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BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Mayor Of The District Of Columbia

The District Of Columbia's Banking And Short Term Investment Management

The District of Columbia's banking and short term investment operations are sound, but some changes could increase the effectiveness of the cash managers, and the potential for increased investment earnings could be realized.

This report discusses banking costs, bank account balance levels, treasury operations, and cash flow information and control. Recommendations are made that would lower account balances, expedite deposits, and improve cash management information control.

UNITED STATES GENERAL ACCOUNTING OFFICE

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

GENERAL GOVERNMENT DIVISION

B-207327

The Honorable Marion S. Barry, Jr.
Mayor of the District of Columbia
Washington, D.C. 20004

Dear Mayor Barry:

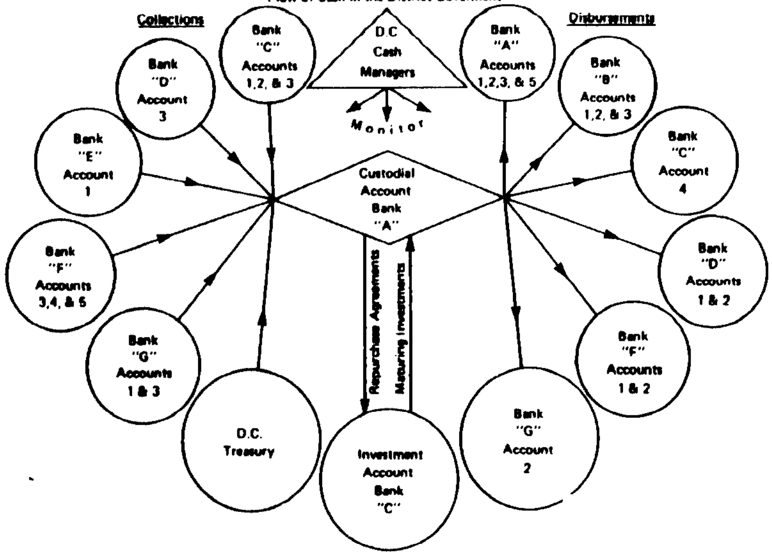
Banking and short term investment management in the District of Columbia is sound, but some changes could reduce banking costs, increase short term investment income, and improve cash flow information.

The objective of cash management and the mandate of the District of Columbia Depository Act of 1977 (D.C. Code 47-342) is to increase the municipality's non-tax revenues by investing cash when it is not needed to meet current obligations. To accomplish this objective, the District maintains cash in 25 bank accounts including collection accounts, disbursement accounts, and one custodial account to control the flow of money into and out of the District. Money not needed for immediate disbursement or for compensation to the banks for account services is transferred from the custodial account into an investment account where interest can be earned through overnight investments. The cash managers, an Assistant Treasurer and a Banking and Investment Manager, monitor receipts, expenditures, and investments through daily balance information from all bank accounts.

The following table shows how cash flows into the District through collection bank accounts and the District Treasury cashiers. It then funnels through the custodial account from which it is wire transferred to an investment account or disbursement accounts. Investments are liquidated and wire transferred to the custodial account if additional funds are needed for disbursement.

Table 1.

Flow of Cash in the District Government



Generally, the District maintains a modern and economical banking and short term investment operation. The cash managers use lockbox bank accounts, 1/ which speed up the deposit of funds collected via mail, and bank wire service, which expedites interbank transfers of funds. They monitor the clearance of large disbursements such as payroll so that funds may remain invested as long as possible. Also, the cash managers monitor bank account and investment balances daily to maintain the District's position of liquidity and maximize short term investments. The cash managers use auxiliary banking services such as check writing and account reconciliation to take advantage of the economies of scale available to banks. They also monitor the compensation for these services through the examination of bank-provided account analyses. 2/

Several areas of the District's cash management activities could be improved. Prices for banking services vary widely for apparently similar services. The District has accumulated

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1/ A lockbox account is a cash management aid, whereby payments to the District are sent to a Post Office Box. The bank picks up, processes, and deposits the payments.

