrent market conditions will determine the attractiveness of diversifying maturities or investing in shorter and larger amounts. At no time shall the anticipated expenditure schedule be exceeded in an attempt to bolster yield.
  
6. Yield - Achieving a positive spread to the cost of borrowing is the desired objective, within the limits of the investment policy's risk constraints. The yield of an equally weighted, rolling six-month treasury-bill portfolio will be the minimum yield objective for non-borrowed funds.

**Attachment B**

CITY OF CORINTH, TEXAS  
Investment Policy

[SAMPLE]  
TEXAS PUBLIC FUNDS INVESTMENT ACT  
CERTIFICATION BY BUSINESS ORGANIZATION

This certification is executed on behalf of the CITY of Corinth, Texas (the "CITY") and \_\_\_\_\_ (the Business Organization), pursuant to the Public Funds Investment Act, Chapter 2256, Texas Government Code (the "Act") in connection with investment transactions conducted between the CITY and the Business Organization.

The undersigned Qualified Representative of the Business Organization hereby certifies on behalf of the Business Organization that:

1. The undersigned is a Qualified Representative of the Business Organization offering to enter an investment transaction with the Investor as such terms are used in the Public Funds Investment Act, Chapter 2256, Texas Government Code; and
2. The Qualified Representative of the Business Organization has received and reviewed the investment policy furnished by the CITY; and
3. The Qualified Representative of the Business Organization has implemented reasonable procedures and controls in an effort to preclude investment transactions conducted between the Business Organization and the CITY that are not authorized by the CITY's investment policy, except to the extent that this authorization is dependent on an analysis of the makeup of the CITY's entire portfolio or requires an interpretation of subjective investment standards.

Qualified Representative of Business Organization

Firm: \_\_\_\_\_

Signature \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

Date: \_\_\_\_\_

# **CITY OF CORINTH, TEXAS INVESTMENT POLICY**

## **PREFACE**

It is the policy of the City of Corinth (the "City") that after allowing for the anticipated cash flow requirements and giving due consideration to the safety and risks of investments, all available funds shall be invested in conformance with these legal and administrative guidelines to obtain a market rate-of-return.

Effective cash management is recognized as essential to good fiscal management. An active cash management and investment policy will be pursued to take advantage of investment interest as a viable and material source of revenue for City funds. The City's portfolio shall be designed and managed in a manner responsive to the public trust and shall be invested in conformance with State and Federal Regulations, applicable Bond Resolution requirements, and adopted investment policy. The City will invest public funds in a manner which will provide the maximum security and a market rate-of-return while meeting the daily cash flow demands of the City.

The City is required under the Public Funds Investment Act (Chapter 2256 of the Texas Government Code) to adopt a formal written investment policy for the investment of public funds. These policies serve to satisfy the statutory requirement (specifically the Public Funds Investment Act, Chapter 2256 of the Texas Government Code [the Act]) to define, adopt and review a formal investment strategy and policy.

## I. PURPOSE

The purpose of this investment policy (the “policy”) is to set forth specific investment policy and strategy guidelines for the City in order to achieve the goals of safety, liquidity, rate-of-return, and public trust for all investment activities.

## II. SCOPE

The investment policy shall govern the investment of all financial assets considered to be part of the City and includes the following separately invested funds or fund types: Operating, Reserve, Bond, Special and Capital Project Funds and any other funds which have been contractually delegated to the City for management purposes. The City may add or delete funds as may be required by law, or for proper accounting procedures. This policy does not include funds governed by approved trust agreements, or assets administered for the benefit of the City by outside agencies under retirement or deferred compensation programs. In addition to this policy, bond funds (including debt service and reserve funds) are governed by bond ordinances and are subject to the provisions of the Internal Revenue Code and applicable federal regulations governing the investment of bond proceeds. The City shall and will maintain responsibility for these funds to the extent required by: Federal and State law; the City Charter; and donor stipulations.

## III. INVESTMENT OBJECTIVES

Funds of the City shall be invested in accordance with all applicable Texas statutes, this policy and any other approved, written administrative procedures. The five objectives of the City’s investment activities shall be as follows (in the order of priority):

- A. Safety - Preservation and safety of Principal. Safety of principal invested is the foremost objective in the investment decisions of the City. Each investment transaction shall seek to ensure the preservation of capital in the overall portfolio. The risk of loss shall be controlled by investing only in authorized securities as defined in this policy, by qualifying the financial institutions with which the City will transact, and by portfolio diversification. Safety is defined as the undiminished return of the principal on the City’s investments.
- B. Liquidity - The investment portfolio shall be managed to maintain liquidity to ensure that funds will be available to meet the City’s cash flow requirements and by investing in securities with active secondary markets. Investments shall be structured in such a manner as to provide liquidity necessary to pay obligations as they become due. A security may be liquidated prior to its stated maturity to meet unanticipated cash requirements or to otherwise favorably adjust the City’s portfolio.
- C. Diversification - Investment maturities shall be staggered throughout the budget cycle to provide cash flow based on the anticipated needs of the City. Diversifying the appropriate maturity structure will reduce market cycle risk.
- D. Market Rate-of-Return (Yield) - The City’s investment portfolio shall be designed to optimize a market rate-of-return on investments consistent with risk constraints and cash flow requirements of the portfolio. The investment portfolio shall be managed in a manner which seeks to attain a market rate-of-return throughout budgetary and economic cycles. The City will not attempt to consistently attain an unrealistic above

market rate-of-return, as this objective will subject the overall portfolio to greater risk. Therefore, the City's rate-of-return objective is secondary to those of safety and liquidity. Rate-of-return (yield) is defined as the annual income returned on an investment, expressed as a percentage.

- E. Public Trust - The Investment Officer(s) shall avoid any transactions that might impair public confidence in the City's ability to govern effectively. The governing body recognizes that in diversifying the portfolio, occasional measured losses due to market volatility are inevitable, and must be considered within the context of the overall portfolio's investment return, provided that adequate diversification has been implemented. The prudence of the investment decision shall be measured in accordance with the tests set forth in Section 2256.006(b) of the Act.

#### **IV. INVESTMENT STRATEGY**

The City maintains a comprehensive and proactive cash management program which is designed to monitor and control all City funds to ensure maximum utilization and yield a market rate-of-return. The basic and underlying strategy of this program is that all of the City's funds are earning interest. It is the responsibility and obligation of the City to maintain a flexible approach and be prepared to modify the investment strategy as market conditions dictate. The investment strategy described is predicated on conditions as they now exist and are subject to change. The investment strategy emphasizes low credit risk, diversification, and the management of maturities. The strategy also considers the expertise and time constraints of the Investment Officers. The allowable investments as defined in Section VII of this policy reflect the avoidance of credit risk. Diversification refers to dividing investments among a variety of securities offering independent returns. This strategy uses local government investment pools to achieve diversification. The active management of maturities refers to structuring the maturity dates of the direct investments so that, while funds are initially invested for a longer period of time, some investments mature as cash needs require. The strategies for the City's investment activities shall be as follows:

##### **Strategy No. 1**

Diversifying the City's investment opportunities through the use of local government investment pools and money market mutual funds as authorized by the City Council. An investment pool is a professionally managed portfolio of shared assets created to invest public funds jointly on behalf of the governmental entities that participate in the pool and whose investment objectives in order of priority match those objectives of the City. Fund withdrawals are usually available from investment pools on a same-day basis, meaning the pools have a high degree of liquidity. Because of the size and expertise of their staff, investment pools are able to prudently invest in a variety of the investment types allowed by state law. In this manner, investment pools achieve desired diversification. The strategy of the City calls for the use of investment pools as a primary source of diversification and a supplemental source of liquidity. Funds that may be needed on a short-term basis but are in excess of the amount maintained at the depository bank are available for deposit in investment pools.

**Strategy No. 2**

Building a ladder of authorized securities with staggered maturities for all or part of the longer-term investable funds. The benefits of this ladder approach include the following:

- A. It is straight-forward and easily understood;
- B. It will assure the City that it will capture a reasonable portion of the yield curve; and,
- C. It provides predictable cash flow with scheduled maturities and reinvestment opportunities.

**Strategy No. 3**

Utilizing the services of a Professional Investment Advisor in order to maximize investment earnings and realize market opportunities when they become available. Other responsibilities of the Investment Advisor include, but are not limited to broker compliance, security selection, competitive bidding, investment reporting, and security documentation. The Investment Advisor must be registered with the Securities and Exchange Commission (SEC) under the Investment Advisor's Act of 1940, as well as, with the Texas State Securities Board and shall adhere to the spirit and philosophy of this policy and avoid recommending or suggesting transactions outside the "Standard of Care" under this policy.

**Strategy No. 4**

The City will utilize five general investment strategies designed to address the unique characteristics of specific fund-types (detailed strategies are presented in Attachment A):

- A. Investment strategies for operating funds and pooled funds containing operating funds have as their primary objective to assure that anticipated cash flows are matched with adequate investment liquidity. The secondary objective is to create a portfolio which will experience minimal volatility during economic cycles.
- B. Investment strategies for debt service funds shall have as the primary objective the assurance of investment liquidity adequate to cover the debt service obligation on the required payment date(s).
- C. Investment strategies for debt service reserve funds shall have as the primary objective the ability to generate a dependable revenue stream to the appropriate debt service fund.
- D. Investment strategies for special projects and capital projects funds will have as their primary objective to assure that anticipated cash flows are matched with adequate investment liquidity.
- E. The investment maturity of bond proceeds (excluding reserve and debt service funds) shall generally be limited to the anticipated cash flow requirement or the "temporary period," as defined by Federal tax law. During the temporary period, bond proceeds may be invested at an unrestricted yield. After the expiration of the temporary period, bond proceeds subject to yield restriction shall be invested considering the anticipated cash flow requirements of the funds and market conditions to achieve compliance with the applicable regulations.

### **Strategy No. 5**

The City generally intends to hold all of its securities until they mature and will accomplish this by maintaining sufficient liquidity in its portfolio so that it does not need to sell a security early. Should it become necessary to sell a security prior to maturity, where the sale proceeds are less than the current book value, the prior written consent of the City Manager must be obtained. Securities may be sold prior to maturity by the Director of Finance at or above their book value at any time, without the consent of the City Manager.

### **Strategy No. 6**

All demand deposits of the City will be concentrated with one central depository. The City's depository procedure will maximize the City's ability to pool cash for investment purposes, and provide more manageable banking relationships. In addition, depositories not holding demand deposits of the City may be eligible to bid on City investments.

### **Strategy No. 7**

This policy shall further seek to maintain good depository bank relationships while minimizing the cost of banking services. The City will seek to maintain a depository contract which will be managed to a level that minimizes the cost of the banking relationship to the City, while allowing the City to earn an appropriate return on idle demand deposits.

### **Strategy No. 8**

A single pooled fund group, as defined in this policy, may be utilized at the discretion of the Investment Officer(s). However, earnings from investments will be allocated on a pro-rata cash basis to the individual funds and used in a manner that will best service the interests of the City.

### **Strategy No. 9**

Procedures shall be established and implemented in order to maximize investable cash by decreasing the time between the actual collection and the deposit of receipts, and by the controlling of disbursements.

## **V. FINANCE AUDIT COMMITTEE**

- A. Members** - There is hereby created a Finance Audit Committee consisting of the ~~City Manager, Director of Finance, a secondary Investment Officer designated by the Director of Finance~~ Mayor, two members of the City Council and two citizens appointed by the City Council ~~by majority vote~~. The Mayor will be a permanent member of the Committee. The other four members of the Committee will be appointed by the City Council to serve a two-year term and shall not exceed two successive terms. The Mayor and the two members of the City Council shall be voting members of the Committee. The Community Representative members shall be non-voting members of the Committee.
- B. Scope** - The Finance Audit Committee shall meet at least once per calendar quarter ~~annually~~ to determine general strategies and to monitor results. Included in its deliberations will be such topics as: economic outlook, portfolio diversification, maturity structure, potential risk to the City's funds, authorized brokers and dealers, and the target rate-of-return on the investment portfolio.
- C. Procedures** - The Finance Audit Committee shall provide minutes of its meetings. Any

two members of the Finance Audit Committee may request a special meeting, and a majority of the members shall constitute a quorum. The Finance Audit Committee shall establish its own rules of procedures. The Finance Audit Committee shall abide by the Rules of Procedure and Policies as set forth in Resolution 09-05-01-11, as amended, and the Charter of the City of Corinth.

## VI. RESPONSIBILITY AND STANDARD OF CARE

- A. The responsibility for the daily operation and management of the City's investments shall be outlined within this section.
1. Delegation of Authority - Management responsibility for the investment program is hereby delegated to the Director of Finance, who shall be authorized to deposit, withdraw, invest, transfer or manage the funds of the City and shall establish written procedures for the operation of the investment program, consistent with this policy. Such procedures shall include explicit delegation of authority to other persons responsible for investment transactions. All persons involved in investment activities will be referred to in this policy as "Investment Officers." No persons may engage in investment transactions, except as provided under the terms of this policy and the procedures established by the Director of Finance.
  2. The Director of Finance shall assume responsibility for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate Investment Officers. The system of controls shall be designed to provide reasonable assurance that ensures the assets of the City are protected from loss, theft or misuse. The concept of reasonable assurance recognizes that:
    - a. The cost of control should not exceed the benefits likely to be derived; and,
    - b. The valuation of costs and benefits requires estimates and judgments by management.
  3. The Director of Finance shall be designated as the primary Investment Officer for the City and shall be responsible for investment decisions and activities under the direction of the City Manager. The Director of Finance may delegate any phase of the investment program to a secondary Investment Officer. Both the Director of Finance and the designated secondary Investment Officer are responsible for daily investment decisions and activities. However, ultimate responsibility for investment decisions will rest with the Director of Finance.
- B. Prudence - The standard of prudence to be applied by the Investment Officer shall be the "prudent investor" rule, which states, "investments shall be made with judgment and care, under prevailing circumstances, that a person of prudence, discretion and intelligence would exercise in the management of the person's own affairs, not for speculation, but for investment, considering the probable safety of capital and the probable income to be derived." In determining whether the Investment Officer has exercised prudence with respect to an investment decision, the determination shall be made taking into consideration the following:
1. The investment of all funds over which the Investment Officer had responsibility rather than a consideration as to the prudence of a single investment; and

2. The investment decision was consistent with the written investment policy and procedures of the City.
- C. Due Diligence** - The Director of Finance, designated secondary Investment Officer, Mayor, City Council, City Manager, other Finance employees and citizen committee members acting in accordance with written policies and procedures and exercising due diligence, shall not be held personally responsible for a specific security's credit risk or market price changes, provided that these deviations are reported in a timely manner and that appropriate action is taken to control adverse developments.
- D. Ethical Standards and Conflicts of Interest**
1. All City Investment Officials having a direct or indirect role in the investment of City funds shall act as custodians of the public trust avoiding any transaction which might involve a conflict of interest, the appearance of a conflict of interest, or any activity which might otherwise discourage public confidence. Officers and employees involved in the investment process shall refrain from personal business activity that could conflict with proper execution of the investment program, or which could impair the ability to make impartial investment decisions.
  2. An Investment Officer who has a personal business relationship with the depository bank or with any entity seeking to sell an investment to the City shall file a statement disclosing that personal business interest.
  3. An Investment Officer has a personal business relationship with a business organization if:
    - a. The Investment Officer or one related to the Investment Officer within the second degree of affinity or consanguinity owns 10% or more of the voting stock or shares of the business organization or owns \$5,000 or more of the fair market value of the business organization;
    - b. Funds received by the Investment Officer or one related to the Investment Officer within the second degree of affinity or consanguinity from the business organization exceed 10% of the Investment Officers gross income for the prior year; or
    - c. The Investment Officer or one related to the Investment Officer within the second degree of affinity or consanguinity has acquired from the business organization during the prior year investments with a book value of \$2,500 or more for the personal account of the Investment Officer.
    - d. An Investment Officer who is related within the second degree of affinity or consanguinity to an individual seeking to sell an investment to the City shall file a statement disclosing that relationship. A statement required under this subsection must be filed with the Texas Ethics Commission and the City Council.
- E. Training** - The City shall provide periodic training in investments for the investment personnel through courses and seminars offered by professional organizations and associations in order to ensure the quality and capability of the City's investment

personnel making investment decisions in compliance with the Public Funds Investment Act (PFIA). The Investment Officers and the Finance Audit Committee members shall attend at least one training session containing at least 10 hours of instruction relating to the officer's responsibility under the PFIA within 12 months after assuming duties, and thereafter shall attend at least 8 hours of additional investment training in subsequent two-year periods which begin on the first day of the fiscal year and consist of the two consecutive fiscal years after that date. The Government Finance Officers Association of Texas, the Government Treasurers Organization of Texas, the Texas Municipal League, or the North Central Texas Council of Governments are approved as independent training sources by the City Council.

## VII. AUTHORIZED INVESTMENTS

- A. Generally - Safety of principal is the primary objective in investing public funds and can be accomplished by limiting credit risk and interest rate risk. Credit risk is the risk associated with the failure of a security issuer or backer to pay back principal and interest on a timely basis. Interest rate risk is the risk that the value of a portfolio will decline due to an increase in the general level of interest rates. In order to provide for safety of principal as the City's primary objective, only certain investments are authorized as acceptable investments for the City. The following list of authorized investments for the City intentionally excludes some investments authorized by state law. These restrictions are intended to limit possible risk and provide the maximum measure of safety to City funds. In the event an authorized investment loses its required minimum credit rating, all prudent measures will be taken to liquidate said investment. Additionally, the City is not required to liquidate investments that were authorized at the time of purchase.
- B. Authorized and Acceptable Investments - The authorized list of investment instruments is as follows:
1. Obligations of the United States or its agencies and instrumentalities or any obligation fully guaranteed or insured by the Federal Deposit Insurance Corporation (FDIC), *excluding mortgage-backed securities*.
  2. Direct obligations of the State of Texas, or its agencies and instrumentalities, other obligations, the principal of and interest on which are unconditionally guaranteed or insured by, or backed by the full faith and credit of, the State of Texas or the United States or their respective agencies and instrumentalities, excluding mortgage-related securities.
- C. Certificates of Deposit - A certificate of deposit issued by a depository institution that has its main office or branch office in this state and is secured in accordance with the specific collateralization requirements contained in section XI.B of this policy. In addition, an investment in "bundled" or "shared" CDs made in accordance with the following conditions is permitted:
1. The funds are invested through a broker that has its main office or a branch office in this state selected from a list adopted by the City as required by Section 2256.025; or through a depository institution that has its main office or a branch office in this state and that is selected by the City;

2. The selected broker or depository institution arranges for the deposit of the funds in certificates of deposit in one or more federally insured depository institutions, wherever located, for the account of the City.
  3. The full amount of the principal and accrued interest of each of the CD is insured by the United States or an instrumentality of the United States; and
  4. The City appoints the depository institution, a clearing broker-dealer registered with the Securities and Exchange Commission and operating pursuant to SEC Rule 15c3-3, or an entity described in the Public Funds Collateral Act, Section 2257.041(d), as custodian for the City with respect to those CDs issued for the City's account.
- D. Eligible Local Government Investment Pools - AAA-rated public funds investment pools, with a weighted average maturity of 60 days or less, individually approved by formal Council resolution, which invest in instruments and follow practices allowed by the current law as defined in Section 2256.016 of the Texas Government Code. The pool must be continuously rated no lower than AAA or AAA-m or at an equivalent rating by at least one nationally recognized rating service. A public funds investment pool created to function as a money market mutual fund must mark to market daily and stabilize at a \$1 net asset value.
- E. Repurchase Agreements - Fully collateralized repurchase agreements having a defined termination date, placed through a primary government securities dealer or a financial institution doing business in the State of Texas, and fully secured by cash and obligations of the United States or its agencies and instrumentalities. This collateral must be pledged to the City and held in safekeeping with a third-party custodian approved by the City of Corinth. All collateral must be maintained at a market value of no less than the principal amount of the outstanding funds disbursed. All transactions shall be governed by signed Security Industry and Financial Markets Association, (SIFMA) Master Repurchase Agreement. Repurchase agreements must also be collateralized in accordance with State law as described in Section XI of this policy. Authorization under this section includes flexible repurchase agreements which may be used for specific investment of bond proceeds *but shall not include reverse repurchase agreements*.
- F. Bankers' Acceptances, and Commercial Paper (LIMITED USE) - These investments are authorized for the City to the extent that they are contained in the portfolios of approved public funds investment pools or money market funds in which the City invests.
- G. AAA-rated SEC-Regulated 2a7 No-Load Money Market Mutual Funds - An SEC-registered, no load money market mutual fund which has a dollar weighted average stated maturity of 60 days or less whose assets consist exclusively of the assets described in section VII.A. and whose investment objectives includes the maintenance of a stable net asset value of \$1 for each share: furthermore, it provides the City with a prospectus and other information required by the SEC Act of 1934 or the Investment Advisor Act of 1940 and which provides the City with a prospectus and other information required by the Securities Exchange Act of 1934 (15 USC Section 78a et. Seq.) or the Investment Company Act of 1990 (15 USC Section 80a-1 et. Seq.).

**H. Unauthorized Securities** - State law specifically prohibits investment in the following securities:

1. An obligation whose payment represents the coupon payments on the outstanding principal balance of the underlying mortgage-backed security and pays no principal.
2. An obligation whose payment represents the principal stream of cash flow from the underlying mortgage-backed security and bears no interest.
3. Collateralized mortgage obligations that have a stated final maturity date of greater than 10 years.
4. Collateralized mortgage obligations, the interest rate of which is determined by an index that adjusts opposite to the changes in a market index.

**VIII. DIVERSIFICATION**

**A. Generally** - Diversification of investment instruments shall be utilized to avoid incurring unreasonable risks resulting from over-concentration of investments in a specific maturity, a specific issue, or a specific class of securities. With the exception of U.S. Government securities (debt obligations issued by the U. S. Government, its agencies, or instrumentalities) as authorized in this policy, and authorized local government investment pools, no more than forty percent (40%) of the total investment portfolio will be invested in any one security type or with a single financial institution. Diversification of the portfolio considers diversification by maturity dates and diversification by investment instrument.

**B. Diversification by Maturities** - The longer the maturity of investments, the greater their price volatility. Therefore, it is the City's policy to concentrate its investment portfolio in shorter-term securities in order to limit principal risks caused by change in interest rates. The City will attempt to match its investments with anticipated cash flow requirements. Unless matched to a specific cash flow (including the anticipated cash flow requirements of bond proceeds within the temporary period), the City will not directly invest in securities maturing more than three (3) years from the date of purchase. However, the above described obligations, certificates, or agreements may be collateralized using longer date instruments. The City shall diversify the use of investment instruments to avoid incurring unreasonable risks inherent in over-investing in specific instruments, individual financial institutions or maturities. Maturity scheduling shall be managed by the Investment Officer so that maturities of investments shall be timed to coincide with projected cash flow needs.

The entire City portfolio, or single pooled fund group if utilized, shall maintain a maximum average dollar-weighted maturity, based on the stated maturity date, of less than three hundred sixty five (365) days. Investment maturities for debt service interest and sinking funds and/or other types of reserve funds, whose use is never anticipated, shall maintain a maximum average dollar-weighted maturity, based on the stated maturity date, of less than three hundred sixty-five (365) days.

- C. Diversification by Investment Instrument - Diversification by investment instrument shall not exceed the following guidelines for each type of instrument:

	Maximum % of Portfolio
U.S. Treasury Obligations	100%
U.S. Government Agency Securities and Instrumentalities	100%
Authorized Local Government Investment Pool	50%
Local Government Obligations	10%
Fully Collateralized Certificates of Deposit	50%
Fully Collateralized Repurchase Agreements	25%
SEC-Regulated No-Load Money Market Mutual Fund	50%
U.S. Treasury & Agency Callables	30%

**IX. SECURITY SWAPS**

Security swaps may be considered as an investment option for the City. A swap out of one instrument into another is acceptable to increase yield, realign for disbursement dates, extend or shorten maturity dates and to improve market sector diversification. Swaps may be initiated by brokers/dealers who are on the City's approved list. A horizon analysis is required for each swap proving benefit to the City before the trade decision is made, which will accompany the investment file for record keeping.

