



# **PERFORMANCE AUDIT REPORT**

## **Reviewing the Operations of the Pooled Money Investment Board**

**A Report to the Legislative Post Audit Committee  
By the Legislative Division of Post Audit  
State of Kansas  
February 2000**

# **Legislative Post Audit Committee**

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## **Legislative Division of Post Audit**

**THE LEGISLATIVE POST** Audit Committee and its audit agency, the Legislative Division of Post Audit, are the audit arm of Kansas government. The programs and activities of State government now cost about \$8 billion a year. As legislators and administrators try increasingly to allocate tax dollars effectively and make government work more efficiently, they need information to evaluate the work of governmental agencies. The audit work performed by Legislative Post Audit helps provide that information.

We conduct our audit work in accordance with applicable government auditing standards set forth by the U.S. General Accounting Office. These standards pertain to the auditor's professional qualifications, the quality of the audit work, and the characteristics of professional and meaningful reports. The standards also have been endorsed by the American Institute of Certified Public Accountants and adopted by the Legislative Post Audit Committee.

The Legislative Post Audit Committee is a bipartisan committee comprising five senators and five representatives. Of the Senate members, three are appointed by the President of the Senate and two are appointed by the Senate Minority Leader. Of the Representatives, three are appointed by the Speaker of the House and two are appointed by the Minority Leader.

Audits are performed at the direction of the Legislative Post Audit Committee. Legislators or committees should make their requests for per-

formance audits through the Chairman or any other member of the Committee. Copies of all completed performance audits are available from the Division's office.

### **LEGISLATIVE POST AUDIT COMMITTEE**

Senator Lana Oleen, Chair  
Senator Anthony Hensley  
Senator Pat Ranson  
Senator Chris Steineger  
Senator Ben Vidricksen

Representative Kenny Wilk, Vice-Chair  
Representative Richard Alldritt  
Representative John Ballou  
Representative Lynn Jenkins  
Representative Ed McKechnie

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Barbara J. Hinton, Legislative Post Auditor

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LEGISLATURE OF KANSAS  
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February 17, 2000

To: Members, Legislative Post Audit Committee

Senator Lana Oleen, Chair  
Senator Anthony Hensley  
Senator Pat Ranson  
Senator Chris Steineger  
Senator Ben Vidricksen

Representative Kenny Wilk, Vice-Chair  
Representative Richard Alldritt  
Representative John Ballou  
Representative Lynn Jenkins  
Representative Ed McKechnie

This report contains the findings, conclusions, and recommendations from the completed performance audit, *Reviewing the Operations of the Pooled Money Investment Board*. The audit was conducted by McBride Lock & Associates, an audit firm under contract with the Legislative Division of Post Audit.

We would be happy to discuss the findings presented in this report with any legislative committees, individual legislators, or other State officials.

Barbara J. Hinton  
Legislative Post Auditor



**EXECUTIVE SUMMARY**  
**LEGISLATIVE DIVISION OF POST AUDIT**

*As part of its responsibilities, the Pooled Money Investment Board .....page 1  
does the following:*

- *helps ensure that cash flow needs of State agencies for moneys in the State Treasury are met*
- *manages State idle funds and municipal investment moneys in accordance with the requirements of State law*
- *ensures that investment income is received and properly credited to the appropriate accounts*
- *maintains custodial accountability for moneys for which it responsible*

*The audit reviewed each of the above areas of responsibility, and found no deficiencies.*

**Agency Response .....page 9**

This audit was conducted by McBride Lock & Associates, an audit firm under contract with the Legislative Division of Post Audit. If you need any additional information about the audit's findings, please contact Randy Tongier at the Division's offices. Our address is: Legislative Division of Post Audit, 800 SW Jackson Street, Suite 1200, Topeka, Kansas 66612. You also may call (785) 296-3792, or contact us via the Internet at: [LPA@lpa.state.ks.us](mailto:LPA@lpa.state.ks.us).



