

Approved: 2/13/95  
Date

MINUTES OF THE HOUSE COMMITTEE ON APPROPRIATIONS.

The meeting was called to order by Chairperson Robin Jennison at 1:30 p. m. on February 9, 1995 in Room 514-S of the Capitol.

All members were present except:

Representative Edlund, excused  
Representative Gross, excused

Representative Goossen, excused  
Representative Haulmark, excused

Committee staff present: Alan Conroy, Legislative Research Department  
Susan Wieggers, Legislative Research Department  
Jim Wilson, Revisor of Statutes  
Mike Corrigan, Revisor of Statutes  
Lenore Olson, Committee Secretary

Conferees appearing before the committee:

Ron Green - Audit Supervisor, Division of Post Audit  
Gloria Timmer - Director, Division of the Budget

Others attending: See attached list

Ron Green, Audit Supervisor, Division of Post Audit, presented a detailed post audit report on the Municipal Investment Pool (MIP). The report concluded no one could have anticipated that interest rates would rise as fast as they did during 1994. The Treasurer's Office, like virtually all other bond investors, suffered market losses on its investments as a result of this rapid interest-rate increase. Mr. Green said the report indicates that in the exchanges of securities between the MIP and the State's idle funds portfolio, it was found the State's idle funds portfolio was not treated equitably. One of the recommendations was that the managers of the MIP have adequate guidance on how the Pool's assets should be invested, and the State Treasurer's Office and the Pooled Money Investment Board adopt specific, written investment objectives and policies for each segment of the MIP (Attachment 1).

A motion was made by Representative Helgerson, seconded by Representative Farmer, to approve the minutes of February 6, 1995. The motion carried.

A motion was made by Representative Reinhardt, seconded by Representative Wilk, to introduce a bill regarding the Department of Social and Rehabilitation Services. The bill is for a pilot project decentralizing services for SRS and the Department on Aging, to transfer the responsibilities of the Medicaid program for long-term care to the Department on Aging, to include requesting a federal waiver to allow the State of Kansas to use the Medicaid money for in-home services. The motion carried.

A motion was made by Representative Gatlin, seconded by Representative Neufeld, to introduce a bill which would limit any company involved with hospitals from owning more than 12 percent of the beds in the State of Kansas. The motion carried.

The Chair announced **HB 2131** which was previously scheduled for a hearing today, was no longer needed as the problem which has caused the need for this bill has been solved.

**HB 2131 - Administration of the certificate fees fund for the state board of education.**

The Chair directed the Committee to turn to **HB 2136.**

**HB 2136 - Securities Act Fee Fund; ending balances.**

CONTINUATION SHEET

MINUTES OF THE HOUSE COMMITTEE ON APPROPRIATIONS, Room 514-S Statehouse, at 1:30 p.m. on February 9, 1995.

Gloria Timmer, Director, Division of the Budget, testified in support of **HB 2136** and said this bill would eliminate the \$500,000 ending balance in the Securities Act Fee Fund in FY 96 by transferring this amount to the State General Fund. Ms. Timmer requested the bill be amended to provide a \$50,000 ending balance (Attachment 2).

A motion was made by Representative Carmody, seconded by Representative Gatlin, to amend **HB 2136** to provide a \$50,000 ending balance rather than the \$0 balance specified in the original bill. The bill is to also be amended to remove the word "remaining" and to replace it with the word "unencumbered." The motion carried.

A motion was made by Representative Minor, seconded by Representative Gatlin to pass as amended **HB 2136**. The motion carried.

A letter from the Division of the Budget was distributed to the Committee. The letter listed corrections of technical errors contained in the budget document previously submitted to the Legislature (Attachment 3).

The meeting adjourned at 2:20 p.m.  
The next meeting is scheduled for February 13, 1995.

# APPROPRIATIONS COMMITTEE GUEST LIST

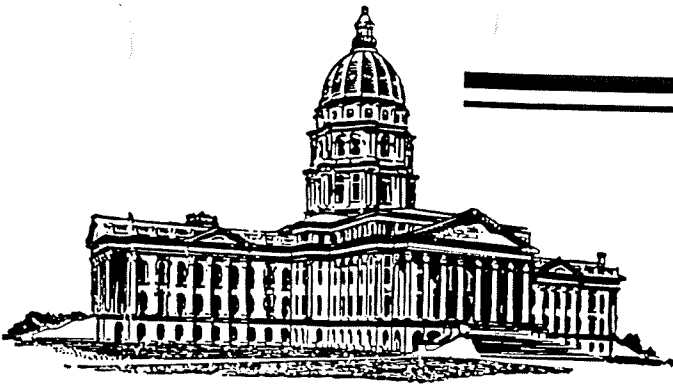
DATE: 2/9/95

NAME	REPRESENTING
Ron Green	Legis. Post Audit
James Crawford	Intern - Rep. Wells
Paul Hinton	Post Audit
Kathy Sexton	Div of Budget
Gloria Timmer	Div of Budget
Nicole Cheyney	Intern - Rep Farmer
John Wine	Sec. Comm.
Steve Wasson	✓ ✓
Gay Beth Moore	Self
NORM WILKS	KASB
Jeff Glasgow	Taxpayer
Bill Featherston	Kansas Association of Nursing Students
Julie Muegggenberg	KU - Nursing School
Julie Good MSN ARNP	KSNA
Wanda Murrin RN	KU School of Nsg.
Ed. Fischer RN	KU School of Nursing
Deverlee Goodrich	Baker Nsg Student
Sonye Gordon	Bethel Nsg Student
Jean Jagan	Bethel College Nursing

# APPROPRIATIONS COMMITTEE GUEST LIST

DATE: 2/9/95

NAME	REPRESENTING
Aune Green	Dodge City Comm. College
Kristina Weber	DECC 115 District
Belinda Link	Neosho Co. College - Chanute
Stephanie Hill	Butler Co. Comm. College
Candette S. Metaker, RN	University of KS School of Nursing
Jafana Simon	State Treasurer's Office



# PERFORMANCE AUDIT REPORT

## Examining the Investment Practices of the Municipal Investment Pool

A Report to the Legislative Post Audit Committee  
By the Legislative Division of Post Audit  
State of Kansas  
January, 1995

95-44

*2/9/95*  
*Appropriations Cmte*  
*Attachment 1*



LEGISLATURE OF KANSAS  
**LEGISLATIVE DIVISION OF POST AUDIT**

MERCANTILE BANK TOWER  
800 SOUTHWEST JACKSON STREET, SUITE 1200  
TOPEKA, KANSAS 66612-2212  
TELEPHONE (913) 296-3792  
FAX (913) 296-4482

January 30, 1995

To: Members, Kansas Legislature

When this audit of the Municipal Investment Pool was presented to the Legislative Post Audit Committee January 26, a number of somewhat technical questions were raised. Among other things, those questions covered the methodology used in the exchange of securities between the Municipal Investment Pool and the State's idle funds portfolio. These issues are summarized on pages 25-27 of the report.

This letter has been inserted in the audit report to provide some additional information that may help clarify those issues.

**1. What is the best way to "value" securities being exchanged between two separate investment portfolios?**

The State Treasurer noted at the meeting and in her response to the audit that there was a disagreement between her staff and our office as to whether actual market values or "net present values" would be the most appropriate way to value securities that were being exchanged.

During the audit, officials in the State Treasurer's Office told us they used the net present value method in an attempt to ensure that each exchange of securities between the Short-Term Municipal Investment Pool and the State's idle funds portfolio was equitable. (A net present value calculation is a way to compare future and present cash amounts. That calculation takes into account the fact that present cash amounts can be invested to earn additional moneys in the future.)

The net present value method is simply a mathematical approach that can be used to try to approximate the current value of a security. However, all the bond experts we talked with in Kansas and in other states during this audit told us they would use market values to measure the value of securities being exchanged, if that information were available. The market value of a security represents what an informed buyer would be willing to pay for that security. That market value "automatically" takes into account future cash flows, and when they will occur. Thus, the market value of a security is the best measure of its current value. For these securities, the State Treasurer's Office had market value information readily available.

The analyses we performed in the audit report--and our conclusions that the exchanges resulted in a \$2 million loss to the State's idle funds--were based on the market value of the securities that were exchanged.

**2. Why didn't the "net present values" the State Treasurer's Office calculated approximate the market value of the securities exchanged**

**between the Short-Term Pool and the idle funds portfolio, as would have been expected?**

At the meeting, we noted that the "present values" the State Treasurer's Office had calculated and used in making the exchanges were incorrect in part because of a \$500,000 typographical error we identified on one of the exchanges. We pointed out that error in a list of questions submitted to the Treasurer's Office on January 9. On January 23, the Office notified us that a \$500,000 security had been transferred from the Short-Term Municipal Investment Pool to the State's idle funds portfolio to correct that error.

During the audit, however, we identified another major contributing factor.

In performing a net present value calculation in this situation, a person has to select a rate of return that could be earned on the securities in each portfolio. A person should expect to receive a higher rate of return on longer-term securities than on shorter-term securities.

In its calculations, the Treasurer's Office assumed that securities with an average maturity of 77 days would earn the same rate of return as securities with an average maturity of 481 days. The effect of the Office's assumption was to overvalue the securities in the Short-Term Pool in relation to securities in the idle funds portfolio. Again, the bond experts we talked with in Kansas and around the country said that the rates of return selected for these calculations should reflect the current market rates of return for such investments.

When we calculated the net present value of the securities that had been exchanged--after correcting the \$500,000 typographical error and selecting rates of return that took into account the length of the investments being exchanged--the resulting figures were very close to the market values for those securities. In our opinion, if the net present values of the securities being exchanged had been calculated correctly, the State Treasurer's Office wouldn't have exchanged the securities that were exchanged, and would have been able to identify securities to exchange that were of equivalent values.

I hope this information is helpful in your understanding of the issues raised in this audit report. As always, please let me know if you have any questions.

Sincerely,

  
Barbara J. Hinton  
Legislative Post Auditor

# **PERFORMANCE AUDIT REPORT**

## **EXAMINING THE INVESTMENT PRACTICES OF THE MUNICIPAL INVESTMENT POOL**

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### **OBTAINING AUDIT INFORMATION**

This audit was conducted by Ron Green, Cindy Denton, and Tim Patton. If you need any additional information about the audit's findings, please contact Mr. Green at the Division's office.

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# EXAMINING THE INVESTMENT PRACTICES OF THE MUNICIPAL INVESTMENT POOL

## Summary of Legislative Post Audit's Findings


The Municipal Investment Pool was established in 1992 to provide local units of government an additional option for investing idle revenues. The Pool is operated by the State Treasurer's Office, which has established three different portfolios--Overnight, Short-Term, and Intermediate-Term--within the Municipal Investment Pool.

**What's the Current Value of the Funds in the Municipal Investment Pool?** Several factors (including rising interest rates, large withdrawals for construction projects, and negative publicity about the Pool) caused the amount of money on deposit in the Pool to decline by nearly half from a high of \$1.3 billion in mid-1994 to \$703.7 million at year end. About \$683 million of the amount on deposit represented principal and the remainder was interest the Pool owed to depositors. On December 31, 1994, the Pool's investments were valued at about 97% of their cost; the market value of the Pool's assets was about 96% of the total owed to depositors. Market values have dropped because rapidly rising interest rates eroded the value of the Pool's investments in 1994.

**Has the Municipal Investment Pool Been Properly Managed to Avoid Liquidity Problems?** The State followed a number of good practices in setting up the Pool, but in our opinion the State Treasurer's Office bought longer-term investments than it should have. As interest rates rose in the first half of 1994, the Treasurer's Office shortened maturities on new investments, but that action did not avert later liquidity problems. Because of the length of investments already made (averaging well over one year) and the decline of new deposits coming into the Pool, the Treasurer's Office was forced to sell securities before maturity and take other steps to meet the Pool's cash-flow needs. In the last three months of 1994, about \$323 million worth of securities were sold to meet cash-flow needs of the Short-Term and Intermediate-Term Pools, resulting in losses of nearly \$2.8 million. In December 1994, about \$90 million of securities in the Overnight Pool were sold for re-investment purposes, at a recognized loss of about \$5 million.

To increase liquidity, the State Treasurer's Office exchanged securities between the Short-Term Pool and other pools it managed. In our opinion, these exchanges did not result in equal trades of value. Exchanges between the Short-Term Investment Pool and the State idle funds portfolio cost the State portfolio \$2 million more than it would have spent to acquire the same securities in the open market. We also questioned whether the Treasurer's Office's handling of the three portfolios within the Municipal Investment Pool resulted in Pool participants sharing equally in the Pool's gains and losses, as called for by the contract all participants sign.

This audit report includes several recommendations to help improve future operation and management of the Municipal Investment Pool. We would be happy to discuss these recommendations or any other items in the report with any legislative committees, individual legislators, or other State or local officials.

  
Barbara J. Hinton  
Legislative Post Auditor

## **EXAMINING THE INVESTMENT PRACTICES OF THE MUNICIPAL INVESTMENT POOL**

The 1992 Legislature established a Municipal Investment Pool which serves much like a money market fund for municipalities and State agencies. Cities, counties, school districts, and other municipalities can deposit money with the State Treasurer to be invested in the Pool only after they have offered that money to local banks and those banks have declined to offer interest rates at least as high as the State "investment rate." Funds may be deposited in the Pool for the same length of time that they were offered to the local banks. For example, if a municipality offered funds to the banks for a six-month term, it could put those funds in the Pool for six months.

The Pooled Money Investment Board has been given the responsibility for investing the moneys in the Pool. The types of investments that may be made are specified in State law and are primarily U.S. government securities which are considered safe. In June 1994, the Pool had about \$1.3 billion invested on behalf of the participating units of government.

The State Treasurer has divided the Pool into Intermediate-Term, Short-Term, and Overnight portfolios, reflecting the length of deposits. The investments held in June 1994 for the Intermediate-Term Pool matured at an average of 529 days while the money municipalities had deposited in the Intermediate-Term Pool were committed for an average of 189 days. The investments in the Short-Term Pool matured in an average of 441 days, while the deposits committed to that portfolio matured in an average of 40 days. (The Overnight Pool was not created until December 1994.)

Legislators have expressed concerns that the investments purchased for the Pool may have too long a maturity given the average amount of time that municipalities have committed funds to the Pool. The concern was that in a rising interest rate environment, municipalities may withdraw funds from the Pool to invest at higher rates, which could create liquidity problems for the Pool. This performance audit addresses the following questions:

1. **What's the current value of the funds in the Municipal Investment Pool?**
2. **Has the Municipal Investment Pool been properly managed to avoid liquidity problems?**

To answer these questions, we reviewed the history of the Municipal Investment Pool and procedures for how the Pool was managed on a daily basis. We interviewed State Treasury officials and other professionals in the financial investment field. We analyzed data on participants' deposits and the investment and exchanges

of securities. In addition, we surveyed officials in 24 other states in which state treasurers operate local government investment pools. In conducting this audit, we followed all applicable government auditing standards set forth by the U.S. General Accounting Office except that we did not verify the accuracy of some of the computer generated data provided by the State Treasurer's Office.

We found that the amount of money on deposit in the Municipal Investment Pool dropped significantly in the latter half of 1994 from \$1.3 billion to \$700 million. In addition, the rapid rise in interest rates during this period eroded the value of the investments. By the end of 1994, the market values of the Pool's investments were 97% of their costs; and the market value of the Pool's total assets was about 96% of the total amount owed to participants. It should be noted that these losses would not be realized unless the investments are sold before maturity.

We also found that the State followed a number of good practices when setting up the Municipal Investment Pool; however, the State Treasurer's Office needs to develop specific policies and procedures in a number of areas relating to the Pool's investments. Based on several measures, we think the State Treasurer's Office bought longer-term investments than it should have for this type of Pool.

The Treasurer's Office shortened maturities on new investments as interest rates began to rise, but that action did not avert later liquidity problems in the Pool. The Treasurer's Office also sold securities, borrowed money, and traded securities between funds to meet the Pool's cash-flow needs. In our opinion, the exchange of securities did not result in equal trades between pools. For example, the securities exchange between the Municipal Investment Pool and the State's idle funds portfolio resulted in a \$2 million net loss to the idle funds portfolio, and increased the maturity of securities held in that portfolio. We also questioned whether the Treasurer's Office's handling of the three portfolios within the Municipal Investment Pool resulted in Pool participants sharing equally in the Pool's gains and losses, as called for by the contract all participants sign.

These and other findings will be discussed in more detail following a brief overview of the Municipal Investment Pool.

## **Overview of the Municipal Investment Pool**

The 1992 Legislature passed legislation allowing the State Treasurer to establish a Municipal Investment Pool. The Pool provides an opportunity for all municipalities and some State agencies to combine their idle funds and invest them at higher rates of return than they could have achieved independently.

Any governmental entity, unit, or subdivision in the State of Kansas having authority to receive, hold, and spend public moneys may invest money in the Pool. Examples of those entities include the following:

- counties
- cities
- townships
- school districts
- vocational technical schools
- community colleges
- community mental health centers
- community facilities for the mentally retarded
- universities

### **The State Treasurer Administers the Pool, And the Pooled Money Investment Board Is Responsible For Overseeing the Pool's Investments**

By law, the Pool's investments must be low-risk in nature and generally may not be for longer than four years. Those investments are limited to the following:

- direct obligations of the U.S. government or U.S. government agencies
- obligations that are insured as to interest and principal by the U.S. government or U.S. government agencies
- securities of U.S.-sponsored enterprises that may be accepted as security for public funds under federal law, including mortgage-backed securities of such enterprises (limited to 10% of total investments)
- certificates of deposit in certain Kansas financial institutions
- repurchase agreements with certain Kansas financial institutions or with primary government securities dealers

To further reduce risk to the Pool's participants, the law establishes a reserve fund for the Pool. Any gains from the sale of investments are placed in the reserve fund. The reserve fund is used to absorb losses from the sale of investments before maturity.

The law allows the State Treasurer to assess reasonable charges to cover the expenses of administering the Pool. Those charges can't exceed 1% of the interest

earned on the Pool's investments. The State Treasurer also is required to contract for an annual review of the comparative investment performance of the Pool.

State law says that moneys and investments in the Municipal Investment Pool shall be managed by the Pooled Money Investment Board. The Board is comprised of the State Treasurer and four persons appointed by the Governor.