**X. AUTHORIZED FINANCIAL DEALERS AND INSTITUTIONS**

- A. The Director of Finance will maintain a list of financial institutions authorized to provide investment services to the City. In addition, a list will also be maintained of approved broker/dealers authorized to provide investment services in the State of Texas. These will include financial institutions that qualify under Securities & Exchange Commission Rule 15-C3-1 (uniform net capital rule). No public deposit shall be made except in a qualified public depository as established by state laws.
- B. All financial institutions and broker/dealers who desire to become qualified bidders for investment transactions must supply the Director of Finance with the following, as appropriate: audited financial statements, proof of Financial Industry Regulatory Authority certification trading resolution, proof of State registration, completed broker/dealer questionnaire and certification of having read the City's investment policy.
- C. The Finance Audit Committee shall be responsible for adopting the list of brokers and dealers of government securities. Their selection shall be among only primary government securities dealers that report directly to the New York Federal Reserve Bank, unless a comprehensive credit and capitalization analysis reveals that other firms are adequately financed to conduct public business. The Finance Audit Committee shall base its evaluation of security dealers and financial institutions upon:
  1. Financial conditions, strength and capability to fulfill commitments;
  2. Overall reputation with other dealers or investors;

3. Regulatory status of the dealer;
  4. Background and expertise of the individual representatives.
- D.** Investment Officers shall only conduct business with securities dealers approved by the Finance Audit Committee and will not purchase investments from any financial organization until the organization's registered principal has executed a written instrument stating that he or she has thoroughly reviewed the City's investment policy and acknowledges that reasonable procedures and controls have been implemented to preclude imprudent investment activities arising out of transactions between the organization and the City, except to the extent that this authorization is dependent on an analysis of the makeup of the City's entire portfolio or requires an interpretation of subjective investment standards.
- E.** To guard against default possibilities under these conditions, and to assure diversification of bidders, business with any one issuer, or investment broker, should be limited to forty percent (40%) of the total portfolio at any point in time. In this way, bankruptcy, receivership or legal action would not immobilize the City's ability to meet payroll or other expenses.
- F.** All investments (governments or bank C.D.'s) will be solicited on a competitive basis with at least three (3) institutions. The Finance Audit Committee can approve exceptions on a case by case basis or on a general basis in the form of guidelines. These guidelines shall take into consideration the investment type maturity date, amount, and potential disruptiveness to the City's investment strategy. The investment will be made with the broker/dealer offering the best yield/quality to the City. The quotes may be accepted orally, in writing, electronically, or any combination of these methods.
- G.** An annual review of the financial condition and registrations of qualified financial organizations will be conducted by the Director of Finance.
- H.** A current audited financial statement is required to be on file for each financial institution and broker/dealer in which the City invests.
- I.** If the City has contracted with a Registered Investment Advisor for the management of its funds, the advisor shall be responsible for performing due diligence on and maintaining a list of broker/dealers with which it shall transact business on behalf of the City. The advisor shall determine selection criteria and shall annually present a list of its authorized broker/dealers to the City for review and likewise shall execute the aforementioned written instrument stating that the advisor has reviewed the City's investment policy and has implemented reasonable procedures and controls in an effort to preclude imprudent investment activities with the City. The advisor shall obtain and document competitive bids and offers on all transactions and present these to the City as part of its standard trade documentation.

- J. It is the policy of the City that all security transactions entered into with the City shall be conducted on a “Delivery-versus-Payment” basis through the Federal Reserve System. By doing this, City funds are not released until the City has received, through the Federal Reserve wire, the securities purchased. The City shall authorize the release of funds only after receiving notification from the safekeeping bank that a purchased security has been received in the safekeeping account of the City. The notification may be oral, but shall be confirmed in writing.

## XI. SAFEKEEPING AND COLLATERALIZATION

- A. Safekeeping - All securities owned by the City shall be held by a third-party safekeeping agent selected by the City. The collateral for bank deposits will be held in the City’s name in the bank’s trust department, in a Federal Reserve Bank account in the City’s name, or third-party financial institutions doing business in the state of Texas, in accordance with state law. Original safekeeping receipts shall be obtained and held by the City. The City shall contract with a bank or banks for the safekeeping of securities either owned by the City as part of its investment portfolio or held as collateral to secure time deposits.
- B. Collateralization - Consistent with the requirements of the Public Funds Collateral Act, it is the policy of the City to require full collateralization of all City funds on deposit with a depository bank. The market value of the investments securing the deposit of funds shall be at least equal to 102% of the amount of the deposits of funds reduced to the extent that the deposits are insured by the Federal Deposit Insurance Corporation (FDIC). Securities pledged as collateral shall be held by an independent third party with whom the City has a current custodial agreement. The agreement is to specify the acceptable investment securities as collateral, including provisions relating to possession of the collateral, the substitution or release of investment securities, ownership of securities, and the method of valuation of securities. The safekeeping agreement must clearly state that the safekeeping bank is instructed to release purchased and collateral securities to the City in the event the City has determined that the depository bank has failed to pay on any matured investments in certificates of deposit, or has determined that the funds of the City are in jeopardy for whatever reason, including involuntary closure or change of ownership. A clearly marked evidence of ownership, e.g., safekeeping receipt, must be supplied to the City and retained by the City.
  - 1. The City may accept the following to insure or collateralize bank deposits:
    - a. Guaranteed or insured by the Federal Deposit Insurance Corporation or its successor or the National Credit Union Share Insurance Fund or its successor;
    - b. United States Treasuries & Agencies
    - c. Other securities as approved by the Finance Audit Committee
  - 2. For certificates of deposit and other evidences of deposit, collateral shall be at 102% of market value. The market value of collateral will always equal or exceed 102% of the principal plus accrued interest of deposits at financial institutions.
  - 3. Financial institutions with which the City invests or maintains other deposits shall provide monthly, and as requested by the Investment Officer, a listing of the

collateral pledged to the City, marked to current market prices. The listing shall include total pledged securities itemized by name, type, description, par value, current market value, maturity date, and Moody's or Standard & Poor's rating, if applicable. The City and the financial institution shall jointly assume the responsibility for ensuring that the collateral is sufficient.

**C. Collateralized Deposits** - Consistent with the requirements of State law, the City requires all bank deposits to be federally insured or collateralized with eligible securities. Financial institutions serving as City depositories will be required to sign a "Depository Agreement" with the City and the City's safekeeping agent. The collateralized deposit portion of the Agreement shall define the City's rights to the collateral in the event of default, bankruptcy, or closing and shall establish a perfected security interest in compliance with Federal and State regulations, including:

1. Agreement must be in writing;
2. Agreement has to be executed by the Depository and the City contemporaneously with the acquisition of the asset;
3. Agreement must be approved by the Board of Directors or designated committee of the Depository and a copy of the meeting minutes must be delivered to the City; and
4. Agreement must be part of the Depository's "official record" continuously since its execution.

## **XII. INTERNAL CONTROL**

The Investment Officer shall establish a system of written internal controls, which shall be reviewed annually by independent auditors. The controls shall be designed to prevent loss of public funds due to fraud, error, misrepresentation, unanticipated market changes, or imprudent actions. The internal controls are to be reviewed annually in conjunction with an external independent audit. This review will provide assurance of compliance with policies and procedures as specified by this policy. The City, in conjunction with its annual financial audit, shall perform a compliance audit of management controls and adherence to the City's established investment policy.

## **XIII. PERFORMANCE**

The City's investment portfolio shall be designed to obtain a market rate-of-return on investments consistent with risk constraints and cash flow requirements of the City. This investment policy establishes "weighted average yield to maturity" as the standard portfolio performance measurement.

## **XIV. REPORTING**

**A. Quarterly** - The Director of Finance shall prepare and submit a signed quarterly investment report to the Finance Audit Committee that summarizes current market conditions, economic developments, and anticipated investment conditions. The report shall summarize investment strategies employed in the most recent quarter and describe the portfolio in terms of investment securities, maturities, risk characteristics,

and shall explain the total investment return for the quarter. The City shall also monitor the credit ratings on securities that require minimum ratings. This may be accomplished through staff research, or with the assistance of broker-dealers, investment advisors, banks or safekeeping agents.

- B. Annual Report** - Within 180 days of the end of the fiscal year, the Director of Finance shall present an annual report on the investment program and investment activity. This report may be presented as a component of the fourth quarter report to the City Manager and City Council. The quarterly reports prepared by the Director of Finance shall be formally reviewed at least annually by an independent auditor, and the result of the review shall be reported to the City Council by that auditor.
- C. Methods** - The quarterly and annual investment reports shall include a succinct management summary that provides a clear picture of the status of the current investment portfolio and transactions made over the past quarter. This management summary will be prepared in a manner which will allow the City to ascertain whether investment activities during the reporting period have conformed to the investment policy. The report will be prepared in compliance with generally accepted accounting principles. The report will be provided to the City Council. The report will include the following:
1. A listing of individual securities held at the end of the reporting period. This list will include the name of the fund or pooled group fund for which each individual investment was acquired;
  2. Unrealized gains or losses resulting from appreciation or depreciation by listing the beginning and ending book and market value of securities for the period. Market values shall be obtained from financial institutions or portfolio reporting services independent from the broker/dealer from which the security was purchased;
  3. Additions and changes to the market value during the period;
  4. Fully accrued interest for the reporting period;
  5. Average weighted yield to maturity of portfolio on entity investments as compared to applicable benchmarks;
  6. Listing of investments by maturity date;
  7. The percentage of the total portfolio which each type of investment represents; and
  8. Statement of compliance of the City's investment portfolio with State Law and the investment strategy and policy approved by the City Council.
  9. Market yield benchmark comparison of the average 90-day U. S. Treasury Bill auction yield during the reporting period.
  10. The guidelines of retaining records for seven years as recommended in the *Texas State Library Municipal Records Manual* should be followed. The Director of Finance shall oversee the filing and/or storing of investment records.

## **XV. INVESTMENT POLICY ADOPTION AND AMENDMENT**

The City's investment policy shall be adopted and amended by resolution of the City Council only. The City's written policies and procedures for investments are subject to review not less than annually to stay current with changing laws, regulations and needs of the City. The City Council, not less than annually, shall adopt a written instrument stating that it has reviewed the investment policy and investment strategies and that the written instrument so adopted shall record any changes made to either the policy or strategies.

## Attachment A

### CITY OF CORINTH, TEXAS Investment Strategy Statement

#### **Operating Funds**

1. Suitability - Any investment eligible in the investment policy is suitable for Operating Funds.
2. Safety of Principal - All investments shall be of high quality securities with no perceived default risk. Market price fluctuations will occur. However, by managing the weighted average days to maturity for the Operating Fund's portfolio to less than 270 days and restricting the maximum allowable maturity to three years, the price volatility of the overall portfolio will be minimized.
3. Marketability - Securities with active and efficient secondary markets are necessary in the event of an unanticipated cash flow requirement. Historical market "spreads" between the bid and offer prices of a particular security-type of less than a quarter of a percentage point will define an efficient secondary market.
4. Liquidity - The Operating Fund requires the greatest short-term liquidity of any of the Fund types. Short-term investment pools and money market mutual funds will provide daily liquidity and may be utilized as a competitive yield alternative to fixed maturity investments.
5. Diversification - Investment maturities should be staggered throughout the budget cycle to provide cash flow based on the anticipated operating needs of the City. Market cycle risk will be reduced by diversifying the appropriate maturity structure out through two years.
6. Yield - Attaining a competitive market yield for comparable security-types and portfolio restrictions is the desired objective. The yield of an equally weighted, rolling three-month treasury-bill portfolio will be the minimum yield objective.

#### **Reserve Funds**

1. Suitability - Any investment eligible in the investment policy is suitable for Debt Service Reserve Funds. Bond resolution and loan documentation constraints and insurance company restrictions may create specific considerations in addition to the investment policy.
2. Safety of Principal - All investments shall be of high quality securities with no perceived default risk. Market price fluctuations will occur. However, managing Debt Service Reserve Fund maturities to not exceed the call provisions of the borrowing reduces the investment's market risk if the City's debt is redeemed and the Reserve Fund liquidated. The fund shall maintain a maximum average dollar-weighted maturity, based on the stated maturity date, of less than three hundred sixty-five (365) days. No stated final investment maturity shall exceed the shorter of the final maturity of the borrowing or three years. Annual mark-to-market requirements or specific maturity and average life limitations within the borrowing's documentation will influence the

attractiveness of market risk and reduce the opportunity for maturity extension.

3. Marketability - Securities with less active and efficient secondary markets are acceptable for Debt Service Reserve Funds.
4. Liquidity - Debt Service Reserve Funds have no anticipated expenditures. The Funds are deposited to provide annual debt service payment protection to the City's debt holders. The funds are "returned" to the City at the final debt service payment. Market conditions and arbitrage regulation compliance determine the advantage of security diversification and liquidity. Generally, if investment rates exceed the cost of borrowing, the City is best served by locking in investment maturities and reducing liquidity. If the borrowing cost cannot be exceeded, then concurrent market conditions will determine the attractiveness of locking in maturities or investing shorter and anticipating future increased yields.
5. Diversification - Market conditions and the arbitrage regulations influence the attractiveness of staggering the maturity of fixed rate investments for Debt Service Reserve Funds. At no time shall the final debt service payment date of the bond issue be exceeded in an attempt to bolster yield.
6. Yield - Achieving a positive spread to the applicable borrowing cost is the desired objective. Debt Service Reserve Fund portfolio management shall at all times operate within the limits of the investment policy's risk constraints.

### **Special Project and Capital Project Funds**

1. Suitability - Any investment eligible in the investment policy is suitable for Special Project and Capital Project Funds.
2. Safety of Principal - All investments will be of high quality securities with no perceived default risk. Market fluctuations will however occur, by restricting the maximum maturity to three years, managing the weighted average days to less than 270 days, restricting the maximum allowable maturity to two years, and by managing Special Project and Capital Project Funds to balance the short term and long term anticipated cash flow requirements of the plant or equipment being depreciated, replaced or repaired, the market risk of the Fund portfolio will be minimized.
3. Marketability - The balancing of short-term and long-term cash flow needs requires the short-term portion of the Special Project and Capital Project Funds portfolio to have securities with active and efficient secondary markets. Historical market "spreads" between the bid and offer prices of a particular security-type of less than a quarter of a percentage point will define an efficient secondary market. Securities with less active and efficient secondary markets are acceptable for the long-term portion of the portfolio.
4. Liquidity - Special Project and Capital Project Funds used as part of a CIP plan or scheduled repair and replacement program are reasonably predictable. However unanticipated needs or emergencies may arise. Selecting investment maturities that provide greater cash flow than the anticipated needs will reduce the liquidity risk of unanticipated expenditures.

5. Diversification - Investment maturities should blend the short-term and long-term cash flow needs to provide adequate liquidity and yield enhancement and stability. A “barbell” maturity ladder may be appropriate.
6. Yield - Attaining a competitive market yield for comparable security-types and portfolio structures is the desired objective. The yield of an equally weighted, rolling six-month treasury-bill portfolio will be the minimum yield objective.

### **Bond Funds**

1. Suitability - Any investment eligible in the investment policy is suitable for Bond Funds.
2. Safety of Principal - All investments will be of high quality securities with no perceived default risk. Market price fluctuations will occur. However, by managing Bond Funds to not exceed the shorter of three years or the anticipated expenditure schedule and maintaining a maximum average dollar-weighted maturity, based on the stated maturity date, of less than three hundred sixty-five (365) days the market risk of the overall portfolio will be minimized.
3. Marketability - Securities with active and efficient secondary markets are necessary in the event of an unanticipated cash flow requirement. Historical market “spreads” between the bid and offer prices of a particular security-type of less than a quarter of a percentage point will define an efficient secondary market.
4. Liquidity - Bond Funds used for capital improvements programs have reasonably predictable draw down schedules. Therefore investment maturities should generally follow the anticipated cash flow requirements. Investment pools and money market mutual funds will provide readily available funds generally equal to one month’s anticipated cash flow needs, or a competitive yield alternative for short term fixed maturity investments. A singular repurchase agreement may be utilized if disbursements are allowed in the amount necessary to satisfy any expenditure request. This investment structure is commonly referred to as a flexible repurchase agreement.
5. Diversification - Market conditions and arbitrage regulations influence the attractiveness of staggering the maturity of fixed rate investments for construction, loan and bond proceeds. Generally, when investment rates exceed the applicable cost of borrowing, the City is best served by locking in most investments. If the cost of borrowing cannot be exceeded, then concurrent market conditions will determine the attractiveness of diversifying maturities or investing in shorter and larger amounts. At no time shall the anticipated expenditure schedule be exceeded in an attempt to bolster yield.
6. Yield - Achieving a positive spread to the cost of borrowing is the desired objective, within the limits of the investment policy’s risk constraints. The yield of an equally weighted, rolling six-month treasury-bill portfolio will be the minimum yield objective for non-borrowed funds.

**Attachment B**

CITY OF CORINTH, TEXAS  
Investment Policy

[SAMPLE]  
TEXAS PUBLIC FUNDS INVESTMENT ACT  
CERTIFICATION BY BUSINESS ORGANIZATION

This certification is executed on behalf of the City of Corinth, Texas (the "City") and \_\_\_\_\_ (the Business Organization), pursuant to the Public Funds Investment Act, Chapter 2256, Texas Government Code (the "Act") in connection with investment transactions conducted between the City and the Business Organization.

The undersigned Qualified Representative of the Business Organization hereby certifies on behalf of the Business Organization that:

1. The undersigned is a Qualified Representative of the Business Organization offering to enter an investment transaction with the Investor as such terms are used in the Public Funds Investment Act, Chapter 2256, Texas Government Code; and
2. The Qualified Representative of the Business Organization has received and reviewed the investment policy furnished by the City; and
3. The Qualified Representative of the Business Organization has implemented reasonable procedures and controls in an effort to preclude investment transactions conducted between the Business Organization and the City that are not authorized by the City's investment policy, except to the extent that this authorization is dependent on an analysis of the makeup of the City's entire portfolio or requires an interpretation of subjective investment standards.

Qualified Representative of Business Organization

Firm: \_\_\_\_\_

Signature \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

Date: \_\_\_\_\_

**CITY OF CORINTH, TEXAS  
ECONOMIC DEVELOPMENT CORPORATION  
INVESTMENT POLICY**

PREFACE

It is the policy of the City of Corinth the "City" and the Corinth Economic Development Corporation (the "EDC") that after allowing for the anticipated cash flow requirements and giving due consideration to the safety and risks of investments, all available funds shall be invested in conformance with these legal and administrative guidelines to obtain a market rate of return.

Effective cash management is recognized as essential to good fiscal management. An active cash management and investment policy will be pursued to take advantage of investment interest as a viable and material source of revenue for EDC funds. The EDC's portfolio shall be designed and managed in a manner responsive to the public trust and shall be invested in conformance with State and Federal Regulations, applicable Bond Resolution requirements, and adopted investment policy. The EDC will invest public funds in a manner which will provide the maximum security and a market rate of return while meeting the daily cash flow demands of the EDC.

The EDC is required under the Public Funds Investment Act (Chapter 2256 of the Texas Government Code) to adopt a formal written investment policy for the investment of public funds. These policies serve to satisfy the statutory requirement (specifically the Public Funds Investment Act, Chapter 2256 of the Texas Government Code [the Act]) to define, adopt and review a formal investment strategy and policy.

## I. PURPOSE

The purpose of this investment policy (the “policy”) is to set forth specific investment policy and strategy guidelines for the EDC in order to achieve the goals of safety, liquidity, rate-of-return, and public trust for all investment activities.

## II. SCOPE

The investment policy shall govern the investment of all financial assets considered to be part of the EDC and includes the following separately invested funds or fund types: Operating, Reserve, and Bond Funds, although the EDC has only operating funds. This policy does not include funds governed by approved trust agreements, or assets administered for the benefit of the EDC by outside agencies under retirement or deferred compensation programs. The City shall and will maintain responsibility for these funds to the extent required by: Federal and State law; the City Charter; and donor stipulations.

## III. INVESTMENT OBJECTIVES

Funds of the EDC shall be invested in accordance with all applicable Texas statutes, this policy and any other approved, written administrative procedures. The five objectives of the EDC’s investment activities shall be as follows (in the order of priority):

- A. Safety – Preservation and safety of Principal. Safety of principal invested is the foremost objective in the investment decisions of the EDC. Each investment transaction shall seek to ensure the preservation of capital in the overall portfolio. The risk of loss shall be controlled by investing only in authorized securities as defined in this policy, by qualifying the financial institutions with which the EDC will transact, and by portfolio diversification. Safety is defined as the undiminished return of the principal on the EDC’s investments.
- B. Liquidity - The investment portfolio shall be managed to maintain liquidity to ensure that funds will be available to meet the EDC’s cash flow requirements and by investing in securities with active secondary markets. Investments shall be structured in such a manner as to provide liquidity necessary to pay obligations as they become due. A security may be liquidated prior to its stated maturity to meet unanticipated cash requirements or to otherwise favorably adjust the EDC’s portfolio.
- C. Diversification - Investment maturities shall be staggered throughout the budget cycle to provide cash flow based on the anticipated needs of the EDC. Diversifying the appropriate maturity structure will reduce market cycle risk.
- D. Market Rate-of-Return (Yield) - The EDC’s investment portfolio shall be designed to optimize a market rate-of-return on investments consistent with risk constraints and cash flow requirements of the portfolio. The investment portfolio shall be managed in a manner which seeks to attain a market rate-of-return throughout budgetary and economic cycles. The EDC will not attempt to consistently attain an unrealistic above market rate-of-return, as this objective will subject the overall portfolio to greater risk. Therefore, the EDC’s rate-of-return objective is secondary to those of safety and liquidity. Rate-of-return (yield) is defined as the annual income returned on an investment, expressed as a percentage.
- E. Public Trust - The Investment Officer(s) shall avoid any transactions that might impair public confidence in the EDC’s ability to govern effectively. The governing body recognizes that in diversifying the portfolio, occasional measured losses due to market

volatility are inevitable, and must be considered within the context of the overall portfolio's investment return, provided that adequate diversification has been implemented. The prudence of the investment decision shall be measured in accordance with the tests set forth in Section 2256.006(b) of the Act.

#### **IV. INVESTMENT STRATEGY**

The City maintains a comprehensive and proactive cash management program which is designed to monitor and control all EDC funds to ensure maximum utilization and yield a market rate of return. The basic and underlying strategy of this program is that all of the EDC's funds are earning interest. It is the responsibility and obligation of the City to maintain a flexible approach and be prepared to modify the investment strategy as market conditions dictate. The investment strategy described is predicated on conditions as they now exist and are subject to change. The investment strategy emphasizes low credit risk, diversification, and the management of maturities. The strategy also considers the expertise and time constraints of the Investment Officers. The allowable investments as defined in Section VII of this policy reflect the avoidance of credit risk. Diversification refers to dividing investments among a variety of securities offering independent returns. This strategy uses local government investment pools to achieve diversification. The active management of maturities refers to structuring the maturity dates of the direct investments so that, while funds are initially invested for a longer period of time, some investments mature as cash needs require. The strategies for the EDC's investment activities shall be as follows:

##### **Strategy No. 1**

Diversifying the EDC's investment opportunities through the use of local government investment pools and money market mutual funds as authorized by the EDC Board, and the City Council. An investment pool is a professionally managed portfolio of shared assets created to invest public funds jointly on behalf of the governmental entities that participate in the pool and whose investment objectives in order of priority match those objectives of the EDC. Fund withdrawals are usually available from investment pools on a same-day basis, meaning the pools have a high degree of liquidity. Because of the size and expertise of their staff, investment pools are able to prudently invest in a variety of the investment types allowed by state law. In this manner, investment pools achieve desired diversification. The strategy of the EDC calls for the use of investment pools as a primary source of diversification and a supplemental source of liquidity. Funds that may be needed on a short-term basis but are in excess of the amount maintained at the depository bank are available for deposit in investment pools.

##### **Strategy No. 2**

Building a ladder of authorized securities with staggered maturities for all or part of the longer-term investable funds. The benefits of this ladder approach include the following:

- A.** It is straight-forward and easily understood;
- B.** It will assure the EDC that it will capture a reasonable portion of the yield curve; and,
- C.** It provides predictable cash flow with scheduled maturities and reinvestment opportunities.

##### **Strategy No. 3**

Utilizing the services of a Professional Investment Advisor in order to maximize investment earnings and realize market opportunities when they become available. Other responsibilities of the Investment Advisor include, but are not limited to broker compliance,

security selection, competitive bidding, investment reporting, and security documentation. The Investment Advisor must be registered with the Securities and Exchange Commission (SEC) under the Investment Advisor's Act of 1940 as well as with the Texas State Securities Board and shall adhere to the spirit and philosophy of this policy and avoid recommending or suggesting transactions outside the "Standard of Care" under this policy.

#### **Strategy No. 4**

The EDC will utilize a general investment strategy designed to address the unique characteristics of specific fund-types (detailed strategies are presented in Attachment A):

- A. Investment strategies for operating funds and pooled funds containing operating funds have as their primary objective to assure that anticipated cash flows are matched with adequate investment liquidity. The secondary objective is to create a portfolio which will experience minimal volatility during economic cycles.
- B. Investment strategies for reserve funds shall have as the primary objective the ability to generate a dependable revenue stream to the appropriate reserve fund.
- C. Investment strategies for special projects and capital projects funds will have as their primary objective to assure that anticipated cash flows are matched with adequate investment liquidity.
- D. The investment maturity of bond proceeds (excluding reserve and debt service funds) shall generally be limited to the anticipated cash flow requirement or the "temporary period," as defined by Federal tax law. During the temporary period, bond proceeds may be invested at an unrestricted yield. After the expiration of the temporary period, bond proceeds subject to yield restriction shall be invested considering the anticipated cash flow requirements of the funds and market conditions to achieve compliance with the applicable regulations.