**FINANCIAL MANAGEMENT AUDIT REPORT**

**Reviewing the Operations of the  
Pooled Money Investment Board**

**For the Year Ended June 30, 1999**



## Reviewing the Operations of the Pooled Money Investment Board

The Pooled Money Investment Board (PMIB) was created by the 1974 Legislature and came into being on January 13, 1975, assuming all powers, duties and functions of the then-abolished State Board of Treasury Examiners. The organization, primary functions and duties of the Board may be found under the State Moneys Law, KSA 75-4201 et seq. During the 1992 Legislative Session, SB 480 increased the membership of the Board from three to five members; four were appointed by the Governor and the fifth, the State Treasurer, served as the chairperson of the Board as defined by the statute. SB 476, Session Laws of 1996, further changed the composition of the Board. The membership increased to six, comprised of four gubernatorial and two statutory appointments. Both the State Treasurer and the State Securities Commissioner were members per statute. Additionally, the Governor would now be responsible for appointing the Chairman. The State Securities Commissioner served as a non-voting member. As part of the 1997 Legislative Session, the membership was reduced to five with the passage of SB 282 which eliminated the non-voting member position occupied by the State Securities Commissioner. No additional structural changes were made to the Board.

SB 480 made sweeping changes to the state moneys law in 1992. Investment authority was broadened to include investments in U.S. Government securities (U.S. Treasury and Federal Agency instruments). High grade commercial paper was added during the 1996 Legislative Session via SB 476. It is estimated that the use of commercial paper accounted for an additional \$3.5 million in investment income (over comparable Federal Agency investment alternatives) since its inception in FY 1996. Late in FY 1996 (6/3/96) the Board combined the investment portfolio of the Municipal Investment Pool with the Pooled Money Investment Portfolio (PMIP) in order to more effectively manage and closely match cash flow needs thereby reducing liquidity risk. The operating account, formally known as the active account, continues to be maintained in one bank.

With the passage of SB 480, Investment accounts replaced the former inactive accounts, offering Kansas banks two investment options-apportioned and competitively bid. The apportionment process was administered in much the same manner as former inactive accounts. Approximately one-half of the investable state moneys (after setting aside funds for liquidity purposes) were prorated to Kansas banks on the basis of equity capital. Interest rates paid on the apportioned offering were revised to reflect yield rather than the discount rate of current U.S. Treasury securities with a similar maturity. The remaining investable state moneys were offered to Kansas banks on a competitive bid basis, at interest rates based on U.S. Treasury and Federal Agency securities of similar terms. During the 1997 Legislative Session (SB 132) the apportionment process was eliminated, and funds offered to Kansas banks were then available at interest rates based upon the current market.

## Objective

This audit work is to fulfill the requirements of KSA 46-1106(a). That statute calls for a written audit report on the financial management practices of the Pooled Money Investment Board. The audit firm conducting the annual Statewide single audit performs certain audit work at the PMIB as part of that audit. We have reviewed those audit efforts to create additional efficiencies and to reduce duplication of audit effort.

## Scope of Effort

The audit efforts were performed in accordance with *Government Auditing Standards* for performance audits.

The audit work was responsive to the following questions:

Did the Pooled Money Investment Board's procedures help ensure that cash flow needs of State agencies for moneys in the State Treasury were met?

Did the Pooled Money Investment Board manage State idle funds and municipal investment moneys in accordance with the requirements of State law?

Did the Pooled Money Investment Board ensure that investment income was received and properly credited to the appropriate accounts?

Did the Pooled Money Investment Board maintain adequate custodial accountability for moneys for which it was responsible?

This report will address each question with specific observations summarizing the process and any noted statutory violations or inefficiencies. Finally, the report will provide recommendations to alleviate the concerns.

### Question 1:

Did the Pooled Money Investment Board's procedures help ensure that cash flow needs of State Agencies for moneys in the State Treasury were met?

PMIB has established policies and procedures to help ensure the cash flow needs are met. These policies are in effect for the daily and the longer-term needs of the agencies.

The daily cash flow needs are performed by an office specialist at PMIB in close communication with the State Treasurer's Office (STO). An initial cash calculation is performed at 8:00 a.m. This calculation considers the following items:

- Current collected bank balance

- Repurchase agreement maturities
- ACH clearings
- Estimated bank clearings
- Idle fund maturities (including interest)
- Idle fund purchases
- Municipal Investment Pool (MIP) Deposit and Withdrawals
- CD Maturities
- KDOT Purchases and Maturities
- HCSF Purchases and Maturities

This provides for the available funds for the initial repurchase agreement maturities. A final cash calculation sheet provides for a more substantial information on collected funds and bank clearings from the STO. This final calculation then provides the basis to ensure that idle state funds are invested to the maximum level. A daily liquidity analysis is also performed to ensure that adequate funds could be made available if liquidation would be requested from day-to-day deposits. A 25% - 50% - 75% scenario is also built into the analysis to provide analysis of the availability of funds under those environments.