2/ Account analyses are statements furnished by the bank which show charges for services provided for an account. These analyses tell the account holder how much money must be kept on deposit to compensate the bank for these services.

earnings credits 1/ on surplus deposits in some checking accounts and may forego investment earnings on undeposited funds at the District Treasury. Finally, inadequate knowledge and control of anticipated cash flows decreases the effectiveness of the cash managers.

OBJECTIVES, SCOPE, AND METHODOLOGY

The purpose of our work was to evaluate the economy and efficiency of the banking, cash management, and short term investment operations of the District government. In addition, we determined whether the present system will give the District a timely forecast of future cash needs.

We performed our review in accordance with GAO's current "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions." We examined the District of Columbia Self-Government and Governmental Reorganization Act, commonly referred to as the Home Rule Act; the District of Columbia Depository Act; and the pertinent laws and regulations relating to cash management activities in the District government. We interviewed District cash management and Treasury officials to gain an understanding of the present system and to discuss possible improvements.

We requested and examined copies of banking service contracts and bank account analyses for all District bank accounts; individual bank statements and collateral reports for selected accounts; and daily investment information for use in determining proper levels of collateral, the timing of availability of deposited funds, bank compensation, and prices for bank services. We did not determine if prices charged for banking service were appropriate or if the District was in compliance with the set-aside provisions of the Depository Act. Banks are not referred to by name in this report to maintain confidentiality.

We also reviewed the information flow between District agencies and the cash managers. We assessed the adequacy of communication between key agency officials, who are responsible for cash receipts and disbursements, and the cash managers as well as the extent to which this information contributes to accurate cash forecasting.

1/ An earnings credit rate is applied to deposits that are available for the bank to invest. The amount of earnings credits are offset against account charges.

BANKING RELATIONS ARE ADEQUATE, BUT SOME PRICES MAY BE HIGH, AND EARNINGS CREDITS HAVE AMASSED

While the District's overall cash management is sound, several areas could be improved. Bank documents showed that the District's deposits are properly protected and become available for use without undue delay and, with one exception, banks were compensated according to contractual requirements. However, account analyses showed that the District paid widely variant prices for bank services and accumulated surplus earnings credits in some accounts.

The District's bank accounts are properly protected by collateral as shown by comparison of bank statement balances to collateral pledged for selected days. This is in accordance with the Depository Act which states that "Any public funds on deposit in excess of the amount insured by an agency of the federal government shall be fully secured by [collateral 1/]* * *."

The banks provide adequate availability on deposited funds. Funds availability is the amount of time required for a deposit to clear and become available for the District's use or withdrawal. The banks provide the District with approximately 1-day availability on funds deposited as shown by individual daily bank statements and monthly account analyses. In this situation, 1-day availability is acceptable bank performance.

The analyses that we examined showed that over a 40-month period the District compensated banks in reasonable conformance with bank service contracts, with one exception, which will be discussed later.

Is the wide range of prices paid to banks appropriate?

The District pays banks a wide range of prices for apparently similar banking services. Account analyses showed, for example, that Bank D requires $40.33 of the average collected balance 2/ to be on deposit for each check written to compensate

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1/ Generally, collateral under the Depository Act are obligations fully insured or guaranteed by the United States Government or the District of Columbia.

2/ Average collected balance is the average amount of money that is available for withdrawal or use by the District. The bank requires that part of this balance be kept at a certain level in return for the services it provides to the District.

for services rendered in connection with the account (see table 2). The cost of other District bank accounts ranges from $10.65 to $25.28 per check written for similar bank services. Bank D, therefore, is charging 160 percent of the next highest priced bank (Bank F, account #2) and almost 380 percent of the lowest priced bank (Bank A, account #2).

Account #1 at Bank D represents financial services set aside by the Mayor. The District of Columbia Depository Act states that the Mayor shall determine which financial services shall be set aside for award to the highest ranking commercial banks on the basis of evaluation criteria in section 5(a) of the act, including the mix of their loans in the community and the minority employment practices of the institutions. The cost to the District of the specific financial services within the set-aside portion is not to exceed 175 percent of the highest cost to the District of identified financial services awarded on non-set-aside bids received in the same solicitation.