#### **Strategy No. 5**

The EDC generally intends to hold all of its securities until they mature and will accomplish this by maintaining sufficient liquidity in its portfolio so that it does not need to sell a security early. Should it become necessary to sell a security prior to maturity, where the sale proceeds are less than the current book value, the prior written consent of the EDC Executive Director, or the City Manager must be obtained. Securities may be sold prior to maturity by the Director of Finance at or above their book value at any time, without the consent of the City Manager.

#### **Strategy No. 6**

All demand deposits of the EDC will be concentrated with one central depository, so long as, the FDIC insurance limits are not exceeded. The City's depository procedure will maximize the EDC's ability to pool cash for investment purposes, and provide more manageable banking relationships. In addition, depositories not holding demand deposits of the EDC may be eligible to bid on EDC investments.

#### **Strategy No. 7**

This policy shall further seek to maintain good depository bank relationships while minimizing the cost of banking services. The City will seek to maintain a depository contract which will be managed to a level that minimizes the cost of the banking relationship to the EDC, while allowing the EDC to earn an appropriate return on idle demand deposits.

### **Strategy No. 8**

A single pooled fund group of EDC funds, as defined in this policy, may be utilized at the discretion of the Investment Officer. However, earnings from investments will be allocated on a pro-rata cash basis to the individual funds and used in a manner that will best service the interests of the EDC.

### **Strategy No. 9**

Procedures shall be established and implemented in order to maximize investable cash by decreasing the time between the actual collection and the deposit of receipts, and by the controlling of disbursements.

## **V. FINANCE AUDIT COMMITTEE**

- A. Members** – There is hereby created a Finance Audit Committee consisting of the City Manager, Director of Finance, a secondary Investment Officer designated by the Director of Finance Mayor, two members of the City Council and two citizens appointed by the City Council ~~by majority vote.~~ The Mayor will be a permanent member of the Committee. The other four members of the Committee will be appointed by the City Council to serve a two-year term and shall not exceed two successive terms. The Mayor and the two members of the City Council shall be voting members of the Committee. The Community Representative members shall be non-voting members of the Committee.
- B. Scope** – The Finance Audit Committee shall meet at least once per calendar quarter annually to determine general strategies and to monitor results. Included in its deliberations will be such topics as: economic outlook, portfolio diversification, maturity structure, potential risk to the EDC's funds, authorized brokers and dealers, and the target rate-of-return on the investment portfolio.
- 1. Procedures** – The Finance Audit Committee shall provide minutes of its meetings. Any two members of the Finance Audit Committee may request a special meeting and a majority of the members shall constitute a quorum. ~~The Finance Audit Committee shall establish its own rules of procedures.~~ The Finance Audit Committee shall abide by the Rules of Procedure and Policies as set forth in Resolution 09-05-01-11, as amended, and the Charter of the City of Corinth.

## **VI. RESPONSIBILITY AND STANDARD OF CARE**

- A.** The responsibility for the daily operation and management of the EDC's investments shall be outlined within this section.
- 1. Delegation of Authority** - Management responsibility for the investment program is hereby delegated to the Director of Finance, who shall be authorized to deposit, withdraw, invest, transfer or manage the funds of the City and shall establish written procedures for the operation of the investment program, consistent with this policy. Such procedures shall include explicit delegation of authority to other persons responsible for investment transactions. All persons involved in investment activities will be referred to in this policy as "Investment Officers." No persons may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the Director of Finance.
- 2.** The Director of Finance shall assume responsibility for all transactions undertaken and shall establish a system of controls to regulate the activities of subordinate Investment Officials. The system of controls shall be designed to provide

reasonable assurance that ensures the assets of the City are protected from loss, theft or misuse. The concept of reasonable assurance recognizes that:

- a. The cost of control should not exceed the benefits likely to be derived; and,
  - b. The valuation of costs and benefits requires estimates and judgments by management.
3. The Director of Finance shall be designated as the primary Investment Officer for the City and shall be responsible for investment decisions and activities under the direction of the City Manager. The Director of Finance may delegate any phase of the investment program to a secondary Investment Officer. Both the Director of Finance and the designated secondary Investment Officer are responsible for daily investment decisions and activities. However, ultimate responsibility for investment decisions will rest with the Director of Finance.
- B. Prudence** - The standard of prudence to be applied by the Investment Officer shall be the "prudent investor" rule, which states, "investments shall be made with judgment and care, under prevailing circumstances, that a person of prudence, discretion and intelligence would exercise in the management of the person's own affairs, not for speculation, but for investment, considering the probable safety of capital and the probable income to be derived." In determining whether the Investment Officer has exercised prudence with respect to an investment decision, the determination shall be made taking into consideration the following:
1. The investment of all funds over which the Investment Officer had responsibility rather than a consideration as to the prudence of a single investment; and
  2. The investment decision was consistent with the written investment policy and procedures of the EDC.
- C. Due Diligence** - The Director of Finance, designated secondary Investment Officer, Mayor, City Council, City Manager, other Finance employees and the citizen committee members acting in accordance with written policies and procedures and exercising due diligence, shall not be held personally responsible for a specific security's credit risk or market price changes, provided that these deviations are reported in a timely manner and that appropriate action is taken to control adverse developments.
- D. Ethical Standards and Conflicts of Interest**
1. All EDC Investment Officers having a direct or indirect role in the investment of EDC funds shall act as custodians of the public trust avoiding any transaction which might involve a conflict of interest, the appearance of a conflict of interest, or any activity which might otherwise discourage public confidence. Officers and employees involved in the investment process shall refrain from personal business activity that could conflict with proper execution of the investment program, or which could impair the ability to make impartial investment decisions.
  2. An Investment Officer who has a personal business relationship with the depository bank or with any entity seeking to sell an investment to the EDC shall file a statement disclosing that personal business interest.
  3. An Investment Officer has a personal business relationship with a business

organization if:

- a. The Investment Officer or person related to the Investment Officer by the second degree of affinity or consanguinity owns 10% or more of the voting stock or shares of the business organization or owns \$5,000 or more of the fair market value of the business organization;
  - b. Funds received by the Investment Officer or person related to the investment officer by the second degree of affinity or consanguinity from the business organization exceed 10% of the Investment Officer's gross income for the prior year; or
  - c. The Investment Officer or person related to the Investment Officer by the second degree of affinity or consanguinity has acquired from the business organization during the prior year investments with a book value of \$2,500 or more for the personal account of the Investment Officer.
  - d. An Investment Officer who is related within the second degree of affinity or consanguinity to an individual seeking to sell an investment to the EDC shall file a statement disclosing that relationship. A statement required under this subsection must be filed with the Texas Ethics Commission and the City Council.
- E. Training - The City shall provide periodic training in investments for the investment personnel through courses and seminars offered by professional organizations and associations in order to ensure the quality and capability of the EDC's investment personnel making investment decisions in compliance with Public Funds Investment Act (PFIA). The Investment Officers and Finance Audit Committee members shall attend at least one training session containing at least 10 hours of instruction relating to the officer's responsibility under the PFIA within 12 months after assuming duties, and thereafter shall attend at least 8 hours of additional investment training in subsequent two-year periods which begin on the first day of the fiscal year and consist of the two consecutive fiscal years after that date. The Government Finance Officers Association of Texas, the Government Treasurers Organization of Texas, the Texas Municipal League, or the North Central Texas Council of Governments are approved as independent training sources by the City Council.

## VII. AUTHORIZED INVESTMENTS

- A. Generally - Safety of principal is the primary objective in investing public funds and can be accomplished by limiting credit risk and interest rate risk. Credit risk is the risk associated with the failure of a security issuer or backer to pay back principal and interest on a timely basis. Interest rate risk is the risk that the value of a portfolio will decline due to an increase in the general level of interest rates. In order to provide for safety of principal as the EDC's primary objective, only certain investments are authorized as acceptable investments for the EDC. The following list of authorized investments for the EDC intentionally excludes some investments authorized by state law. These restrictions are intended to limit possible risk and provide the maximum measure of safety to EDC funds. In the event an authorized investment loses its required minimum credit rating, all prudent measures will be taken to liquidate said investment. Additionally, the EDC is not required to liquidate investments that were authorized at the time of purchase.
- B. Authorized and Acceptable Investments - The authorized list of investment

instruments is as follows:

1. Obligations of the United States or its agencies and instrumentalities, or any obligation fully guaranteed or insured by the Federal Deposit Insurance Corporation (FDIC), *excluding mortgage-backed securities*.
  2. Direct obligations of the State of Texas, or its agencies and instrumentalities, other obligations, the principal of and interest on which are unconditionally guaranteed or insured by, or backed by the full faith and credit of, the State of Texas or the United States or their respective agencies and instrumentalities, excluding mortgage-related securities.
- C. Certificates of Deposit – A certificate of deposit issued by a depository institution that has its main office or branch office in this state, and is secured in accordance with the specific collateralization requirements contained in section XI, B of this policy. -In addition, an investment in "bundled" or "shared" CDs made in accordance with the following conditions is permitted:
1. The funds are invested through a broker that has its main office or a branch office in this state selected from a list adopted by the City as required by Section 2256.025; or through a depository institution that has its main office or a branch office in this state and that is selected by the City;
  2. The selected broker or depository institution arranges for the deposit of the funds in certificates of deposit in one or more federally insured depository institutions, wherever located, for the account of the City.
  3. The full amount of the principal and accrued interest of each of the CD is insured by the United States or an instrumentality of the United States;
  4. The City appoints the depository institution, a clearing broker-dealer registered with the Securities and Exchange Commission and operating pursuant to SEC Rule 15c3-3, or an entity described in the Public Funds Collateral Act, Section 2257.041(d), as custodian for the City with respect to those CDs issued for the City's account.
- D. Eligible Local Government Investment Pools - AAA-rated public funds investment pools, with a weighted average maturity of 60 days or less, individually approved by formal Council resolution, which invest in instruments and follow practices allowed by the current law as defined in Section 2256.016 of the Texas Government Code. The pool must be continuously rated no lower than AAA or AAA-m or at an equivalent rating by at least one nationally recognized rating service. A public funds investment pool created to function as a money market mutual fund must mark to market daily and stabilize at a \$1 net asset value.
- E. Repurchase Agreements - Fully collateralized repurchase agreements having a defined termination date, placed through a primary government securities dealer or a financial institution doing business in the State of Texas, and fully secured by cash and obligations of the United States or its agencies and instrumentalities. This collateral must be pledged to the EDC and held in safekeeping with a third-party custodian approved by the City. All collateral must be maintained at a market value of no less than the principal amount of the outstanding funds disbursed. All transactions shall be governed by signed Security Industry and Financial Markets Association (SIFMA) Master Repurchase Agreement. Repurchase agreements must also be

collateralized in accordance with State law as described in Section XI of this policy. Authorized under this section includes flexible repurchase agreements which may be used for specific investment of bond proceeds but *shall not include reverse purchase agreements*.

- F. Bankers' Acceptances, and Commercial Paper (LIMITED USE) - These investments are authorized for the EDC to the extent that they are contained in the portfolios of approved public funds investment pools or money market funds in which the EDC invests.
- G. AAA-rated SEC-Regulated 2a7 No-Load Money Market Mutual Funds - An SEC-registered, no load money market mutual fund which has a dollar weighted average stated maturity of 60 days or less whose assets consist exclusively of the assets described in section VII.A and whose investment objectives includes the maintenance of a stable net asset value of \$1 for each share: furthermore, it provides the EDC with a prospectus and other information required by the SEC Act of 1934 or the Investment Advisor Act of 1940 and which provides the EDC with a prospectus and other information required by the Securities Exchange Act of 1934 (15 USC. Section 78a et. Seq.) & the Investment Company Act of 1990 (15 USC Section 80a-1 et. Seq.).
- H. Unauthorized Securities - State law specifically prohibits investment in the following securities:
  - 1. An obligation whose payment represents the coupon payments on the outstanding principal balance of the underlying mortgage-backed security and pays no principal.
  - 2. An obligation whose payment represents the principal stream of cash flow from the underlying mortgage-backed security and bears no interest.
  - 3. Collateralized mortgage obligations that have a stated final maturity date of greater than 10 years.
  - 4. Collateralized mortgage obligations, the interest rate of which is determined by an index that adjusts opposite to the changes in a market index.

## VIII. DIVERSIFICATION

- A. Generally - Diversification of investment instruments shall be utilized to avoid incurring unreasonable risks resulting from over-concentration of investments in a specific maturity, a specific issue, or a specific class of securities. With the exception of U.S. Government securities (debt obligations issued by the U. S. Government, its agencies, or instrumentalities) as authorized in this policy, and authorized local government investment pools, no more than forty percent (40%) of the total investment portfolio will be invested in any one security type or with a single financial institution. Diversification of the portfolio considers diversification by maturity dates and diversification by investment instrument.
- B. Diversification by Maturities - The longer the maturity of investments, the greater their price volatility. Therefore, it is the EDC's policy to concentrate its investment portfolio in shorter-term securities in order to limit principal risks caused by change in interest rates. The EDC will attempt to match its investments with anticipated cash flow requirements. Unless matched to a specific cash flow (including the anticipated cash flow requirements of bond proceeds within the temporary period), the EDC will not

directly invest in securities maturing more than two (2) years from the date of purchase. However, the above described obligations, certificates, or agreements may be collateralized using longer date instruments. The EDC shall diversify the use of investment instruments to avoid incurring unreasonable risks inherent in over-investing in specific instruments, individual financial institutions or maturities. Maturity scheduling shall be managed by the Investment Officer so that maturities of investments shall be timed to coincide with projected cash flow needs.

The entire EDC portfolio, or single pooled fund group if utilized, shall maintain a maximum average dollar-weighted maturity, based on the stated maturity date, of less than two hundred seventy (270) days. Investment maturities for debt service interest and sinking funds and/or other types of reserve funds, whose use is never anticipated, shall maintain a maximum average dollar-weighted maturity, based on the stated maturity date, of less than three hundred sixty-five (365) days.

- C. Diversification by Investment Instrument - Diversification by investment instrument shall not exceed the following guidelines for each type of instrument:

	Maximum % of Portfolio
U.S. Treasury Obligations	100%
U.S. Government Agency Securities and Instrumentalities	100%
Authorized Local Government Investment Pool	100%
Local Government Obligations	10%
Fully Insured Certificates of Deposit	50%
Fully Collateralized Repurchase Agreements	25%
SEC-Regulated No-Load Money Market Mutual Fund	100%
U.S. Treasury & Agency Callables	30%

**IX. SECURITY SWAPS**

Security swaps may be considered as an investment option for the EDC. A swap out of one instrument into another is acceptable to increase yield, realign for disbursement dates, extend or shorten maturity dates and improve market sector diversification. Swaps may be initiated by brokers/dealers who are on the City's approved list. A horizon analysis is required for each swap proving benefit to the EDC before the trade decision is made, which will accompany the investment file for record keeping.

**X. AUTHORIZED FINANCIAL DEALERS AND INSTITUTIONS**

- A. The Director of Finance will maintain a list of financial institutions authorized to provide investment services to the City. In addition, a list will also be maintained of approved broker/dealers authorized to provide investment services in the State of Texas. These will include financial institutions that qualify under Securities & Exchange Commission Rule 15-C3-1 (uniform net capital rule). No public deposit shall be made except in a qualified public depository as established by state laws.
- B. All financial institutions and broker/dealers who desire to become qualified bidders for investment transactions must supply the Director of Finance with the following, as appropriate: audited financial statements, proof of Financial Industry Regulatory Authority certification, trading resolution, proof of State registration, completed broker/dealer questionnaire and certification of having read the EDC's investment policy.

- C.** The Finance Audit Committee shall be responsible for adopting the list of brokers and dealers of government securities. Their selection shall be among only primary government securities dealers that report directly to the New York Federal Reserve Bank, unless a comprehensive credit and capitalization analysis reveals that other firms are adequately financed to conduct public business. The Finance Audit Committee shall base its evaluation of security dealers and financial institutions upon:
1. Financial conditions, strength and capability to fulfill commitments;
  2. Overall reputation with other dealers or investors;
  3. Regulatory status of the dealer;
  4. Background and expertise of the individual representatives.
- D.** Investment Officers shall only conduct business with securities dealers approved by the Finance Audit Committee and will not purchase investments from any financial organization until the organization's registered principal has executed a written instrument stating that he or she has thoroughly reviewed the EDC's investment policy and acknowledges that reasonable procedures and controls have been implemented to preclude imprudent investment activities arising out of transactions between the organization and the EDC, except to the extent that this authorization is dependent on an analysis of the makeup of the EDC's entire portfolio or requires an interpretation of subjective investment standards.
- E.** To guard against default possibilities under these conditions, and to assure diversification of bidders, business with any one issuer, or investment broker, should be limited to forty percent (40%) of the total portfolio at any point in time. In this way, bankruptcy, receivership or legal action would not immobilize the EDC's ability to meet payroll or other expenses.
- F.** All investments (governments or bank C.D.'s) will be solicited on a competitive basis with at least three (3) institutions. The Finance Audit Committee can approve exceptions on a case by case basis or on a general basis in the form of guidelines. These guidelines shall take into consideration the investment type maturity date, amount, and potential disruptiveness to the EDC's investment strategy. The investment will be made with the broker/dealer offering the best yield/quality to the EDC. The quotes may be accepted orally, in writing, electronically, or any combination of these methods.
- G.** An annual review of the financial condition and registrations of qualified financial organizations will be conducted by the Director of Finance.
- H.** A current audited financial statement is required to be on file for each financial institution and broker/dealer in which the EDC invests.
- I.** If the City has contracted with a Registered Investment Advisor for the management of its funds, the advisor shall be responsible for performing due diligence on and maintaining a list of broker/dealers with which it shall transact business on behalf of the EDC. The advisor shall determine selection criteria and shall annually present a list of its authorized broker/dealers to the City for review and likewise shall execute the aforementioned written instrument stating that the advisor has reviewed the EDC's investment policy and has implemented reasonable procedures and controls in an effort to preclude imprudent investment activities with the EDC. The advisor shall

obtain and document competitive bids and offers on all transactions and present these to the City as part of its standard trade documentation.

- J. It is the policy of the City that all security transactions entered into with the EDC shall be conducted on a "Delivery-versus-Payment" basis through the Federal Reserve System. By doing this, EDC funds are not released until the City has received, through the Federal Reserve wire, the securities purchased. The City shall authorize the release of funds only after receiving notification from the safekeeping bank that a purchased security has been received in the safekeeping account of the EDC. The notification may be oral, but shall be confirmed in writing.

## **XI. SAFEKEEPING AND COLLATERALIZATION**

- A. Safekeeping - All securities owned by the EDC shall be held by a third-party safekeeping agent selected by the EDC's Investment Officer. Bank deposits will be held in the EDC's name in the bank's trust department, in a Federal Reserve Bank account in the EDC's name, or third-party financial institutions doing business in the state of Texas, in accordance with state law. Original safekeeping receipts shall be obtained and held by the City and the EDC. The City and the EDC shall contract with a bank or banks for the safekeeping of securities either owned by the EDC as part of its investment portfolio or held as collateral to secure time deposits, if collateralized time deposits are specifically authorized by the board.
- B. Collateralized Deposits - Consistent with the requirements of State law, the EDC requires all bank deposits to be federally insured. If the board and the City do agree that collateralized accounts are acceptable in specific situations the provisions above may be amended for EDC accounts.

## **XII. INTERNAL CONTROL**

The Investment Officer shall establish a system of written internal controls, which shall be reviewed annually by independent auditors. The controls shall be designed to prevent loss of public funds due to fraud, error, misrepresentation, unanticipated market changes, or imprudent actions. The internal controls are to be reviewed annually in conjunction with an external independent audit. This review will provide assurance of compliance with policies and procedures as specified by this policy. The City, in conjunction with its annual financial audit, shall perform a compliance audit of management controls and adherence to the EDC's established investment policy.

## **XIII. PERFORMANCE**

The EDC's investment portfolio shall be designed to obtain a market rate-of-return on investments consistent with risk constraints and cash flow requirements of the EDC. This investment policy establishes "weighted average yield to maturity" as the standard portfolio performance measurement.

## **XIV. REPORTING**

- A. Quarterly - The Director of Finance shall prepare and submit a signed quarterly investment report to the Economic Development Board and the Finance Audit Committee that summarizes current market conditions, economic developments, and anticipated investment conditions. The report shall summarize investment strategies employed in the most recent quarter and describe the portfolio in terms of investment securities, maturities, risk characteristics, and shall explain the total investment return

for the quarter. The City shall also monitor the credit ratings on securities that require minimum ratings. This may be accomplished through staff research, or with the assistance of broker-dealers, investment advisors, banks or safekeeping agents.

- B. Annual Report** - Within 180 days of the end of the fiscal year, the Director of Finance shall present an annual report on the investment program and investment activity. This report may be presented as a component of the fourth quarter report to the Economic Development Board, City Manager and the City Council. The quarterly reports prepared by the Director of Finance shall be formally reviewed at least annually by an independent auditor, and the result of the review shall be reported to the City Council by that auditor.
- C. Methods** - The quarterly and annual investment reports shall include a succinct management summary that provides a clear picture of the status of the current investment portfolio and transactions made over the past quarter. This management summary will be prepared in a manner which will allow the EDC to ascertain whether investment activities during the reporting period have conformed to the investment policy. The report will be prepared in compliance with generally accepted accounting principles. The report will include the following:
1. A listing of individual securities held at the end of the reporting period. This list will include the name of the fund or pooled group fund for which each individual investment was acquired;
  2. Unrealized gains or losses resulting from appreciation or depreciation by listing the beginning and ending book and market value of securities for the period. Market values shall be obtained from financial institutions or portfolio reporting services independent from the broker/dealer from which the security was purchased;
  3. Additions and changes to the market value during the period;
  4. Fully accrued interest for the reporting period;
  5. Average weighted yield to maturity of portfolio on entity investments as compared to applicable benchmarks;
  6. Listing of investments by maturity date;
  7. The percentage of the total portfolio which each type of investment represents; and
  8. Statement of compliance of the EDC's investment portfolio with State Law and the investment strategy and policy approved by the City Council.
  9. Market yield benchmark comparison of the average 90-day U. S. Treasury Bill auction yield during the reporting period.
  10. The guidelines of retaining records for seven years as recommended in the *Texas State Library Municipal Records Manual* should be followed. The Director of Finance shall oversee the filing and/or storing of investment records.

## **XV. INVESTMENT POLICY ADOPTION AND AMENDMENT**

The EDC's investment policy shall be reviewed by the Economic Development Board and formally adopted and amended by resolution by the City Council. The City's written policies and procedures for investments are subject to review not less than annually to stay current with changing laws, regulations and needs of the City. The City Council, not less than annually, shall adopt a written instrument stating that it has reviewed the investment policy and investment strategies and that the written instrument so adopted shall record any changes made to either the policy or strategies.

## Attachment A

CITY OF CORINTH, TEXAS  
Economic Development Corporation  
Investment Strategy Statement

### **Operating Funds**

1. Suitability - Any investment eligible in the investment policy is suitable for Operating Funds.
2. Safety of Principal - All investments shall be of high quality securities with no perceived default risk. Market price fluctuations will occur. However, by managing the weighted average days to maturity for the Operating Fund's portfolio to less than 270 days and restricting the maximum allowable maturity to two years, the price volatility of the overall portfolio will be minimized.
3. Marketability - Securities with active and efficient secondary markets are necessary in the event of an unanticipated cash flow requirement. Historical market "spreads" between the bid and offer prices of a particular security-type of less than a quarter of a percentage point will define an efficient secondary market.
4. Liquidity - The Operating Fund requires the greatest short-term liquidity of any of the Fund types. Short-term investment pools and money market mutual funds will provide daily liquidity and may be utilized as a competitive yield alternative to fixed maturity investments.
5. Diversification - Investment maturities should be staggered throughout the budget cycle to provide cash flow based on the anticipated operating needs of the EDC. Market cycle risk will be reduced by diversifying the appropriate maturity structure out through two years.
6. Yield - Attaining a competitive market yield for comparable security-types and portfolio restrictions is the desired objective. The yield of an equally weighted, rolling three-month treasury-bill portfolio will be the minimum yield objective.

### **Reserve Funds**

1. Suitability - Any investment eligible in the investment policy is suitable for Debt Service Reserve Funds. Bond resolution and loan documentation constraints and insurance company restrictions may create specific considerations in addition to the investment policy.
2. Safety of Principal - All investments shall be of high quality securities with no perceived default risk. Market price fluctuations will occur. However, managing Debt Service Reserve Fund maturities to not exceed the call provisions of the borrowing reduces the investment's market risk if the EDC's debt is redeemed and the Reserve Fund liquidated. The fund shall maintain a maximum average dollar-weighted maturity, based on the stated maturity date, of less than three hundred sixty-five (365) days. No stated final investment maturity shall exceed the shorter of the final maturity of the borrowing or two years. Annual mark-to-market requirements or specific maturity and average life limitations within the borrowing's documentation will influence the attractiveness of market risk and reduce the opportunity for maturity extension.