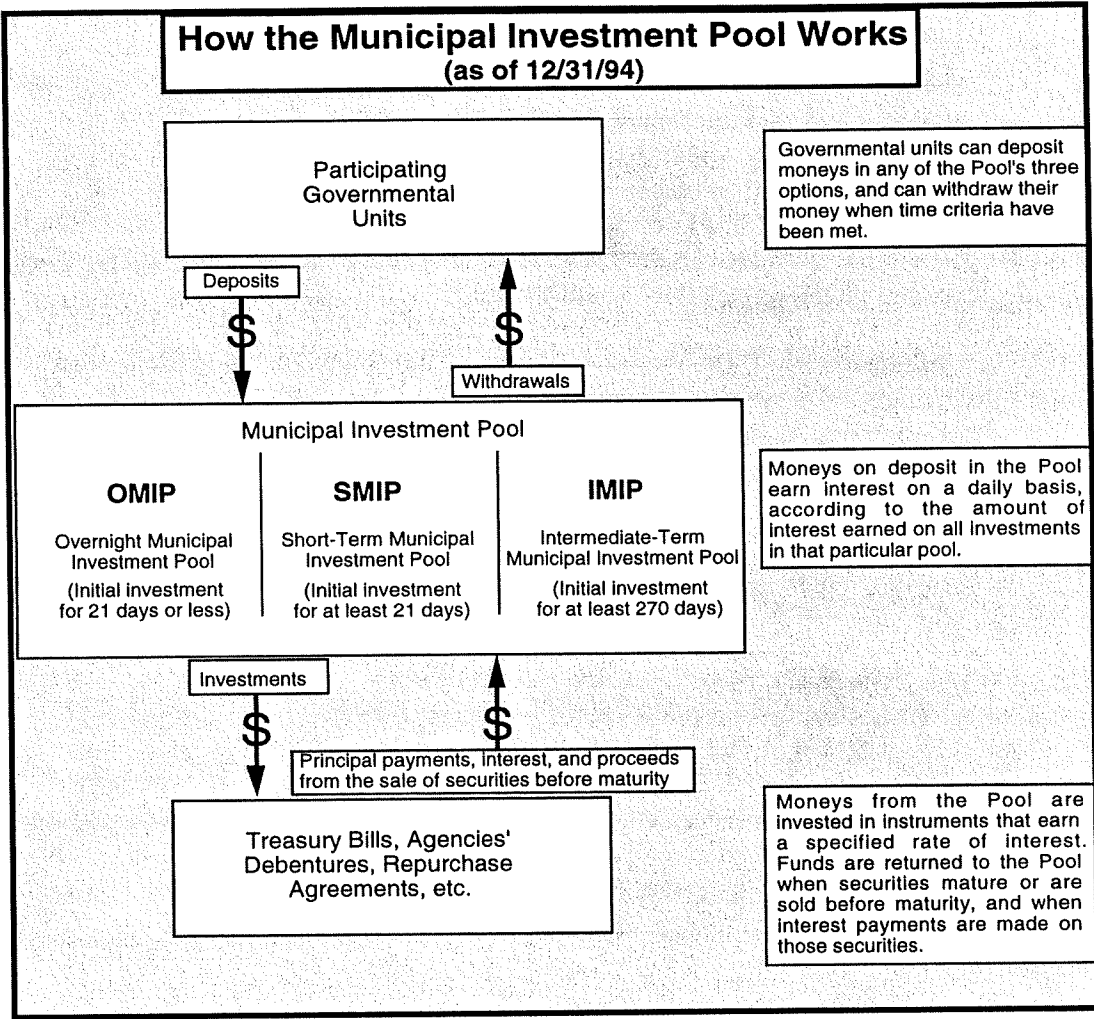
**Before a governmental unit can invest money in the Municipal Investment Pool, it first must offer that money to local financial institutions.** The money must be offered to commercial banks, federally chartered savings and loans, or federally chartered savings banks that have an office located within the governmental unit or within the county or counties in which all or part of the governmental unit is located. The money also must be offered to the financial institutions for a specified amount of time. If none of the eligible financial institutions offer to pay the State "investment rate"—a statutorily defined interest rate based on yields on U.S. government securities or on federal funds rates—on the funds offered for investment, the governmental unit may then invest the moneys in the Municipal Investment Pool or in other investments available to it. Deposits into the Pool must be for the same amount of time they were offered to the local financial institutions.

**On December 1, 1993, the State Treasurer's Office split the Pool's investments into two portfolios.** These were the Short-Term Municipal Investment Pool (SMIP) and Intermediate-Term Municipal Investment Pool (IMIP). All existing deposits were assigned to the Short-Term Pool. To move money to the Intermediate-Term Pool, participants had to sign a new agreement specifying that they were committing their funds for at least nine months. Early withdrawals from the Intermediate-Term Pool are penalized with the loss of 90 days' interest earnings.

**On December 19, 1994, the State Treasurer created a third investment portfolio.** The State Treasurer said the Overnight Municipal Investment Pool (OMIP) was established in response to rising interest rates and the cash-flow needs of participants. When the Overnight Pool was created, new requirements were placed on the Short-Term Pool. Those requirements were that funds had to be committed for at least 21 days, and that a 45-day interest penalty would be imposed for early withdrawals. The graphic on the facing page summarizes the requirements of each pool and how the Municipal Investment Pool works as a whole.

Despite the existence of three segments, there is only one Municipal Investment Pool. When a governmental unit opens an account in the Pool, its representatives sign a contract—called a participation agreement—that outlines how transactions will be handled. According to the State Treasurer's Office, participants make deposits in the portfolio that best matches their expected cash flow needs.

## How the Municipal Investment Pool Works (as of 12/31/94)



1-11

## What's the Current Value of the Funds in the Municipal Investment Pool?

The amount of money on deposit in the Municipal Investment Pool stayed fairly constant at between \$1.1 billion and \$1.3 billion during the first half of calendar year 1994, but dropped significantly during the latter half of 1994 to \$703.7 million by December 31. Among the reasons cited for the large drop in balances in the Pool are rapidly rising interest rates that made other investment options more attractive for municipalities, large withdrawals in the summer and fall of 1994 to pay for construction projects, and negative publicity about the Pool.

On December 31, 1994, the market value of the investments made by the Municipal Investment Pool was \$668.3 million, or about 97% of the cost of those investments. On December 31, the market value of the Pool's assets was about 96% of the total amount owed to depositors. Market values have dropped primarily because rising interest rates have eroded the value of the Pool's investments. Such "paper" losses would be realized only if the Pool's current investments had to be sold before their maturity dates to meet cash flow needs. These findings are discussed in more detail in the sections that follow.

### Money on Deposit in the Municipal Investment Pool Has Dropped Significantly from \$1.3 Billion in Mid-1994 To about \$700 Million at the End of the Year

The first deposits into the Municipal Investment Pool were received in August 1992. By the end of that year, the balance exceeded \$380 million. (These balances include participants' deposits and interest credited to their accounts.) By November 30, 1993, the total balance in the Municipal Investment Pool had risen above \$700 million.

**Moneys on Deposit in the Municipal Investment Pool (a)**  
(dollar amounts shown are in millions)

1994 End of Month	Short-Term Pool	Intermediate- Term Pool	Overnight Pool	Total Municipal Invest. Pool
January	\$ 987.8	\$ 178.8	NA	\$1,166.6
February	1,022.4	277.6	NA	1,300.0
March	994.5	309.4	NA	1,303.9
April	940.3	330.9	NA	1,271.2
May	914.2	350.0	NA	1,264.2
June	975.7	365.7	NA	1,341.4
July	908.5	383.0	NA	1,291.5
August	727.8	420.1	NA	1,147.9
September	579.8	438.4	NA	1,018.2
October	494.9	403.1	NA	898.0
November	382.3	340.8	NA	723.1
December	164.1	296.0	\$ 243.6	703.7

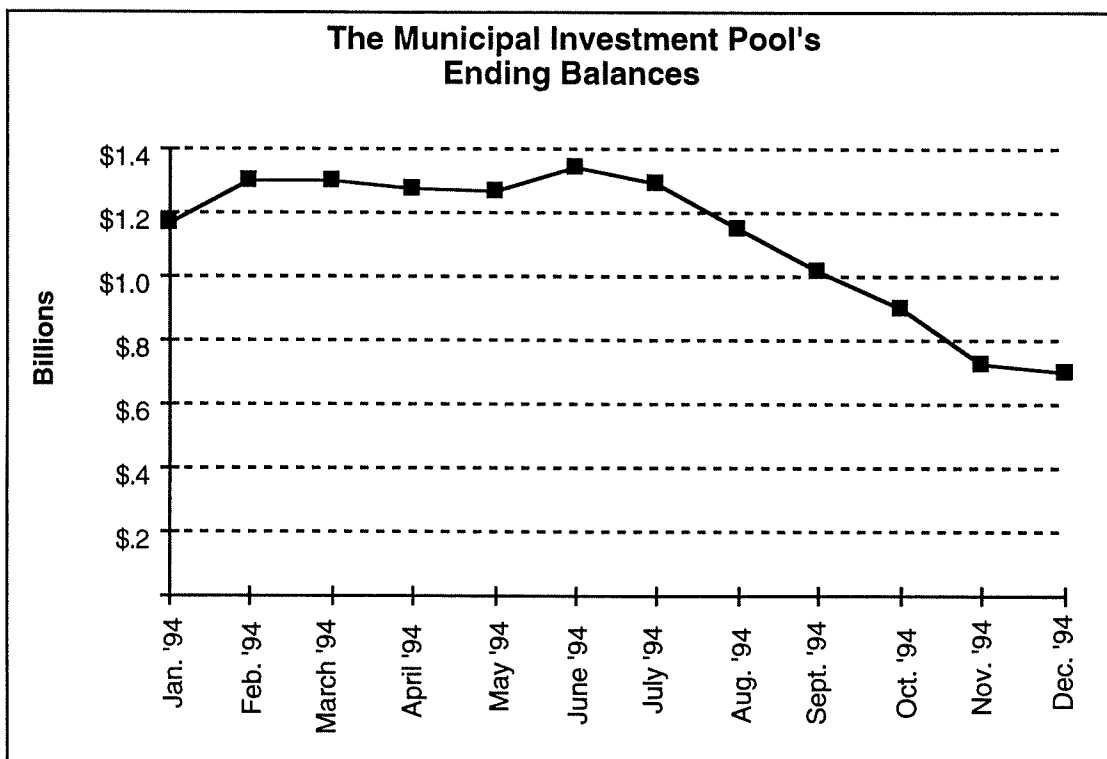
(a) These moneys include deposits by participants and any interest earned and credited to the Pool as of the end of each month.

1-12



In December 1993, the State Treasurer established an Intermediate-Term Pool and a Short-Term Pool. Existing deposits at the time were placed in the Short-Term Pool. In December 1994, the Overnight Pool was created. The table on the facing page shows the month-end balances of the Municipal Investment Pool during 1994.

As the table shows, the amount of money on deposit in the Short-Term Pool stayed fairly constant during the first half of 1994, but dropped significantly during the latter half of the year. Moneys on deposit in the Intermediate-Term Pool increased steadily during most of 1994, but began to decline in the last quarter. In December, participants transferred some of their deposits to the new Overnight Pool. The following graphic illustrates the history of the Pool's overall balances.



As the chart shows, the Pool has seen about a \$600 million decrease in balances over the last six months of the year. The main reason for that was a decline in the amount of new money being deposited in the Pool. In general, the amounts of money withdrawn from the Pool have stayed fairly constant. Appendix A shows the monthly deposits, withdrawals, and interest earnings credited for each portion of the Pool.

**The number of participants in the Short-Term and Intermediate-Term Pools has increased since mid-1994, but the amount on deposit has declined significantly.** The following tables compare the number and types of participants in the three investment pools as of June 30, before the Pools started experiencing significant declines in deposits, and as of December 31.

**Short-Term Pool Participants and Amount on Deposit  
as of June 30 and December 31, 1994**  
(dollar amounts shown are in millions)

	<u># of Participants</u>		<u>Amount on Deposit</u>		<u>% of Pool</u>	
	<u>June</u>	<u>December</u>	<u>June</u>	<u>December</u>	<u>June</u>	<u>December</u>
State Agencies	5	5	\$140.4	\$16.8	14.4%	10.3%
Cities	43	48	215.5	43.4	22.1	26.4
School Districts	41	50	271.0	44.7	27.7	27.3
Counties	28	28	299.4	52.3	30.7	31.9
Other	<u>25</u>	<u>30</u>	<u>49.4</u>	<u>6.8</u>	<u>5.1</u>	<u>4.1</u>
<b>TOTAL</b>	142	161	\$975.7	\$164.0	100.0%	100.0%

**Intermediate-Term Pool Participants and Amount on Deposit**

	<u># of Participants</u>		<u>Amount on Deposit</u>		<u>% of Pool</u>	
	<u>June</u>	<u>December</u>	<u>June</u>	<u>December</u>	<u>June</u>	<u>December</u>
State Agencies	5	5	\$148.0	\$157.1	40.4%	53.1%
Cities	27	33	134.6	77.5	36.8	26.2
School Districts	19	30	38.1	35.6	10.4	12.0
Counties	15	15	33.2	16.4	9.1	5.6
Other	<u>19</u>	<u>23</u>	<u>11.8</u>	<u>9.4</u>	<u>3.3</u>	<u>3.1</u>
<b>TOTAL</b>	85	106	\$365.7	\$296.0	100.0%	100.0%

**Overnight Pool Participants and Amount on Deposit**

	<u># of Participants</u>		<u>Amount on Deposit</u>		<u>% of Pool</u>	
	<u>June</u>	<u>December</u>	<u>June</u>	<u>December</u>	<u>June</u>	<u>December</u>
State Agencies	NA	2	NA	\$9.0	NA	3.7%
Cities	NA	23	NA	27.4	NA	11.3
School Districts	NA	28	NA	45.8	NA	18.8
Counties	NA	16	NA	149.7	NA	61.4
Other	<u>NA</u>	<u>18</u>	<u>NA</u>	<u>11.7</u>	<u>NA</u>	<u>4.8</u>
<b>TOTAL</b>	NA	87	NA	\$243.6	NA	100.0%

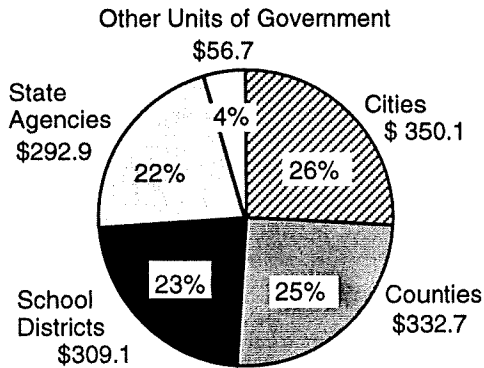
Many participants have shifted their funds from the Short-Term Pool to the Overnight Pool; counties have the largest amount of money invested in the new Overnight Pool. The Intermediate-Term Pool did not experience as dramatic a reduction in funds because participants commit those funds for a longer period of time and deposits are not as readily available for withdrawal. In December, State agencies had more than half the money on deposit in the Intermediate-Term Pool. For the Municipal Investment Pool as a whole, the pie charts on the facing page show total deposits for each category of governmental unit as of June and December 1994.

In that six-month period, State agencies' deposits dropped by \$105 million (from \$288 to \$183 million). As of June 30, the State agencies with the largest amounts on deposit were the Kansas Department of Transportation (\$140 million) and the Insurance Department's Health Care Stabilization Fund (\$103 million). By December 31, the Department of Transportation's balance had dropped to \$19 million, and the Insurance Department's balance had increased to \$156 million.

## Municipal Investment Pool Participants

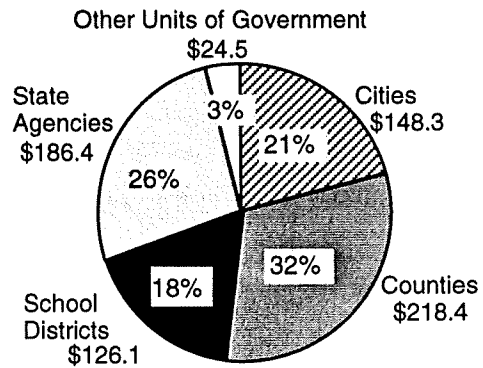
(dollar amounts shown are in millions)

**Deposits as of June 30, 1994**



**Total Deposits \$1,341.5**

**Deposits as of December 31, 1994**



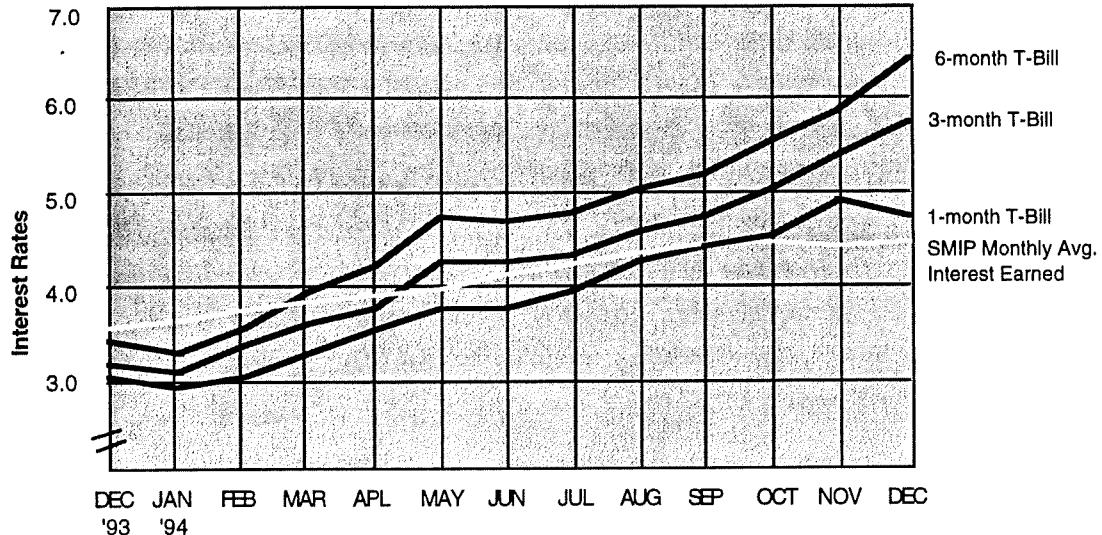
**Total Deposits \$703.7**

According to the State Treasurer's Office, deposits have dropped significantly in the Short-Term Pool because of a combination of factors. The amount on deposit in the Short-Term Pool declined from \$976 million in June to \$382 million at the end of November (the last month before the Overnight Pool was established). The State Treasurer's Office cited several factors to explain that decline, including the following:

- *rapidly rising interest rates.* Between February and November 1994, the Federal Reserve Board increased short-term interest rates by 2.5 percentage points. In May 1994, the rate being paid on three-month Treasury bills moved above the yield being paid by the Short-Term Pool. When that happened, other investment options became more attractive to some of the Pool's participants. The graphic on page 10 compares the increase in short-term interest rates with the Short-Term Pool's yield. The speed of interest rate increases in 1994 was nearly unprecedented in this century.
- *large withdrawals of bond proceeds for construction projects, and large debt service payments.* According to a recent report written by the Treasurer's Office, in the Spring of 1994 the Municipal Investment Pool contained almost \$700 million in municipalities' bond proceeds for construction projects. By State law, bond proceeds are not required to be offered to local financial institutions, and may be deposited directly into the Pool without stated commitment dates. According to the report, "many of the bond proceeds were deposited without [commitment] dates at all and were left on a day-to-day basis." During late Summer and Fall, as those construction projects were well under way, large amounts of those bond proceeds were withdrawn. About this

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**Interest Rates on One-, Three-, and Six-Month Maturity  
Treasury Bills Compared With the SMIP Monthly  
Average Rate, 12/93 - 12/94**



This chart shows that short-term Treasury Bill rates have increased faster than the yield paid by the Short-Term Pool in 1994. By October 1994, the SMIP yield was lower than all the Treasury Bill rates.

same time, large debt service payments were made out of the Pool for the Department of Transportation and local entities. These debt service payments are typically at their highest in September and October, according to the Treasurer's Office.