Table 2
Comparison of Services Provided For Disbursing Accounts

Bank and account	Average collected balance required per check written
Bank A	
Account #1	$14.07
Account #2	10.65
Account #3	15.43
Bank B	
Account #1	$23.11
Account #2	24.19
Account #3	20.85
Bank D	
Account #1	$40.33
Bank F	
Account #1	$24.90
Account #2	25.28

We attempted to compare prices by dividing the required average collected balance in the checking accounts by the total number of checks issued on these accounts, since banks identify services in various ways for pricing purposes.

The District extended the original banking services contracts based on noncompetitive agreements. Most of the contracts were due to expire within a very short period around October 1981. The Depository Act, as amended in 1981, states "Contracts terminating prior to October 1, 1981, may be extended for periods not to exceed 1 year without competition." This extension was authorized in the 1981 amendment to avoid a disruption of the financial operations of the District and to capture a greater period of performance for ranking purposes.

The District will face the same problem in October 1982 when the grace period expires and competitive bids must be obtained for banking services. The cash managers have told us that information is being obtained from banks in preparation for soliciting competitive bids for banking services.

Earnings credits amassed due to surplus deposits in some non-interest bearing accounts

While banks require a certain level of balances as compensation for services, in one bank the District has maintained higher average balances than necessary. This has resulted in an accumulation of surplus earnings credits.

The District has amassed approximately $300,000 of surplus earnings credits on deposits in four accounts in one bank. This represents 2 years of prepaid expenses, since the District was charged an average of $12,600 a month for services rendered on these accounts over a 4-year period.

Since we began our audit, the District recognized that it had accumulated the surplus earnings credits. Account analyses show that the District lowered account balances in late fiscal year 1981 and early fiscal year 1982, thereby using the surplus credits and freeing account balances for other purposes, such as overnight investment.

DISTRICT OF COLUMBIA HAS GOOD INVESTMENT PRACTICES

The District properly invests its idle funds almost exclusively in repurchase agreements. 1/ In addition, cash managers keep this money invested as long as possible and at the highest rate available.

District officials told us that they invest funds on a daily basis after obtaining competitive bids from several banks and brokers. The Depository Act directs the Mayor to invest all funds not required to be immediately disbursed. The investment instruments used are generally repurchase agreements, an approved form of investment according to the Depository Act. According to investment information provided by the District, approximately $103.4 million was invested daily on the average, during fiscal year 1981. According to the cash managers, these investments earned approximately $16.7 million in interest.

At no time during fiscal year 1981 did the average daily investment portfolio drop below $50 million. Included in that figure, on the average, was $39.2 million of investments representing outstanding checks written against its disbursing accounts and also approximately $10 million representing a 1-day supply of cash for the District. The funds necessary to cover these checks are kept in the investment pool as long as possible. The cash manager said this is accomplished by using historical data that shows when checks will most likely be presented for payment. This is a good example of efficient cash management.

INTEREST COULD BE EARNED ON MONIES RECEIVED AT THE DISTRICT TREASURY

The District may be losing the investment value of cash received by its Treasury cashiers after noon, since it is not deposited in the custodial account until the next day. The deposit of money on the same day that it is received would free up other District account balances for overnight investment.

The District could advance the date on which deposits become available through expedited deposit of afternoon receipts. All receipts collected up to noon are deposited that day, but, until recently, they were not invested. Receipts collected after noon are sent to the bank with the next day's deposit. The District is

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1/ Repurchase agreements represent temporary investments of District funds in debt obligations of the U.S. Government and Federal Government agencies.

thus losing the investment value of this money which could be substantial depending upon the amount of afternoon receipts. We were unable to determine the average receipts collected after noon since historical information of that nature is not available. However, approximately $560,000 was collected on the average between noon and 4:30 p.m. daily on the 6 days which we observed. If this collection activity is typical, an expedited deposit, providing more investable funds would be potentially worth about $86,000. 1/

An after hours deposit might require additional staff hours to tally late-in-the-day receipts and prepare them for armored car pick up. However, if the District were to deposit after noon receipts by 6:00 or 7:00 p.m. each day, the bank should accelerate the availability of such funds by a full day. Corporate, institutional, and correspondent bank depositors routinely make bank deposits after normal banking hours for same day credit to their checking accounts. The servicing bank may be able to suggest procedures to expedite these deposits.