3. Marketability - Securities with less active and efficient secondary markets are acceptable for Debt Service Reserve Funds.
4. Liquidity - Debt Service Reserve Funds have no anticipated expenditures. The Funds are deposited to provide annual debt service payment protection to the City's debt holders. The funds are "returned" to the EDC at the final debt service payment. Market conditions and arbitrage regulation compliance determine the advantage of security diversification and liquidity. Generally, if investment rates exceed the cost of borrowing, the EDC is best served by locking in investment maturities and reducing liquidity. If the borrowing cost cannot be exceeded, then concurrent market conditions will determine the attractiveness of locking in maturities or investing shorter and anticipating future increased yields.
5. Diversification - Market conditions and the arbitrage regulations influence the attractiveness of staggering the maturity of fixed rate investments for Debt Service Reserve Funds. At no time shall the final debt service payment date of a bond issue, if any, be exceeded in an attempt to bolster yield.
6. Yield - Achieving a positive spread to the applicable borrowing cost is the desired objective. Debt Service Reserve Fund portfolio management shall at all times operate within the limits of the investment policy's risk constraints.

### **Bond Funds**

1. Suitability - Any investment eligible in the Investment Policy is suitable for Bond Funds.
2. Safety of Principal - All investments will be of high quality securities with no perceived default risk. Market price fluctuations will occur. However, by managing Bond Funds to not exceed the shorter of two years or the anticipated expenditure schedule and maintaining a maximum average dollar-weighted maturity, based on the stated maturity date, of less than three hundred sixty-five (365) days the market risk of the overall portfolio will be minimized.
3. Marketability - Securities with active and efficient secondary markets are necessary in the event of an unanticipated cash flow requirement. Historical market "spreads" between the bid and offer prices of a particular security-type of less than a quarter of a percentage point will define an efficient secondary market.
4. Liquidity - Bond Funds used for capital improvements programs have reasonably predictable draw down schedules. Therefore investment maturities should generally follow the anticipated cash flow requirements. Investment pools and money market mutual funds will provide readily available funds generally equal to one month's anticipated cash flow needs, or a competitive yield alternative for short term fixed maturity investments. A singular repurchase agreement may be utilized if disbursements are allowed in the amount necessary to satisfy any expenditure request. This investment structure is commonly referred to as a flexible repurchase agreement.
5. Diversification - Market conditions and arbitrage regulations influence the attractiveness of staggering the maturity of fixed rate investments for construction, loan and bond proceeds. Generally, when investment rates exceed the applicable cost of borrowing, the EDC is best served by locking in most investments. If the cost of borrowing cannot be exceeded, then concurrent market conditions will determine the attractiveness of diversifying maturities or investing in shorter and larger amounts.

At no time shall the anticipated expenditure schedule be exceeded in an attempt to bolster yield.

6. Yield - Achieving a positive spread to the cost of borrowing is the desired objective, within the limits of the investment policy's risk constraints. The yield of an equally weighted, rolling six-month treasury-bill portfolio will be the minimum yield objective for non-borrowed funds.

**Attachment B**

CITY OF CORINTH, TEXAS  
Investment Policy

[SAMPLE]  
TEXAS PUBLIC FUNDS INVESTMENT ACT  
CERTIFICATION BY BUSINESS ORGANIZATION

This certification is executed on behalf of the City of Corinth, Texas (the "City") and \_\_\_\_\_ (the Business Organization), pursuant to the Public Funds Investment Act, Chapter 2256, Texas Government Code (the "Act") in connection with investment transactions conducted between the City and the Business Organization.

The undersigned Qualified Representative of the Business Organization hereby certifies on behalf of the Business Organization that:

1. The undersigned is a Qualified Representative of the Business Organization offering to enter an investment transaction with the Investor as such terms are used in the Public Funds Investment Act, Chapter 2256, Texas Government Code; and
2. The Qualified Representative of the Business Organization has received and reviewed the investment policy furnished by the City; and
3. The Qualified Representative of the Business Organization has implemented reasonable procedures and controls in an effort to preclude investment transactions conducted between the Business Organization and the City that are not authorized by the City's investment policy, except to the extent that this authorization is dependent on an analysis of the makeup of the City's entire portfolio or requires an interpretation of subjective investment standards.

Qualified Representative of Business Organization

Firm: \_\_\_\_\_

Signature \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

Date: \_\_\_\_\_

**Finance Audit Committee Regular Session**

**Meeting Date:** 12/13/2018  
**Title:** Annual Investment Report  
**Submitted For:** Lee Ann Bunselmeyer, Director  
**Submitted By:** Chris Rodriguez, Financial Services Manager  
**Finance Review:** N/A **Legal Review:** N/A

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**AGENDA ITEM**

Consider and act on the Fiscal Year 2017-2018 Annual Investment Report

**AGENDA ITEM SUMMARY/BACKGROUND**

In accordance with Public Funds Investment Act, Chapter 2256, Section 02399(a), of the Texas Government Code, the investment officer must prepare and submit to the governing body a written report of the investment transactions within 180 days of the end of the fiscal year. The report must summarize current market conditions, economic developments, and anticipated investment conditions and include the following:

1. A listing of individuals securities held at the end of the reporting period. This list will include the name of the fund or pooled group fund for which each individual investment was acquired.
2. Unrealized gain or losses resulting from appreciation or depreciation by listing the beginning and ending book and market value of securities for the period. Market values shall be obtained from financial institutions or portfolio reporting services, independent from the broker/dealer from which the security was purchased.
3. Additions and changes to the market value during the period.
4. Fully accrued interest for the reporting period.
5. Average weighted yield to maturity of portfolio on entity investments, as compared to applicable benchmarks.
6. Listing of investments by maturity date.
7. The percentage of the total portfolio which each type of investment represents; and
8. Statement of compliance of the City's investment portfolio with State Law and the investment strategy and policy approved by the City Council.
9. Market yield benchmark comparison of the average 90-days U.S. Treasury Bill auction yield during the reporting period.

The investment report must be formally reviewed at least annually by an independent auditor and the results of the review must be reports. Appendix A includes the independent review by First Southwest Asset Management on November 20, 2018.

**RECOMMENDATION**

Staff recommends the acceptance of the Annual Investment Report.

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**Attachments**

Annual Investment Report

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City of Corinth, Texas

ANNUAL INVESTMENT REPORT

*For Fiscal Year Ended September 30, 2018*



Bob Hart  
*City Manager*

Lee Ann Bunselmeyer  
*Director of Finance,  
Communication &  
Strategic Services*

Prepared By:  
Chris Rodriguez  
*Assistant Finance Director*



December 13, 2018

TO: Honorable Mayor and Members of the City Council

The Annual Investment Report is written in accordance with state statutes, specifically the Public Funds Investment Act, section 2256 of the Texas Government Code. This report is presented to comply with the City's investment policy that states "within one hundred (180) days of the end of the fiscal year, the Director of Finance shall present an annual report on the investment program and investment activity. This report may be presented as a component of the fourth quarter report to the City Manager and City Council."

#### I. STATUTORY AND POLICY REQUIREMENTS

On February 15, 2018, a resolution was passed to adopt a formal investment policy for the City of Corinth. The Investment Policy is required by state law to be reviewed each year. The policy designates the Director of Finance as being responsible for the City's investment program. The Director of Finance is also responsible for establishing written procedures for the operation of the program. These procedures include the explicit delegation of authority to persons who carry out the daily investment transactions. Investment officials have the authority to invest all funds for the City of Corinth, the Corinth Crime Control and Prevention District and Corinth Economic Development Corporation with the exception of funds contributed to the Texas Municipal Retirement System (TMRS); other funds established by the City for deferred employee compensation; and revenue bond escrow funds. These funds are managed by outside investment managers and administrators and are monitored by the Finance Department.

The funds of the City of Corinth, Texas, are invested in compliance with Article. 842(a-1) entitled the "Public Funds Investment Act" of the Texas Government Code. Staff annually reviews the policy guidelines and objectives to ensure compliance with the changes in state law, and with the investment strategies adopted by the City Council as summarized below in order of importance.

1) Safety – Preservation and safety of Principal.

Safety of principal invested is the foremost objective in the investment decisions of the City. Each investment transaction shall seek to ensure the preservation of capital in the overall portfolio. The risk of loss shall be controlled by investing only in authorized securities as defined in this Policy, by qualifying the financial institutions and broker with which the City will transact, and by portfolio diversification. Safety is defined as the undiminished return of the principal on the City's investments.

2) Liquidity.

The investment portfolio shall be managed to maintain liquidity to ensure that funds will be available to meet the City's cash flow requirements and by investing in securities with active secondary markets. Investments shall be structured in such a manner as to provide liquidity necessary to pay obligations as they become due. A security may be liquidated prior to its stated maturity to meet unanticipated cash requirements or to otherwise favorably adjust the City's portfolio.

3) Diversification.

Investment maturities shall be staggered throughout the budget cycle to provide cash flow based on the anticipated needs of the City. Diversifying the appropriate maturity structure will reduce market cycle risk.

4) Market Rate-of-Return (Yield).

The City's investment portfolio shall be designed to optimize a market rate-of-return on investments consistent with risk constraints and cash flow requirements of the portfolio. The investment portfolio shall be managed in a manner which seeks to attain a market rate of return throughout budgetary and economic cycles. The City will not attempt to consistently attain an unrealistic above market rate-of-return, as this objective will subject the overall portfolio to greater risk. Therefore, the City's rate of return objective is secondary to those of safety and liquidity. Rate of return (yield) is defined as the annual income returned on an investment, expressed as a percentage.

5) Public Trust

The Investment Officer shall avoid any transactions that might impair public confidence in the City's ability to govern effectively. The governing body recognizes that in diversifying the portfolio, occasional measured losses due to market volatility are inevitable, and must be considered within the context of the overall portfolio's investment return, provided that adequate diversification has been implemented. The prudence of the investment decision shall be measured in accordance with the tests set forth in Section 2256.006(b) of the Act.

## II. BANK DEPOSITORY

Depository services support the objectives of the City's cash and investment management program. Those objectives are to maximize investment yield after satisfying the goals of safety and liquidity. A depository services contract is required for municipalities and the City of Corinth contracts with Independent Bank. Frost Bank serves as the City's safekeeping institution and acts as a third-party custodian.

There are four significant cash management services that are provided to the City. These services are (1) a control concentration/sweep account, (2) the on-line cash management system, (3) positive pay, and (4) safekeeping services. These automated services facilitate full utilization of available cash thus maximizing interest income. The Independent Bank contract was renewed on June 1, 2014 for a two-year period with an additional option for three one-year renewals. This is the final year on the current bank contract.

## III. INVESTMENT ACCOUNTING METHODOLOGY

The accounts of the City of Corinth are maintained on a funds basis or account groups, each of which is considered a separate accounting entity. Each fund is invested separately, as long as it maintains a sufficient fund balance. The investment activity of each fund is summarized in the tables presented in this report.

The enclosed Annual Investment Report is compliant with the investment strategies adopted by the City Council as well as in accordance with the relevant provisions of the Tex. Gov't Code Ch. 2256. The objectives adopted by the City Council will continue to drive the investment program in the next fiscal year to achieve optimum protection of public funds.

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Lee Ann Bunselmeyer  
Director of Finance, Communication  
& Strategic Services

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Chris Rodriguez  
Assistant Finance Director

**CITY OF CORINTH**  
**ANNUAL INVESTMENT REPORT**  
*For Period Ending September 30, 2018*

Security Type	Par Value	Book Value	Market Value	% of Mkt to Book
U. S. Federal Agency-Coupon	\$ 7,169,910	\$ 7,167,908	\$ 7,110,156	99.19%
U.S. Federal Agency -Callable	5,900,000	5,899,131	5,859,390	99.33%
Managed Pools	2,106,147	2,106,147	2,106,147	100.00%
Money Market	291,914	291,914	291,914	100.00%
Bank Cash	7,919,114	7,919,114	7,919,114	100.00%
	<u>\$ 23,387,085</u>	<u>\$ 23,384,213</u>	<u>\$ 23,286,721</u>	<u>99.58%</u>

**PORTFOLIO SUMMARY REPORT**

Beginning Par Value as of 9/30/2017	\$ 28,282,591
Beginning Book Value as of 9/30/2017	\$ 28,290,486
Beginning Market Value as of 9/30/2017	\$ 28,246,842
WAM at Beginning Date (Days)	191
Ending Par Value as of 9/30/2018	\$ 23,387,085
Ending Book Value as of 9/30/2018	\$ 23,384,213
Ending Market Value as of 9/30/2018	\$ 23,286,721
WAM at Ending Date (Days)	183
Change to Market Value <sup>(1)</sup>	\$ (4,960,121)

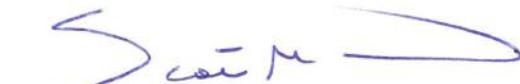
<sup>(1)</sup> The net decrease in the Market Value is due to the capital expenditures for the new Public Safety Facility and the Lake Sharon Road extension.

This report is prepared in accordance with Chapter 2256 of the Public Funds Investment Act ("PFIA") Section 2256.023(a) which states that "Not less than quarterly, the investment officer shall prepare and submit to the governing body of the entity a written report of the investment transactions for all funds covered by this chapter for the preceding reporting period."

The investment portfolio complied with the PFIA and the City's approved Investment Policy and Strategy throughout the period.

\_\_\_\_\_  
Lee Ann Bunselmeyer  
Director of Finance & Strategic Services

\_\_\_\_\_  
Chris Rodriguez  
Assistant Finance Director

  
\_\_\_\_\_  
Scott McIntyre  
First Southwest Asset Management

## INVESTMENT STRATEGIES COMPLIANCE REPORT

For Period Ending September 30, 2018

### OPERATING FUNDS

The investment strategy for operating funds and commingled pools containing operating funds have as their primary objective to assure that anticipated cash flows are matched with adequate investment liquidity. The secondary objective is to structure a portfolio, which will minimize volatility during economic cycles. This may be accomplished by purchasing high quality, short-term securities, which will compliment each other in a laddered maturity structure. A dollar-weighted average maturity of 270 days or less will be maintained and calculated by using the stated final maturity date of each security.

Beginning Book Value as of 9/30/2017	\$	11,769,102
Beginning Market Value as of 9/30/2017	\$	11,751,393
WAM at Beginning Date (Days)		176
Ending Book Value as of 9/30/2018	\$	12,694,000
Ending Market Value as of 9/30/2018	\$	12,640,309
Unrealized Gain/(Loss)	\$	(53,691)
Change to Market Value <sup>(1)</sup>	\$	888,916
WAM at Ending Date (Days)		164
WAM Policy Benchmark $\leq$		270

<sup>(1)</sup> The net increase in the Market Value for the Operating Funds is due to savings in the General Fund expenditures and postponing the hiring of three additional firefighters.

### DEBT SERVICE RESERVE FUND

Investment strategies for debt service reserve and contingency funds shall have as the primary objective the ability to generate a dependable revenue stream to the appropriate fund from securities with a low degree of volatility. Securities should be of high quality and, except as may be required by the bond ordinance specific to an individual issue, of short to intermediate-term maturities. Volatility shall be further controlled through the purchase of securities carrying the highest coupon available, within the desired maturity and quality range, without paying a premium, if at all possible. Such securities will tend to hold their value during economic cycles. A dollar weighted average maturity of 365 days or less will be maintained and calculated by using the stated final maturity date of each security.

Beginning Book Value as of 9/30/2017	\$	289,209
Beginning Market Value as of 9/30/2017	\$	289,209
WAM at Beginning Date (Days)		1
Ending Book Value as of 9/30/2018	\$	291,914
Ending Market Value as of 9/30/2018	\$	291,914
Unrealized Gain/(Loss)	\$	-
Change to Market Value <sup>(2)</sup>	\$	2,705
WAM at Ending Date (Days)		1
WAM Policy Benchmark $\leq$		365

<sup>(2)</sup> No significant change.

## INVESTMENT STRATEGIES COMPLIANCE REPORT

For Period Ending September 30, 2018

### BOND/CAPITAL PROJECT FUNDS

Investment strategies for bond funds will have as their primary objective to assure that anticipated cash flows are matched with adequate investment liquidity. These portfolios should include at least 10% in highly liquid securities to allow for flexibility and unanticipated project outlays. The stated final maturity dates of securities held should not exceed the estimated project completion date. A dollar weighted average maturity of 365 days or less will be maintained and calculated by using the stated final maturity of each security.

Beginning Book Value as of 9/30/2017	\$	14,548,186
Beginning Market Value as of 9/30/2017	\$	14,522,401
WAM at Beginning Date (Days)		219
Ending Book Value as of 9/30/2018	\$	8,648,992
Ending Market Value as of 9/30/2018	\$	8,606,576
Unrealized Gain/(Loss)	\$	(42,416)
Change to Market Value <sup>(1)</sup>	\$	(5,915,825)
WAM at Ending Date (Days)		255
WAM Policy Benchmark $\leq$		365

<sup>(1)</sup> The net decrease in the Market Value is due to the capital expenditures for the new Public Safety Facility and the Lake Sharon Road extension. The current bank account balance for the bond funds is \$2,795,853.

### SPECIAL REVENUE FUNDS

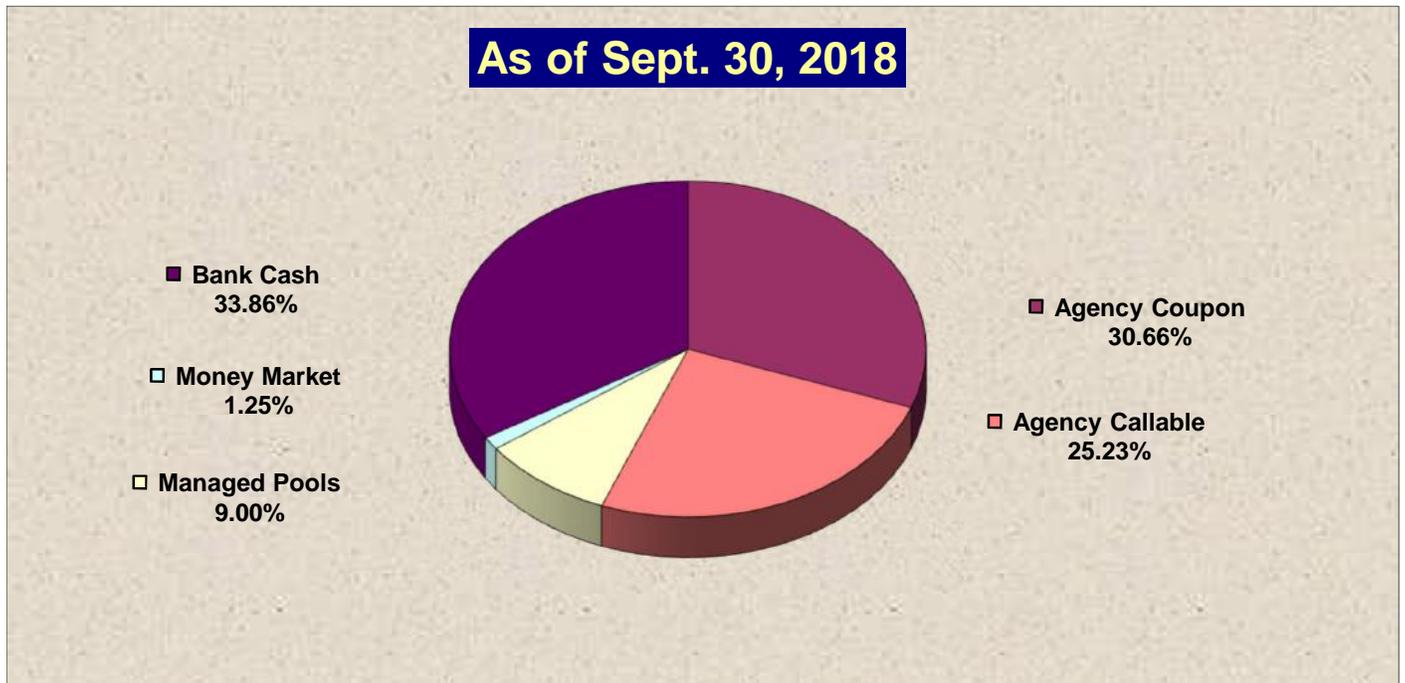
Investment strategies for construction projects or special revenue fund portfolios will have as their primary objective to assure that anticipated cash flows are matched with adequate investment liquidity. These portfolios should include at least 10% in highly liquid securities to allow for flexibility and unanticipated project outlays. The stated final maturity dates of securities held should not exceed the estimated project completion date. A dollar weighted average maturity of 270 days or less will be maintained and calculated by using the stated final maturity of each security.

Beginning Book Value as of 9/30/2017	\$	1,683,988
Beginning Market Value as of 9/30/2017	\$	1,683,838
WAM at Beginning Date (Days)		159
Ending Book Value as of 9/30/2018	\$	1,749,308
Ending Market Value as of 9/30/2018	\$	1,747,922
Unrealized Gain/(Loss)	\$	(1,386)
Change to Market Value <sup>(2)</sup>	\$	64,084
WAM at Ending Date (Days)		96
WAM Policy Benchmark $\leq$		270

<sup>(2)</sup> No significant change.

**ANNUAL INVESTMENT REPORT**  
**Portfolio Summary By Market Sector**

Market Sector	Dec. 31, 2017	Mar. 31, 2018	June 30, 2018	Sept. 30, 2018
U.S. Federal Agency -Coupon	\$ 7,292,000	\$ 8,819,910	\$ 7,669,910	\$ 7,169,910
U.S. Federal Agency-Callable	6,150,000	5,650,000	5,900,000	5,900,000
Managed Pools	3,718,347	3,580,895	2,095,889	2,106,147
Money Market	289,739	290,455	291,079	291,914
Bank Cash	12,535,526	7,729,768	7,399,923	7,919,114
<b>Total Par Value:</b>	<b>\$ 29,985,612</b>	<b>\$ 26,071,027</b>	<b>\$ 23,356,801</b>	<b>\$ 23,387,085</b>



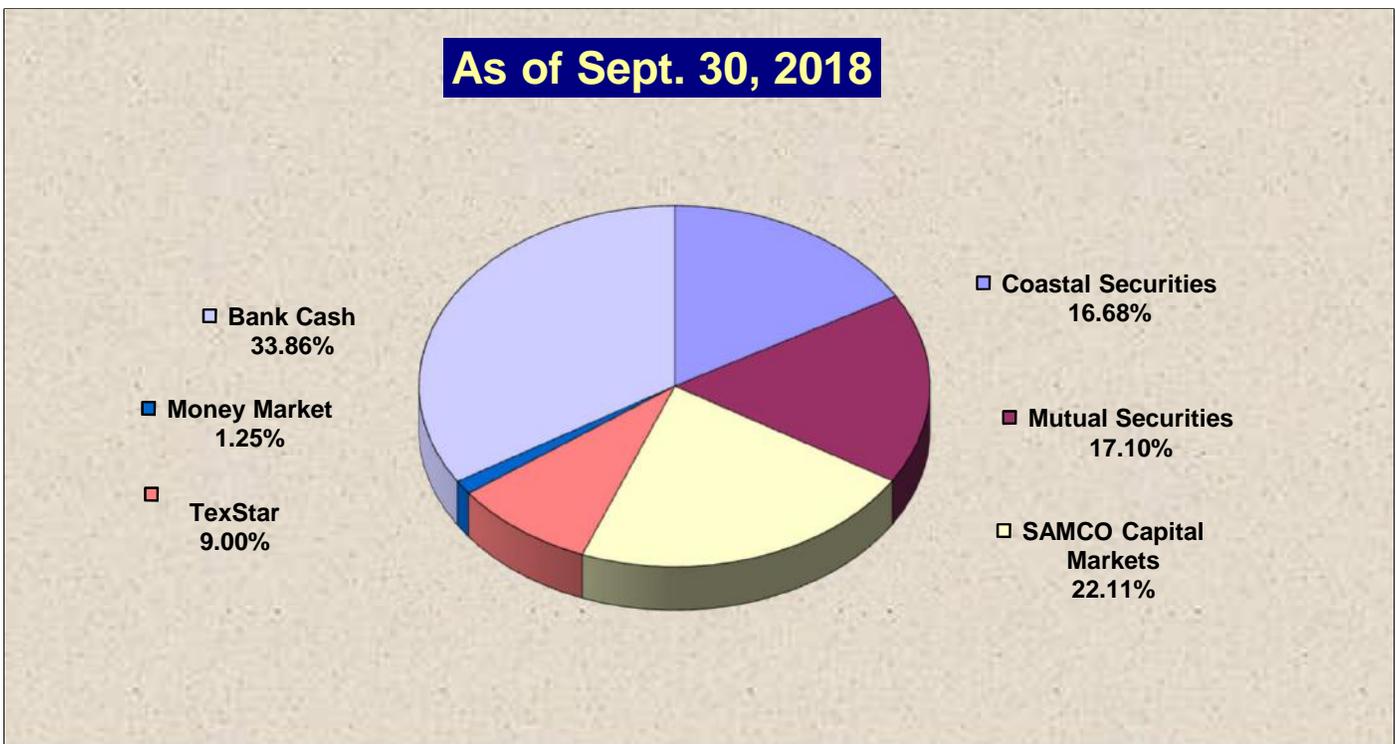
The portfolio is restricted to U.S. Treasuries, U.S. Agencies, bonds issued by Texas public entities and rated AA or better, fully insured/collateralized certificates of deposit, and fully collateralized repurchase agreements. The investments are diversified by security type to protect interest income from the volatility of interest rates and to protect the portfolio from the risk of principal loss in any one market.