- *negative publicity.* The State Treasurer ran for re-election in 1994; the election was held in November. According to the State Treasurer's Office, the Treasurer's opponent presented "negative and false information" about the Municipal Investment Pool. In December 1994, public concerns over losses in the Orange County, California, investment pool were said to have made matters worse.

The establishment of the Overnight Pool in December appeared to have reduced the rate of decline in the Municipal Investment Pool's deposits. The overall balance in the Pool declined by only \$19 million in December, compared to an average decline of about \$141.6 million over each of the previous three months.

**The Market Value of the Pool's Investments  
On December 31 Was About 97% of Their Cost**

The market value of a security reflects what the security could be sold for in the financial markets at a specified point in time. The following table compares the cost and market values of the investments made by the Municipal Investment Pool as

of December 31, 1994. (Throughout this report, the term cost refers to "amortized cost," which means the actual price paid, including the amount of any premium or discount that has not been recognized as income to date on that investment. We use the word "cost" for the sake of simplicity.)

**Market Value of Investments in the  
Municipal Investment Pool  
as of December 31, 1994**  
(dollar amounts shown are in millions)

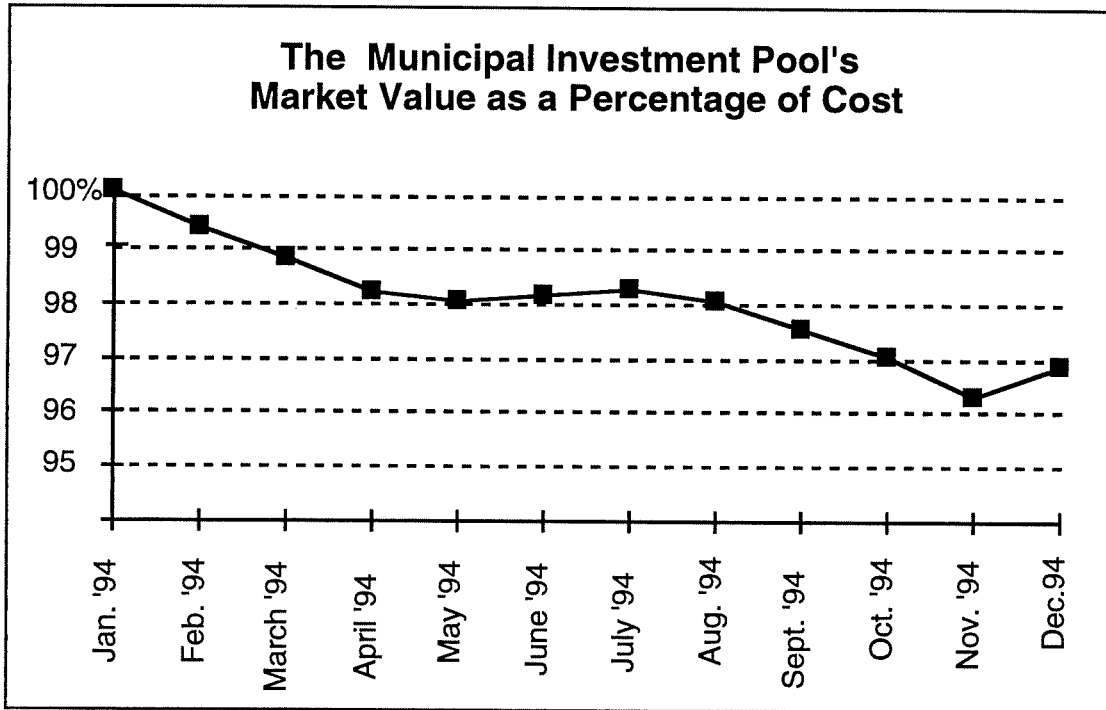
<u>Pool</u>	<u>Cost</u>	<u>Market Value(a)</u>	<u>Difference</u>	<u>Market Value as a % of Cost</u>
Short-Term	\$159.7	\$150.7	(\$9.0)	94.4%
Intermediate-Term	\$291.7	\$279.1	(\$12.6)	95.7%
Overnight	<u>\$238.5</u>	<u>\$238.5</u>	<u>(\$0)</u>	99.9%
Total Pool	\$689.9	\$668.3	(\$21.6)	96.9%

(a) In accordance with standard practices, the market values shown above do not include accrued interest.

The market value of the Pool's investments has been eroded by rising interest rates in 1994. In times of rising interest rates, the market value of existing fixed-income investments decreases, because an investor is only willing to pay a price for a security that will yield the current market rate. So securities issued when the interest rate was lower will have a reduced market value to compensate the buyer. This is what has happened to many of the Pool's securities.

Since February 1994, interest rates have been on the rise. For example, six-month Treasury Bill yields have risen from 3.32% in December 1993 to 5.95% in November 1994. As a result, the market value of the securities in the Short-Term and Intermediate-Term Pools' investment portfolios has dropped. The Overnight Pool has newly purchased, very short-term securities that are nearly equivalent to cash. The Overnight Pool is not exposed to any significant risk from interest rate increases.

As the table shows, the market value as a percentage of cost for the entire Pool was 96.9% at the end of December. That percentage was somewhat skewed by the new Overnight Pool, which held investments valued at 99.9% of cost. The market values for the Short-Term and Intermediate-Term Pools were at 94.4% and 95.7%, respectively, of the cost of those investments. Stated another way, the market value was about 4.5 to 5.5% less than those investments cost. The following graphic illustrates the history of the Pool's market value compared to cost.



The Municipal Investment Pool's total assets were about 96% of the amount owed to participants on December 31. The total assets of the Municipal Investment Pool include the market value of investments, accrued interest, and cash. The following table shows that the market value of the Pool's assets at the end of 1994 was short of covering the participants' principal on deposit by about 1.2%.

#### Municipal Investment Pool Assets Compared to Participants' Principal December 31, 1994

(dollar amounts shown are in millions)

	Amount Owed to Participants	Liquidation Value of Total Assets(a)	Difference	Total Assets as a % of Amount Owed To Participants
Principal Only	\$682.9	\$674.8	(\$8.1)	98.8%
Principal and Interest	\$703.7 (b)	\$674.8	(\$28.9)	95.9%

(a) The par value of the securities was \$684.2 million.

(b) The amount shown here has not been reduced by any early withdrawal penalties, which were estimated to be about \$4.2 million if all deposits were withdrawn on December 31.

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**Losses in the market value of the Pool's investments are realized only if investments have to be liquidated before their maturity dates to meet the Pool's cash-flow needs.** If investment securities are held until they mature, no loss occurs. For example, a security with a par value of \$1 million will pay \$1 million at maturity even though it might currently be worth only \$950,000 on the open market. Thus, losses in the market value of the the Pool's investments are realized only if investments have to be sold before their maturity dates to meet cash flow needs.

Legislative concerns that led to this audit were that, given the rising interest-rate environment, participants might withdraw funds from the Pool to invest at higher interest rates elsewhere, which could create liquidity problems for the Pool. The State Treasurer announced in December that a number of investments had been sold at a loss to meet the demands for withdrawals in that Pool. In the last three months of 1994, the Treasurer's Office recognized losses of \$7.8 million on the sale of the Pool's securities. The following question addresses the steps the State Treasurer's Office has taken to manage the Pool to avoid liquidity problems, and the steps that have been taken to address the liquidity problems that have arisen.

## **Has the Municipal Investment Pool Been Properly Managed to Avoid Liquidity Problems?**

The State followed a number of good practices in setting up the Municipal Investment Pool, but based on several measures, we think the State Treasurer's Office invested too long for the type of pool being managed. After interest rates started to increase and the Pool ran into liquidity problems, the Treasurer's Office took several steps to meet the Pool's cash-flow needs. Those steps included shortening the length of new investments being purchased, selling securities that would incur the least amount of loss, and using short-term borrowing authority to put off the need to sell securities at a loss.

The State Treasurer's staff also exchanged longer-term investments held by the Short-Term Pool for shorter-term investments held by the State's idle funds portfolio and the Intermediate-Term Pool. These exchanges did not result in equal trades between the pools. For example, the securities exchange between the Municipal Investment Pool and the State's idle funds portfolio resulted in a \$2 million net loss to the idle funds portfolio, and increased the maturity of securities held in that portfolio. We also questioned whether the Treasurer's Office's handling of the three portfolios within the Municipal Investment Pool resulted in pool participants sharing equally in the Pool's gains and losses, as called for by the contract all participants sign. These and related findings are discussed in detail in the following sections.

### **The State Followed a Number of Good Practices In Setting Up the Municipal Investment Pool**

The National Association of State Treasurers and the Government Finance Officers Association have published reports on the establishment and management of local government investment pools. We reviewed those publications to identify practices that these organizations said should be followed in establishing and managing a municipal investment pool.

As the box on the following page shows, Kansas has followed a number of the recommended practices in establishing and managing its Municipal Investment Pool. In addition to the good practices shown in the box, the State Treasurer's Office has established a reserve fund for its Municipal Investment Pool, as required by State law. All gains from the sale of investments are placed in the reserve fund, and any losses from the sale of investments before maturity are charged against the reserve fund. This helps smooth out fluctuations in the earnings of the Pool over time, and provides for a more stable rate of return for the Pool's participants.

**We identified two areas where there were weaknesses in how the Pool was set up and managed.** First, the Pooled Money Investment Board and the State Treasurer's Office have not established specific policies and objectives for each of the three investment portfolios within the Municipal Investment Pool. Each portfolio has



**Comparison of Kansas' Municipal Investment Pool to Practices Recommended by the National Association of State Treasurers And the Government Finance Officers Association**

**Recommended Practices**

- State law usually controls the kinds of investment instruments the pool can use. Those investments should be limited to high-grade marketable securities with relatively short maturities, such as certificates of deposit, and U.S. Treasury and agency obligations.
- The state treasurer usually manages the actual investments with the assistance of an investment board or management committee comprising pool participants.
- Most pools have adopted internal administrative procedures and an investment policy that specifies:
  - credit standards for investments
  - eligible types of investments
  - allowable maturity ranges
  - limits of the amounts of different types of investments that will be held in the portfolio
  - methods and frequency for calculating valuation, yields, and earnings
  - monthly statements of accounts and reports on holdings
- Some pools create policy boards or advisory councils consisting of pool participants to improve communication between the participants and money managers.
- Periodic reviews of investment transactions should be conducted to find any discrepancies between policy and actual transactions.
- An outside agency should conduct an audit and report the findings to policy makers.

**What Kansas Has Done**

- Kansas law limits investments to U.S. government securities, certificates of deposit, repurchase agreements, and mortgage-backed securities. The law sets a limit four years on investments, with the exception of mortgage-backed securities.
- The State Treasurer's Office administers the Pool and the Pooled Money Investment Board's staff makes the actual investments.
- The State Treasurer's Office has adopted internal administrative procedures and an investment policy. Those policies have incorporated what the law says regarding the eligible types of investments and allowable maturity ranges. They include methods for valuing the portfolio and calculating earnings and yields. The policies and procedures also contain provisions for monthly statements to participants.
- The policies and procedures for Kansas' Municipal Investment Pool call for the establishment of an advisory board. The Board was not appointed until January 1995.
- Investment transactions are reviewed by the Pooled Money Investment Board, by participants, and by an independent certified public accountant.
- State law requires an annual comparative performance review. The first performance review was conducted in December 1994. The Treasurer's Office also contracts for an annual financial audit of the Pool.

### The Municipal Investment Pool Offers a Number of Advantages To Local Units of Government

Municipal investment pools have become a popular way for local units of government to invest funds that won't be needed on an immediate basis. At least half the 50 states now operate a municipal investment pool. Those pools range in size from \$300 million to \$9 billion, and have been in existence for as long as 23 years. Advantages of the Kansas Municipal Investment Pool include:

- **Higher rates of return** - By pooling their money, local units of government can invest in securities that might not be available to them on an individual basis. Also, the costs of investing are spread over many units of government and over larger sums of money, consuming less of the return generated from the investments.

- **Professional management** - Small units of government often can't justify having professional money managers on staff. By using the Municipal Investment Pool, they can take advantage of money managers employed by the Pooled Money Investment Board.

- **No safekeeping charges or broker fees** - As an institutional investor, the Pool is able to purchase securities directly from primary dealers and does not incur brokerage fees a municipality might incur if it purchased securities directly.

Also, the municipality does not have to pay safekeeping charges for the securities it holds. The only cost depositors pay is an administrative fee of 1% of the interest earned each month.

- **Ability to pay principal and interest on bonds directly from the Pool** - The Kansas State Treasurer acts as paying agent for the vast majority of bonds issued by Kansas municipalities. Pool participants have the option of making their debt principal and interest payments directly from their Pool accounts. This allows them to keep their money in the pool and earn interest on their funds up to the day before the payments are made.

- **Ability to make transfers and distributions to other units of government** - Making such transfers within the Pool eliminates wire fees for both the payer and the receiver.

different deposit maturities, which would affect how long the moneys would be invested and what types of securities would be purchased.

Such policies not only would guide the investment officers who manage the Pool's investments, but also would inform local units of government about how they could expect their funds to be invested.

In its 1989 report entitled *Local Government Investment Pools*, the National Association of State Treasurers noted that, as investments in such pools grow larger

...a written statement of the pool's objectives and the policies designed to meet those objectives becomes imperative. Internal guidelines should identify credit standards, eligible instruments, allowable maturity ranges, and limits of portfolio concentration for each security type....Written internal safeguards are essential for the protection of the pool's integrity and the ability to properly monitor pool activity.

A second area of concern was the fact that although the Municipal Investment Pool's written policies called for the State Treasurer to appoint an advisory board comprised of nine members, the board was not appointed until January 1995. During the first two years of the Pool's existence, an advisory board might have been able to offer valuable advice on how the Pool's investments should have been handled, and may have helped the Treasurer's Office avoid the liquidity problems that the Pool experienced in 1994.

## **Based on Several Measures, We Think the State Treasurer's Office Invested Too Long for the Type of Pool Being Managed**

The Pooled Money Investment Board and Municipal Investment Pool policy statements say that the investment objectives for the Pool are safety, liquidity, and rate of return, in that order. In Kansas, as in other states with local government investment pools, State law limits the types of investments that can be made so that the default risk is minimized. Fixed-income investments guaranteed by the U.S. government or its agencies have a negligible risk of default.

The key decision to be made, then, is how long to invest the money, because that decision impacts both the pool's liquidity and its yield. If an investment pool is invested for a very short average maturity—such as 30 days—one risk is that interest rates will fall, and the pool would have lost the opportunity of “locking in” higher rates. However, that scenario would not result in any risk to the principal amount on deposit. On the other hand, if an investment pool is invested for a longer average maturity—such as 500 days—and interest rates move higher, the pool's rate of return may become less than competitive with market rates, and securities may have to be sold (at a loss) to meet withdrawal demands. In that scenario, participants in the pool may not receive all of the principal they have deposited, and the yields earned on those deposits would be lowered.

**Both the National Association of State Treasurers and the Government Finance Officers Association suggest that local government investment pool deposits should be invested for relatively short durations.** The Association of State Treasurers' report referred to earlier notes that most of these investment pools are comparable to money market mutual funds. “Since most pools place no limit on the timing or amount of deposits or redemptions,” that report states, “the funds remain comfortably liquid.” The report goes on to say, “To maintain high liquidity most pools find it necessary to invest their funds in high-grade marketable securities with relatively short maturities (under one year).”

A 1991 publication put out by the Government Finance Officers Association, *An Introduction to External Money Management for Public Cash Managers*, also discusses portfolio maturities for local government investment pools. That report noted the following:

Most pools invest in short-term securities with average maturities sufficiently short to avoid market price risks. A few pools, however, hold uncharacteristically longer portfolio securities, subjecting their portfolios and their participants to greater market price volatility.... A pool that invests in longer-term securities may be subject to market price fluctuations that will eventually be passed on to the participants. Historically, investment losses involving long-term securities purchased by state investment pools resulted in reform efforts to preclude such practices....”

That report also stated that “history has shown that even during periods of rising interest rates, portfolios with short maturities can maintain a stable principal valuation and thus the funds can maintain a stable share price.”

A consistent theme we drew from these reports was that local government investment pools should be managed conservatively to ensure that municipalities will not lose the moneys they have placed in the pool.