Since we began our review, the District has made an effort to reduce and use surplus balances in the custodial account by making an afternoon investment of a large percentage of funds deposited at noon by the District Treasury. The District has thereby earned an additional $125,000 interest in 5 months. The cash managers now intend to investigate the feasibility of a late-in-the-day deposit of afternoon receipts at the District Treasury. Presently, the District Treasury hand-carries large checks to the custodial bank for deposit up to 3:00 p.m.

We also noted that the facilities used by the District Treasurer's main cashiering unit are badly overcrowded and, in our opinion, may expose the District to security problems in handling cash. The District's bankers, who are experienced in security matters, could examine the present situation and suggest improvements.

CASH FLOW INFORMATION AND CONTROL COULD BE IMPROVED

Cash forecasting is made difficult by inadequate information and control over anticipated cash receipts and disbursements. Two major complaints of the cash managers are the lack of (1) information flow from key agency officials and (2) control over the financial actions of these same officials.

1/ Assuming $560,000 of deposits available for overnight investment at 15.4 percent.

Effective cash management is predicated on timely furnishing of disbursement and receipt information to the cash managers by locally responsible officials. According to the Municipal Finance Officers Association's (MFOA) Implementing Effective Cash Management in Local Government, all activities of an effective cash manager stem from a comprehensive knowledge of historical cash flow and predicted future cash expenditures and receipts. Another MFOA publication, A Treasury Management Handbook, states that the establishment of sound financial control and cash information is the first step in treasury management.

The cash managers have tried to educate key agency officials that timely information concerning expenditures and receipts is important. However, most information is still relayed "after the fact." According to the cash managers, large Federal payments are sometimes mailed directly to the agencies which do not immediately send them to the District Treasury for deposit. This can result in the loss of the investment value of money. Similarly, officials responsible for making large disbursements do not always alert the cash manager when making substantial payments.

Four bank accounts maintained outside the District's cash management system illustrate poor financial control. These accounts are used for the deposit of money collected by private collection agencies and payments to these agencies. According to one cash manager, these accounts are nominally, but not actually, under his control. Approximately $1 million passes through these accounts yearly, but bank statements and account analyses were not available to him. He also told us that idle funds are left in the accounts so District agencies can make future payments to the collection agencies. In our opinion, the cash managers cannot maximize the investment of idle funds in these accounts due to the lack of information pertaining to necessary account balance levels. After we alerted them to this situation, the cash managers began investing a portion of these balances daily. This is accomplished by asking agency officials what portion of the balances is reserved for payment of collection agencies.

Currently, the District cash managers forecast cash flow for the fiscal year with monthly and occasionally daily updates. They make cash management decisions on a daily basis, reviewing the status of District bank accounts and managing funds and investment maturities accordingly. The cash managers have developed historically based predictions of check clearance for large disbursements, such as payroll, so as to stagger deposits in the disbursing accounts to cover withdrawals as checks are presented by employees.

CONCLUSIONS

In general, the District of Columbia has a sound cash management system. The District utilizes bank wire, lockbox, and other auxiliary banking services and maximizes the investment of idle funds. There are, however, several areas where cash management could be improved.

The wide range in bank service charges indicates that the District may be paying inappropriate prices to some banks. Competitive bidding for bank services, in addition to being a legal requirement, is a good cash management tool for obtaining the best price for banking services. This benefit will be lost if contracts are allowed to expire and banking services continue through noncompetitive price changes under temporary agreements. Therefore, it is important that the cash managers gather the information needed to identify needed services and to rank the banks in time to obtain competitive bids and award contracts before October 1982. Although the Depository Act requires the District to award contracts to set-aside banks on the basis of the ranking criteria, the prices to be paid can be negotiated to assure that the District minimizes the cost of banking services from all banks.