Performance Indicators	Policy Benchmark	Dec. 31, 2017	Mar. 31, 2018	June 30, 2018	Sept. 30, 2018
Average Yield to Maturity		1.115%	1.355%	1.390%	1.380%
≥ Policy Benchmark-(Six Month T-Bill)		1.484%	1.905%	2.099%	2.330%
Callable Securities ≤	30.00%	20.51%	21.67%	25.26%	25.23%
Investment By Type ≤					
U.S. Treasuries	100.00%	0.00%	0.00%	0.00%	0.00%
U.S. Agencies	100.00%	44.82%	55.50%	58.10%	55.89%
Certificates of Deposit	100.00%	0.00%	0.00%	0.00%	0.00%
Managed Pools	50.00%	12.40%	13.74%	8.97%	9.00%
Money Market	100.00%	0.97%	1.11%	1.25%	1.25%
Bank Cash	100.00%	41.81%	29.65%	31.68%	33.86%

**Note:** The portfolio is slightly above the benchmark for callable securities for the year. The Average Yield to Maturity is slightly below the Policy Benchmark for September 30th.

**ANNUAL INVESTMENT REPORT**  
**Portfolio Summary By Broker/Dealer**

Dealers/Brokers	Dec. 31, 2017	Mar. 31, 2018	June 30, 2018	Sept. 30, 2018
<b>Broker/Dealer</b>				
Coastal Securities	\$ 4,950,000	\$ 3,900,000	\$ 3,900,000	\$ 3,900,000
Mutual Securities	1,000,000	4,000,000	4,000,000	4,000,000
SAMCO Capital Markets	<b>7,492,000</b>	<b>6,569,910</b>	<b>5,669,910</b>	<b>5,169,910</b>
Total Broker/Dealer	\$ 13,442,000	\$ 14,469,910	\$ 13,569,910	\$ 13,069,910
<b>Managed Pools/ Depository Bank</b>				
TexStar	\$ 3,718,347	\$ 3,580,895	\$ 2,095,889	\$ 2,106,147
Money Market	289,739	290,455	291,079	291,914
Bank Cash	12,535,526	7,729,768	7,399,923	7,919,114
Total Managed Pools/Depository Bank	\$ 16,543,612	\$ 11,601,117	\$ 9,786,891	\$ 10,317,175
Total Par Value:	\$ 29,985,612	\$ 26,071,027	\$ 23,356,801	\$ 23,387,085

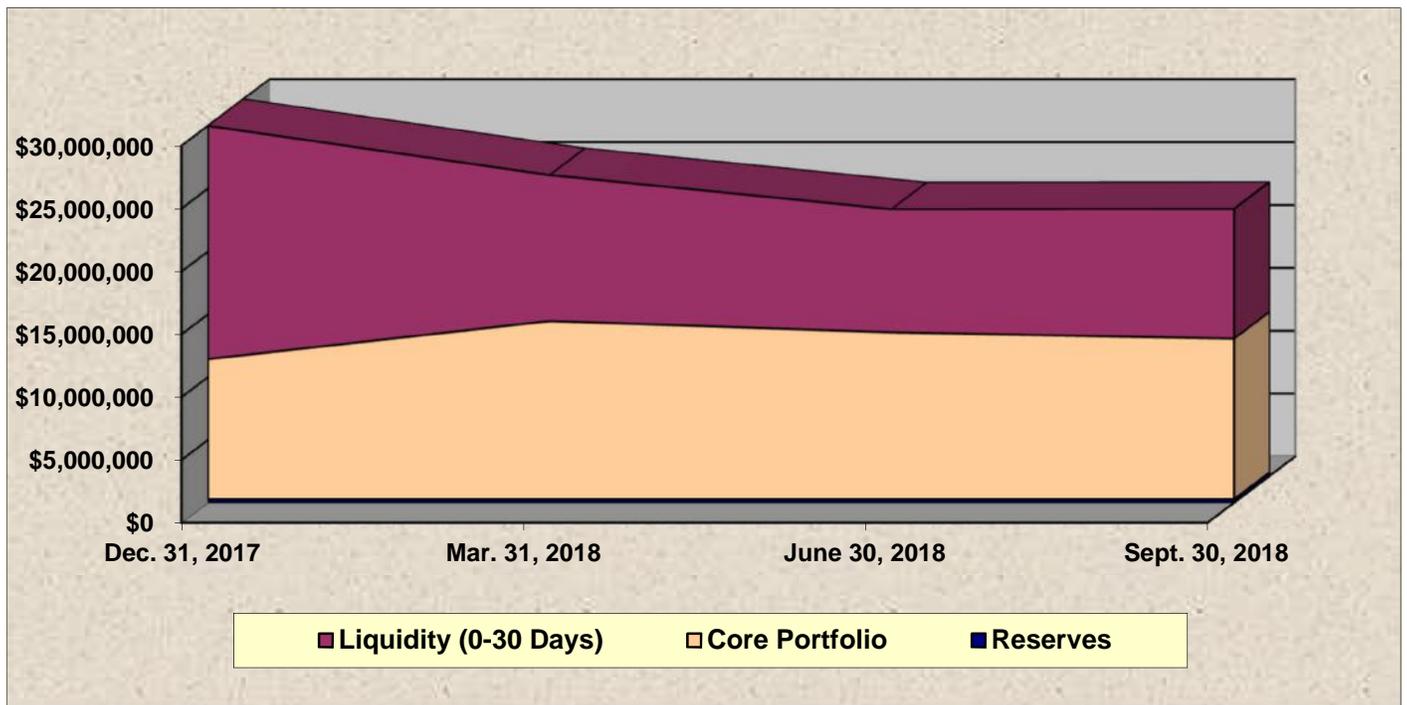


To guard against default possibilities, and to promote diversification of bidders, business with any one issuer, or investment broker, is limited to forty (40%) percent of the total portfolio at any point in time. As shown in the table below, the portfolio adhered to this provision throughout the quarter.

Performance Indicators	Policy Benchmark	Dec. 31, 2017	Mar. 31, 2018	June 30, 2018	Sept. 30, 2018
Highest Broker Percent ≤	40.00%	24.99%	25.20%	24.28%	22.11%

**ANNUAL INVESTMENT REPORT**  
*Portfolio Summary By Maturity*

Maturity Time Frame	Dec. 31, 2017	Mar. 31, 2018	June 30, 2018	Sept. 30, 2018
0-30 Days	\$ 18,548,612	\$ 11,601,117	\$ 9,786,891	\$ 10,317,175
31-90 Days	170,000	-	500,000	2,467,000
91-180 Days	1,000,000	500,000	2,467,000	4,150,000
181-270 Days	500,000	3,617,000	4,150,000	-
271-360 Days	3,617,000	4,150,000	-	750,000
361-450 Days	4,150,000	-	750,000	-
451-540 Days	-	500,000	4,000,000	4,000,000
541 Days & Over	2,000,000	5,702,910	1,702,910	1,702,910
	<u>\$ 29,985,612</u>	<u>\$ 26,071,027</u>	<u>\$ 23,356,801</u>	<u>\$ 23,387,085</u>



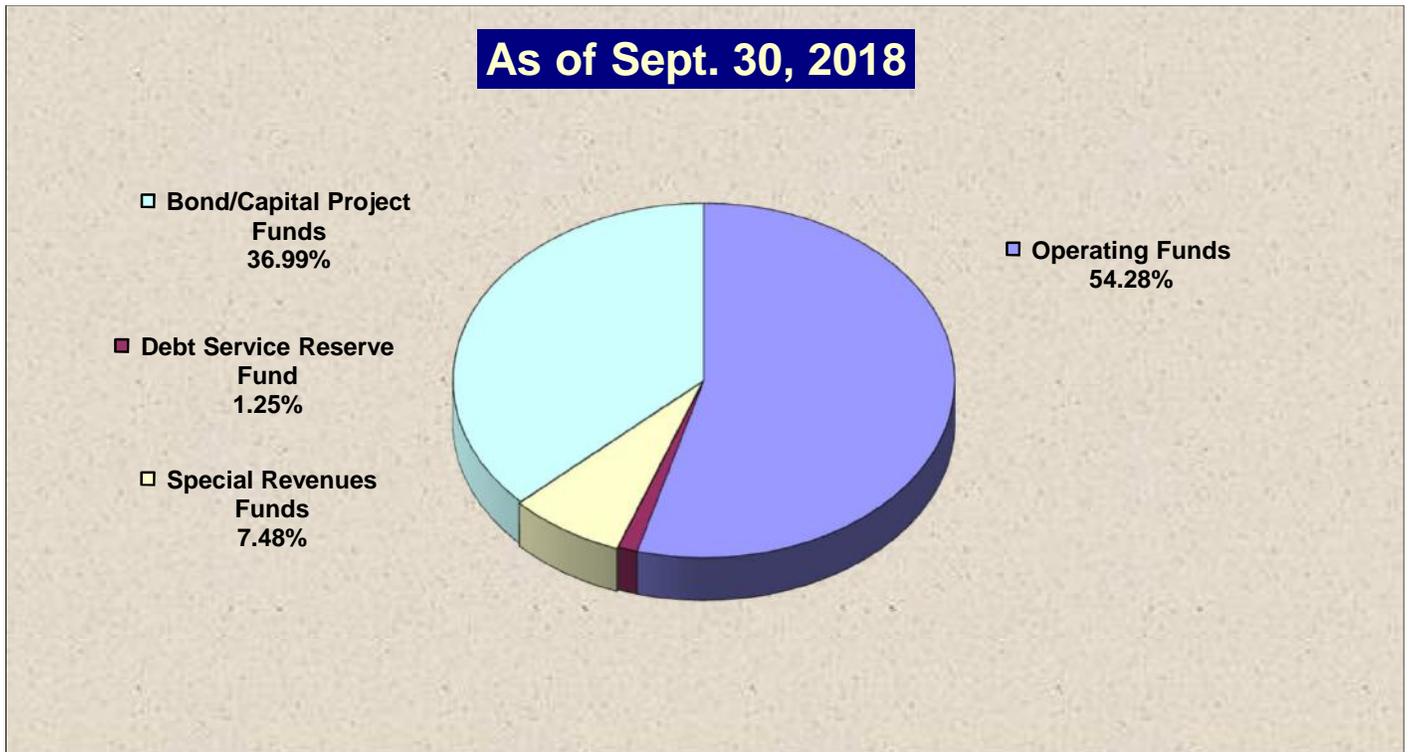
The risk of market price volatility is minimized through maturity diversification. The maturities on our investments are staggered over a series of three-month increments to provide cash flow based on the anticipated needs of the City. Liquidity is achieved by matching investment maturities with forecasted cash flow requirements and by investing in securities with active secondary markets. Short-term investment pools and money market funds provide daily liquidity and are utilized as a competitive yield alternative to fixed maturity investments.

Performance Indicators	Policy Benchmark	Dec. 31, 2017	Mar. 31, 2018	June 30, 2018	Sept. 30, 2018
Weighted Avg. Maturity ≤	365 Days	162	264	237	183
Maturities ≤30 days ≥	5.00%	61.86%	44.50%	41.90%	44.11%

**Note:** The portfolio is within the benchmark limits for the Weighted Average Maturity and liquidity is at 44% at the end of the fiscal year.

**ANNUAL INVESTMENT REPORT**  
**Portfolio Summary By Fund Type**

Fund Type	Dec. 31, 2017	Mar. 31, 2018	June 30, 2018	Sept. 30, 2018
Operating Funds	\$ 20,522,631	\$ 15,244,932	\$ 18,112,018	\$ 12,695,541
Debt Service Reserve Fund	289,739	290,232	291,079	291,914
Special Revenues Funds	170,000	1,209,715	350,000	1,749,237
Bond/Capital Project Funds	9,003,241	9,326,149	4,603,704	8,650,393
	<u>\$ 29,985,612</u>	<u>\$ 26,071,027</u>	<u>\$ 23,356,801</u>	<u>\$ 23,387,085</u>



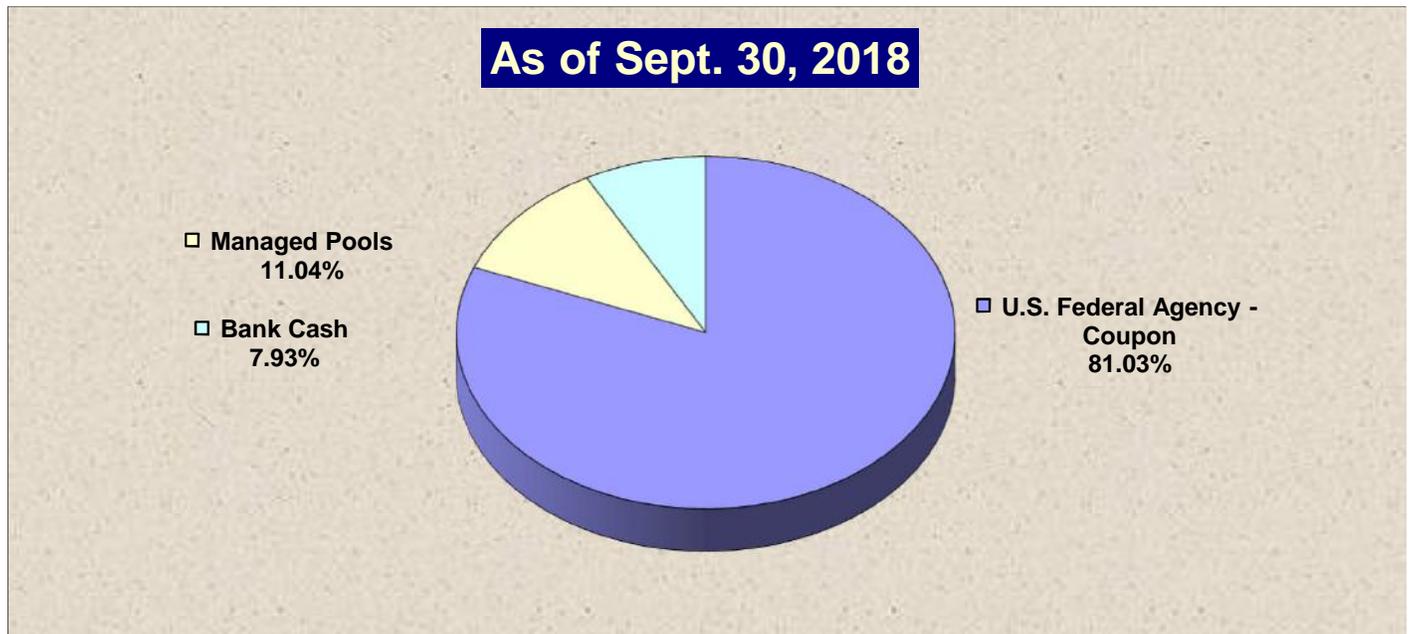
As shown in the graph above, the investments in the portfolio are distributed by fund type. Preservation and safety of principal of these investments is the most important strategy. All investments shall be high quality securities with no perceived default risk. Market fluctuations will occur; however, by managing the weighted-average days to maturity (WAM) for each fund type, losses are minimized.

Performance Indicators	Policy Benchmark	Dec. 31, 2017	Mar. 31, 2018	June 30, 2018	Sept. 30, 2018
WAM by Fund ≤					
Operating Funds	270 Days	155	247	212	164
Debt Service Reserve Funds	365 Days	1	1	1	1
Special Revenue Funds	270 Days	67	1	166	96
Bond Funds	365 Days	185	337	353	255

**Note:** The Weighted Average Maturity is below the policy benchmark for all funds as of September 30, 2018.

**ANNUAL INVESTMENT REPORT**  
Economic Development Corporation

Market Sector	Dec. 31, 2017	Mar. 31, 2018	June 30, 2018	Sept. 30, 2018
U.S. Federal Agency -Coupon	\$ 2,150,000	\$ 2,447,090	\$ 3,097,090	\$ 3,097,090
U.S. Federal Agency-Callable	250,000	750,000	-	-
Managed Pools	785,625	788,316	791,725	421,872
Bank Cash	229,643	121,164	270,936	303,201
<b>Total Par Value:</b>	<b>\$ 3,415,268</b>	<b>\$ 4,106,569</b>	<b>\$ 4,159,751</b>	<b>\$ 3,822,164</b>



The portfolio is restricted to U.S. Treasuries, U.S. Agencies, bonds issued by Texas public entities and rated AA or better, fully insured/collateralized certificates of deposit, and fully collateralized repurchase agreements. The investments are diversified by security type to protect interest income from the volatility of interest rates and to protect the portfolio from the risk of principal loss in any one market.

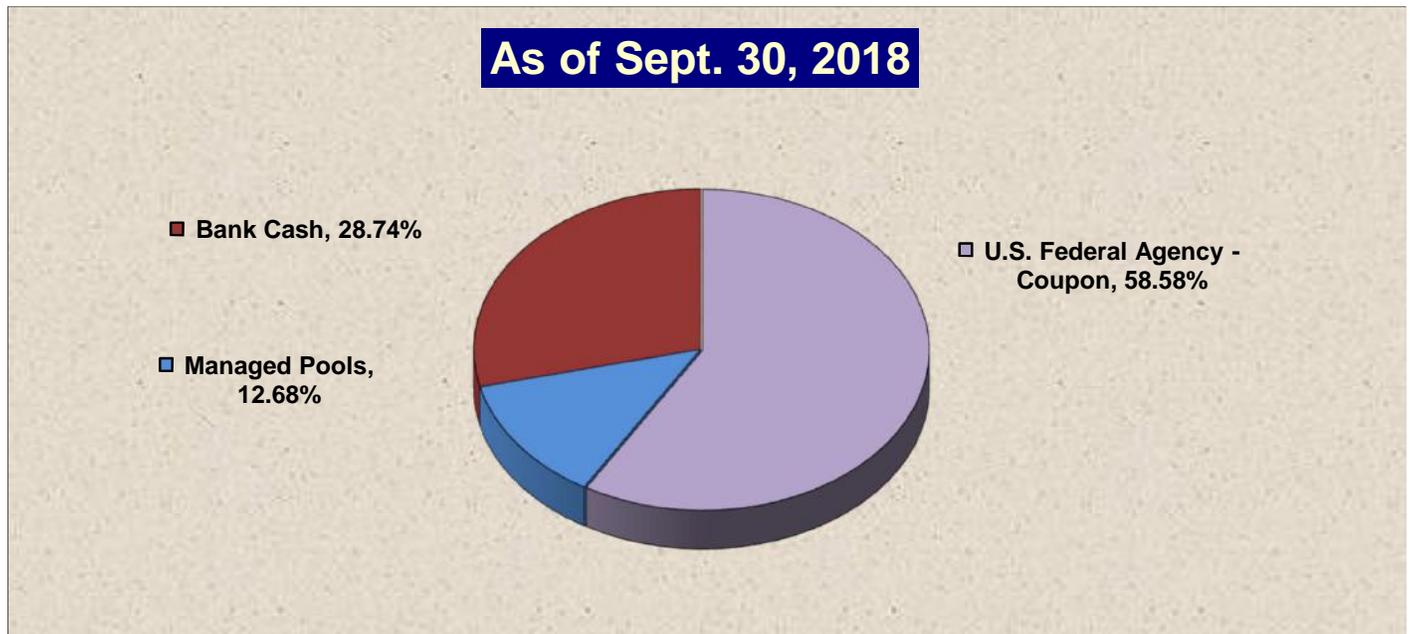
Performance Indicators	Policy Benchmark	Dec. 31, 2017	Mar. 31, 2018	June 30, 2018	Sept. 30, 2018
Average Yield to Maturity		1.166%	1.437%	1.520%	1.500%
≥ Policy Benchmark-(Six Month T-Bill)		1.484%	1.905%	2.099%	2.330%
Callable Securities ≤	30.00%	7.32%	18.26%	0.00%	0.00%
Investment By Type ≤					
U.S. Treasuries	100.00%	0.00%	0.00%	0.00%	0.00%
U.S. Agencies	100.00%	70.28%	77.85%	74.46%	81.03%
Managed Pools	100.00%	23.00%	19.20%	19.03%	11.04%
Money Market	100.00%	0.00%	0.00%	0.00%	0.00%
Bank Cash	100.00%	6.72%	2.95%	6.51%	7.93%
Weighted Avg. Maturity ≤	270 Days	220	288	205	149
Maturities ≤30 days ≥	5.00%	29.73%	22.15%	25.55%	18.97%

**Note:** The portfolio is within the policy benchmark for the Average Weighted Maturity for the fourth quarter of the fiscal year. The liquidity for the portfolio is 19% at the end of the fiscal year.

## ANNUAL INVESTMENT REPORT

### Street Maintenance Sales Tax

Market Sector	Dec. 31, 2017	Mar. 31, 2018	June 30, 2018	Sept. 30, 2018
U.S. Federal Agency -Coupon	\$ 400,000	\$ 200,000	\$ 700,000	\$ 700,000
U.S. Federal Agency-Callable	-	500,000	-	-
Managed Pools	-	150,132	150,771	151,509
Bank Cash	563,395	204,933	294,569	343,456
<b>Total Par Value:</b>	<b>\$ 963,395</b>	<b>\$ 1,055,065</b>	<b>\$ 1,145,340</b>	<b>\$ 1,194,966</b>



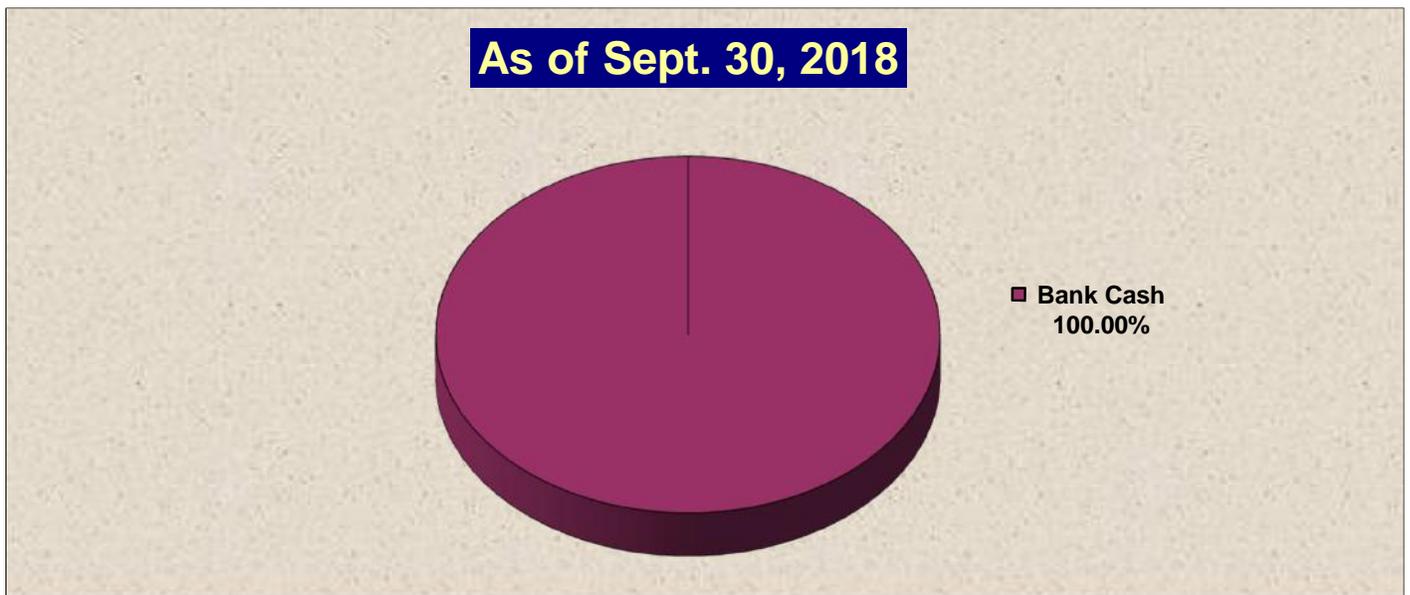
The portfolio is restricted to U.S. Treasuries, U.S. Agencies, bonds issued by Texas public entities and rated AA or better, fully insured/collateralized certificates of deposit, and fully collateralized repurchase agreements. The investments are diversified by security type to protect interest income from the volatility of interest rates and to protect the portfolio from the risk of principal loss in any one market.

Performance Indicators	Policy Benchmark	Dec. 31, 2017	Mar. 31, 2018	June 30, 2018	Sept. 30, 2018
Average Yield to Maturity		1.008%	1.036%	1.294%	1.304%
≥ <i>Policy Benchmark-(Six Month T-Bill)</i>		1.484%	1.905%	2.099%	2.330%
Callable Securities ≤	30.00%	0.00%	47.39%	0.00%	0.00%
Investment By Type ≤					
U.S. Treasuries	100.00%	0.00%	0.00%	0.00%	0.00%
U.S. Agencies	100.00%	41.52%	66.35%	61.12%	58.58%
Managed Pools	100.00%	0.00%	14.23%	13.16%	12.68%
Money Market	100.00%	0.00%	0.00%	0.00%	0.00%
Bank Cash	100.00%	58.48%	19.42%	25.72%	28.74%
Weighted Avg. Maturity ≤	270 Days	101	115	116	57
Maturities ≤ 30 days ≥	5.00%	58.48%	33.65%	38.88%	41.42%

**Note:** The portfolio is within the policy benchmark for the Weighted Average Maturity for the fiscal year. The liquidity for the portfolio is 41% at the end of the fiscal year.