A longer review analysis of cash flow availability is also provided. The STO provides to PMIB on approximately a quarterly basis an anticipated cash flow analysis for the upcoming 15 to 24 months. See the Performance Audit Report – Reviewing the Operations of the State Treasurer’s Office for the year ended June 30, 1999. This report provides the expected cash receipt and disbursements over that time period on a daily basis. From this information a report is prepared by PMIB which provides the daily cash flow and investment analysis for the upcoming 15 to 24 months. This report, entitled the PMIB Investment Portfolio Exposure Report (Cash Flow Forecast Model), provides analysis to guide the investment policy especially as it pertains to maturity dates. The first two columns provide the cash inflows and outflows for state operations.

The third column is the date by which the MIP deposits are reaching maturity. The fourth column is the maturities as they are currently scheduled to occur. The sixth column provides for a variance. If the amount is positive then adequate maturities are providing for anticipated cash flow needs. A negative amount provides indication that additional maturities need to be available for that date.

These efforts have ensured that the cash flow needs for the state agencies are met for the near and long terms. It also provides for a reasonable maximization of invested funds. The statutory requirement states that “The PMIB shall adopt rules and regulations...with a primary emphasis on safety and liquidity”. These requirements are being met.

**Question 2:**

Did the Pooled Money Investment Board manage idle funds and municipal investment moneys in accordance with the requirements of State Law?

The policy of the PMIB as currently stated is to invest the Pooled Money Investment Portfolio in a manner which will provide a reasonable rate of return with the maximum security while meeting the daily cash flow demands of the State and conforming to all statutes governing the investment of state moneys. The standard of prudence to be used by investment officials shall be the prudent person standard, which shall be applied in the context of managing an overall portfolio. This standard states that investments shall be made with judgment and care, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital, as well as the probable income to be derived.

The investment policy applies to all moneys in the treasury of the state or coming lawfully into the possession of the treasurer, pursuant to K.S.A. 75-4201, et seq., including the municipal investment pool. The moneys are accounted for in the Board's annual financial report to the Legislature and include investment account moneys, as specified in K.S.A. 75-4209, as amended. The board specifically manages the Pooled Money Investment Portfolio, Health Care Stabilization Fund, and Special Funds. The PMIB performs transaction execution, investment accounting, and provides investment advice for the Kansas Department of Transportation (KDOT). KDOT, however, retains responsibility for the investment decisions on the KDOT investments. The PMIB also administers the Municipal Investment Pool.

The primary objectives, in priority order of the Board's investment activities, are as follows:

**Safety.** Safety of principal is the foremost objective of the investment program.

**Liquidity.** The pooled money investment portfolio will remain sufficiently liquid to meet all operating requirements that might be reasonably anticipated. This is accomplished by structuring the portfolio so that securities mature concurrent with cash needs to meet anticipated demands.

**Return on Investment.** The pooled money investment portfolio shall be designed with the objective of attaining a reasonable rate of return throughout budgetary and economic cycles, taking into account investment risk constraints and the cash flow characteristics of the portfolio. Return on investment is a secondary importance compared to the safety and liquidity objectives described above.

The objectives meet the statutory requirements established by KSA 75-4209, 75-4210, 75-4210a, 75-4221a, 75-4222, 75-4232, 75-4234, 75-4236 and 75-4237.

The composition of assets at June 30, 1999 in the Pooled Money Investment Pool (PMIP) are as follows:

	PMIP (In Millions)
Cash	\$27.295
Deposit in Transit	35.100
Investment: (at amortized cost)	
U.S. Gov't Agency Securities	\$688.430
U.S. Mortgage Backed Securities	.818
Kansas Bank CD's	136.901
Commercial Paper	864.906
Repurchase Agreement	381.300
Loan Refunding Securities	36.575
 Total Investments	 \$2,108.930
 Kansas Venture Capital, Inc.	 4.000
PMIB Loans	14.789
Interest Receivable	3.238
	<hr/>
	\$2,193.352
 KDOT	 465.228
Health Care Stabilization Fund	202.309
Special Funds	6.723
Elimination Entry	(1.340)
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	\$2,866.272
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The investment portfolio is invested in accordance with the requirements, restrictions and limitations of KSA 75-4209.

Question 3:

Did the Pooled Money Investment Board ensure that investment income was received and properly credited to the appropriate accounts?

Two primary systems of accountability are maintained which are reconciled monthly. The two systems are:

- Investments – accrual basis
- Investments – cash basis

The cash basis statement allows for reconciliation to the STO and the Director of Accounts and Reports. Interest income is accounted for as received and investments are stated at cost. The investment balance is agreed to the balance of investments actually being held by the STO. The investment income is reconciled to the Director of Accounts and Reports monthly. Those reports are supported by LOTUS spreadsheets which note the basis of accounting. The LOTUS accounting is supported by details such as trade tickets, dealer confirmations and interest advice.