The State Treasurer's Office generally has invested the Pool's deposits for substantially longer than the other states we surveyed. The following table shows the average length of deposit commitments and investments for Kansas' Municipal Investment Pool over the last 10 months of 1994. These figures were provided by the State Treasurer's Office; we did not attempt to verify their accuracy. Also, the maturity figures shown here and throughout the report are for the "weighted average maturity" of the deposits and investments, which takes into account how much money is deposited or invested for how long. Finally, these figures show the data for all investments in each portfolio, not just investments that were made during that month.

**Length of Deposit Commitments and Investments  
in the Municipal Investment Pool**

1994	<u>Short-Term Pool</u>		Average investments were for this many times longer than average deposits	<u>Intermediate-Term Pool</u>		Average investments were for this many times longer than average deposits
	<u>Weighted Average Maturity (in days)</u>			<u>Weighted Average Maturity (in days)</u>		
	<u>Deposits</u>	<u>Invest.</u>		<u>Deposits</u>	<u>Invest.</u>	
Jan.	70	309	4.4 times	265	512	1.9 times
Feb.	72	313	4.3 times	244	493	2.0 times
March (a)	65	485	7.5 times	215	611	2.8 times
April	57	496	8.7 times	186	609	3.3 times
May	46	487	10.6 times	213	557	2.6 times
June	40	441	11.0 times	189	529	2.8 times
July	39	459	11.8 times	167	485	2.9 times
Aug.	29	537	18.5 times	152	435	2.9 times
Sept.	31	644	20.8 times	143	395	2.8 times
Oct.	34	673	19.8 times	149	401	2.7 times
Nov.	31	567	18.3 times	154	570	3.7 times
Dec.	45	694	15.4 times	160	623	3.9 times

(a) The method of calculating the weighted average maturity of investments changed in the investment industry in March 1994, regarding the maturity dates of callable securities.

As the table shows, the deposit commitment maturities were much shorter in the Short-Term Pool than in the Intermediate-Term Pool, as might be expected. Investment maturities in the two pools varied between 300 and 700 days. In relation to deposit commitments, investment maturities in the Short-Term Pool were much longer than in the Intermediate-Term Pool. For example, in June 1994 the Short-Term Pool's investments averaged 11 times longer than deposits, while the Intermediate-Term Pool's investments were about three times longer than its deposits. In the fall of 1994, the average maturity of investments in the Short-Term Pool rose above 600

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days, because securities with shorter maturities were being sold to raise cash, leaving the securities with longer maturities untouched.

We also surveyed 24 other states that operate local government investment pools to determine how their funds were managed. The weighted average investment maturity for those states as of November 30 (or the closest date for which states could provide comparable information) was 104 days. The other states' averages ranged from 23-448 days. In Kansas, the weighted average maturity as of that date was about 570 days in each of the two pools. (Appendix B provides a complete summary of the information we obtained from the other states surveyed.)

**Officials in the State Treasurer's Office indicated that Kansas did not need to maintain as much liquidity as other local government pools.** Unlike Kansas, none of the other states we surveyed requires a time commitment on the deposits into their investment pools. Since the Intermediate-Term Pool was created in December 1993, moneys deposited in that Pool have had to be committed for at least nine months. Also, participants who withdraw funds before the end of their deposit commitments are assessed an interest penalty.

Until December 1994, the Short-Term Pool had no minimum commitment period, but deposits were committed for the same time period that was offered to local financial institutions. When the Overnight Pool was created December 19, the rules were changed for the Short-Term Pool. Since then, moneys deposited in the Short-Term Pool have had to be committed for at least 21 days, and participants that withdraw funds early would pay an interest penalty.

Pool officials said that because the Kansas Pool did not have "withdrawals on demand," as did the pools in other states, the Kansas Pool did not need to maintain as much daily liquidity and therefore could make longer-term investments.

Officials mentioned two other factors affecting their decision to make longer investments:

- the amount of money that had traditionally been "rolled over," or left in the pool for an additional period after the original time commitment expired. During calendar year 1994, about 85-90% of the deposits were rolled over each month.
- the net inflow of new money that had historically come into the Pool. Through March 1994, monthly deposits generally had exceeded withdrawals from the Pool.

For these and other reasons, officials thought they would be able to rely on new money coming into the Pool to help meet any withdrawal obligations. Pool officials concluded that they could count on a "core" amount of money always being on deposit in the Pool. (Since November 1993, the total amount on deposit in the three portfolios within the Pool never dropped below \$700 million.)

**The Municipal Investment Pool  
Was Not Alone in Seeing  
The Market Value  
Of Its Investments Decline**

During calendar year 1994, Kansas' Municipal Investment Pool suffered declines in the market value of its investments as a result of rapid rises in short-term interest rates. Financial institutions and others that invest in fixed-income securities suffered the same fate.

Figures published in Sheshunoff's *Banks of Kansas* (an industry publication) show that the average ratio of market value to book value for portfolios held by Kansas banks declined during the period from December 31, 1993, to June 30, 1994, (the most recent figures available).

**Market Value  
As a Percent of Book Value**

<u>Date</u>	<u>Average Bank Ratio</u>	<u>SMIP Ratio</u>	<u>IMIP Ratio</u>
12-31-93	101.51	99.93	100.00
06-30-94	<u>98.96</u>	<u>98.22</u>	<u>98.08</u>
<b>Change</b>	<b>(2.55)</b>	<b>(1.71)</b>	<b>(1.92)</b>

As the table shows, the average bank portfolio was worth about 99 cents on the dollar at June 30 and the Pool's investments were not far behind at 98 cents on the dollar. In the first six months of 1994, the market value of the portfolios of Kansas banks declined more than the market value of the Pool's investments.

On November 9, 1994, the federal Office of the Comptroller of the Currency said it would not force U.S. banks to take bond losses into account when calculating their capital for regulatory purposes. Under the new ruling, banks still must report the market value of their bonds under Financial Accounting Standard 115.

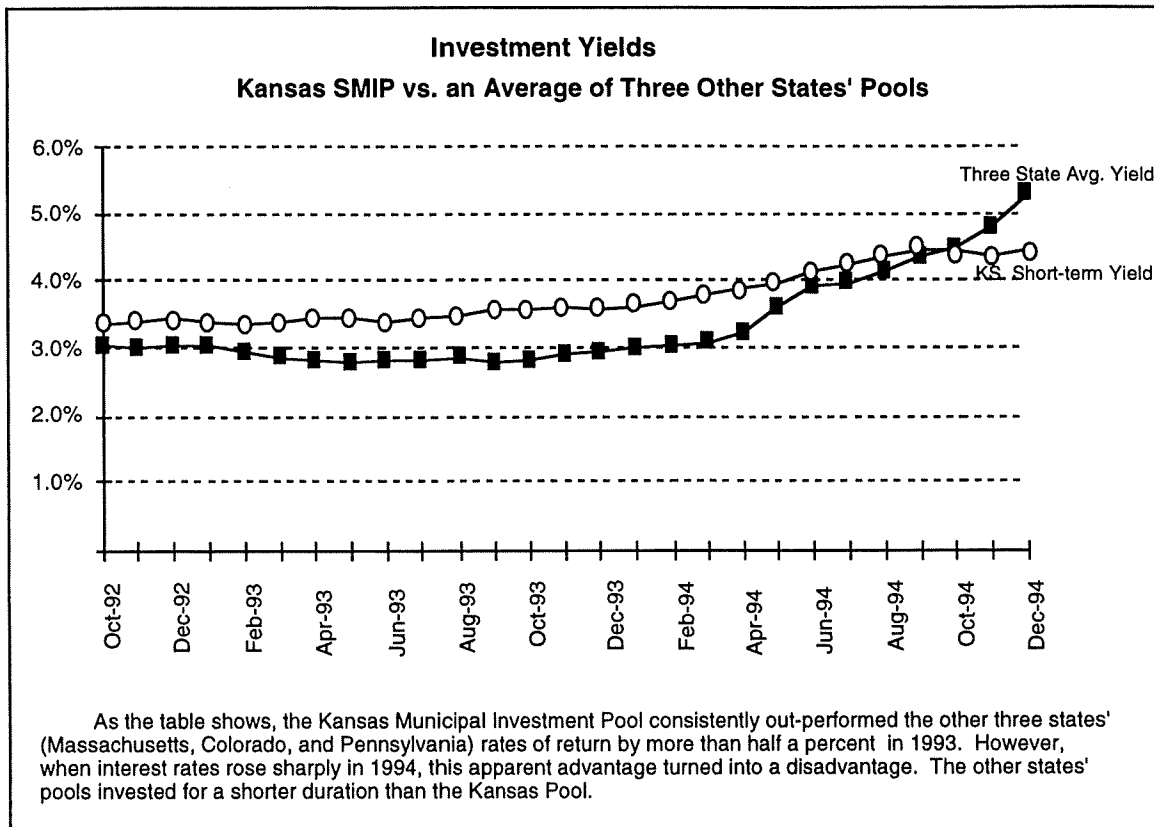
There is no precise formula or limit to dictate how "long" investments should be in a portfolio. No one can know in advance what will happen in the financial markets the next year, or even the next day, and certainly other sophisticated investment managers suffered serious losses in their bond portfolios as a result of the rapid rise in interest rates during 1994. However, given the following factors, we think it would have been better for the investments in the Municipal Investment Pool to have been made for shorter durations:

- *the newness of the Municipal Investment Pool.* Officials managing the Pool used their experience with the Pool to formulate their investment strategies. However, the Pool had been in existence only since August 1992.
- *the fact that interest rates were at historical lows in 1993.* Officials managing the Pool could foresee the likelihood of interest rate increases, although not the speed or magnitude of those increases in 1994.
- *the fact that at times a large percentage of the Pool's funds were bond proceeds.* According to the State Treasurer's Office, in the Spring of 1994 about \$700 million of the \$1.3 billion on deposit in the Pool was bond proceeds. Most of these bond

proceeds had no deposit commitment dates, and a large percentage of them could have been expected to be paid out within a relatively short time.

If the State Treasurer's Office had followed the practices of other states in investing in shorter-term securities—at least in the Short-Term Pool—Pool participants would have received lower returns on their deposits in 1993 and much of 1994. However, as the figure on the following page shows, Kansas' yield dropped below three comparison states' yields after October 1994. Given the long average maturities of the securities currently in the Short-Term Pool, that pool's yield likely will

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stay below the yield of those other states' pools for some time. Over time, Kansas' yield and the other states' yields likely will even out. However, the other states will have earned market rates of return with less likelihood of losses being realized because securities had to be sold to meet cash-flow needs.

**After Interest Rates Began to Rise Early in 1994,  
The State Treasurer's Office Shortened the Maturities of  
New Investments It Purchased**

Once interest rates started rising, the State Treasurer's Office could not change the maturities on the investments purchased in the past, but could manage for greater liquidity by buying only shorter-term investments. That appears to be what occurred. The table on the following page shows the percentage of longer-term investments (those maturing in more than one year) the State Treasurer's Office purchased for both the Short-Term and Intermediate-Term Pools since December 1993.

As the table shows, in December 1993 and January 1994 (before interest rates began increasing), about 20-30% of the dollar value of new investments purchased for the Short-Term Pool was for longer than one year. In March, only about 11% of new investments were for a year or longer, and as interest rates continued to rise, new investments of a year or longer dropped to zero.

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For the Intermediate-Term Pool, a higher percentage of new investments beyond one year would be expected, because of the longer time commitment of deposits in that portfolio. Although the trend for the Intermediate-Term Pool fluctuated, by September 1994 the percentage of new investments beyond one year in the Intermediate-Term Pool declined to zero.

**Percentage of Investments Made in Longer-Term Securities  
Short-Term and Intermediate-Term Pools  
December 1993-1994**

(dollar amounts shown are in millions)

**Short-Term Investment Pool**

<u>Months</u>	<u>Total \$ in new Investments</u>	<u>Amount of new Investments with Maturities of One year or more</u>	<u>New investments Beyond one year as a % of total New investments</u>
December 1993	\$499.6	\$107.3	21.5%
January 1994	424.1	134.7	31.8
February	216.1	38.0	17.6
March	172.5	18.9	11.0
April	134.6	10.8	8.0
May	225.3	12.0	5.3
June	498.4	22.2	4.5
July	348.5	6.5	1.9
August	498.4	0	0.0
September	425.4	0	0.0
October	111.8	0	0.0
November	19.0	0	0.0
December	4.1	0	0.0

**Intermediate Investment Pool**

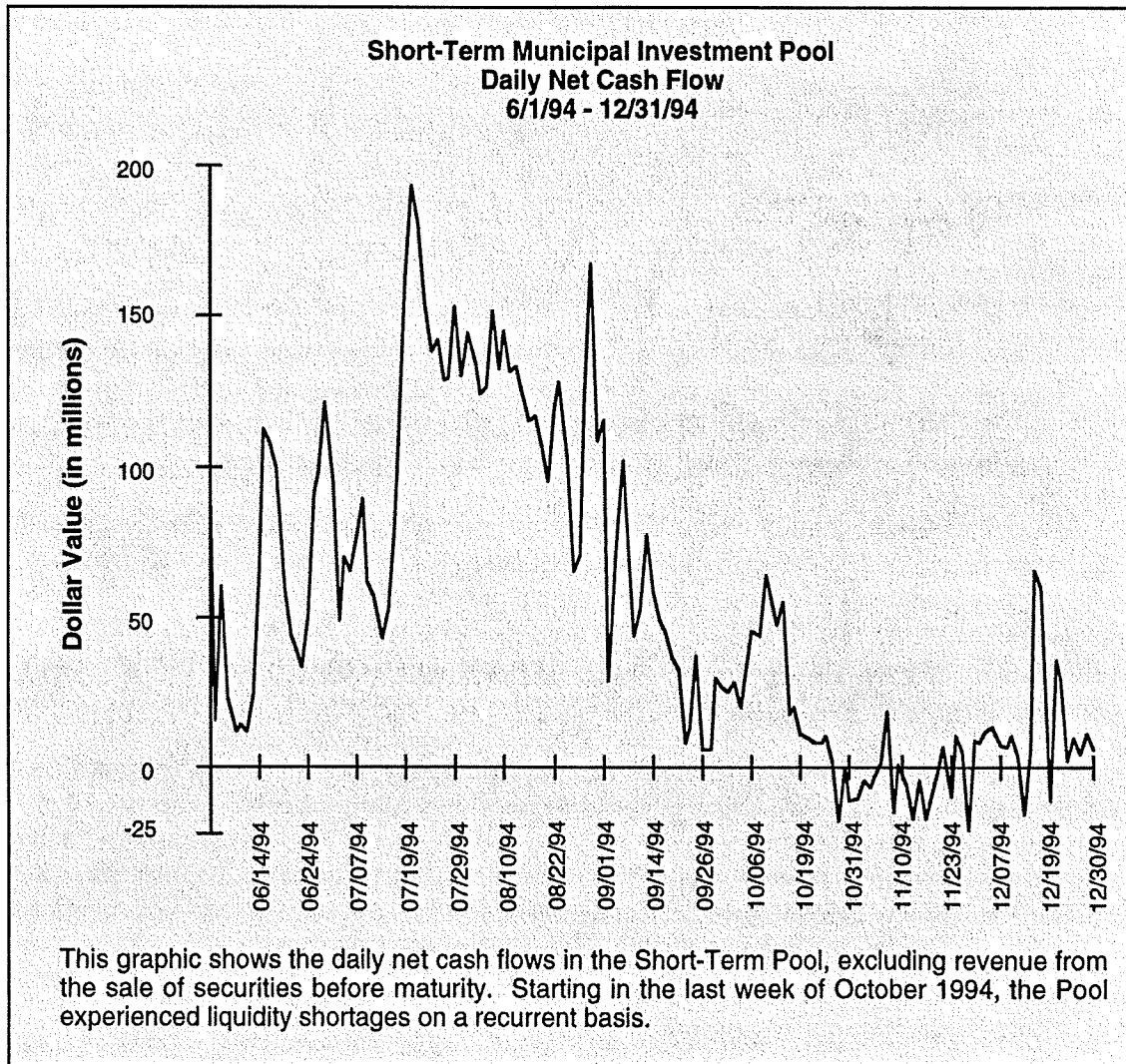
<u>Months</u>	<u>Total \$ in new Investments</u>	<u>Amount of new Investments with Maturities of One year or more</u>	<u>New investments Beyond one year as a % of total New investments</u>
December 1993	\$70.4	\$49.1	69.8%
January 1994	107.0	70.3	65.7
February	96.7	45.3	46.8
March	33.1	8.6	26.0
April	31.5	17.5	55.6
May	18.6	0.7	3.8
June	22.5	8.1	35.8
July	36.3	0.7	1.8
August	63.6	7.3	11.4
September	47.2	0	0.0
October	25.7	0	0.0
November	21.8	0	0.0
December	17.8	0	0.0



### The State Treasurer's Office Has Taken Several Steps to Manage the Liquidity Problems That Have Arisen in the Short-Term Pool

In October and November 1994, the amount of moneys available from new deposits and maturing securities in the Municipal Investment Pool often fell short of the moneys needed to make payments to participants withdrawing their moneys from the Pool. That fact is illustrated in the accompanying graphic. Most of the liquidity problems were occurring in the Short-Term Pool.

In an attempt to manage the liquidity problems in the Short-Term Pool, officials in the Treasurer's Office took three major steps; they sold securities before maturity, borrowed money on a short-term basis, and exchanged securities with other investment portfolios to generate cash for the Short-Term Pool.



**The State Treasurer's Office sold some securities before their maturity dates, resulting in a loss on those securities.** When securities must be sold for liquidity purposes, the selection of securities that result in the smallest possible losses is prudent. Officials in the State Treasurer's Office said they followed that principle, and provided us with examples of the daily reports that show which securities could be sold for the least loss. The table below summarizes the sales of securities sold at a loss in the last three months of 1994.