**ANNUAL INVESTMENT REPORT**  
**Crime Control & Prevention District**

Market Sector	Dec. 31, 2017	Mar. 31, 2018	June 30, 2018	Sept. 30, 2018
U.S. Federal Agency -Coupon	\$ -	\$ -	\$ -	\$ -
Bank Cash	326,673	361,367	396,998	391,477
<b>Total Par Value:</b>	<b>\$ 326,673</b>	<b>\$ 361,367</b>	<b>\$ 396,998</b>	<b>\$ 391,477</b>



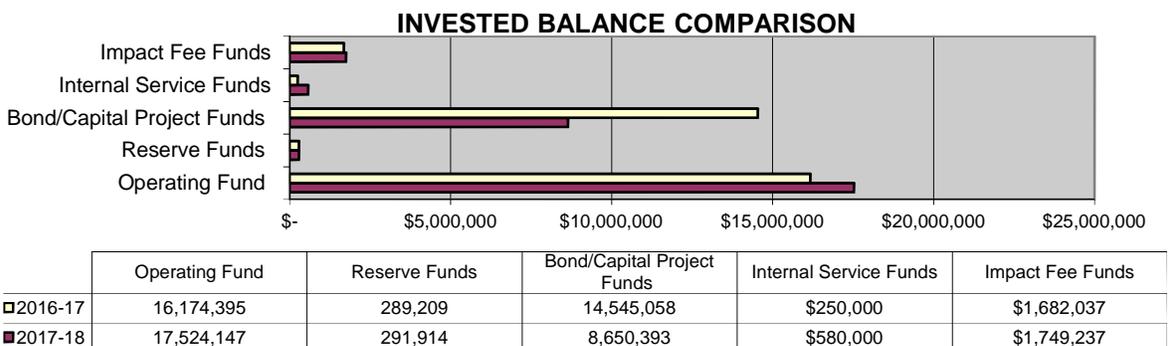
The portfolio is restricted to U.S. Treasuries, U.S. Agencies, bonds issued by Texas public entities and rated AA or better, fully insured/collateralized certificates of deposit, and fully collateralized repurchase agreements. The investments are diversified by security type to protect interest income from the volatility of interest rates and to protect the portfolio from the risk of principal loss in any one market.

Performance Indicators	Policy Benchmark	Dec. 31, 2017	Mar. 31, 2018	June 30, 2018	Sept. 30, 2018
Average Yield to Maturity		1.000%	1.000%	1.000%	1.000%
≥ Policy Benchmark-(Six Month T-Bill)		1.484%	1.905%	2.099%	2.330%
Callable Securities ≤	30.00%	0.00%	0.00%	0.00%	0.00%
Investment By Type ≤					
U.S. Treasuries	100.00%	0.00%	0.00%	0.00%	0.00%
U.S. Agencies	100.00%	0.00%	0.00%	0.00%	0.00%
Managed Pools	100.00%	0.00%	0.00%	0.00%	0.00%
Bank Cash	100.00%	100.00%	100.00%	100.00%	100.00%
Weighted Avg. Maturity ≤	270 Days	1	1	1	1

**Note:** Due to liquidity needs, the fund balance is not invested. All funds are held in the bank account.

**CITY OF CORINTH**  
**INVESTED BALANCE COMPARISON**  
*(For Periods Ending September 30)*

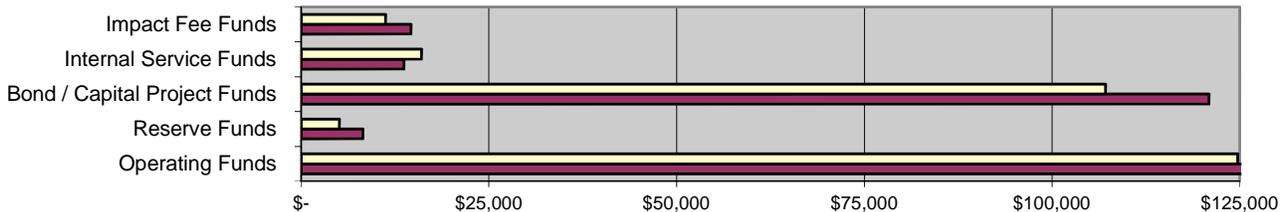
<b>Fund Name</b>	<b>Actual 2017-18</b>	<b>Actual 2016-17</b>	<b>Variance</b>
<b>OPERATING FUNDS</b>			
100 General Fund	\$ 4,902,875	\$ 4,922,000	\$ (19,125)
110 Water/Sewer Operations	2,689,684	1,811,724	877,960
120 Storm Water Utility Fund	648,958	800,839	(151,881)
130 Economic Development Corporation	3,822,164	3,470,022	352,142
131 Crime Control & Prevention District	391,477	299,739	91,738
132 Street Maintenance Sales Tax	1,194,966	888,347	306,619
Independent Bank Cash	3,874,024	3,981,724	(107,700)
	<u>\$ 17,524,147</u>	<u>\$ 16,174,395</u>	<u>\$ 1,349,752</u>
<b>RESERVE FUNDS</b>			
200 Debt Service	\$ 291,914	\$ 289,209	\$ 2,705
	<u>\$ 291,914</u>	<u>\$ 289,209</u>	<u>\$ 2,705</u>
<b>BOND / CAPITAL PROJECTS FUNDS</b>			
193 General Fund Capital Expenditure Fund	\$ 1,432,910	\$ 1,455,000	\$ (22,090)
194 Utility Capital Expenditure Fund	650,000	-	650,000
706 GF Capital Projects - 2016 C.O.	1,200,000	7,539,655	(6,339,655)
709 GF Capital Projects - 2017 C.O.	921,630	2,000,853	(1,079,223)
803 Water - 2016 C.O.	1,150,000	-	1,150,000
804 Water - 2017 C.O.	250,000	-	250,000
805 Wastewater - 2017 C.O.	250,000	-	250,000
Independent Bank Cash	2,795,853	3,549,549	(753,696)
	<u>\$ 8,650,393</u>	<u>\$ 14,545,058</u>	<u>\$ (5,894,665)</u>
<b>INTERNAL SERVICE FUNDS</b>			
300 General Fund Vehicle Replacement	-	-	-
301 Fire Vehicle Replacement	330,000	-	330,000
302 Technology Replacement	-	-	-
310 Utility Vehicle Replacement	250,000	250,000	-
311 Utility Meter Replacement	-	-	-
	<u>\$ 580,000</u>	<u>\$ 250,000</u>	<u>\$ 330,000</u>
<b>IMPACT FEE FUNDS</b>			
610 Water/Sewer Impact Fees	-	170,000	(170,000)
611 Wastewater Impact Fees	500,000	-	500,000
620 Storm Drainage Impact Fees	-	-	-
630 Roadway Impact Fees	-	-	-
699 Street Escrow Fund	-	-	-
Independent Bank Cash	1,249,237	1,512,037	(262,800)
	<u>\$ 1,749,237</u>	<u>\$ 1,682,037</u>	<u>\$ 67,200</u>
	<u><u>\$ 28,795,691</u></u>	<u><u>\$ 32,940,699</u></u>	<u><u>\$ (4,145,008)</u></u>



**CITY OF CORINTH**  
**INTEREST EARNINGS COMPARISON**  
*(For Periods Ending September 30)*

<b>Fund</b>	<b>Name</b>	<b>Actual 2017-18</b>	<b>Actual 2016-17</b>	<b>Variance</b>
<b>OPERATING FUNDS:</b>				
100	General Fund	123,265	65,390	57,875
110	Water/Sewer Operations	26,917	14,632	12,286
120	Storm Water Utility Fund	11,142	6,400	4,742
130	Economic Development Corporation	48,456	29,498	18,957
131	Crime Control & Prevention District	3,340	2,034	1,306
132	Street Maintenance Sales Tax	11,953	6,788	5,165
		<b>\$ 225,073</b>	<b>\$ 124,742</b>	<b>\$ 100,331</b>
<b>RESERVE FUNDS:</b>				
200	Debt Service	\$ 8,215	\$ 5,081	\$ 3,134
		<b>\$ 8,215</b>	<b>\$ 5,081</b>	<b>\$ 3,134</b>
<b>BOND /CAPITAL PROJECTS FUNDS</b>				
193	General Fund Capital Expenditure Fund	21,153	17,620	3,533
194	Utility Capital Expenditure Fund	5,545	3,468	2,077
706	GF Capital Projects - 2016 C.O.	32,536	82,653	(50,117)
709	GF Capital Projects - 2017 C.O.	28,772	3,376	25,396
803	Water - 2016 C.O.	20,762	-	20,762
804	Water - 2017 C.O.	6,250	-	6,250
805	Wastewater - 2017 C.O.	5,897	-	5,897
		<b>\$ 120,915</b>	<b>\$ 107,117</b>	<b>\$ 13,798</b>
<b>INTERNAL SERVICE FUNDS</b>				
300	General Fund Vehicle Replacement	1,490	944	546
301	Fire Vehicle Replacement	4,411	2,863	1,548
302	Technology Replacement	1,063	306	757
310	Utility Vehicle Replacement	5,667	3,965	1,701
311	Utility Meter Replacement	1,087	7,970	(6,883)
		<b>\$ 13,718</b>	<b>\$ 16,048</b>	<b>\$ (2,330)</b>
<b>IMPACT FEE FUNDS</b>				
610	Water/Sewer Impact Fees	3,538	3,571	(33)
611	Wastewater Impact Fees	7,016	2,920	4,097
620	Storm Drainage Impact Fees	842	766	75
630	Roadway Impact Fees	1,838	2,762	(923)
630	Street Escrow	1,411	1,205	206
		<b>\$ 14,646</b>	<b>\$ 11,223</b>	<b>\$ 3,422</b>
		<b>\$ 382,567</b>	<b>\$ 264,211</b>	<b>\$ 118,355</b>

**INTEREST EARNINGS COMPARISON**



	Operating Funds	Reserve Funds	Bond / Capital Project Funds	Internal Service Funds	Impact Fee Funds
2016-17	\$124,742	\$5,081	\$107,117	\$16,048	\$11,223
2017-18	\$225,073	\$8,215	\$120,915	\$13,718	\$14,646

City of Corinth, Texas

ANNUAL INVESTMENT REPORT

*For Fiscal Year Ended September 30, 2018*



**APPENDIX A**

**First Southwest Portfolio Assessment**

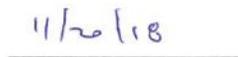
**City of Corinth, Texas**  
**Portfolio Assessment**  
Quarter Ending September 30, 2018

*Fund Groups Included: Consolidated, Eco Development, Crime Control and Street Maintenance Tax.*

- The Fed was unusually active during the recently completed fiscal year, raising the overnight rate target by 25 bps in December 2017, March 2018, June 2018 and September 2018. The September increase was the eighth tightening move since the Fed began “normalizing” policy *from zero* in December 2015. The significance of this aggressive Fed action is that fixed income investors are experiencing *unrealized* losses, and in most cases *a portfolio yield below established benchmarks*. This will continue to be the case as long as the Fed is tightening policy. The shorter the weighted average maturity (WAM), the smaller the unrealized loss is likely to be. This is a long way of saying that, at 183 days, the City’s overall portfolio is well positioned to minimize unrealized losses and benefit from future rate increases.
- The City’s consolidated portfolio yield was 1.38% at quarter end. This is 31 basis points above the average yield at the end of the last fiscal year, but approximately 75 basis points below the six month trailing average of the six-month Treasury bill. The most obvious reason for the shortfall is that 34% of available funds are held at the depository bank earning 1.0%. Adjusting the cash rate to match the month-end TexPool 7-day average rate of 2.07% would boost the overall portfolio yield to 1.76%.
- The Economic Development Corp, Street Maintenance Tax and Crime Control and Prevention portfolios are also held back by the same low 1.0% earnings rate.
- There was no undue credit risk assumed; no direct exposure to foreign markets, leverage or speculation in any of the portfolios.
- Bank deposits are adequately secured through a Federal Home Loan Bank (FHLB) standby letter of credit in the amount of \$10 million effective 8/16/2018.
- The portfolio strategy and investment management appear prudent, and investment reporting appears accurate.
- Coastal Securities was acquired by FTN Financial meaning a change is required in approved brokers.



Scott D. McIntyre, CFA  
Managing Director



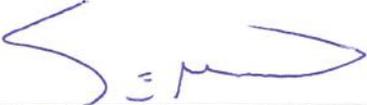
Date



**City of Corinth, Texas**  
Portfolio Exceptions  
Quarter Ending September 30, 2018  
*Fund Groups Included: Consolidated, Eco Development, Crime Control and Street Maintenance Tax.*

The following exception(s) were noted during our review of the above-captioned investment report:

There were no exceptions noted.

  
\_\_\_\_\_  
Scott D. McIntyre, CFA  
Managing Director  
FirstSouthwest Asset Management, LLC

11/20/18  
\_\_\_\_\_  
Date

City of Corinth, Texas

ANNUAL INVESTMENT REPORT

*For Fiscal Year Ended September 30, 2018*



**APPENDIX B**

**Investment Report  
For Month Ending September 30, 2018**



**City of Corinth portfolio  
Texas Compliance Change in Val Report  
Sorted by Fund  
October 1, 2017 - September 30, 2018**

Inv #	Issuer	Fund	Purch Date	Interest Accrual	Beginning Book Value				Ending Book Value
Cusip	Par Value	YTM	Mat Date	Interest Received	Beginning Market Value	Purchases/ Additions	Redemptions	Change in Value	Ending Market Value
<b>Fund: Pooled Cash</b>									
10012	NTHSTR	00	10/01/2017	83,466.89	9,043,310.04	9,633,609.67	10,757,805.64	-1,124,195.97	7,919,114.07
SYS10012	7,919,114.07	1.000	/ /	0.00	9,043,310.04	9,633,609.67	10,757,805.64	-1,124,195.97	7,919,114.07
<b>Sub Totals For: Fund: Pooled Cash</b>				83,466.89	9,043,310.04	9,633,609.67	10,757,805.64	-1,124,195.97	7,919,114.07
				0.00	9,043,310.04	9,633,609.67	10,757,805.64	-1,124,195.97	7,919,114.07
<b>Fund: Pooled Cash- Crime C</b>									
10323	NTHSTR	00A	10/01/2017	3,558.35	299,739.29	107,700.78	15,963.14	91,737.64	391,476.93
SYS10322	391,476.93	1.000	/ /	0.00	299,739.29	107,700.78	15,963.14	91,737.64	391,476.93
<b>Sub Totals For: Fund: Pooled Cash- Crime C</b>				3,558.35	299,739.29	107,700.78	15,963.14	91,737.64	391,476.93
				0.00	299,739.29	107,700.78	15,963.14	91,737.64	391,476.93
<b>Fund: Pooled Cash-Eco Dev</b>									
10021	NTHSTR	00B	10/01/2017	516.27	336,545.38	536,629.13	569,973.07	-33,343.94	303,201.44
SYS10021	303,201.44	0.100	/ /	0.00	336,545.38	536,629.13	569,973.07	-33,343.94	303,201.44
<b>Sub Totals For: Fund: Pooled Cash-Eco Dev</b>				516.27	336,545.38	536,629.13	569,973.07	-33,343.94	303,201.44
				0.00	336,545.38	536,629.13	569,973.07	-33,343.94	303,201.44
<b>Fund: Pooled Cash - Street</b>									
10401	NTHSTR	00C	10/01/2017	3,504.85	488,346.70	368,148.49	513,038.71	-144,890.22	343,456.48
SYS10042	343,456.48	1.000	/ /	0.00	488,346.70	368,148.49	513,038.71	-144,890.22	343,456.48
<b>Sub Totals For: Fund: Pooled Cash - Street</b>				3,504.85	488,346.70	368,148.49	513,038.71	-144,890.22	343,456.48
				0.00	488,346.70	368,148.49	513,038.71	-144,890.22	343,456.48

**Fund: General Fund**

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Cusip	Par Value	YTM	Mat Date	Interest Received	Beginning Market Value	Purchases/ Additions	Redemptions	Change in Value	Ending Market Value
10580	FHLMC	100	06/30/2017	531.67	275,012.22	0.00	275,000.00	-275,012.22	0.00
3134G9WU7	0.00	0.000	12/28/2017	1,087.78	274,819.72	0.00	275,000.00	-274,819.72	0.00
10590	FNMA	100	09/30/2017	1,795.00	149,791.94	0.00	149,890.70	-149,791.94	0.00
3136G3AG0	0.00	0.000	02/26/2019	1,800.00	149,315.00	0.00	149,890.70	-149,315.00	0.00
10592	FFCB	100	09/30/2017	6,855.90	500,343.75	0.00	500,000.00	-500,343.75	0.00
3133EHYJ6	0.00	0.000	09/12/2019	6,875.00	498,643.75	0.00	500,000.00	-498,643.75	0.00
10607	FFCB	100	02/28/2018	7,348.50	0.00	598,153.18	0.00	598,536.58	598,536.58
3133EH5G4	600,000.00	2.181	01/04/2021	4,347.00	0.00	598,153.18	0.00	587,700.00	587,700.00
10140	TXSTAR	100	10/01/2017	6,674.42	0.00	505,875.27	0.00	505,875.27	505,875.27
SYS10140	505,875.27	1.999	/ /	5,875.27	0.00	505,875.27	0.00	0.00	0.00
10327	NTHSTR	100	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10327	0.00	0.450	/ /	0.00	0.00	0.00	0.00	0.00	0.00
10574	FNMA	100	03/20/2017	1,837.50	146,960.92	0.00	0.00	34.40	146,995.32
3136G2H91	147,000.00	1.273	11/20/2018	1,837.50	146,661.90	0.00	0.00	132.30	146,794.20
10563	FHLB	100	12/19/2016	4,296.52	499,159.66	0.00	499,703.05	-499,159.66	0.00
313382CU5	0.00	0.000	11/27/2018	6,277.08	498,150.00	0.00	499,703.05	-498,150.00	0.00
10565	FHLB	100	12/20/2016	3,915.45	400,060.64	0.00	400,022.97	-400,060.64	0.00
3130AAHG6	0.00	0.000	12/14/2018	5,472.89	399,440.00	0.00	400,022.97	-399,440.00	0.00
10564	FFCB	100	12/20/2016	8,333.34	1,000,000.00	0.00	1,000,000.00	-1,000,000.00	0.00
3133EGW35	0.00	0.000	12/20/2018	11,840.28	996,000.00	0.00	1,000,000.00	-996,000.00	0.00
10556	FNMA	100	08/05/2016	1,605.00	150,449.65	0.00	0.00	-363.76	150,085.89
3136G16Y0	150,000.00	0.824	12/26/2018	1,605.00	149,295.00	0.00	0.00	285.00	149,580.00
10567	FFCB	100	01/03/2017	5,866.67	499,905.83	0.00	499,974.58	-499,905.83	0.00
3133EG2S3	0.00	0.000	01/03/2019	7,431.11	498,750.00	0.00	499,974.58	-498,750.00	0.00

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10569	FHLB	100	01/17/2017	5,729.17	500,000.00	0.00	500,000.00	-500,000.00	0.00
3130AAMC9	0.00	0.000	01/17/2019	7,013.89	498,850.00	0.00	500,000.00	-498,850.00	0.00
10570	FFCB	100	02/01/2017	6,481.95	500,000.00	0.00	500,000.00	-500,000.00	0.00
3133EG5Q4	0.00	0.000	02/01/2019	7,565.28	498,750.00	0.00	500,000.00	-498,750.00	0.00
10599	FAMC	100	01/17/2018	14,111.11	0.00	1,000,000.00	0.00	1,000,000.00	1,000,000.00
3132X0E72	1,000,000.00	2.000	01/17/2020	10,000.00	0.00	1,000,000.00	0.00	991,400.00	991,400.00
10601	FHLB	100	01/29/2018	13,578.89	0.00	998,830.00	0.00	999,223.25	999,223.25
3130ADFP2	1,000,000.00	2.080	01/29/2020	10,100.00	0.00	998,830.00	0.00	990,000.00	990,000.00
10600	FHLB	100	01/30/2018	12,110.66	0.00	1,000,000.00	0.00	1,000,000.00	1,000,000.00
3130ADDH2	1,000,000.00	1.718	01/30/2020	8,125.00	0.00	1,000,000.00	0.00	997,400.00	997,400.00
10572	FHLMC	100	02/14/2017	1,246.87	300,000.00	0.00	300,000.00	-300,000.00	0.00
3134GAX90	0.00	0.000	02/14/2020	1,687.50	299,880.00	0.00	300,000.00	-299,880.00	0.00
10596	FHLB	100	11/29/2017	8,179.17	0.00	499,280.00	0.00	499,482.08	499,482.08
3130ACTL8	500,000.00	1.999	11/25/2020	4,766.67	0.00	499,280.00	0.00	490,100.00	490,100.00
<b>Sub Totals For: Fund: General Fund</b>				110,497.79	4,921,684.61	4,602,138.45	4,624,591.30	-21,486.22	4,900,198.39
				103,707.25	4,908,555.37	4,602,138.45	4,624,591.30	-555,581.17	4,352,974.20
<b>Fund: Utility Fund</b>									
10533	FFCB	110	01/27/2016	408.33	300,000.00	0.00	300,000.00	-300,000.00	0.00
3133EFWC7	0.00	0.000	11/27/2017	1,312.50	299,850.00	0.00	300,000.00	-299,850.00	0.00
10581	FHLMC	110	06/30/2017	725.00	375,016.67	0.00	375,000.00	-375,016.67	0.00
3134G9WU7	0.00	0.000	12/28/2017	1,483.33	374,754.17	0.00	375,000.00	-374,754.17	0.00
10615	FHLB	110	06/30/2018	1,324.55	0.00	400,022.97	0.00	400,243.11	400,243.11
3130AAHG6	400,000.00	1.296	12/14/2018	0.00	0.00	400,022.97	0.00	399,512.89	399,512.89
10612	FFCB	110	05/31/2018	1,416.67	0.00	340,000.00	0.00	340,000.00	340,000.00
3133EGW35	340,000.00	1.249	12/20/2018	224.31	0.00	340,000.00	0.00	339,184.00	339,184.00

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Cusip	Par Value	YTM	Mat Date	Interest Received	Beginning Market Value	Purchases/ Additions	Redemptions	Change in Value	Ending Market Value
10557	FNMA	110	08/05/2016	2,889.00	270,809.37	0.00	0.00	-654.77	270,154.60
3136G16Y0	270,000.00	0.824	12/26/2018	2,889.00	268,731.00	0.00	0.00	513.00	269,244.00
10624	FFCB	110	09/30/2018	18.05	0.00	500,000.00	0.00	501,065.28	501,065.28
3133EG5Q4	500,000.00	1.297	02/01/2019	0.00	0.00	500,000.00	0.00	499,015.28	499,015.28
10211	TXSTAR	110	10/01/2017	14,274.07	616,724.34	562,959.51	0.00	562,959.51	1,179,683.85
SYS10211	1,179,683.85	1.999	/ /	12,959.51	616,724.34	562,959.51	0.00	562,959.51	1,179,683.85
10358	NTHSTR	110	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10358	0.00	0.450	/ /	0.00	0.00	0.00	0.00	0.00	0.00
10018	TXPOOL	110	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10018	0.00	5.271	/ /	0.00	0.00	0.00	0.00	0.00	0.00
10023	FEDER	110	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10023	0.00	5.190	/ /	0.00	0.00	0.00	0.00	0.00	0.00
10588	FHLB	110	09/01/2017	4,763.89	251,839.14	0.00	250,000.00	-251,839.14	0.00
313375K48	0.00	0.000	09/14/2018	5,000.00	251,500.00	0.00	250,000.00	-251,500.00	0.00
<b>Sub Totals For: Fund: Utility Fund</b>				25,819.56	1,814,389.52	1,802,982.48	925,000.00	876,757.32	2,691,146.84
				23,868.65	1,811,559.51	1,802,982.48	925,000.00	875,080.51	2,686,640.02
<b>Fund: Drainage Fund</b>									
10582	FHLMC	120	06/30/2017	676.67	350,015.56	0.00	350,000.00	-350,015.56	0.00
3134G9WU7	0.00	0.000	12/28/2017	1,384.44	349,770.56	0.00	350,000.00	-349,770.56	0.00
10558	FNMA	120	08/05/2016	1,605.00	150,449.65	0.00	0.00	-363.76	150,085.89
3136G16Y0	150,000.00	0.824	12/26/2018	1,605.00	149,295.00	0.00	0.00	285.00	149,580.00
10610	FNMA	120	04/01/2018	1,587.50	0.00	249,356.41	0.00	249,587.18	249,587.18
3136G2XJ1	250,000.00	1.456	08/23/2019	1,252.36	0.00	249,356.41	0.00	246,825.00	246,825.00
10302	TXSTAR	120	10/01/2017	5,478.13	300,838.98	248,118.81	300,000.00	-51,881.19	248,957.79
SYS10302	248,957.79	1.999	/ /	5,352.66	300,838.98	248,118.81	300,000.00	-51,881.19	248,957.79