The accrual basis report is provided to the Board monthly. This report is obtained primarily from the EVARE Desktop Investment System. It is agreed to the STO Daily Cash Sheet (cash basis) but also accounts for accrued interest and amortization for each investment. A second system, IPAC, is used for the MIP and provides a detail accountability for each of the participants in that system.

The Pooled Money Investment Board maintains responsibilities for the following:

- State Idle Cash (includes MIP)
- KDOT
- Health Care Stabilization Fund
- Special Funds.

The software package generates a tickler file which provides a sheet for each maturity or coupon date. On the day the security matures or a coupon is received the accountant prepares an investment advice and receipt voucher and sends it to the cashiers office for posting.

In prior years, the Municipal Investment Pool had its own portfolio, but was combined in 1997 with the PMIP Portfolio. Municipalities invest with PMIP in two ways:

1. Overnight Pool – The municipality is paid the weighted overnight rate that the PMIP earned that night (usually 2 – 3 purchases are weighted) less 30 basis points (which is 1/100 of a %, i.e., .3%). This is credited daily to the municipality, monthly from the General Fund to the MIP fund.
2. Fixed Rate Deposits – The municipality can invest in either 90 day, 180 day or 1 year “maturities”. The Senior Investment Officer quotes a rate to the municipality, which is the then current commercial paper rate (Per Boomborg News) for the 90 day and 180 day and the U.S. Gov’t Agency Rate for 1 year because commercial paper has no maturities beyond 270 days), less 25 basis points. This is credited to the municipality upon “maturity”, and transferred to the MIP Fund.

The computation of the transfer was reviewed. The overnight interest is taken from the month-end trial balance, and the fixed income investments are credited directly.

PMIB also maintains a system, GAINS, which amongst other capabilities produces for each day an interest payment report and a maturity report which is used to prepare the memo to the STO Cashier. The report is also used to prepare the Receipt Voucher which posts the interest to the interest income account in the appropriate fund.

No exceptions were noted in our review of this area.

#### Question 4:

Did the Pooled Money Investment Board maintain adequate custodial accountability for moneys for which it was responsible?

The accountability issues pertaining to the PMIB investments are discussed in the response to question 3. As noted in that section, the PMIB accounting staff maintains accountability on a cash basis which is reconcilable with the State's STARS system. An accrual based accounting system is prepared which provides the board a monthly evaluation of the investment activity and current status.

As established by Statute the State Treasurer's office is the custodian of the investment instruments which consist of safekeeping receipts and certificates of deposits. A balance of the safekeeping receipts is maintained by the clearing accounting maintained by United Missouri Bank (UMB). The balances of these receipts range between \$70,000,000 and \$200,000,000 and aid in the facilitation of purchasing of certain investments, namely repurchase agreements, which require the on-hand availability of a balance of securities. No loss of investment return or breach of custodianship occurs as a result of this arrangement.

No concerns are evident in the PMIB custodial accountability.

#### Other Overall Matters

The PMIB personnel maintain their office in a professional and efficient manner. The individuals effectively performed and communicated their responsibilities. The results of this audit therefore include commendation to that affect.

The PMIB is also subject to the requirements of KSA 75-4264 which establishes that a comparative investment performance review and an audit of the PMIB investment program be conducted. The results of the most recent review was submitted to the PMIB on August 31, 1999. The report recommended changes to the policies and procedures given the current State statutes. Our review of the follow-up by the PMIB indicates that such policies have been appropriately modified to comply with State statute. The Director of Investments has made progress in the establishment of procedures in response to that audit.



AGENCY RESPONSE

STATE OF KANSAS



**POOLED MONEY INVESTMENT BOARD**

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DIRECTOR OF INVESTMENTS  
Derl S. Treff

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February 7, 2000

Mr. Robert J. Lock  
McBride, Lock & Associates, C.P.A.  
1221 Baltimore, Suite 406  
Kansas City, MO 64105

Dear Mr. Lock:

I have received the draft of the Financial Management Audit for the year ended June 30, 1999 and agree that your commentary provides a reasonably accurate synopsis of our operations.

I appreciate the professional manner in which the audit was conducted.

Sincerely,

A handwritten signature in black ink that reads "Derl S. Treff".

DERL S. TREFF  
Director of Investments

DST:mcg