**Summary of Securities Sold at a Loss  
October-December 1994**

	<u>Total Sales of Securities</u>	<u>Total Losses on those Sales</u>
<b><u>Intermediate Pool</u></b>		
October 94	\$ 0	\$ 0
November 94	8,495,000	5,894
December 94	22,685,000	42,348
<b><u>Short-Term Pool</u></b>		
October 94	52,405,000	286,480
November 94	117,885,000	280,826
December 94	121,605,000	2,172,265
<b><u>Overnight Pool</u></b>		
December 94	<u>90,150,000</u>	<u>4,978,084</u>
<b>TOTAL for the Municipal Investment Pool</b>	<b>\$ 413,225,000</b>	<b>\$ 7,765,897</b>

As the table shows, the majority of the losses occurred on sales of securities that had been transferred to the Overnight Pool after it was created on December 19. Those securities originally were purchased within the Short-Term Pool. (The transfer of securities to the Overnight Pool will be discussed later in this report.)

Until mid-December 1994, the reserve fund helped cushion the losses experienced by the Municipal Investment Pool. The reserve fund grows when securities are sold (before maturity) at a gain, and shrinks when securities are sold at a loss. The reserve fund reached a peak of \$1.2 million in February 1994, but was depleted on December 13. After the reserve fund was exhausted, any further losses decreased the rate of return payable to Pool participants.

**The State Treasurer's Office borrowed moneys on a very short-term basis through what is known as "reverse repurchase agreements."** The use of reverse repurchase agreements for the Municipal Investment Pool was authorized by the 1994 Legislature. Reverse repurchases are short-term (usually one day) transactions for borrowing money to raise needed cash. Pledging certain Pool investments as collateral, the State Treasurer's Office borrows money from a securities dealer at a specified rate.

Reverse repurchases are used when it's less costly to pay interest on borrowed money than to sell securities at a loss before they mature. State Treasury officials told us they analyzed which step was most beneficial each time they made any of

these transactions. We could not verify that such a procedure was followed, because this type of information is not routinely maintained.

Reverse repurchases were used on 14 days in November 1994, with an average of \$28.7 million borrowed each day. The largest amount borrowed on any day was \$65 million. The Pool paid a total interest cost of about \$90,500 to borrow money in November 1994.

**The State Treasurer's Office traded longer-term securities in the Short-Term Pool for shorter-term securities in other pools.** By the end of October 1994, the average maturity of the investments in the Short-Term Pool was about 670 days. The sale of those securities well before their maturity dates would have resulted in relatively large losses.

As an alternative, the Treasurer's Office decided to exchange some of the Short-Term Pool's longer-term investments (those maturing 1-4 years in the future) for shorter-term investments owned by other investment pools managed by the State Treasurer—the State's idle funds portfolio, and the Intermediate-Term Pool. (The State's idle funds consist of moneys on deposit by various State agencies, which are invested under the general supervision of the Pooled Money Investment Board. The State Treasurer is the Chair of the Board.)

The table below summarizes the six exchanges that were made, and shows the market value of the traded securities at the close of business the day the exchanges were made.

**Summary for the Exchanges of Securities  
Between the Short-Term Pool and the  
State's Idle Funds and the Intermediate-Term Pool (a)**

<u>Market Value of Securities (a)</u>			
<u>Date of Trade</u>	<u>Idle to SMIP</u>	<u>SMIP to Idle</u>	<u>Net Difference</u>
Nov. 21	\$ 34,893,882	\$ 35,015,633	
Nov. 21	70,800,301	68,583,223	
Nov. 30	<u>12,047,887</u>	<u>12,072,836</u>	
<b>Total</b>	<b>\$117,742,070</b>	<b>\$115,671,692</b>	<b>\$2,070,378</b>
<u>Date of Trade</u>	<u>IMIP to SMIP</u>	<u>SMIP to IMIP</u>	<u>Net Difference</u>
Nov. 21	\$ 35,474,892	\$ 34,086,332	
Nov. 30	15,286,396	14,894,420	
Dec. 13	<u>17,043,019</u>	<u>16,711,340</u>	
<b>Total</b>	<b>\$ 67,804,307</b>	<b>\$ 65,692,092</b>	<b>\$2,112,215</b>

(a) In accordance with standard practices, the market values shown above do not include accrued interest.

**Investment Exchanges the Treasurer's Office Made to Increase Liquidity in the Municipal Investment Pool Resulted in the State's Idle Funds Portfolio Receiving \$2 Million Less Than it Would Have If Its Securities Had Been Sold in the Open Market**

As the previous table shows, the exchange of securities between the Short-Term Pool and the State's idle funds portfolio resulted in the idle funds portfolio trading \$117.7 million worth of securities to receive only \$115.7 million worth of securities. Because the Treasurer's Office liquidated the securities transferred into the Short-Term Pool almost immediately, the Short-Term Pool got the benefit of that \$2 million difference right away.

The State Treasurer's Office did not use market value in making these exchanges. Instead, officials used an analysis called a "net present value" calculation to value the securities that were being exchanged. (Such a calculation is designed to estimate the current value of money that will be received at some future date—i.e., future principal and interest payments on securities such as bonds or notes.)

Treasury officials told us they used this method to structure the exchanges so that each investment pool would be treated equitably. As the comparison table shows, however, the exchange did not result in the two pools being treated equally. In effect, the State's idle funds portfolio gave up securities worth \$2 million more than it would have if these securities had been sold in the open market. The State Treasurer's Office has pointed out that quoted market values are not necessarily what the Office would have paid or received in the market place for these securities. However, quoted market values are the best available estimate of that amount.

**Officials in the State Treasurer's Office contend there was no "loss" on the exchanges of securities.** First, they pointed out that the State's idle funds portfolio will receive significant amounts of additional interest income on the investments transferred into the idle funds portfolio, because of higher "calculated" interest rates on those investments. However, the idle funds portfolio would have received that same amount of additional interest income if it had sold its securities in the open market, and bought the same securities as those it acquired from the Short-Term Pool. It also would have had about \$2 million in cash left over.

Second, the Treasurer's staff said that if the idle funds portfolio had sold its securities and bought the same securities as it acquired from the Short-Term Pool in the open market, rather than through an exchange, the idle funds portfolio would have had a loss (the difference between the cost of the investments and the amount received on the open market when they are sold). The Treasurer's Office has indicated it does not plan to "recognize" any market-value losses on the exchanged securities until those securities are actually sold. (We could not tell how the exchange actually was handled because the Treasurer's Office does not maintain a general ledger, which would record such transactions as they occur. The most recent financial-compliance audit of the Pool strongly recommended that a general ledger system be implemented.)

Our analyses showed that, whether a loss is recorded at the time of a sale, or whether it is recorded at the time of an exchange, the total net income, gains, and losses over time for those securities would be identical. The only difference would be when and how these losses and gains were recorded in the Treasurer's Office's accounting records.

Finally, in our opinion, accounting for these trades in accordance with generally accepted accounting principles would require the Treasurer's Office to recognize and report the losses in market value at the time of the exchange, even if no securities had been sold. If those principles had been applied, the traded securities would have been "revalued" to current market values at the time of the exchange, and the difference between the cost and the new market value would have been recorded as a loss in the Pool where the securities originally were purchased.

**The exchanges the State Treasurer's Office made increased the weighted average maturity of the investments in the idle funds portfolio, thus increasing the level of "interest-rate" risk for that portfolio.** The average maturity of securities exchanged out of the idle funds portfolio was 77 days, while the average maturity of the securities exchanged into that portfolio was 481 days. Given the rising interest-rate environment at the time the trades were made, it is not clear that the State Treasurer's Office would have made the same decision to buy these longer-term securities for the idle funds portfolio if there had simply been ready cash in that portfolio to invest.

The exchange of securities increased the average maturity in the State's idle funds portfolio by about 36 days. When investment maturities are further out in time, there is a greater exposure for losses if interest rates continue to rise. For example, the securities received by the idle funds pool on November 21 had declined in market value by about \$600,000 as of December 31, 1994. (Once again, those losses will not be realized unless the securities are sold before maturity.)

#### **The Treasurer's Office's Handling of the Portfolios within the Municipal Investment Pool Did Not Appear to Result in Pool Participants Sharing Equally in the Pool's Gains and Losses**

As the table on page 25 showed, besides the investment exchanges the State Treasurer's Office made between the Short-Term Pool and the State's idle funds portfolio, additional exchanges also were made between the Short-Term Pool and the Intermediate-Term Pool.

Much like the exchanges with the State's idle funds, these exchanges were not done on a market-value basis, and in our opinion resulted in about a \$2 million advantage to the Short-Term Pool and a \$2 million disadvantage to the Intermediate-Term Pool.

In addition, when the State Treasurer's Office created the Overnight Pool on December 19, investments were transferred from the Short-Term Pool into the Over-

night Pool. These investments were sold during the last half of December at a loss of nearly \$5 million. Those losses were recognized in the Overnight portfolio even though they had been incurred in the Short-Term Pool's portfolio.

We questioned the State Treasurer and her staff about these transactions and why losses were not recognized in the Short-Term portfolio (where they occurred) before the investments were transferred to the Intermediate-Term and Overnight portfolios. Because each portfolio has its own set of investors, its own length of commitment, and its own investments, it seemed to us that the rate of return paid to those investors would be linked to the individual investment portfolios. It seemed unfair, for example, that the investors in the Overnight Pool had to absorb losses on investments purchased for the Short-Term Pool.

The Treasurer and her staff told us that, because all three portfolios were part of the Municipal Investment Pool, and because the Pool still owned the same securities after the exchanges, no losses were recognized at the time of the exchanges because no investments had been sold. According to them, having separate pools was simply an attempt to reward local units of government that could commit moneys to the Pool for longer periods of time with higher rates of return. They told us that trading securities and recognizing losses in the different pools simply allowed them to manage the returns generated by the three portfolios. The Treasurer's staff also pointed out that the Pool's investors make investment decisions on the interest rates being paid by the Pool in relation to other interest rates that are available at the time. If a local unit of government can earn 5% by investing in the Pool and only 4.5% from alternative investments, they said, local officials don't care how the Pool came to earn 5%.

K.S.A. 1994 Supp. 12-1677a creates a municipal investment pool fund and says that all moneys deposited in the Municipal Investment Pool shall be deposited into that fund. The law further says that "Interest earnings experienced by the fund on investments attributable to each participating municipality shall be prorated and applied to the individual accounts of the municipalities..." That law is unclear about whether more than one investment portfolio can be established and whether losses and earnings on specific investments must be tied to specific sets of investors. However, the Pool's participation agreement suggests that any gains and losses should be shared equally by all Pool investors. Section 2.03 of that agreement says that each participant:

...shall own an undivided beneficial interest in the assets of the Municipal Investment Pool which shall consist of the proportional amount that each Participant Account bears to the total amount of all Participants' Accounts in the Municipal Investment Pool, computed on a daily basis.

The fact that disproportionate shares of the losses are allocated to certain pools appears to be contrary to that agreement.

The State Treasurer told us she was considering several options for the Pool, including the possibility of merging all investments into a single portfolio and credit-

ing interest to accounts in each of the three pools based on the earnings of the overall portfolio. This would help eliminate the confusion about whether there is one pool or three. To adequately resolve this issue may require a clarification in the law or revision of the Pool's policies and procedures to let everyone know how investments, losses, and yields will be handled.

### **Conclusion**

No one could have anticipated that interest rates would rise as fast as they did during 1994. The Treasurer's Office, like virtually all other bond investors, suffered market losses on its investments as a result of this rapid interest-rate increase.

The Treasurer's Office has indicated that the investments of the Municipal Investment Pool were managed based on the history of the Pool, using the best information available at the time. However, we think the Pool should have been managed more conservatively, through the purchase of securities with shorter maturities, so that the principal of deposits would not be at risk. The policies adopted for the Municipal Investment Pool place safety as the highest priority.

In the exchanges of securities between the Municipal Investment Pool and the State's idle funds portfolio, we found that the State's idle funds portfolio was not treated equitably. That situation needs to be reviewed and corrected as soon as possible. In addition, the State's policy on any future exchanges needs to be clarified in law or in written policies of the Pooled Money Investment Board.

The concept of the Municipal Investment Pool is a good one that can offer many advantages for local units of government. However, safeguards need to be established that will maintain some level of flexibility in investing, while at the same time help ensure that the liquidity problems that have occurred in the last half of 1994 do not repeat themselves.

### **Recommendations**

1. To ensure that the managers of the Municipal Investment Pool have adequate guidance on how the Pool's assets should be invested, the State Treasurer's Office and the Pooled Money Investment Board should adopt specific, written investment objectives and policies for each segment of the Municipal Investment Pool. Those policies should include limitations or guidelines on the maturity of investments, so that investment maturities are reasonably related to the length of deposits.

2. To ensure that the Pool's practices conform to section 2.03 of its participation agreement with municipalities, the State Treasurer should adopt procedures that ensure that any investment losses incurred by the Pool are equally spread among the participants' accounts on a pro-rata basis, as opposed to being absorbed unevenly by particular groups of Pool participants.
3. The State Treasurer's Office and the Pooled Money Investment Board should review the impact of the exchanges of securities between the Municipal Investment Pool and State idle funds pool. The Pooled Money Investment Board should ensure that appropriate adjustments are implemented to "make whole" the State idle funds pool. The Board should provide documentation to the Legislative Post Audit Committee regarding the results of its review and adjustments.
4. The Pooled Money Investment Board should make recommendations to the 1995 Legislature regarding whether to allow or prohibit any future exchange of securities between the Municipal Investment Pool and the State idle funds portfolio. If such exchanges are allowed, the Board should adopt strict controls to ensure that each investment portfolio is treated equally.
5. To ensure that the Municipal Investment Pool is being operated as the Legislature intended, the Legislature should clarify K.S.A. 1994 Supp. 12-1677a to either authorize or prohibit the operation of multiple municipal investment portfolios within the Municipal Investment Pool.



## APPENDIX A

### Summary of Monthly Activity within the Municipal Investment Pool

This appendix summarizes the 1994 monthly deposits, withdrawals, and balances in each portfolio within the Municipal Investment Pool. Balances in the Short-Term Pool declined steadily throughout the last six months. Balances in the Intermediate-Term Pool steadily increased until October, when they begin declining. The Overnight Pool only had one month of data because it was established on December 19, 1994.

The last page of this appendix shows the combined data for the entire Municipal Investment Pool.

**Short-Term Municipal Investment Pool  
Participant Activity - 1994**

<u>Month</u>	<u>Deposits</u>	<u>Withdrawals</u>	<u>Interest</u>	<u>Net Change</u>	<u>Ending Balance</u>
January	\$555,568,664	\$639,728,955	\$3,239,239	(\$ 80,921,052)	\$ 987,791,635
Febuary	243,409,379	211,797,980	3,019,327	34,630,727	1,022,422,362
March	282,771,214	313,953,544	3,304,871	(27,877,459)	994,544,903
April	144,396,594	201,741,008	3,118,685	(54,225,729)	940,319,174
May	219,335,556	248,658,933	3,162,751	(26,160,627)	914,158,547
June	359,442,955	301,113,286	3,251,002	61,580,670	975,739,218
July	303,265,137	372,914,427	3,342,582	(66,306,707)	908,504,092
August	138,378,874	322,199,209	3,093,231	(180,727,104)	727,776,989
September	151,428,748	301,798,701	2,396,794	(147,973,159)	579,803,829
October	137,442,509	224,451,217	2,122,058	(84,886,650)	494,917,180
November	99,956,318	214,194,054	1,604,771	(112,632,964)	382,284,215
December	61,367,222	280,696,116	1,078,464	(218,250,430)	164,033,785

**Intermediate-Term Municipal Investment Pool  
Participant Activity - 1994**

<u>Month</u>	<u>Deposits</u>	<u>Withdrawals</u>	<u>Interest</u>	<u>Net Change</u>	<u>Ending Balance</u>
January	\$105,672,794	\$ 4,438	\$ 439,593	\$106,107,949	\$178,771,955
Febuary	98,160,243	70,250	754,381	98,844,374	277,616,329
March	30,899,434	147,933	1,040,503	31,792,004	309,408,333
April	20,604,574	225,988	1,107,032	21,485,618	330,893,951
May	18,138,271	270,297	1,240,295	19,108,269	350,002,220
June	14,821,240	353,533	1,260,359	15,728,066	365,730,286
July	16,179,199	240,352	1,368,046	17,306,893	383,037,179
August	36,061,745	517,511	1,493,496	37,037,730	420,074,909
September	26,196,340	9,500,935	1,583,909	18,279,314	438,354,223
October	8,312,968	45,269,223	1,651,053	(35,305,202)	403,149,021
November	7,515,676	71,291,722	1,426,460	(62,349,586)	340,799,435
December	8,564,071	54,575,559	1,244,844	(44,766,644)	296,032,791

**Overnight Municipal Investment Pool  
Participant Activity - 1994**

<u>Month</u>	<u>Deposits</u>	<u>Withdrawals</u>	<u>Interest</u>	<u>Net Change</u>	<u>Ending Balance</u>
December	\$259,605,805	\$16,296,690	\$327,837	\$243,636,952	\$243,636,952

**Total Municipal Investment Pool  
Participant Activity - 1994**

<u>Month</u>	<u>Deposits</u>	<u>Withdrawals</u>	<u>Interest</u>	<u>Net Change</u>	<u>Ending Balance</u>
January	\$661,241,458	\$639,733,393	\$3,678,832	\$ 25,186,897	\$1,166,563,590
Febuary	341,569,622	211,868,230	3,773,708	133,475,101	1,300,038,691
March	313,670,648	314,101,477	4,345,374	3,914,545	1,303,953,236
April	165,001,168	201,966,996	4,225,717	(32,740,111)	1,271,213,125
May	237,473,827	248,929,230	4,403,046	(7,052,358)	1,264,160,768
June	374,264,195	301,466,819	4,511,361	77,308,736	1,341,469,504
July	319,444,337	373,154,779	4,710,628	(48,999,814)	1,291,541,272
August	174,440,619	322,716,720	4,586,727	(143,689,374)	1,147,851,898
September	177,625,088	311,299,636	3,980,703	(129,693,845)	1,018,158,053
October	145,855,477	269,720,440	3,773,111	(120,091,852)	898,066,201
November	107,471,994	285,485,776	3,031,231	(174,982,550)	723,083,651
December	329,537,098	351,568,365	2,651,145	(19,381,122)	703,703,528

## **APPENDIX B**

### **Survey Results for Kansas and Other States That Have Municipal Investment Pools Operated by State Treasurers' Offices**

We surveyed 24 other states reported by the National Association of State Treasurers' to have municipal investment pools. The survey was aimed at determining whether Kansas followed similar practices in investing municipal funds as other states followed. The information provided by those states is contained in this appendix.