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Cusip	Par Value	YTM	Mat Date	Interest Received	Beginning Market Value	Purchases/ Additions	Redemptions	Change in Value	Ending Market Value
10332	NTHSTR	120	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10332	0.00	0.450	/ /	0.00	0.00	0.00	0.00	0.00	0.00
<b>Sub Totals For: Fund: Drainage Fund</b>				9,347.30	801,304.19	497,475.22	650,000.00	-152,673.33	648,630.86
				9,594.46	799,904.54	497,475.22	650,000.00	-154,541.75	645,362.79
<b>Fund: Economic Development</b>									
10593	FAMC	130	09/30/2017	1,500.00	500,737.50	0.00	500,000.00	-500,737.50	0.00
3132X0NNS6	0.00	0.000	02/01/2018	1,512.50	500,137.50	0.00	500,000.00	-500,137.50	0.00
10616	FHLB	130	06/30/2018	3,475.69	0.00	1,000,000.00	0.00	1,002,215.28	1,002,215.28
3130ACR89	1,000,000.00	1.371	11/02/2018	0.00	0.00	1,000,000.00	0.00	1,001,515.28	1,001,515.28
10566	FHLB	130	12/20/2016	2,458.07	350,053.06	0.00	350,029.41	-350,053.06	0.00
3130AAHG6	0.00	0.000	12/14/2018	3,820.83	349,510.00	0.00	350,029.41	-349,510.00	0.00
10606	FHLMC	130	02/28/2018	4,881.25	0.00	496,479.89	0.00	497,500.00	497,500.00
3134G35V8	500,000.00	2.003	03/13/2020	4,468.75	0.00	496,479.89	0.00	491,750.00	491,750.00
10007	TXPOOL	130	10/01/2017	10,374.47	783,476.80	10,395.30	372,000.00	-361,604.70	421,872.10
SYS10007	421,872.10	1.995	/ /	10,395.30	783,476.80	10,395.30	372,000.00	-361,604.70	421,872.10
10379	NTHSTR	130	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10379	0.00	0.250	/ /	0.00	0.00	0.00	0.00	0.00	0.00
10534	FFCB	130	01/27/2016	612.50	450,000.00	0.00	450,000.00	-450,000.00	0.00
3133EFWC7	0.00	0.000	11/27/2017	1,968.75	449,775.00	0.00	450,000.00	-449,775.00	0.00
10595	FHLB	130	11/06/2017	6,770.83	0.00	500,100.00	0.00	500,009.72	500,009.72
3130ACRE6	500,000.00	1.479	11/06/2018	3,750.00	0.00	500,100.00	0.00	499,650.00	499,650.00
10583	FHLB	130	08/15/2017	5,750.00	500,312.54	0.00	0.00	-433.29	499,879.25
313381EC5	500,000.00	1.285	12/06/2018	4,647.92	500,252.08	0.00	0.00	-1,102.08	499,150.00
10578	FFCB	130	04/17/2017	3,960.00	300,000.00	0.00	0.00	0.00	300,000.00
3133EHFK4	300,000.00	1.320	04/17/2019	3,960.00	299,190.00	0.00	0.00	-1,260.00	297,930.00

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10562	FNMA	130	12/08/2016	1,587.50	249,125.64	0.00	249,356.41	-249,125.64	0.00
3136G2XJ1	0.00	0.000	08/23/2019	1,922.64	248,300.00	0.00	249,356.41	-248,300.00	0.00
10609	FFCB	130	03/27/2018	3,606.34	0.00	297,000.87	0.00	297,023.65	297,023.65
3133EJHL6	297,090.00	2.390	03/27/2020	3,527.94	0.00	297,000.87	0.00	295,129.21	295,129.21
<b>Sub Totals For: Fund: Economic Development</b>				44,976.65	3,133,705.54	2,303,976.06	1,921,385.82	384,794.46	3,518,500.00
				39,974.63	3,130,641.38	2,303,976.06	1,921,385.82	376,355.21	3,506,996.59
<b>Fund: Street Maintenance S</b>									
10551	FHLB	132	06/16/2016	420.00	200,000.00	0.00	200,000.00	-200,000.00	0.00
3130A8HM8	0.00	0.000	01/16/2018	720.00	199,820.00	0.00	200,000.00	-199,820.00	0.00
10617	FHLB	132	06/30/2018	1,453.48	0.00	499,703.05	0.00	500,413.96	500,413.96
313382CU5	500,000.00	1.294	11/27/2018	0.00	0.00	499,703.05	0.00	499,727.08	499,727.08
10579	FFCB	132	04/17/2017	2,640.00	200,000.00	0.00	0.00	0.00	200,000.00
3133EHFK4	200,000.00	1.320	04/17/2019	2,640.00	199,460.00	0.00	0.00	-840.00	198,620.00
10155	TXSTAR	132	10/01/2017	1,748.60	0.00	151,509.25	0.00	151,509.25	151,509.25
SYS10155	151,509.25	1.999	/ /	1,509.25	0.00	151,509.25	0.00	0.00	0.00
10331	NTHSTR	132	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10331	0.00	0.450	/ /	0.00	0.00	0.00	0.00	0.00	0.00
<b>Sub Totals For: Fund: Street Maintenance S</b>				6,262.08	400,000.00	651,212.30	200,000.00	451,923.21	851,923.21
				4,869.25	399,280.00	651,212.30	200,000.00	299,067.08	698,347.08
<b>Fund: General Fund Capital</b>									
10589	FHLB	193	09/01/2017	4,763.89	251,839.14	0.00	250,000.00	-251,839.14	0.00
313375K48	0.00	0.000	09/14/2018	5,000.00	251,500.00	0.00	250,000.00	-251,500.00	0.00
10613	FFCB	193	05/31/2018	1,375.00	0.00	330,000.00	0.00	330,000.00	330,000.00
3133EGW35	330,000.00	1.249	12/20/2018	217.71	0.00	330,000.00	0.00	329,208.00	329,208.00

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Cusip	Par Value	YTM	Mat Date	Interest Received	Beginning Market Value	Purchases/ Additions	Redemptions	Change in Value	Ending Market Value
10626	FFCB	193	09/30/2018	5.72	0.00	150,000.00	0.00	150,103.13	150,103.13
3133EHYJ6	150,000.00	1.374	09/12/2019	0.00	0.00	150,000.00	0.00	148,213.13	148,213.13
10608	FFCB	193	03/27/2018	2,463.10	0.00	202,849.13	0.00	202,864.69	202,864.69
3133EJHL6	202,910.00	2.390	03/27/2020	2,409.56	0.00	202,849.13	0.00	201,570.79	201,570.79
10464	NTHSTR	193	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10464	0.00	0.450	/ /	0.00	0.00	0.00	0.00	0.00	0.00
10535	FAMC	193	01/11/2016	1,507.95	455,146.50	0.00	455,000.00	-455,146.50	0.00
31315P5L9	0.00	0.000	01/08/2018	2,798.25	454,954.50	0.00	455,000.00	-454,954.50	0.00
10559	FHLMC	193	08/25/2016	5,000.00	500,000.00	0.00	0.00	0.00	500,000.00
3134G96J1	500,000.00	1.000	02/25/2019	5,000.00	496,350.00	0.00	0.00	750.00	497,100.00
10576	FNMA	193	04/06/2017	4,125.00	250,000.00	0.00	0.00	0.00	250,000.00
3135G0S46	250,000.00	1.644	01/27/2020	4,125.00	249,650.00	0.00	0.00	-3,425.00	246,225.00
<b>Sub Totals For: Fund: General Fund Capital</b>				19,240.66	1,456,985.64	682,849.13	705,000.00	-24,017.82	1,432,967.82
				19,550.52	1,452,454.50	682,849.13	705,000.00	-30,137.58	1,422,316.92
<b>Fund: Water/Wastewater Cap</b>									
10621	FFCB	194	08/31/2018	533.33	0.00	499,974.58	0.00	501,011.94	501,011.94
3133EG2S3	500,000.00	1.292	01/03/2019	0.00	0.00	499,974.58	0.00	499,481.11	499,481.11
10627	FFCB	194	09/30/2018	5.72	0.00	150,000.00	0.00	150,103.13	150,103.13
3133EHYJ6	150,000.00	1.374	09/12/2019	0.00	0.00	150,000.00	0.00	148,213.13	148,213.13
10465	NTHSTR	194	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10465	0.00	0.450	/ /	0.00	0.00	0.00	0.00	0.00	0.00
<b>Sub Totals For: Fund: Water/Wastewater Cap</b>				539.05	0.00	649,974.58	0.00	651,115.07	651,115.07
				0.00	0.00	649,974.58	0.00	647,694.24	647,694.24
<b>Fund: General Debt Service</b>									

**City of Corinth portfolio  
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Inv #	Issuer	Fund	Purch Date	Interest Accrual	Beginning Book Value				Ending Book Value
Cusip	Par Value	YTM	Mat Date	Interest Received	Beginning Market Value	Purchases/ Additions	Redemptions	Change in Value	Ending Market Value
10328	NTHSTR	200	10/01/2017	2,950.06	289,209.11	2,704.69	0.00	2,704.69	291,913.80
SYS10328	291,913.80	1.000	/ /	2,704.69	289,209.11	2,704.69	0.00	2,704.69	291,913.80
10017	TXSTAR	200	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10017	0.00	5.288	/ /	0.00	0.00	0.00	0.00	0.00	0.00
<b>Sub Totals For: Fund: General Debt Service</b>				2,950.06	289,209.11	2,704.69	0.00	2,704.69	291,913.80
				2,704.69	289,209.11	2,704.69	0.00	2,704.69	291,913.80
<b>Fund: GF Vehicle &amp; Equip</b>									
10462	NTHSTR	300	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10462	0.00	0.250	/ /	0.00	0.00	0.00	0.00	0.00	0.00
<b>Sub Totals For: Fund: GF Vehicle &amp; Equip</b>				0.00	0.00	0.00	0.00	0.00	0.00
				0.00	0.00	0.00	0.00	0.00	0.00
<b>Fund: Fire Vehicle Replace</b>									
10614	FFCB	301	05/31/2018	1,375.00	0.00	330,000.00	0.00	330,000.00	330,000.00
3133EGW35	330,000.00	1.249	12/20/2018	217.71	0.00	330,000.00	0.00	329,208.00	329,208.00
10510	NTHSTR	301	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10510	0.00	0.450	/ /	0.00	0.00	0.00	0.00	0.00	0.00
<b>Sub Totals For: Fund: Fire Vehicle Replace</b>				1,375.00	0.00	330,000.00	0.00	330,000.00	330,000.00
				217.71	0.00	330,000.00	0.00	329,208.00	329,208.00
<b>Fund: Utility Vehicle &amp; Eq</b>									
10577	FNMA	310	04/06/2017	4,125.00	250,000.00	0.00	0.00	0.00	250,000.00
3135G0S46	250,000.00	1.649	01/27/2020	4,125.00	249,650.00	0.00	0.00	-3,425.00	246,225.00
10463	NTHSTR	310	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10462	0.00	0.450	/ /	0.00	0.00	0.00	0.00	0.00	0.00
<b>Sub Totals For: Fund: Utility Vehicle &amp; Eq</b>				4,125.00	250,000.00	0.00	0.00	0.00	250,000.00
				4,125.00	249,650.00	0.00	0.00	-3,425.00	246,225.00

**City of Corinth portfolio**  
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Inv #	Issuer	Fund	Purch Date	Interest Accrual	Beginning Book Value				Ending Book Value
Cusip	Par Value	YTM	Mat Date	Interest Received	Beginning Market Value	Purchases/ Additions	Redemptions	Change in Value	Ending Market Value
<b>Fund: Utility Meter Replac</b>									
10511	NTHSTR	311	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10511	0.00	0.450	/ /	0.00	0.00	0.00	0.00	0.00	0.00
<b>Sub Totals For: Fund: Utility Meter Replac</b>				0.00	0.00	0.00	0.00	0.00	0.00
				0.00	0.00	0.00	0.00	0.00	0.00
<b>Fund: Water Impact Fees</b>									
10591	FHLB	610	09/30/2017	2,424.86	171,950.82	0.00	170,000.00	-171,950.82	0.00
313372SN5	0.00	0.000	03/09/2018	2,440.21	171,801.29	0.00	170,000.00	-171,801.29	0.00
10052	TXSTAR	610	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10013	0.00	0.209	/ /	0.00	0.00	0.00	0.00	0.00	0.00
<b>Sub Totals For: Fund: Water Impact Fees</b>				2,424.86	171,950.82	0.00	170,000.00	-171,950.82	0.00
				2,440.21	171,801.29	0.00	170,000.00	-171,801.29	0.00
<b>Fund: Wastewater Impact Fe</b>									
10611	FHLB	611	04/20/2018	2,050.51	0.00	350,029.41	0.00	350,009.17	350,009.17
3130AAHG6	350,000.00	1.296	12/14/2018	687.75	0.00	350,029.41	0.00	349,370.00	349,370.00
10625	FNMA	611	09/30/2018	5.00	0.00	149,890.70	0.00	150,061.45	150,061.45
3136G3AG0	150,000.00	1.379	02/26/2019	0.00	0.00	149,890.70	0.00	149,315.00	149,315.00
10315	TXSTAR	611	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10315	0.00	0.209	/ /	0.00	0.00	0.00	0.00	0.00	0.00
<b>Sub Totals For: Fund: Wastewater Impact Fe</b>				2,055.51	0.00	499,920.11	0.00	500,070.62	500,070.62
				687.75	0.00	499,920.11	0.00	498,685.00	498,685.00
<b>Fund: Roadway Impact Fees</b>									
10301	TXSTAR	630	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10301	0.00	0.209	/ /	0.00	0.00	0.00	0.00	0.00	0.00

**City of Corinth portfolio**  
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Inv #	Issuer	Fund	Purch Date	Interest Accrual	Beginning Book Value				Ending Book Value
Cusip	Par Value	YTM	Mat Date	Interest Received	Beginning Market Value	Purchases/ Additions	Redemptions	Change in Value	Ending Market Value
<b>Sub Totals For: Fund: Roadway Impact Fees</b>				0.00	0.00	0.00	0.00	0.00	0.00
				0.00	0.00	0.00	0.00	0.00	0.00
<b>Fund: Street Escrow</b>									
10329	NTHSTR	699	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10329	0.00	0.450	/ /	0.00	0.00	0.00	0.00	0.00	0.00
10019	TXPOOL	699	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10019	0.00	4.928	/ /	0.00	0.00	0.00	0.00	0.00	0.00
<b>Sub Totals For: Fund: Street Escrow</b>				0.00	0.00	0.00	0.00	0.00	0.00
				0.00	0.00	0.00	0.00	0.00	0.00
<b>Fund: Street 2007 CO</b>									
10064	TXPOOL	703	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10009	0.00	0.131	/ /	0.00	0.00	0.00	0.00	0.00	0.00
10138	TXSTAR	703	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10138	0.00	0.132	/ /	0.00	0.00	0.00	0.00	0.00	0.00
10330	NTHSTR	703	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10330	0.00	0.250	/ /	0.00	0.00	0.00	0.00	0.00	0.00
<b>Sub Totals For: Fund: Street 2007 CO</b>				0.00	0.00	0.00	0.00	0.00	0.00
				0.00	0.00	0.00	0.00	0.00	0.00
<b>Fund: Tech 2007 CO</b>									
10380	NTHSTR	704	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10380	0.00	0.613	/ /	0.00	0.00	0.00	0.00	0.00	0.00
10065	TXPOOL	704	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS100099	0.00	2.246	/ /	0.00	0.00	0.00	0.00	0.00	0.00
10139	TXSTAR	704	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10139	0.00	0.145	/ /	0.00	0.00	0.00	0.00	0.00	0.00

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Inv #	Issuer	Fund	Purch Date	Interest Accrual	Beginning Book Value				Ending Book Value
Cusip	Par Value	YTM	Mat Date	Interest Received	Beginning Market Value	Purchases/ Additions	Redemptions	Change in Value	Ending Market Value
<b>Sub Totals For: Fund: Tech 2007 CO</b>				0.00	0.00	0.00	0.00	0.00	0.00
				0.00	0.00	0.00	0.00	0.00	0.00
<b>Fund: Fire 2010 CO</b>									
10370	NTHSTR	705	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10370	0.00	0.510	/ /	0.00	0.00	0.00	0.00	0.00	0.00
<b>Sub Totals For: Fund: Fire 2010 CO</b>				0.00	0.00	0.00	0.00	0.00	0.00
				0.00	0.00	0.00	0.00	0.00	0.00
<b>Fund: 2016 CO General Capi</b>									
10555	FHLMC	706	06/28/2016	3,866.67	2,000,000.00	0.00	2,000,000.00	-2,000,000.00	0.00
3134G9WU7	0.00	0.000	12/28/2017	8,000.00	1,998,600.00	0.00	2,000,000.00	-1,998,600.00	0.00
10552	FHLB	706	06/16/2016	1,155.00	550,000.00	0.00	550,000.00	-550,000.00	0.00
3130A8HM8	0.00	0.000	01/16/2018	1,980.00	549,505.00	0.00	550,000.00	-549,505.00	0.00
10554	FHLMC	706	06/30/2016	3,266.67	1,000,000.00	0.00	1,000,000.00	-1,000,000.00	0.00
3134G9G76	0.00	0.000	06/29/2018	5,311.11	995,100.00	0.00	1,000,000.00	-995,100.00	0.00
10560	FHLMC	706	08/25/2016	10,000.00	1,000,000.00	0.00	0.00	0.00	1,000,000.00
3134G96J1	1,000,000.00	1.000	02/25/2019	10,000.00	992,700.00	0.00	0.00	1,500.00	994,200.00
10561	FHLB	706	08/30/2016	8,305.03	1,000,000.00	0.00	1,000,000.00	-1,000,000.00	0.00
3130A8YM9	0.00	0.000	02/28/2019	9,175.82	993,200.00	0.00	1,000,000.00	-993,200.00	0.00
10628	FFCB	706	09/30/2018	7.64	0.00	200,000.00	0.00	200,137.50	200,137.50
3133EHYJ6	200,000.00	1.374	09/12/2019	0.00	0.00	200,000.00	0.00	197,617.50	197,617.50
10573	FHLMC	706	02/14/2017	831.25	200,000.00	0.00	200,000.00	-200,000.00	0.00
3134GAX90	0.00	0.000	02/14/2020	1,125.00	199,920.00	0.00	200,000.00	-199,920.00	0.00
10549	TXSTAR	706	10/01/2017	2,895.67	1,789,655.45	203,110.70	1,992,766.15	-1,789,655.45	0.00
SYS10549	0.00	1.351	/ /	3,110.70	1,789,655.45	203,110.70	1,992,766.15	-1,789,655.45	0.00

**City of Corinth portfolio  
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Inv #	Issuer	Fund	Purch Date	Interest Accrual	Beginning Book Value				Ending Book Value
Cusip	Par Value	YTM	Mat Date	Interest Received	Beginning Market Value	Purchases/ Additions	Redemptions	Change in Value	Ending Market Value
<b>Sub Totals For: Fund: 2016 CO General Capi</b>				30,327.93	7,539,655.45	403,110.70	6,742,766.15	-6,339,517.95	1,200,137.50
				38,702.63	7,518,680.45	403,110.70	6,742,766.15	-6,326,862.95	1,191,817.50
<b>Fund: 2017 CO General Capi</b>									
10585	FHLB	709	08/31/2017	2,381.94	1,001,142.75	0.00	1,000,000.00	-1,001,142.75	0.00
3130AAKJ6	0.00	0.000	01/09/2018	3,111.11	1,000,863.89	0.00	1,000,000.00	-1,000,863.89	0.00
10622	FHLB	709	08/31/2018	260.42	0.00	250,000.00	0.00	250,381.94	250,381.94
3130AAMC9	250,000.00	1.248	01/17/2019	0.00	0.00	250,000.00	0.00	249,656.94	249,656.94
10618	FHLB	709	07/31/2018	847.48	0.00	500,000.00	0.00	500,000.00	500,000.00
3130A8YM9	500,000.00	1.007	02/28/2019	412.09	0.00	500,000.00	0.00	497,200.00	497,200.00
10586	TXSTAR	709	10/01/2017	19,266.50	1,000,853.46	1,020,776.62	1,850,000.00	-829,223.38	171,630.08
SYS10586	171,630.08	1.999	/ /	20,776.62	1,000,853.46	1,020,776.62	1,850,000.00	-829,223.38	171,630.08
<b>Sub Totals For: Fund: 2017 CO General Capi</b>				22,756.34	2,001,996.21	1,770,776.62	2,850,000.00	-1,079,984.19	922,012.02
				24,299.82	2,001,717.35	1,770,776.62	2,850,000.00	-1,083,230.33	918,487.02
<b>Fund: Water 2007 CO</b>									
10066	TXPOOL	800	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10009	0.00	0.050	/ /	0.00	0.00	0.00	0.00	0.00	0.00
10135	TXSTAR	800	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10135	0.00	0.103	/ /	0.00	0.00	0.00	0.00	0.00	0.00
10333	NTHSTR	800	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10333	0.00	0.250	/ /	0.00	0.00	0.00	0.00	0.00	0.00
<b>Sub Totals For: Fund: Water 2007 CO</b>				0.00	0.00	0.00	0.00	0.00	0.00
				0.00	0.00	0.00	0.00	0.00	0.00
<b>Fund: Wastewater 2007 CO</b>									
10067	TXPOOL	801	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10009	0.00	0.035	/ /	0.00	0.00	0.00	0.00	0.00	0.00

**City of Corinth portfolio**  
**Texas Compliance Change in Val Report**  
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Inv #	Issuer	Fund	Purch Date	Interest Accrual	Beginning Book Value				Ending Book Value
Cusip	Par Value	YTM	Mat Date	Interest Received	Beginning Market Value	Purchases/ Additions	Redemptions	Change in Value	Ending Market Value
10136	TXSTAR	801	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10136	0.00	0.031	/ /	0.00	0.00	0.00	0.00	0.00	0.00
10334	NTHSTR	801	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10334	0.00	0.250	/ /	0.00	0.00	0.00	0.00	0.00	0.00
<b>Sub Totals For: Fund: Wastewater 2007 CO</b>				0.00	0.00	0.00	0.00	0.00	0.00
				0.00	0.00	0.00	0.00	0.00	0.00
<b>Fund: Drainage 2007 CO</b>									
10137	TXSTAR	802	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10137	0.00	0.090	/ /	0.00	0.00	0.00	0.00	0.00	0.00
10458	NTHSTR	802	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10458	0.00	0.250	/ /	0.00	0.00	0.00	0.00	0.00	0.00
10068	TXPOOL	802	10/01/2017	0.00	0.00	0.00	0.00	0.00	0.00
SYS10009	0.00	2.972	/ /	0.00	0.00	0.00	0.00	0.00	0.00
<b>Sub Totals For: Fund: Drainage 2007 CO</b>				0.00	0.00	0.00	0.00	0.00	0.00
				0.00	0.00	0.00	0.00	0.00	0.00
<b>Fund: 2016 CO WATER</b>									
10619	FHLB	803	07/31/2018	423.74	0.00	250,000.00	0.00	250,000.00	250,000.00
3130A8YM9	250,000.00	1.007	02/28/2019	206.04	0.00	250,000.00	0.00	248,600.00	248,600.00
10598	FHLMC	803	01/10/2018	5,981.25	0.00	496,250.00	0.00	497,500.00	497,500.00
3134G35V8	500,000.00	2.003	03/13/2020	5,568.75	0.00	496,250.00	0.00	491,750.00	491,750.00
10602	FFCB	803	01/16/2018	5,865.00	0.00	398,718.39	0.00	399,024.39	399,024.39
3133EH5G4	400,000.00	2.182	01/04/2021	3,864.00	0.00	398,718.39	0.00	391,800.00	391,800.00
<b>Sub Totals For: Fund: 2016 CO WATER</b>				12,269.99	0.00	1,144,968.39	0.00	1,146,524.39	1,146,524.39
				9,638.79	0.00	1,144,968.39	0.00	1,132,150.00	1,132,150.00
<b>Fund: 2017 CO WATER PROJEC</b>									

**City of Corinth portfolio**  
**Texas Compliance Change in Val Report**  
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Inv #	Issuer	Fund	Purch Date	Interest Accrual	Beginning Book Value				Ending Book Value
Cusip	Par Value	YTM	Mat Date	Interest Received	Beginning Market Value	Purchases/ Additions	Redemptions	Change in Value	Ending Market Value
10620	FHLB	804	07/31/2018	423.74	0.00	250,000.00	0.00	250,000.00	250,000.00
3130A8YM9	250,000.00	1.007	02/28/2019	206.04	0.00	250,000.00	0.00	248,600.00	248,600.00
<b>Sub Totals For: Fund: 2017 CO WATER PROJEC</b>				423.74	0.00	250,000.00	0.00	250,000.00	250,000.00
				206.04	0.00	250,000.00	0.00	248,600.00	248,600.00
<b>Fund: 2017 CO WASTEWATER</b>									
10623	FHLB	805	08/31/2018	260.42	0.00	250,000.00	0.00	250,381.94	250,381.94
3130AAMC9	250,000.00	1.248	01/17/2019	0.00	0.00	250,000.00	0.00	249,656.94	249,656.94
<b>Sub Totals For: Fund: 2017 CO WASTEWATER</b>				260.42	0.00	250,000.00	0.00	250,381.94	250,381.94
				0.00	0.00	250,000.00	0.00	249,656.94	249,656.94
<b>Report Grand Totals:</b>				386,698.30	32,948,822.50	26,488,176.80	30,645,523.83	-4,156,051.12	28,792,771.38
				284,587.40	32,901,394.91	26,488,176.80	30,645,523.83	-4,877,070.89	28,024,324.02

City of Corinth, Texas

ANNUAL INVESTMENT REPORT

*For Fiscal Year Ended September 30, 2018*



**APPENDIX C**

**Glossary**

## Glossary

**Accrued Interest** - In the sale of a new issue of municipal bonds, the dollar amount, based on the stated rate or rates of interest, which has accrued on the bonds from the dated date, or other stated date, up to but not including the date of delivery. When a bond is purchased in the secondary market, the dollar amount, based upon the stated rate of interest, which has accrued on the bond from the most recent interest payment date, up to but not including the date of settlement. Accrued interest is paid to the seller by the purchaser and is usually calculated on a 360-day-year basis (assumes each month has 30 days).