The District has surplus earnings credits in one bank but has begun maintaining smaller balances in these checking accounts. Less money left in bank accounts allows more money to be invested and thereby increases the District's interest income.

The District has earned an additional $125,000 in interest through an afternoon investment of District Treasury noon-time deposits. By depositing afternoon receipts the District can earn additional interest. The servicing bank may be able to assist the District in this matter, as well as with the present physical setup of the Treasury cashiering operation.

The cash managers forecast cash flow in the District. Cash forecasts are an integral part of cash management and a useful tool in predicting cash needs. More benefit could be obtained from improved or formalized communications with agency officials since accurate cash forecasts are possible only with timely cash flow information and control. In addition, the cash managers do not have full use of funds in the four accounts maintained for delinquent payment collection. Since the cash managers do not know exactly how much of the balance is restricted for payment to the collection agencies, they cannot maximize the investment of the remaining funds.

RECOMMENDATIONS

The Mayor should:

--Require the District cash managers to maintain balances only as needed to compensate banks and to maximize the use of surplus funds for investment purposes.

--Expedite the deposit of afternoon Treasury receipts to increase the available deposit funds.

--Require all agency controllers to furnish daily information concerning anticipated receipts and disbursements to the cash manager for more effective cash flow forecasting and management.

--Bring the four bank accounts maintained for collection of delinquent payments into the District's cash management system under the control of the cash managers.

AGENCY COMMENTS AND OUR EVALUATION

The Controller, commenting on our draft report on behalf of the Mayor, concurred with our recommendations.

The Controller stated that one reason prices for bank services vary was because the set-aside provisions of the District's Depository Act permits the District to pay up to 175 percent of the highest price awarded on non-set-aside bids. We recognized the set-aside provisions of the Depository Act in the report, but the 175 percent is to be used as a ceiling, not as a minimum. The District can attempt to negotiate a price that is less than 175 percent of non-set-aside bids.

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Section 736(b) of the District of Columbia Self-Government and Governmental Reorganization Act (Public Law 93-193, 87 Stat. 774), approved December 24, 1973, requires the Mayor, within 90 days after receiving our audit report, to state in writing to the District Council what has been done to comply with our recommendations and send a copy of the statement to the Congress. Section 442(a)(5) of the same act also requires the Mayor to report, in the District of Columbia's annual budget request to the District Council, on the status of efforts to comply with such recommendations.

We are sending copies of this report to interested congressional committees; to the Director, Office of Management and Budget; and to each member of the Council of the District of Columbia.

Sincerely yours,

W.J. Anderson

William J. Anderson
Director

GOVERNMENT OF THE DISTRICT OF COLUMBIA
EXECUTIVE OFFICE

CONTROLLER
415 12TH STREET, N.W. ROOM 412
WASHINGTON, D.C. 20004

June 2, 1982

Mr. William J. Anderson
Director
General Government Division
United States General Accounting Office
Washington, D.C. 20548

RE: Draft Report "Cash and Short Term Investment Management"

Dear Mr. Anderson:

I concur with the conclusion of the report that "the District of Columbia has a sound cash management system." Much staff effort and attention is dedicated to this end and the results of our program bear witness to our success.

As you are aware, the objective of governmental cash management is not as simple as that of a profit-maximizing private entity. In a governmental setting, the objective of earning the highest return on investable cash consistent with safety cannot undermine the objective of having cash available on a timely basis for orderly and effective governmental operations. Although the continuing existence of an accumulated operating deficit substantially complicates our ability to pursue these objectives, we have effectively managed our cash position without detrimental interruptions to program operations, while achieving a noteworthy return on investable cash.