Questions	KS	AZ	CA	CT	FL	GA	ID	IL	MD	MA	MT
How long has the municipal pool been in existence -- in years?	2	10	20	23	16	15	13	17	8	15	15
What agency is responsible for overseeing the pool?	Treasurer's Office	Treasurer's Office	Treasurer's Office	Treasurer's Office	State Board of Admin.	Treasurer's Office	Treasurer's Office	Treasurer's Office	Treasurer's Office	Treasurer's Office	Bd. of Investment
What local units can deposit money in the pool -- cities, counties, townships, school districts, etc.?	All plus state agencies	All	All	All plus state agencies	All	All	All	All	All	All plus state agencies	All plus state agencies
Market value of the pool in billion of dollars-- November 1994	\$.7	\$1.6	\$9.0	\$.7	\$6.0	\$2.5	\$.4	\$2.0	\$.3	\$1.3	\$.8
Approximately how many municipalities had deposits in the pool?	135	175	2000	112	641	300	450	1700	250	351	310
What was the weighted average length of maturity for the investments made by the pool -- in days -- as of November 30, 1994?	570	90	448	25	44	55	216	175	23	40	60
What was the average length of time that municipalities had committed money to the pool?	94 days	None	None	None	None	None	None	None	None	None	None
Who does the actual investing of the funds?	Treasurer	Treasurer	Treasurer	Treasurer	State Bd. of Adm.	Treasurer	Treasurer	Treasurer	Treasurer	Treasurer	Bd. of Investment
What types of investment instruments are allowed for the pool?		All Listed	All Listed	All Listed	All Listed	All Listed	All Listed	All Listed	All Listed	All Listed	All Listed
U.S. Gov't Securities	Yes										
Certificates of Deposit	Yes										
Commercial Paper	No										
Repurchase Agreements	Yes										
Bankers' Acceptances	No										
Types of investments allowed are specified by...?	State Law	State Law	State Law	State Law and Policy	State Law and Policy	State Law and Policy	State Law	State Law	State Law	Policy	Policy
What is the maximum length of investment the pool can make?	4 years	NA	5 years	5 years	NA	NA	5 years	NA	90 days	397 days	397 days
Has the pool ever experienced liquidity problems and not been able to meet its obligations?	(a)	No	No	No	No	No	No	No	No	No	No
If moneys are committed for a specified period of time, is there an interest penalty for early withdrawal?	Yes - depends on the pool	No	No	No	No	No	No	No	No	No	No

(a) Liquidity problems in the Municipal Investment Pool are discussed in this report.

(b) About six years ago, South Carolina had liquidity problems which resulted in policy being changed regarding the average length of investment.

(c) Texas had a "run" on its pool in December 1994.

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NV	NJ	NM	NC	OH	OR	SC	TN	TX	UT	VA	WA	WI	WY
5	18	8	13	9	20	10	14	6	13	15	9	20	8
Treasurer's Office	Treasurer's Office	Treasurer's Office	Treasurer's Office	Treasurer's Office	Treasurer's Office	Treasurer's Office	Treasurer's Office	Treasurer's Office	Treasurer's Office	Treasurer's Office	Treasurer's Office	Treasurer's Office	Treasurer's Office
All	All	All	All	All	All	All	All	All	All	All	All	All	All
\$3	\$9.0	\$3	\$1.5	\$3.5	\$1.8	\$4	\$1.1	\$3.7	\$2.0	\$6	\$1.8	\$3.5	\$9
50	900	102	642	1500	810	125	180	1400	417	376	300	1100	84
49	101	29	29	76	212	30	114	196	111	53	52	79	188
None	None	None	None	None	None	None	None	None	None	None	None	None	None
Treasurer	Treasurer	Treasurer	Treasurer	Treasurer	Treasurer	Treasurer	Treasurer	Treasurer	Treasurer	Treasurer	Treasurer	State's Investment Fund	Treasurer
All Listed	All Listed		All Listed	All Listed	All Listed	All Listed	All Listed	All Listed	All Listed	All Listed	All Listed	All Listed	All Listed
		Yes											
		No											
		No											
		Yes											
		No											
State Law	State Law	Policy	State Law	State Law	Policy	State Law	State Law	State Law and Policy	State Law	State Law	State Law	Policy	State Law
240 days	2 years	29 days	NA	2 years	3 years	NA	5 years	3 years	5 years	13 months	1 year	5 years	NA
No	No	No	No	No	No	Yes (b)	No	Yes (c)	No	No	No	No	No
No	No	No	No	No	No	No	No	No	No	No	No	No	No

## **Appendix C**

### **Agency Response**

On January 17 we provided copies of the draft audit report to the State Treasurer's Office. Its response is included as this appendix.



STATE OF KANSAS

Sally Thompson

TREASURER

January 24, 1995

TELEPHONE  
(913) 296-3171

900 JACKSON, SUITE 201  
TOPEKA, KANSAS 66612-1235

Ms. Barbara J. Hinton  
Legislative Post Auditor  
Legislative Division of Post Audit  
800 SW Jackson, Suite 1200  
Topeka, KS 66612-2212



Dear Ms. Hinton:

I appreciate the opportunity to comment on the draft of the Municipal Investment Pool audit. I wish to commend your staff for working so diligently to understand complex investment concepts as well as the intricacies of the Municipal Investment Pool in such a short period of time.

My staff and I have nearly a century of combined professional investment experience and certainly have never seen interest rates rise as quickly and sharply as they did in 1994. The United States has not seen this kind of interest rate surge since 1927 (exhibit 1) and it proved to be the worst year on record for the bond market (exhibit 2). Certainly, no one anticipated that interest rates would rise as they did. The Municipal Investment Pool (MIP), like all short-term, fixed income portfolios, whether they be in banks or in pension funds, suffered market losses as a result of the rapid rise in interest rates. Experts estimate that worldwide unrealized losses in fixed income portfolios could run as high as \$1.5 trillion. Although the MIP has unrealized losses in its portfolio, it has survived a most difficult year which is a testament to its strength and viability.

In terms of the management of the MIP, there is no doubt that this unprecedented year was challenging and called for difficult investment management decisions. On behalf of the PMIB, I am pleased to report to you that the statutory performance audit of the MIP by the nationally recognized Mercer Asset Planning, Inc. concluded that the "...approach adopted by the investment officers was prudent and reasonable...."

I wholeheartedly concur with Post Audit's conclusion that the Pool concept is a "good one." In just over two years the MIP has returned more than \$68.0 million in interest income to its participants. It is \$68.0 million that went back into the local economy to fund necessary services and kept local taxes down. Local governments turn to the MIP because it's safe (the MIP can



only invest in U.S. Treasuries and Agencies, which are considered the safest investments in the world), professionally managed, convenient to use, and economical. I have included a list of local pool participants (exhibit three). I urge you to call pool participants and ask them to tell you about their experiences with the pool.

While the MIP balances have decreased, the participants have increased, illustrating the local confidence in the pool (exhibit four). Also, the chart demonstrates, what we believe will prove to be, the cyclical nature of local use of the MIP.

I appreciate the recommendations of the legislative post auditors and offer the following comments in response to those recommendations.

1. To ensure that the managers of the MIP have adequate guidance on how the Pool's assets should be invested, the State Treasurer's Office and the Pooled Money Investment Board should adopt specific, written investment objectives and policies for each segment of the MIP. Those policies should include limitations or guidelines on the maturity of investments, so that investment maturities are reasonably related to the length of deposits.

**Response:** Based on our experiences over the past year, I will propose that PMIB redefine its guidelines on the maturity of investments.

2. To ensure that the Pool's practices conform to section 2.03 of its participation agreement with municipalities, the State Treasurer should adopt procedures that ensure that any investment losses incurred by the Pool are equally spread among the participants' accounts on a pro-rata basis, as opposed to being absorbed unevenly by particular groups of Pool participants.

**Response:** The participation agreement needs to be updated in a comprehensive fashion. The interest rate environment and our customer's needs necessitated quick action, particularly with regard to the creation of the Overnight option in December. We are in the process of restructuring the agreement and intend to use the input of Legislative Post Audit, Mercer, the MIP Advisory Committee, and legal counsel.

3. The State Treasurer's Office and the Pooled Money Investment Board should review the impact of the exchanges of securities between the Municipal Investment Pool and State idle funds pool. The Pooled Money Investment Board should ensure that appropriate adjustments are implemented to "make whole" the State idle funds pool. The Board should provide documentation to the Legislative Post Audit Committee regarding the results of its review and adjustments.

Response: In my professional opinion as a CPA, there was absolutely no loss to the state idle pool as a result of the exchanges. I authorized the exchange only after concluding that I had complete authority and that the present value calculation holds the idle funds pool "harmless." The exchange was simply a financial management tool used to provide much needed liquidity to the MIP, brought on by the drastic increase in interest rates. The technical calculation that we used to account for the exchanges is a commonly accepted method recognized in accounting and finance texts and appears to us to be the most appropriate methodology for this type of transaction. However, it is not uncommon for professionals to have a difference of opinion; therefore, I would respectfully suggest that in the course of the statewide audit these transactions be reviewed and a definitive answer issued. We will follow their recommendation.

4. The Pooled Money Investment Board should make recommendations to the 1995 Legislature regarding whether to allow or prohibit any future exchange of securities between the Municipal Investment Pool and the State idle funds portfolio. If such exchanges are allowed, the Board should adopt strict control to ensure that each investment portfolio is treated equally.

Response: I certainly agree that there should be strict controls on exchanges. As I've said, the unprecedented increases in interest rates necessitated extraordinary investment management decisions. These exchanges were reviewed by the PMIB. It is my opinion that the exchange option should be available as a management tool. Fortunately, in this most extraordinary year the law was flexible and we could respond.

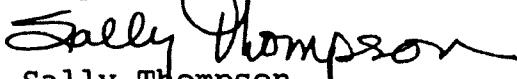
5. To ensure that the Municipal Investment Pool is being operated as the Legislature intended, the Legislature should clarify K.S.A. 1994 Supp. 12-1677a to either authorize or prohibit the operation of multiple investment portfolios within the Municipal Investment Pool.

Response: There is only one Municipal Investment Pool. Today, under the umbrella of the MIP there are three investment options for MIP participants. The three investment options are outlined in policy and are simply in place to provide investment guidelines for MIP users. Because MIP users are required to first offer their public funds to their local banks for a stated maturity (other states' pools do not have this requirement), we also require a stated maturity. Thus, we can make investments based on these maturities and the cash flow history of the MIP. In response to our customers' requests, we have created these investment options over the course of the past two years to meet their cash flow needs. We anticipate that the investment needs of our participants will change and the flexible statutory structure authorized by the 1992 Legislature allows us to respond to participants' needs.

This year has taught me many lessons that I will not soon forget. These lessons will be developed into policy, that will be presented to the Pooled Money Investment Board, reviewed by the MIP Advisory Committee and implemented by the State Treasurer.

Again, I thank you for your suggestions and look forward to continuing our work to meet our mutual goal of improving the financial management of public funds to benefit all Kansans.

Respectfully,

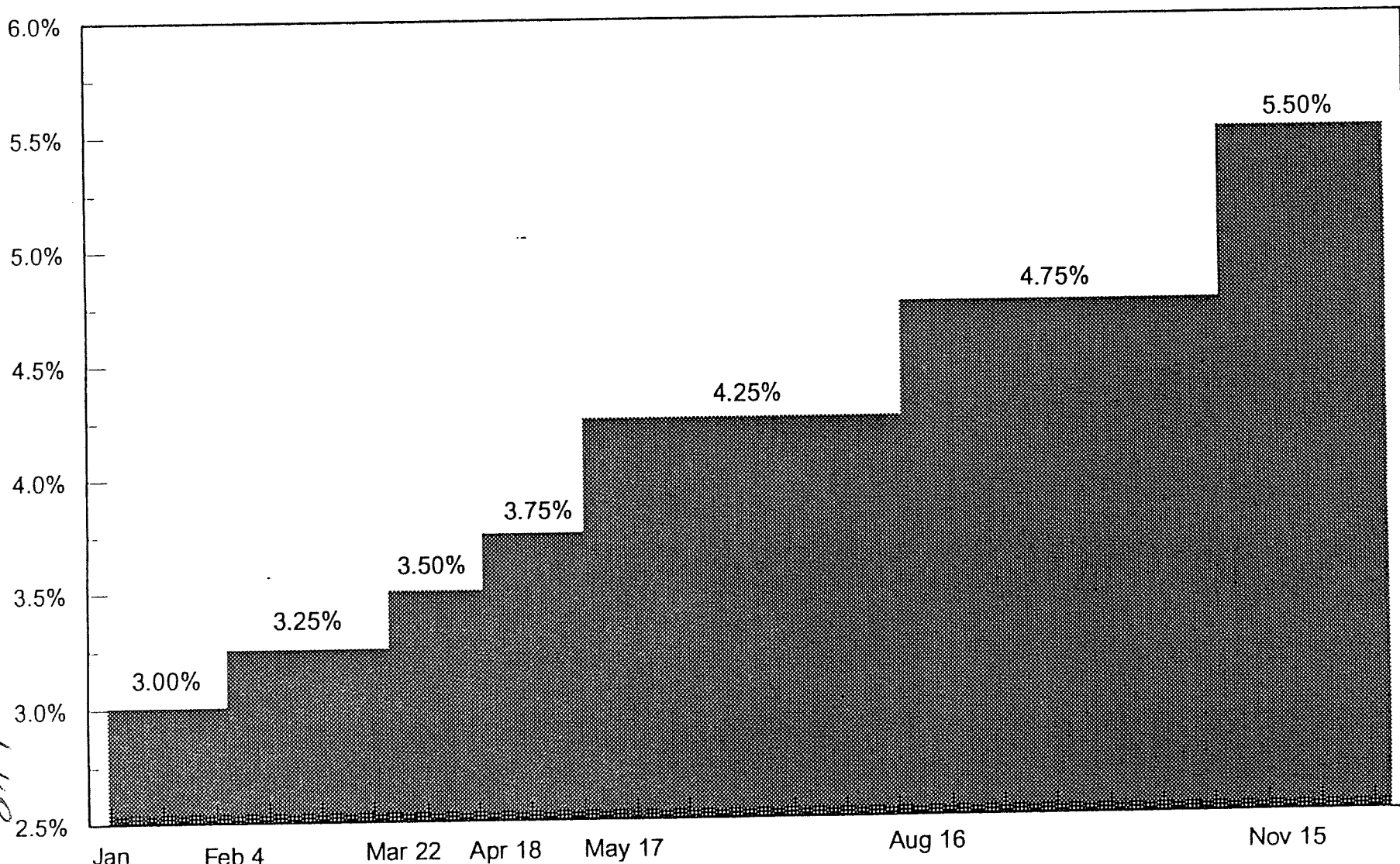
A handwritten signature in cursive script that reads "Sally Thompson". The signature is written in black ink and is positioned above the typed name.

Sally Thompson  
State Treasurer

# Six Interest Rate Increases In 1994

## Second-Fastest Monetary Tightening in History

Fed Funds Rate



87-1

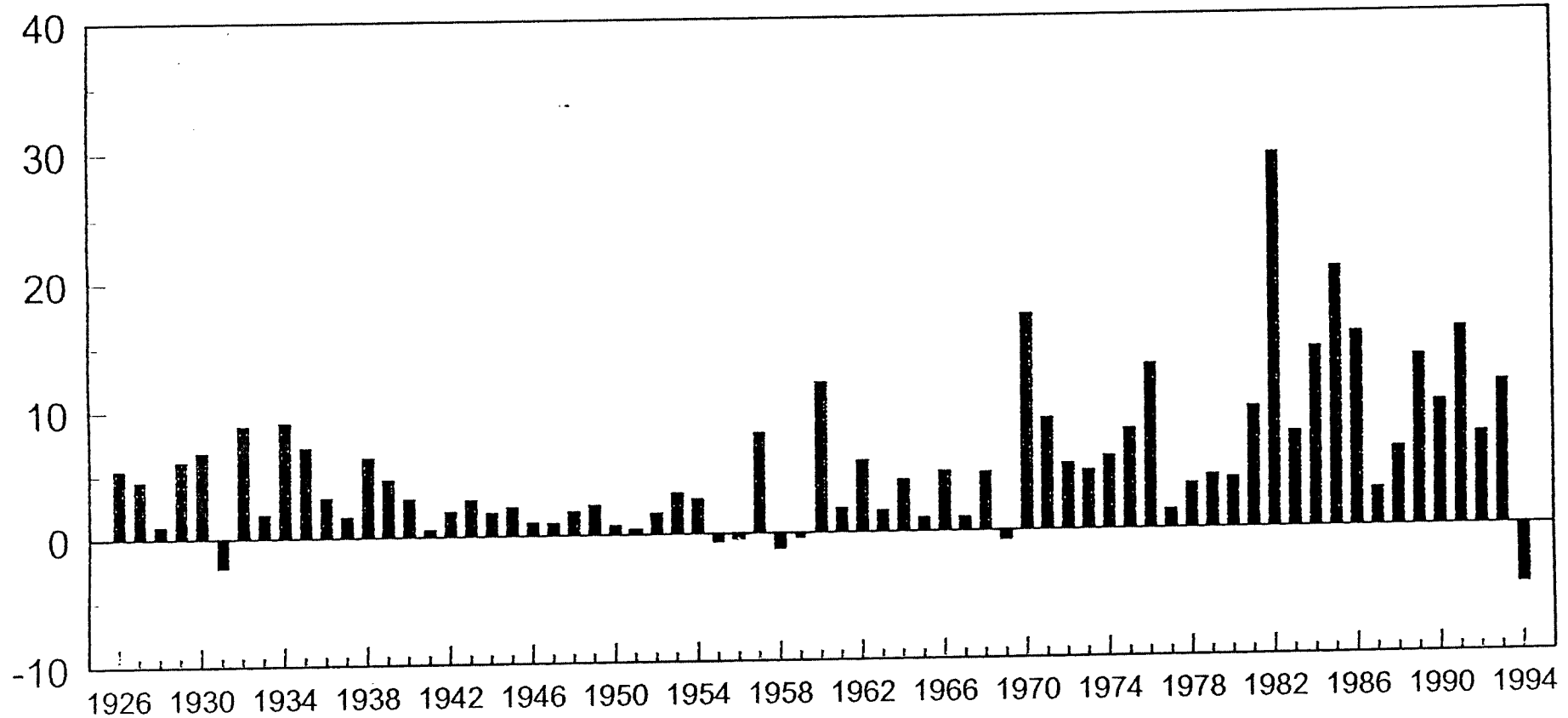
Exhibit 2

# 1994 - The Worst Year on Record

## Total Returns Back To The Great Depression

### Five-Year Treasury Total Returns

Rate of Return (%)