**Agencies** – Federal agency securities.

**Arbitrage** – Generally, transactions by which securities are bought and sold in different markets at the same time for the sake of the profit arising from a difference in prices in the two markets. With respect to the issuance of municipal bonds, arbitrage usually refers to the difference between the interest paid on the bonds issued and the interest earned by investing the bond proceeds in other securities. Arbitrage profits are permitted on bond proceeds for various temporary periods after issuance of municipal bonds. Internal Revenue Service regulations govern arbitrage of municipal bond proceeds.

**Asked** – The price at which securities are offered.

**Bankers' Acceptance (BA)** – A draft or bill or exchange accepted by a bank or trust company. The accepting institution guarantees payment of the bill, as well as the issuer.

**Bearer Bond** – Bond which is presumed to be owned by the person who holds it. The Tax Equity and Fiscal Responsibility Act of 1982 requires the issuance of municipal bonds in fully registered form, with minor exceptions.

**Bid** – The price offered by a buyer of securities. (When you are selling securities, you ask for a bid).

**Book Value** – The original acquisition cost of an investment plus or minus the accrued amortization or accretion.

**Broker** – A broker brings buyers and sellers together for a commission.

**Callable Bond** – a bond issue in which all or part of its outstanding principal amount may be redeemed before maturity by the issuer under specified conditions.

**Call Price** – The price at which an issuer may redeem a bond prior to maturity. The price is usually at a slight premium to the bond's original issue price to compensate the holder for loss of income and ownership.

**Call Risk** – The risk to a bondholder that a bond may be redeemed prior to maturity.

**Capital Appreciation Bond** – Long-term tax exempt security sold at a large discount. Yield is reinvested at a stated rate until maturity at which time the investor receives total payment. Latter represents both principal and interest.

**Certificate of Deposit (CD)** – A time deposit with a specific maturity evidenced by a certificate. Large denomination CD's are typically negotiable.

**Collateral** – Securities, evidence of deposit or other property which a borrower pledges to secure repayment of a loan. Also refers to securities pledged by a bank to secure deposits of public monies.

**Commercial Paper (tax-exempt)** – Short-term, unsecured promissory notes issued in either registered or bearer form, and usually backed by a line of credit with a bank. Maturities do not exceed 270 days and generally average 30 – 45 days.

**Comprehensive Annual Financial Report (CAFR)** – The official annual report for the City of Corinth. It includes five combined statements for each individual fund and account group prepared in conformity with GAAP. It also includes supporting schedules necessary to demonstrate compliance with finance related to legal and contractual provision, extensive introductory material, and a detailed Statistical Section.

**Coupon** – (a) The annual rate of interest that a bond's issuer promises to pay the bondholder on the bond's face value. (b) A certificate attached to a bond evidencing interest due on a payment date.

**Current Yield** – The ratio of the annual dollar amount of interest to the purchase price of a bond, stated as a percentage. For example, a \$1,000 bond purchased at par with an 8% coupon pays \$80 per year, or a current yield of 8%. The same bond, if purchased at a discounted price of \$800, would have a current yield of 10%.

**Dated Date** – The date of a bond issue, printed on each bond, from which interest usually starts to accrue, even though the bonds may actually be delivered at some later date.

**Dealer** – A dealer, as opposed to a broker, acts as a principal in all transactions, buying and selling for his own account.

**Debenture** – A bond secured only by the general credit of the issuer.

**Delivery Date** – Date on which the bonds are physically delivered in exchange for the payment of the purchase price. The date of issuance is the same date as the delivery date.

**Delivery Versus Payment** – There are two methods of delivery of securities: delivery versus payment and delivery versus receipt. Delivery versus payment is delivery of securities with an exchange of money for the securities. Delivery versus receipt is delivery of securities with an exchange of a signed receipt for the securities.

**Discount** – The difference between the cost price of a security and its maturity when quoted at lower than face value. A security selling below original offering price shortly after sale also is considered to be at a discount.

**Discount Securities** – Non-interest bearing money market instruments that are issued a discount and redeemed at maturity for full face value, e.g. U.S. Treasury Bills.

**Diversification** – Dividing investment funds among a variety of securities offering independent returns.

**Federal Credit Agencies** – Agencies of the Federal government set up to supply credit to various classes of institutions and individuals, e.g., S & L's small business firms, students, farmers, farm cooperatives, and exporters.

**Federal Deposit Insurance Corporation (FDIC)** – A federal agency that insures bank deposits, currently up to \$100,000 per deposit.

**Federal Funds Rate** – The rate of interest at which federal funds are traded. This rate is currently pegged by the Federal Reserve through open-market operations.

**Federal Home Loan Banks (FHLB)** – The institutions that regulate and lend to savings and loan associations. The Federal Home Loan Banks play a role analogous to that played by the Federal Reserve Banks vis-à-vis member commercial banks.

**Federal National Mortgage Association (FNMA)** – FNMA, like GNMA was chartered under the Federal National Mortgage Association Act in 1938. FNMA is a federal corporation working under the auspices of the Department of Housing and Urban Development (HUD). It is the largest single provider of residential mortgage funds in the United States. Fannie Mae, as the corporation is called, is a private stockholder owned corporation. The corporation's purchases include a variety of adjustable mortgages and second loans, in addition to fixed-rate mortgages. FNMA's securities are also highly liquid and are widely accepted. FNMA assumes and guarantees that all security holders will receive timely payment of principal and interest.

**Federal Open Market Committee (FOMC)** – Consists of seven members of the Federal Reserve Board and five of the twelve Federal Reserve Bank Presidents. The President of the New York Federal Reserve Bank is a permanent member, while the other Presidents serve on a rotating basis. The Committee periodically meets to set Federal Reserve guidelines regarding purchases and sales of Government Securities in the open market as a means of influencing the volume of bank credit and money.

**Federal Reserve System** – The central bank of the United States created by Congress and consisting of a seven member Board of Governors in Washington, D.C., 12 regional banks and about 5,700 commercial banks that are members of the system.

**Fiscal Year** – A twelve-month period which determines the time frame for financial reporting, budgeting, and accounting. At the end of the fiscal year, financial position and results of operations are determined.

**Government National Mortgage Association (GNMA or Ginnie Mae)** – Securities influencing the volume of bank credit guaranteed by GNMA and issued by mortgage bankers, commercial banks, savings and loan associations, and other institutions. Security holder is protected by full faith and credit of the U.S. Government. Ginnie Mae securities are backed by the FHA, VA or FMHM mortgages. The term "pass throughs" is often used to describe Ginnie Maes.

**Interest** – Compensation for the use of borrowed money, generally expressed as an annual percentage of the principal amount.

**Liquidity** – Usually refers to the ability to convert assets (such as investments) into cash.

**Market Value** – The Current face or par value of an investment multiplied by the net selling price of the security as quoted by a recognized market pricing source quoted on the valuation date.

**Master Repurchase Agreement** – A written contract covering all future transactions between the parties to repurchase – reverse repurchase agreements that establishes each party's rights in the transactions. A master agreement will often specify, among other things, the right of the buyer-lender to liquidate the underlying securities in the event of default by the seller-borrower.

**Maturity** – The date upon which the principal of a municipal bond becomes due and payable to the bondholder.

**Money Market** – The market in which short-term debt instruments (bills, commercial paper, bankers' acceptances, etc.) are issued and traded.

**Note** – A written, short-term promise of the issuer 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. Notes usually mature in less than five years.

**Offer** – The price asked by a seller of securities. (When you are buying securities, you ask for an offer.)

**Open Market Operations** – Purchases and sales of government and certain other securities in the open market by the New York Federal Reserve Bank as directed by the FOMC in order to influence the volume of money and credit in the economy. Purchases inject reserves in the bank system and stimulate growth of money and credit; sales have the opposite effect. Open market operations are the Federal Reserve's most important and most flexible monetary policy tool.

**Original Issue Discount** – An amount which represents the difference by which par value exceeds the public offering price of a new issue or part of an issue of municipal bonds. Original issue discount is amortized over the life of the bonds and is generally treated as tax-exempt interest. When the investor sells the bonds before maturity, any profit or loss realized on such sale is figured on the adjusted cost basis for tax purposes. The adjusted cost basis is calculated for each year the bonds are outstanding by adding the accretion value to the original offering price. The accretion value is determined by the rules and regulations of the Internal Revenue Service. Selling the bonds at a price in excess of the adjusted cost basis would result in a taxable gain for the seller, while a selling price below that level would be treated as a loss for income tax purposes.

**Par Value** – In the case of bonds, the amount of principal which must be paid at maturity. Par value is also referred to as the face amount of a security.

**Pooled Fund Group** – An internally created fund of an investing entity in which one or more institutional accounts of the investing entity are invested.

**Portfolio** – Collection of securities held by an investor.

**Premium** – The amount by which the price paid for a security exceeds par value, generally representing the difference between the nominal interest rate and the actual or effective return to the investor.

**Primary Dealer** – A group of government securities dealers who submit daily reports of market activity and positions and monthly financial statements to the Federal Reserve Bank of New York and are subject to its informal oversight. Primary dealers include Securities and Exchange Commission (SEC) – registered securities broker-dealers, banks, and a few unregulated firms.

**Primary Market** – The market for new issues of municipal securities.

**Principal** – The face amount or par value of a bond or issue of bonds payable on stated dates of maturity.

**Prudent Person Rule** – An investment standard. In some states the law requires that a fiduciary, such as a trustee, may invest money only in a list of securities selected by the custody state—the so-called legal

list. In other states the trustee may invest in a security if it is one which would be bought by a prudent person of discretion and intelligence who is seeking a reasonable income and preservation of capital.

***Qualified Public Depositories*** – A financial institution which does not claim exemption from the payment of any sales or compensating use or ad valorem taxes under the laws of this state, which has segregated for the benefit of the commission eligible collateral having a value of not less than its maximum liability and which has been approved by the Public Deposit Protection Commission to hold public deposits.

***Qualified Representative*** – A Person who holds a position with a business organization, who is authorized to act on behalf of the business organization, and who is one of the following:

- (a) for a business organization doing business that is regulated by or registered with a securities commission, a person who is registered under the rules of the National Association of Securities Dealers;
- (b) for a state or federal bank, a savings bank, or a state or federal credit union, a member of the loan committee for the bank or branch of the bank or a person authorized by corporate resolution to act on behalf of and bind the banking institution; or
- (c) for an investment pool, the person authorized by the elected official or board with authority to administer the activities of the investment pool to sign the written instrument on behalf of the investment pool.

***Rate of Return*** – The yield obtainable on a security based on its purchase price or its current market price. This may be the amortized yield to maturity on a bond the current income return.

***Ratings*** – Evaluations of the credit quality of notes and bonds usually made by independent rating services, although many financial institutions also rate bonds for their own purposes. Ratings generally measure the probability of the timely repayment of principal of and interest on municipal bonds. Ratings are initially made before issuance and are continuously reviewed and may be amended to reflect changes in the issuer's credit position. The information required by the rating agencies varies with each bond issue, but generally includes demographics, debt burden, economic base, finances, and management structure. The information is evaluated and the issue is assigned a letter rating which reflects the creditworthiness of the bonds. The higher the credit rating, the more favorable the effect on the marketability of the bond.

***Repurchase Agreement*** - A simultaneous agreement to buy, hold for a specified time, and sell back at a future date obligations described by Section 2256.009(a)(1), at a market value at the time the funds are disbursed of not less than the principal amount of the funds disbursed. The term includes a direct security repurchase agreement and a reverse security repurchase agreement.

***Safekeeping*** – A service to customers rendered by banks for a fee whereby securities and valuables of all types and descriptions are held in the bank's vaults for protection.

***Secondary Market*** – A market made for the purchase and sale of outstanding issues following the initial distribution.

***Securities and Exchange Commission or SEC*** – The federal agency responsible for supervising and regulating the securities industry. Generally, municipal securities are exempt from the SEC's registration and reporting requirements. However, the SEC has responsibility for the approval of Municipal Securities Rulemaking Board rules, and has jurisdiction, pursuant to SEC Rule 10b-5, over fraud in the sale of municipal securities.

**Security** – Generally, evidence of debt or equity in a common enterprise in which a person invests in the expectation of earning income. The term includes notes, stocks, bonds, debentures, mortgages, and other forms of negotiable and non-negotiable evidences of indebtedness or ownership. Unless exempted, as are municipal bonds, securities transactions are subject to federal and state regulation.

**Separately Invested Asset** – An account or fund of a state agency or local government that is not invested in a pooled fund group.

**Treasury Securities** – Debt obligations of the United States Government sold by the Treasury Department in the forms of bills, notes, and bonds.

**Bills** – Short-term obligations which mature in one year or less, and are sold at a discount in lieu of paying periodic interest.

**Notes** – Interest bearing obligations which mature between one year and 10 years.

**Bonds** – Interest bearing long-term obligations which generally mature in 10 years or more.

**Yield Curve** – A graph which plots the yields on securities with equivalent quality but different maturities, at a given point in time. The vertical axis represents the interest rates, while the horizontal axis depicts the years to maturity. The term structure of interest rates, as reflected by the yield curve, will vary according to market conditions, resulting in a variety of yield curve configurations.

**Normal or Positive Yield Curve** – Indicates that short-term securities have a lower interest rate than long-term securities.

**Inverted or Negative Yield Curve** – Reflects the situation of short-term rates exceeding long-term rates.

**Flat Yield Curve** – Reflects the situation when short and long-term rates are the same.

**Humpback Yield Curve** – An unusual shape, indicating that rates are rising in the early years, peaking in the middle years and declining in later years.

**Yield to Maturity** – The rate of return to the investor earned from payments of principal and interest, with interest compounded semiannually and assuming that interest paid is reinvested at the same rate. Yield to maturity takes into account the time value of the investment.

**Zero Coupon Bond** – A bond which pays no interest, but is issued at a deep discount from par, appreciating to its full value at maturity.

**Finance Audit Committee Regular Session**

**Meeting Date:** 12/13/2018  
**Title:** Authorized Broker/Dealer List  
**Submitted For:** Lee Ann Bunselmeyer, Director  
**Submitted By:** Chris Rodriguez, Financial Services Manager  
**Finance Review:** N/A **Legal Review:** N/A

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**AGENDA ITEM**

Consider and act on the 2018-2019 Authorized Broker/Dealer List for the City of Corinth.

**AGENDA ITEM SUMMARY/BACKGROUND**

In accordance with Public Funds Investment Act, Chapter 2256, of the Texas Government Code, the governing body or the Finance Audit Committee must review, revise and adopt a list of qualified broker at least annually. There are no minimum or maximum number of dealers or brokers that may be used by the City.

The Investment Officer continually monitors the list of approved investment brokers to pursue a diverse and competitive list of bidders. *Potential* broker/dealers must complete and submit the Broker/Dealer Questionnaire and Certification Form. The Investment Officer then evaluates the broker/dealers response based on the criteria listed below. If a broker/dealer has successfully met the established requirements, the Investment Officer will forward the application to the Finance Audit Committee for review.

A review on *active* brokers is also conducted at least annually based on the criteria listed below. The competitiveness and responsiveness of the active brokers is also a major factor, as well. If a broker/dealer is considered to place the City's investment program at risk or is not effective, the Investment Officer will document and recommend to the Finance Audit Committee that the broker/dealer be removed from the approved list.

The Investment Officer may limit the number of investment brokers the City conducts business with upon approval of the Finance Audit Committee. In accordance with the City's Investment Policy, business with any broker/dealer is limited to 40% of the total portfolio at any point in time. The Finance Audit Committee must approve all brokers prior to conducting any investment transactions.

**EVALUATION CRITERIA**

The following criteria are used to evaluate both potential and active broker/dealers:

1. Delivery Process - Delivery vs Payment is required for the protection of the City's assets.
2. Registration - Broker must be registered with the Texas State Securities Commission.
3. Capitalization - Organization should be well capitalized and show profitability, and comply with SEC guidelines.
4. Law Suits - Must be be involved in any type of legal disputes, pending settlements, claims or losses, etc.
5. Worthiness - Must be capable of serving the City's needs as a governmental entity. Must be credible and reputable among other Texas governmental clients.
6. Reports/Research - Must provide daily market analysis. This information is valuable for planning investment strategies and budgeting.
7. Training - Valuable service especially for governments with newly implemented investment programs, investment officers, and for cross training.
8. Primary vs Secondary - Primary dealers are more likely to provide desired securities for purchases as they maintain their own inventory, whereas, secondary dealers must contact their primary dealer for availability of securities. However, depending on each firms' contact with their trading desk, this may not be an issue.

9. Certification - Must sign a written instrument acknowledging that it has received and reviewed our investment policy and that procedures and controls have been implemented to preclude unauthorized investments.

**RECOMMENDATION**

Staff recommends the acceptance of FTN Financial, Mutual Securities, Inc., Service Asset Management, and three overnight investment vehicles (TexPool, TexStar, and Independent Money Market) as the City's 2018-2019 approved broker/dealer list.

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**Attachments**

Broker Dealer Evaluation

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**BROKER/DEALER EVALUATION**  
*Fiscal Year 2018-2019*

BROKER/DEALER EVALUATION						
Firm/ Representative	Primary Dealer	Texas Registered	SEC Compliance	References	Claims, Losses, Investigations	Comments
<b>FTN Financial (Formerly Coastal Securities)</b> Zach Brewer Houston, Texas <i>Approved Broker since 2007</i>	No	N/A	N/A	City of McKinney City of Plano City of Grand Prairie	No	Reliable. Competitive. Provides daily market updates.
<b>Service Asset Management (SAMCO)</b> Robert Phillips Dallas, Texas <i>Approved Broker since 2007</i>	No	Yes	Yes	City of Grand Prairie City of Dallas City of Euless	No	Very Competitive. Provides daily market updates & responds quickly to staff requests.
<b>Mutual Securities, Inc.</b> Michael Swan Laguna Beach, CA <i>Approved Broker since 2009</i>	No	Yes	Yes	City of Carrollton City of Arlington City of Grand Prairie	No	Very Responsive. Honest. Competitive. Long-term Clients

All the brokers listed above have provided the necessary documentation.

MONEY MARKET/POOL EVALUATION						
Firm Name	Net Asset Value	Size	Operating Deadlines	Maximum WAM	2018 Average Monthly Yield*	Management Fee
<b>Independent Bank</b> <i>Approved Since 2009</i>	\$1	Over \$8.68 billion	Before 4:00 p.m.		1.0%	0%
<b>TexPool</b> <i>Approved Pool Since 2007</i>	\$1	\$16.6 billion	Before 4:00 p.m.	Max- 60 days Avg- 28 days	1.73%	.047% basis points State Comptroller & Federated Investors
<b>TexStar</b> <i>Approved Pool Since 2007</i>	\$1	\$6.6 billion	Before 4:00 p.m.	Max -60 days Avg- 41 days	1.73%	.12% basis points JP Morgan Chase & First Southwest

TexPool, and Texstar investments consist exclusively of U.S. Government securities, repurchase agreements collateralized by U.S. Government securities, and AAA-rated no-load money market mutual funds. Additionally, funds are restricted to a maximum weighted average maturity (WAM) of 60 days.

**Finance Audit Committee Regular Session**

**Meeting Date:** 12/13/2018  
**Title:** 2016-2017 Summary of Rebatable Arbitrage  
**Submitted For:** Lee Ann Bunselmeyer, Director  
**Submitted By:** Chris Rodriguez, Financial Services Manager  
**Finance Review:** N/A **Legal Review:** N/A

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**AGENDA ITEM**

Review and discuss the Fiscal Year 2017-2018 Summary of Rebatable Arbitrage.

**AGENDA ITEM SUMMARY/BACKGROUND**

Tax-exempt bonds which were issued on or after September 1, 1986 are subject to federal arbitrage rebate requirements. Arbitrage rebate requirements require that any excess earnings or arbitrage be rebated to the Federal Government. Arbitrage is the ability to obtain tax-exempt bond proceeds and invest the funds in higher yielding taxable securities. The rebate amount due to the Federal Government is equal to the excess of the amount earned on all non-purposed investment purchased with gross proceeds of the bonds over the amount which would have been earned if such non-purchase investments were invested at a rate equal to the yield on the bonds.

The rebate computation and payment to the Federal Government, if applicable, is required to be made at least every five-year period an issue remains outstanding and upon the retirement of an issue. The payment is due to the Federal Government within 60 days from either each Rebate Installment Computation Date or Final Rebate Computation Date. Failure to comply with these Federal Rebate Requirements could lead to substantial late filing penalties and interest and/or, potentially the loss of tax-exempt status for these bonds and subsequent bonds.

First Southwest Asset Management has performed the annual computation to ensure the City's compliance with the Federal Government Requirements. The attached 2017-2018 Summary of Rebatable Arbitrage includes the required annual computation for all bonds through September 30, 2018.

**RECOMMENDATION**

There is no action to be taken on this item.

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**Attachments**

Arbitrage Report

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**City of Corinth, Texas**  
**Summary of Rebatable Arbitrage and Yield Restriction**  
**As of September 30, 2018**

**Final Numbers\***

*(Issues delivered prior to 3/6/2007, which are not presented herein, no longer require calculations)*

Delivery Date	Par Amount	Issue Description	Bond Yield	Rebatable Arbitrage / Yield Restriction 9/30/2017	Rebatable Arbitrage / Yield Restriction 9/30/2018	Upcoming IRS Dates		
						Next IRS Calculation Date**	Next IRS Payment Date**	
03/06/07	\$5,250,000	General Obligation Refunding Bonds, Series 2007	4.134942%	(36,043.89)	(3)	(1)		
09/18/07	\$23,630,000	Combination Tax and Rev. CO, Series 2007	4.526986%	(3,643,454.74)	(3)	(1)		
05/14/10	\$1,500,000	Combination Tax and Rev. CO, Series 2010	3.404388%	(13,351.13)	(2)	(13,895.25)	2/15/2020	4/15/2020
05/19/16	\$1,510,000	General Obligation Refunding Bonds, Series 2016						
05/19/16	\$13,275,000	Combination Tax and Ltd. Surplus Rev. CO, Series 2016	2.382943%	(261,770.39)		(327,116.34)		
	\$14,785,000	Combined Liability						
08/03/17	\$14,240,000	General Obligation Refunding Bonds, Series 2017						
08/03/17	\$4,855,000	Combination Tax and Ltd. Surplus Rev. CO, Series 2017	2.281137%	(4)		(58,157.78)		
	\$19,095,000	Combined Liability						
<b>Total Cumulative Liability</b>				<b>\$0.00</b>	<b>\$0.00</b>			

- (1) All bonds have been redeemed. Report previously issued.
- (2) Issue met Small Issuer for the calendar year. The Tax Certificate states that amounts in excess of the Bona Fide Debt Service Fund will be restricted to a yield that does not exceed the yield on the Obligations; therefore, the liability represents the Yield Restriction Liability.
- (3) Represents liability as of final installment calculation date of September 5, 2017.
- (4) Due to short time period from delivery date to current fiscal year end, will perform calculations at next fiscal year end.

\* Unless otherwise noted, all liabilities represent annual estimations of the rebate and yield restriction amounts as of your current fiscal year end.

\*\* Next IRS Pay Date represents potential payments that are upcoming in the next two years from the current fiscal year end. Actual IRS Calculation Dates and Payment Dates may be accelerated as a result of refundings/defeasances occurring after the date of this summary.