Because all significant cash balances are either clearing previously issued and presented checks, earning compensating balance credit or earning investment income at the highest competitive market interest rates, there are virtually no idle cash balances in our cash management system. In FY81, District earnings on these working funds were as follows:

	Average Balance	Earnings	Effective Return
Investment Balances	$103.4 m	$16.7 m	16.2 %
Compensating Balances	16.4	1.6	9.8
Total Pooled Funds	$119.8 m	18.3 m	15.3 %

By way of comparison, the average U.S. Treasury bill yield in the same period was 14.5%. As an additional comparison, Fairfax County, Virginia, an entity with an effective financial management operation, earned $35.7 million on an average pooled investment balance of $263.2 million for an effective return of 13.6% in FY81. Adjusting for the differential in the Fairfax fiscal year, on the basis of the ratio of average U.S. Treasury bill yields in the two periods, results in an adjusted comparative effective return of 15.1% for the County.

Although cash management has attained a level of demonstrated effectiveness in the few years since the District assumed responsibility from the U.S. Treasury, our on-going premise is that it can be further improved, and we are continually seeking to do so. Even though I concur with the report's observation to this effect, the remainder of my letter provides comments on specific portions of the report.

The report notes a range of compensating balance requirements among different disbursing bank accounts maintained by the District. This is certainly the case, even though accounts are placed by competitive bid, because of two basic structural factors. First, because promotion of affirmative business practices is an objective of the District's Depository Act of equal priority to optimizing governmental financial benefit, "set-aside" banks designated under provisions of the Act can and have acquired District accounts at a 175% cost differential above "non-set-aside" institutions. Second, disbursing bank accounts vary significantly in the regularity and seasonality of bank service activity (e.g. a payroll-type account being very regular and predictable, a tax refund-type account being very irregular and seasonal) so that all disbursing account services are not uniform among bank accounts. Bank D, cited as requiring the highest average collected balance, is a "set-aside" bank with an account involving substantial workload irregularity.

The report also notes the accumulation of surplus earnings credits on compensating balances in one bank. While this is correct, it is important to keep in mind that surplus credit is an asset of the District and is an available offset to both future charges and negative credits. Because of our aggressive investment program, the return on directly invested cash is better than that on compensating balances and, therefore, our efforts are directed to reducing any balances that engender surplus credits. Because the District's central custodial account resides in this bank, however, this is somewhat more complicated than in other institutions. Nonetheless, as the report notes, a reduction has already been initiated and the accumulated surplus reduced by over 20% to date.

A gross benefit of $86,000 has been estimated in the report as the potential that would result from same day deposit of afternoon miscellaneous over-the-counter collections at the District Treasury, although the net benefit would be less due to likely additional resource requirements. Implementation of such an activity is presently being evaluated.

The District's financial reporting and control are formally exercised through the FMS system and GAAP-basis accounting control. This is not a formally cash-based information and control system, nor should it be for proper overall financial management of the District. Past implementation difficulties with the FMS system have not expedited our ability to implement a detailed formal cash basis subsidiary information system. Nonetheless, as the report notes, cash flow forecasts are prepared and regularly updated. Because substantial receipt and disbursement flows are function-oriented, not agency-oriented, (e.g. motor vehicle license fees, real property taxes, payrolls, debt service payments, etc.) and can be monitored, projected and, to an extent, controlled centrally, accurate cash planning can and is performed even without formal detailed agency reporting. The absence of agency information can be troublesome on an exception basis, however, and we are working to formalize regular agency input to gain additional precision in cash forecasting.

Finally, the collection agency-related bank accounts are being brought into formal District Treasury control. The primary rationale for this collection agency mechanism was to reduce past due accounts receivable for various agency service billings. Notwithstanding, the bank accounts themselves need not be subject to different supervision from other bank accounts that are within the purview of the District Treasury. It should be noted, however, that the $1 million annual cash flow in this mechanism must be placed in the perspective of the $2.5 billion overall annual District cash flow that must receive the attention of limited staff resources.

We would like to thank GAO for their efforts in this report. Generally, evaluations of current operations assist our efforts to improve financial management in the government. In this case in particular, there has been a good deal of beneficial reciprocity between GAO staff and staff of the Controller's Office during the study, as evidenced by actions already initiated and noted in the report.

Sincerely,

Alphonse G. Hill
D.C. Controller

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