Source: Ibbotson Associates

William M. Mercer Asset Planning, Inc.

btr-1

MUNICIPAL INVESTMENT POOL ACTIVITY BY SENATE DISTRICT

Municipality Name	For the Period 08/01/92 thru 12/31/94		Ending Balance
	Deposits	Interest Earned	As of 12/31/94
Atchison	70,950,000	360,259	4,210,259
Effingham USD #377	8,000,000	43,242	351,928
Highland Community College	750,000	23,799	773,799
Holton USD #336	8,618,541	109,650	228,191
Jackson County	0	0	0
Perry USD #343	4,921,000	52,188	17,188
Jefferson County RWD #12	<u>501,990</u>	<u>1,210</u>	<u>98,065</u>
Total Senate District 1	<u>93,741,531</u>	<u>590,348</u>	<u>5,679,430</u>
Douglas County	76,988,804	266,393	26,760,526
Lawrence	188,307,161	1,489,281	1,731,473
Lawrence USD #497	174,913,970	1,976,651	13,837,958
Baldwin City USD #348	<u>41,851,375</u>	<u>307,311</u>	<u>824,373</u>
Total Senate District 2	<u>482,061,310</u>	<u>4,039,636</u>	<u>43,154,330</u>
Jefferson County RWD #12	501,990	1,210	98,065
Perry USD #343	4,921,000	52,188	17,188
Leavenworth County	35,675,361	591,274	8,593,364
Leavenworth	10,500,000	183,614	3,658,614
Lansing	3,588,404	42,604	1,679,960
Leavenworth Water Dept	12,100,000	254,912	4,554,912
Leavenworth USD #453	56,658,808	234,240	3,269,326
Ft. Leavenworth USD #207	0	0	0
Basehor	<u>408,340</u>	<u>8,915</u>	<u>575</u>
Total Senate District 3	<u>124,353,903</u>	<u>1,368,957</u>	<u>21,872,004</u>
Wyandotte County USD #204	6,800,000	23,475	0
Bonner Springs	0	0	0
Kansas City	0	0	0
Total Senate District 4-6	<u>6,800,000</u>	<u>23,475</u>	<u>0</u>
Consolidated Fire Dist #2	10,230,000	125,668	1,125,340
Mission	23,054,619	516,339	10,346,544
Mission Hills	6,023,263	83,091	1,133,091
Leawood	64,469,962	510,959	4,355,440
Prairie Village	22,584,505	223,248	2,639,469
Johnson County Community College	372,791,703	1,933,055	2,434,128
Johnson County Park & Rec	27,715,946	267,480	1,990,808
Public Building Commission	40,105,190	135,652	55,325
Johnson County	1,342,054,461	2,931,269	5,370,932
Olathe USD #233	350,564,380	1,635,279	12,980,665
Olathe	66,782,145	938,714	1,067,209
Blue Valley USD #229	398,572,483	1,630,310	298,967
Shawnee Mission USD #512	658,040,522	2,517,505	11,638,368
De Soto USD #232	41,930,977	581,292	1,733,751
Spring Hill USD #230	132,700,863	725,129	1,582,402
Blue Valley Recreation Comm	3,322,884	25,260	418,320
Gardner-Edgerton-Antioch USD	53,935,286	193,589	8,838,700
Bonner Springs	0	0	0

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**MUNICIPAL INVESTMENT POOL ACTIVITY BY SENATE DISTRICT**

Municipality Name	For the Period 08/01/92 thru 12/31/94		Ending Balance As of 12/31/94
	Deposits	Interest Earned	
Atchison	70,950,000	360,259	4,210,259
Effingham USD #377	8,000,000	43,242	351,928
Highland Community College	750,000	23,799	773,799
Holton USD #336	8,618,541	109,650	228,191
Jackson County	0	0	0
Perry USD #343	4,921,000	52,188	17,188
Jefferson County RWD #12	<u>501,990</u>	<u>1,210</u>	<u>98,065</u>
<b>Total Senate District 1</b>	<b><u>93,741,531</u></b>	<b><u>590,348</u></b>	<b><u>5,679,430</u></b>
Douglas County	76,988,804	266,393	26,760,526
Lawrence	188,307,161	1,489,281	1,731,473
Lawrence USD #497	174,913,970	1,976,651	13,837,958
Baldwin City USD #348	<u>41,851,375</u>	<u>307,311</u>	<u>824,373</u>
<b>Total Senate District 2</b>	<b><u>482,061,310</u></b>	<b><u>4,039,636</u></b>	<b><u>43,154,330</u></b>
Jefferson County RWD #12	501,990	1,210	98,065
Perry USD #343	4,921,000	52,188	17,188
Leavenworth County	35,675,361	591,274	8,593,364
Leavenworth	10,500,000	183,614	3,658,614
Lansing	3,588,404	42,604	1,679,960
Leavenworth Water Dept	12,100,000	254,912	4,554,912
Leavenworth USD #453	56,658,808	234,240	3,269,326
Ft. Leavenworth USD #207	0	0	0
Basehor	<u>408,340</u>	<u>8,915</u>	<u>575</u>
<b>Total Senate District 3</b>	<b><u>124,353,903</u></b>	<b><u>1,368,957</u></b>	<b><u>21,872,004</u></b>
Wyandotte County USD #204	6,800,000	23,475	0
Bonner Springs	0	0	0
Kansas City	<u>0</u>	<u>0</u>	<u>0</u>
<b>Total Senate District 4-6</b>	<b><u>6,800,000</u></b>	<b><u>23,475</u></b>	<b><u>0</u></b>
Consolidated Fire Dist #2	10,230,000	125,668	1,125,340
Mission	23,054,619	516,339	10,346,544
Mission Hills	6,023,263	83,091	1,133,091
Leawood	64,469,962	510,959	4,355,440
Prairie Village	22,584,505	223,248	2,639,469
Johnson County Community College	372,791,703	1,933,055	2,434,128
Johnson County Park & Rec	27,715,946	267,480	1,990,808
Public Building Commission	40,105,190	135,652	55,325
Johnson County	1,342,054,461	2,931,269	5,370,932
Olathe USD #233	350,564,380	1,635,279	12,980,665
Olathe	66,782,145	938,714	1,067,209
Blue Valley USD #229	398,572,483	1,630,310	298,967
Shawnee Mission USD #512	658,040,522	2,517,505	11,638,368
De Soto USD #232	41,930,977	581,292	1,733,751
Spring Hill USD #230	132,700,863	725,129	1,582,402
Blue Valley Recreation Comm	3,322,884	25,260	418,320
Gardner-Edgerton-Antioch USD	53,935,286	193,589	8,838,700
Bonner Springs	0	0	0

1-51

**MUNICIPAL INVESTMENT POOL ACTIVITY BY SENATE DISTRICT**

<u>Municipality Name</u>	<u>For the Period 08/01/92 thru 12/31/94</u>		<u>Ending Balance</u>
	<u>Deposits</u>	<u>Interest Earned</u>	<u>As of 12/31/94</u>
Overland Park	471,342,175	2,874,627	2,523,249
Lenexa	170,280,887	1,632,742	15,877,460
Douglas County	76,988,804	266,393	26,760,526
Lawrence	188,307,161	1,489,281	1,731,473
Lawrence USD #497	174,913,970	1,976,651	13,837,958
Baldwin City USD #348	41,851,375	307,311	824,373
Public Wholesale Wtr Dist	14,600,300	31,292	3,750,106
Ottawa	6,200,000	62,425	201,653
Santa Fe Trail USD #434	<u>8,148,589</u>	<u>69,165</u>	<u>660,222</u>
<b>Total Senate District 7-11</b>	<b><u>4,767,512,450</u></b>	<b><u>23,683,726</u></b>	<b><u>134,176,479</u></b>
Iola	8,002,521	111,202	2,086,202
Iola USD #257	14,600,000	58,801	8,801
Allen County	9,160,000	79,394	1,864,394
Fort Scott	5,650,000	73,847	891,563
Neosho County	11,828,551	51,745	3,551,745
Erie	275,000	3,292	125,476
Chanute	<u>0</u>	<u>0</u>	<u>0</u>
<b>Total Senate District 12</b>	<b><u>49,516,072</u></b>	<b><u>378,281</u></b>	<b><u>8,528,181</u></b>
Galena USD #499	4,325,929	40,348	4,366,277
SE KS Education Service Ctr	300,000	3,659	303,659
Girard USD #248	15,142,525	120,006	2,420,531
Frontenac USD #249	<u>5,140,290</u>	<u>94,665</u>	<u>125,258</u>
<b>Total Senate District 13</b>	<b><u>24,908,744</u></b>	<b><u>258,678</u></b>	<b><u>7,215,725</u></b>
SE KS Education Service Ctr	300,000	3,659	303,659
Girard USD #248	15,142,525	120,006	2,420,531
Frontenac USD #249	5,140,290	94,665	125,258
Parsons	85,300	1,012	86,312
Labette County	4,250,000	82,171	1,832,171
Neosho County	11,828,551	51,745	3,551,745
Erie	275,000	3,292	125,476
Chanute	<u>0</u>	<u>0</u>	<u>0</u>
<b>Total Senate District 14</b>	<b><u>37,021,666</u></b>	<b><u>356,550</u></b>	<b><u>8,445,152</u></b>
Coffey County	6,500,000	36,306	0
Burlington USD #244	0	0	0
Elk County	10,809,185	65,094	1,556,233
West Elk USD #282	<u>1,100,000</u>	<u>4,804</u>	<u>202,251</u>
<b>Total Senate District 15</b>	<b><u>18,409,185</u></b>	<b><u>106,204</u></b>	<b><u>1,758,484</u></b>
Butler County	0	0	0
Rose Hill USD #394	15,331,540	255,272	3,201,717
Towanda	1,552,181	12,544	258,419
Augusta USD #402	90,976,408	598,174	9,141,509
Andover	8,357,366	120,002	1,819,990
Burlington USD #244	0	0	0

*1-52*



**MUNICIPAL INVESTMENT POOL ACTIVITY BY SENATE DISTRICT**

<u>Municipality Name</u>	<u>For the Period 08/01/92 thru 12/31/94</u>		<u>Ending Balance</u>
	<u>Deposits</u>	<u>Interest Earned</u>	<u>As of 12/31/94</u>
Coffey County	6,500,000	36,306	0
Eureka	0	0	0
Greenwood County	<u>22,806,555</u>	<u>89,003</u>	<u>1,909,003</u>
<b>Total Senate District 16</b>	<b><u>145,524,050</u></b>	<b><u>1,111,301</u></b>	<b><u>16,330,638</u></b>
Chase County	9,670,000	55,500	2,225,500
Lyon County	99,909,594	488,258	9,780,504
Emporia	48,482,448	184,843	2,585,933
Emporia USD #253	47,095,784	237,608	247,578
Hillsboro USD #410	4,000,000	3,619	0
Hillsboro	0	0	0
Morris County	0	0	0
Council Grove	31,618	78	78
Morris County RWD #1	2,285,000	15,417	0
Santa Fe Trail USD #434	<u>8,148,589</u>	<u>69,165</u>	<u>660,222</u>
<b>Total Senate District 17</b>	<b><u>219,623,033</u></b>	<b><u>1,054,488</u></b>	<b><u>15,499,815</u></b>
Topeka Metro Transit Authority	2,375,966	31,345	541,168
Shawnee County	270,408,317	1,804,450	67,928,686
Topeka USD #501	152,877,273	870,148	5,714,368
Silver Lake USD #372	3,835,000	42,883	0
Topeka	107,722,833	1,492,108	24,350,499
Washburn University	18,714,536	221,346	3,755,628
Metro Topeka Airport Authority	2,102,884	21,249	142,736
Soldier Township	0	0	0
Topeka Tecumseh Fire Dept	0	0	0
Seaman USD #345	16,866,000	86,242	0
Auburn	0	0	0
Shawnee Heights USD #450	<u>3,200,000</u>	<u>7,202</u>	<u>2,107,202</u>
<b>Total Senate District 18-20</b>	<b><u>578,102,809</u></b>	<b><u>4,576,973</u></b>	<b><u>104,540,287</u></b>
Junction City	17,083,620	219,653	1,432,358
Geary County	15,698,526	185,561	915,871
Geary County USD #475	1,000,000	10,251	10,251
Morris County	0	0	0
Council Grove	31,617	78	78
Morris County RWD #1	2,285,000	15,417	0
Kansas Rural Water Finance Authority	7,021,853	104,465	969,237
Pottawatomie County	67,310,808	270,103	12,871,911
Manhattan	60,158,316	932,539	13,332,539
Riley County	32,110,000	187,312	1,129,615
Manhattan USD #383	76,133,194	596,777	6,016,115
Riley Co- Manhattan Health Dept	<u>11,553,723</u>	<u>49,501</u>	<u>650,776</u>
<b>Total Senate District 21</b>	<b><u>290,386,657</u></b>	<b><u>2,571,657</u></b>	<b><u>37,328,751</u></b>
Junction City	17,083,620	219,653	1,432,358
Geary County	15,698,526	185,561	915,871
Geary County USD #475	1,000,000	10,251	10,251
Manhattan	60,158,316	932,539	13,332,539
Riley County	32,110,000	187,312	1,129,615

**MUNICIPAL INVESTMENT POOL ACTIVITY BY SENATE DISTRICT**

Municipality Name	For the Period 08/01/92 thru 12/31/94		Ending Balance As of 12/31/94
	Deposits	Interest Earned	
Manhattan USD #383	76,133,194	596,777	6,016,115
Riley Co- Manhattan Health Dept	<u>11,553,723</u>	<u>49,501</u>	<u>650,776</u>
Total Senate District 22	<u>213,737,379</u>	<u>2,181,594</u>	<u>23,487,525</u>
Concordia USD #333	1,450,000	5,561	90,561
Solomon USD #393	<u>5,400,672</u>	<u>49,066</u>	<u>2,474,128</u>
Total Senate District 23	<u>6,850,672</u>	<u>54,627</u>	<u>2,564,689</u>
Lincoln USD #298	8,940,758	215,957	1,478
Saline County	12,800,000	107,954	4,807
Salina	<u>61,893,984</u>	<u>371,858</u>	<u>22,386</u>
Total Senate District 24	<u>83,634,742</u>	<u>695,769</u>	<u>28,671</u>
Newton	20,880,000	217,870	3,906,085
Hesston	19,458,089	79,485	1,062,478
Harvey County	60,888,659	147,417	10,571,224
Newton USD #373	59,993,563	276,617	2,808,833
North Newton	706,192	11,279	390
Hillsboro	0	0	0
Hillsboro USD #410	4,000,000	3,619	0
Lindsborg	10,518,767	134,150	2,798,965
McPherson USD #418	75,343,507	244,711	1,158,171
McPherson County	86,399,127	565,683	12,835,142
McPherson	28,119,531	273,340	2,862,222
Smoky Hill USD #400	3,200,000	36,828	1,104,893
McPherson Recreation Comm	<u>300,000</u>	<u>2,830</u>	<u>102,830</u>
Total Senate District 25	<u>369,807,435</u>	<u>1,993,829</u>	<u>39,211,233</u>
Wichita	503,920,567	3,121,820	2,468,357
Wichita USD #259	575,600,000	4,225,538	21,325
Sedgwick County	743,741,409	4,698,251	22,522,495
Derby	13,583,426	156,673	2,504,488
Maize USD #266	33,518,716	532,066	2,384,724
Cheney USD #268	36,634,111	218,506	5,190,415
Park City	0	0	0
Mulvane USD #263	24,780,000	287,637	9,752,637
Goddard USD #265	<u>29,477,879</u>	<u>90,867</u>	<u>2,401,443</u>
Total Senate District 26-31	<u>1,961,256,108</u>	<u>13,331,358</u>	<u>47,245,884</u>
Cowley County	0	0	0
Udall USD #463	5,750,799	44,974	2,748,003
Wellington	<u>40,316,934</u>	<u>686,693</u>	<u>12,102,253</u>
Total Senate District 32	<u>46,067,733</u>	<u>731,667</u>	<u>14,850,256</u>

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**MUNICIPAL INVESTMENT POOL ACTIVITY BY SENATE DISTRICT**

<u>Municipality Name</u>	For the Period 08/01/92 thru 12/31/94		Ending Balance As of 12/31/94
	Deposits	Interest Earned	
Township 12 Fire Fund	0	0	0
Reno County	340,208,385	697,094	25,804,225
Hutchinson Comm College	22,300,000	95,917	595,650
Hutchinson USD # 308	25,200,000	106,163	704,482
Hutchinson	44,896,093	488,593	16,026,678
Buhler	0	0	0
Hutchinson Recreation Comm	0	0	0
Wellington	<u>40,316,934</u>	<u>686,693</u>	<u>12,102,253</u>
<b>Total Senate District 33</b>	<b><u>472,921,412</u></b>	<b><u>2,074,460</u></b>	<b><u>55,233,288</u></b>
Reno County	340,208,385	697,094	25,804,225
Hutchinson USD # 308	25,200,000	106,163	704,482
Hutchinson	44,896,093	488,593	16,026,678
Buhler	0	0	0
Hutchinson Recreation Comm	0	0	0
Hutchinson Comm College	<u>22,300,000</u>	<u>95,917</u>	<u>595,650</u>
<b>Total Senate District 34</b>	<b><u>410,304,478</u></b>	<b><u>1,291,850</u></b>	<b><u>42,535,385</u></b>
Great Bend	12,589,316	39,754	36,666
Little River USD #444	12,328,916	45,674	789,376
Russell	<u>5,693,995</u>	<u>19,265</u>	<u>15</u>
<b>Total Senate District 35</b>	<b><u>30,612,227</u></b>	<b><u>104,693</u></b>	<b><u>826,057</u></b>
North Central Kansas Area	<u>1,100,000</u>	<u>8,491</u>	<u>108,491</u>
<b>Total Senate District 36</b>	<b><u>1,100,000</u></b>	<b><u>8,491</u></b>	<b><u>108,491</u></b>
Kinsley	12,146	234	557
Hays USD #489	42,757,697	277,257	325,427
Hodgeman County	0	0	0
Ellis County	<u>8,387,341</u>	<u>75,933</u>	<u>7</u>
<b>Total Senate District 37</b>	<b><u>42,769,843</u></b>	<b><u>277,491</u></b>	<b><u>325,984</u></b>
Dodge City	42,874,571	275,993	2,818,308
Dodge City USD #443	81,775,043	571,247	20,552
Dodge City Community College	0	0	0
Seward County Comm College	0	0	0
Liberal	<u>4,700,000</u>	<u>94,601</u>	<u>2,694,601</u>
<b>Total Senate District 38</b>	<b><u>124,649,614</u></b>	<b><u>847,240</u></b>	<b><u>2,838,860</u></b>
Garden City	27,411,825	59,535	2,578,676
Finney County	12,500,000	38,959	0

1-55

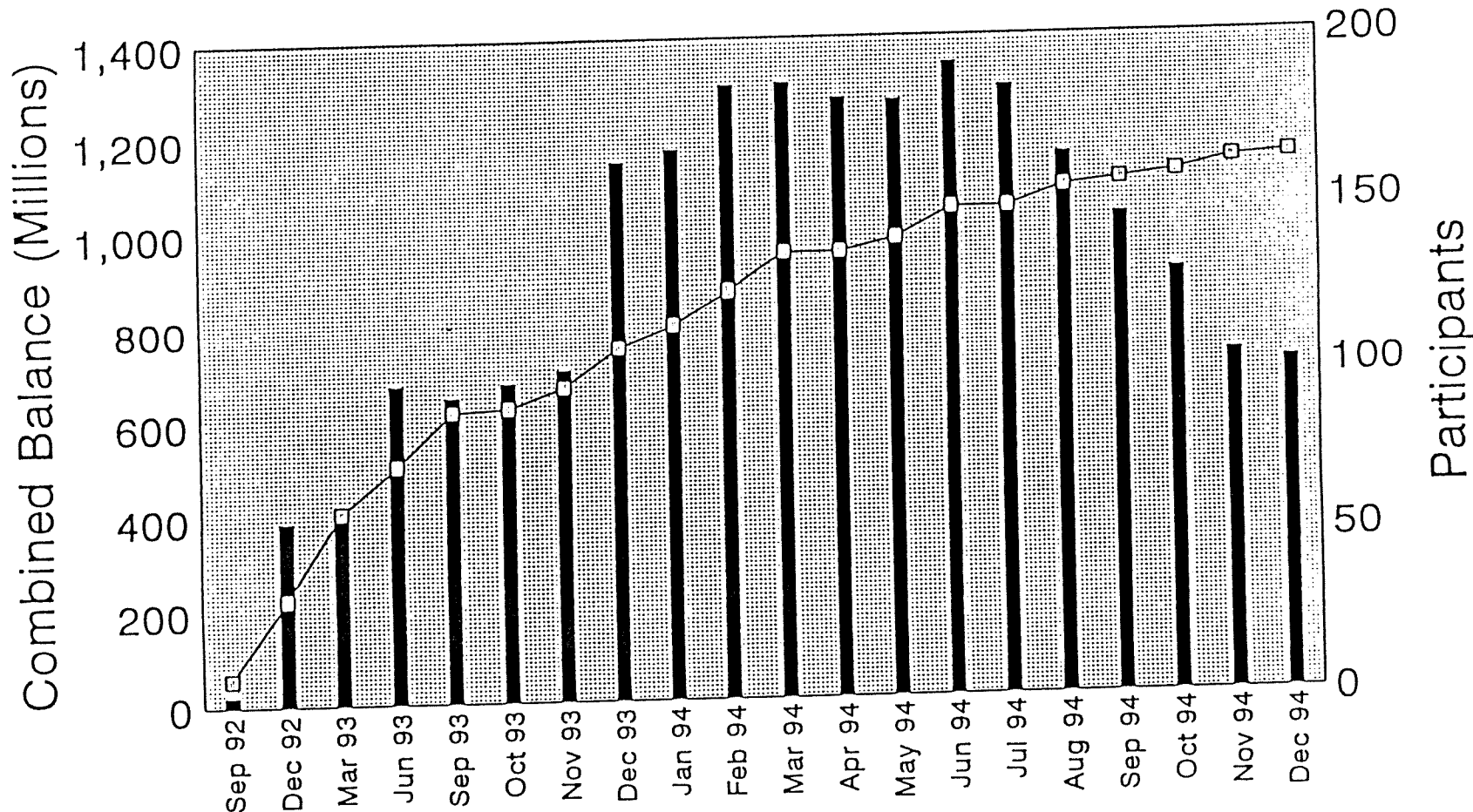
**MUNICIPAL INVESTMENT POOL ACTIVITY BY SENATE DISTRICT**

<u>Municipality Name</u>	<u>For the Period 08/01/92 thru 12/31/94</u>		<u>Ending Balance</u>
	<u>Deposits</u>	<u>Interest Earned</u>	<u>As of 12/31/94</u>
Garden City Recreation Co	420,000	2,023	62,023
Garden City USD #457	17,000,000	69,176	38,979
Garden City Community Coll	7,193,091	66,702	2,112,046
Winchester USD #339	9,000,745	27,484	879,373
Morton County	<u>17,200,000</u>	<u>11,491</u>	<u>411,491</u>
<b>Total Senate District 39</b>	<b><u>90,725,661</u></b>	<b><u>275,370</u></b>	<b><u>6,082,588</u></b>
Colby USD #315	14,409,755	227,863	3,332,740
Wallace County	<u>0</u>	<u>0</u>	<u>0</u>
<b>Total Senate District 40</b>	<b><u>14,409,755</u></b>	<b><u>227,863</u></b>	<b><u>3,332,740</u></b>
<u>State Agencies</u>			
Client Protection Fund Co	2,466,219	34,360	810,632
Dept of Administration	100,000	2,344	0
Emporia State University	4,753,910	89,926	821,776
Health Care Stabilization Fund	218,940,000	4,936,372	156,986,372
KDFA- Ks Water Pollution	420,458,083	3,352,490	5,458,062
KDFA Operations Fund	316,522	3,908	107,116
KDFA-KBEL Guarantee Acct	6,930,000	39,625	1,029,625
KDOT	374,654,169	4,149,262	19,368,641
University of Kansas	<u>8,814,549</u>	<u>104,293</u>	<u>1,803,883</u>
<b>Total State Agencies</b>	<b><u>1,037,433,452</u></b>	<b><u>12,712,580</u></b>	<b><u>186,386,107</u></b>
<b>*TOTAL MIP</b>	<b><u>10,552,134,599</u></b>	<b><u>68,451,168</u></b>	<b><u>703,703,530</u></b>

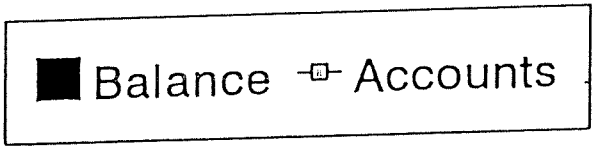
\* Detail does not add to TOTAL MIP due to inclusion of certain entities in more than one senate district, i.e. City of Lawrence is included in Districts 2 and 7 through 11.

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# MUNICIPAL INVESTMENT POOL



MIP GROWTH



53

1-57



DIVISION OF THE BUDGET  
Room 152-E  
State Capitol Building  
Topeka, Kansas 66612-1504  
(913) 296-2436  
FAX (913) 296-0231

Bill Graves  
Governor

Gloria M. Timmer  
Director

M E M O R A N D U M

TO: House Appropriations Committee  
FROM: Gloria M. Timmer, Director of the Budget  
DATE: February 9, 1995  
SUBJECT: HB 2136--Ending Balance of Securities Act Fee Fund

The Governor requested introduction of HB 2136 in support of his FY 1996 budget recommendations and appreciates this committee's cooperation in its introduction. This bill would eliminate the \$500,000 ending balance in the Securities Act Fee Fund in FY 1996 by transferring this amount to the State General Fund. This change is not to penalize the Office of the Securities Commissioner but is the result of an analysis of the fund's cash flow. That analysis indicated that the balance is not needed for cash flow purposes and served no other useful purpose.

Since the bill was introduced, the Division of the Budget and the Securities Commissioner have been in contact and have discovered potential cash flow problems. First, the timing of revenues into the fund will be affected by a change to electronic filing of securities registrations and, second, the timing of expenditures will be affected by the state's change to biweekly payroll in 1996. These two factors change the cash flow projections for the agency enough to suggest that an amendment to the bill is needed. The Securities Commissioner suggested several ways to deal with this issue. The agency and the Division of the Budget have agreed on a solution and request that the Committee amend HB 2136 to provide a \$50,000 ending balance rather than the \$0 balance specified in the original bill.

I appreciate your time and assistance in this matter and am happy to answer any questions you may have.

2/9/95  
Appropriations Cmte  
Attachment 2

## HOUSE BILL No. 2136

By Committee on Appropriations

1-20

9 AN ACT relating to the securities act fee fund; concerning ending bal-  
10 ances therein; amending K.S.A. 17-1271 and repealing the existing  
11 section.  
12

13 *Be it enacted by the Legislature of the State of Kansas:*

14 Section 1. K.S.A. 17-1271 is hereby amended to read as follows: 17-  
15 1271. (a) The securities commissioner shall remit all moneys received  
16 from all fees, charges, deposits or penalties which have been collected  
17 under the Kansas securities act or other laws of this state regulating the  
18 issuance, sale or disposal of securities or regulating dealers in this state  
19 or under the uniform land sales practices act, to the state treasurer at  
20 least monthly. Upon receipt of any such remittance, the state treasurer  
21 shall deposit the entire amount thereof in the state treasury. Twenty per-  
22 cent of each such deposit shall be credited to the state general fund and  
23 the balance shall be credited to the securities act fee fund.

24 (b) On the last day of each fiscal year, the director of accounts and  
25 reports shall transfer from the securities act fee fund to the state general  
26 fund any *remaining* amount in the securities act fee fund ~~exceeding~~  
27 ~~\$500,000~~ so that the beginning balance in the securities act fee fund on <sup>\$500,000</sup>  
28 the first day of each fiscal year is ~~\$500,000~~ ~~or~~ All expenditures from the  
29 securities act fee fund shall be made in accordance with appropriation  
30 acts upon warrants of the director of accounts and reports issued pursuant  
31 to vouchers approved by the securities commissioner or by a person or  
32 persons designated by the securities commissioner.

33 (c) All amounts transferred from the securities act fee fund to the  
34 state general fund under subsection (b) are to reimburse the state general  
35 fund for accounting, auditing, budgeting, legal, payroll, personnel and  
36 purchasing services and any other governmental services which are per-  
37 formed on behalf of the state agency involved by other state agencies  
38 which receive appropriations from the state general fund to provide such  
39 services. Such reimbursements are in addition to those authorized by  
40 K.S.A. 75-3170a and amendments thereto.

41 Sec. 2. K.S.A. 17-1271 is hereby repealed.

42 Sec. 3. This act shall take effect and be in force from and after its  
43 publication in the statute book.



DIVISION OF THE BUDGET  
 Room 152-E  
 State Capitol Building  
 Topeka, Kansas 66612-1504  
 (913) 296-2436  
 FAX (913) 296-0231

Bill Graves  
 Governor

Gloria M. Timmer  
 Director

January 30, 1995

The Honorable Robin Jennison, Chairperson  
 House Committee on Appropriations  
 Room 514-S, Statehouse

and

The Honorable Gus Bogina, Chairperson  
 Senate Committee on Ways and Means  
 Room 120-S, Statehouse

Dear Representative Jennison:

I offer the following corrections to the budget document submitted to the Legislature. The adjustments do not contain policy changes to the recommendations made by the Governor. Rather, they correct technical errors made in posting the detailed budgets or publishing *The FY 1996 Governor's Budget Report*.

Errors were identified through a cooperative process involving the Division of the Budget, state agencies, and your fiscal staff. We are thankful for their cooperation and assistance.

Total adjustments to expenditures are shown below. The net effect is to decrease the FY 1995 ending balance of the State General Fund by \$465,600 and to decrease the FY 1996 balance by \$523,318.

	<u>FY 1995</u>	<u>FY 1996</u>
State General Fund	\$ 465,600	\$ 57,718
All Other Funds	<u>(391,165)</u>	<u>12,048</u>
All Funds	\$ 74,435	\$ 69,766

2/9/95  
 Appropriations Cmte  
 Attachment 3



**Kansas Human Rights Commission**

1. Office Rental Costs

A total of \$569,774 is recommended in expenditures from the Federal Fund in FY 1995, which is an increase of \$3,660 over the \$566,114 contained in *The FY 1996 Governor's Budget Report*. This technical adjustment is necessary to reflect the Governor's recommendation to cover the agency's anticipated office rental increases in the current year.

	<u>FY 1995</u>	<u>FY 1996</u>
State General Fund	\$ --	\$ --
All Other Funds	<u>3,660</u>	<u>--</u>
All Funds	\$ 3,660	

**Kansas Corporation Commission**

2. Unclassified Merit Pool for the Commissioners

The salaries for the three Commissioners were excluded from the 3.5 percent unclassified merit pool for FY 1996. The aggregate expenditure limitation on the Conservation Fee Fund, the Public Service Regulation Fund, and the Motor Carrier License Fee Fund is increased by \$9,943 to include the Commissioners' salaries in the unclassified merit pool.

	<u>FY 1995</u>	<u>FY 1996</u>
State General Fund	\$ --	\$ --
All Other Funds	<u>--</u>	<u>9,943</u>
All Funds	\$ --	\$ 9,943

**Department of Health and Environment**

3. Funding Shift

A total of \$27,000 in expenditures was financed with the incorrect special revenue fund. To correct this error, the expenditure limitation on state operations from the AIDS Project-- Education and Risk Reduction--Federal Fund needs to be increased by \$27,000 for FY 1996, with expenditures from the Immunization Tracking System Fund reduced by a like amount.

Historical Society

## 4. Shrinkage Rate

In calculating shrinkage for the Historical Society, the rate used exceeded the rate intended by the Governor. To reflect the recommendation of the Governor properly, the following amounts need to be added to the recommendation.

	<u>FY 1995</u>	<u>FY 1996</u>
State General Fund	\$ --	\$ 66,521
All Other Funds	<u>--</u>	<u>1,741</u>
All Funds	\$ --	\$ 68,262

Department of Education

## 5. School District Capital Improvements Fund

Of the total \$11.5 million required for bond and interest state aid in FY 1995, the Governor recommended \$11,429,225 from the State General Fund. The remaining \$70,775 was intended to be spent from the balance remaining in the School District Capital Improvements Fund, but this amount technically was not in the Governor's budget. No statutory authority is needed to correct this error, but the budgeted expenditures should be increased by \$70,775 in FY 1995.

	<u>FY 1995</u>	<u>FY 1996</u>
State General Fund	\$ --	\$ --
All Other Funds	<u>70,775</u>	<u>--</u>
All Funds	\$ 70,775	\$ --

Regents Institutions

## 6. Other Operating Expenditures

The Governor recommended a 1.5 percent increase to other operating expenditures for the Regents institutions in FY 1996. Minor errors were made in calculating the amount of this increase at various campuses. The following table corrects these errors in *The FY 1996 Governor's Budget Report*.

	<u>Surplus/ (Shortfall)</u>
FY 1994:	
University of Kansas	\$ (1,650)
KU Medical Center	1,649
KSU - Salina	2,869
Wichita State	(7,925)
Fort Hays State	1,651
Emporia State	9,913
Pittsburg State	<u>(15,310)</u>
	\$ (8,803)

	<u>FY 1995</u>	<u>FY 1996</u>
State General Fund	\$ --	\$ (8,803)
All Other Funds	<u>--</u>	<u>--</u>
All Funds	\$ --	\$ (8,803)

**Department of Wildlife and Parks**

7. Temporary Positions

The FY 1996 salaries and wages for the Fisheries and Wildlife Program of the Department of Wildlife and Parks were understated. Expenditures recommended by the Governor should be increased by \$32,201 from the Wildlife Fee Fund for FY 1996 to correct the error.

	<u>FY 1995</u>	<u>FY 1996</u>
State General Fund	\$ --	\$ --
All Other Funds	<u>--</u>	<u>32,201</u>
All Funds	\$ --	\$ 32,201

**State Conservation Commission**

8. State General Fund Transfer to the State Water Plan Fund

A State General Fund demand transfer to the State Water Plan Fund of \$5,932,800 was approved for FY 1995. This State General Fund transfer is "tracked" through expenditures recommended for the State Conservation Commission. Currently, the budget for the Commission contains \$5,467,200 in expenditures representing the State General Fund transfer. To track the approved transfer correctly, an additional \$465,600 in State Water Plan Fund expenditures need to be shifted to the State General Fund for FY 1995.

	<u>FY 1995</u>	<u>FY 1996</u>
State General Fund	\$ 465,600	\$ --
All Other Funds	<u>(465,600)</u>	<u>--</u>
All Funds	\$ --	\$ --

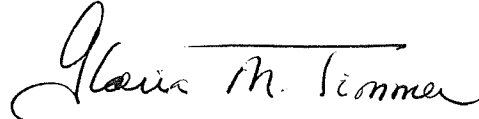
**Kansas Water Office**

9. State Water Plan Fund Expenditures

Expenditures from the State Water Plan Fund for FY 1996 to finance other operating costs are overstated by \$31,837 in *The FY 1996 Governor's Budget Report*. To correct this error, total recommended expenditures from the State Water Plan Fund for the Kansas Water Office must be reduced by \$31,837.

	<u>FY 1995</u>	<u>FY 1996</u>
State General Fund	\$ --	\$ --
All Other Funds	<u>--</u>	<u>(31,837)</u>
All Funds	\$ --	\$ (31,837)

Sincerely,



Gloria M. Timmer  
Director of the Budget