

# Managing City Finances (revised 8/7/02)

## Introduction

The issues addressed in this chapter are directed toward municipal governments; however, the practices discussed apply to any government entity managing public money. The primary financial management objectives of a local government include:

- **Maintain solvency:** This means bringing in enough money to pay the bills and provide services. As with private corporations, a municipal government, through its financial transactions, can become bankrupt. Managing municipal finances to maintain solvency is another way of saying managing them to avoid bankruptcy.
- **Achieve efficient operations:** Whatever types and levels of services are offered to community residents, a financial management objective is to provide these as inexpensively as possible.
- **Spend only in accordance with the municipality's budget:** The administration, through proposing an annual budget, and the governing body, through adopting the budget in the form of an appropriation ordinance, establish the municipality's plan of operations, establish the purposes for which public funds can legally be spent, and set limits on the amounts that can be spent for each purpose. State law requires that a municipality spend money only in accordance with an adopted appropriation ordinance.
- **Meet legal reporting requirements:** In addition to the annual budget, state law requires a municipality to prepare monthly financial reports and a year-end financial audit (home-rule and first class cities) or a statement of annual income and expenditures (second class cities). State and federal regulations require other financial records, such as payroll tax reports.

The success of a municipality in meeting these four primary objectives relates to the municipality's ability to meet numerous secondary financial management goals. For example, managing city finances well means the municipality can pay employees, pay bills, and make tax payments. Proper financial management also allows the municipality to qualify for state and federal funding programs and to borrow money and issue bonds at more favorable terms.

Sound management of municipal finances requires that a municipality plan its finances, carry out the plan, and make changes as necessary when the objectives of the plan are not being met. All of the key officials of a municipality - the governing body, the mayor or manager, the clerk, the treasurer, and the attorney - have functions to carry out in this process.

For instance, the mayor or manager prepares a budget, which is approved, with any amendments, by the governing body. This provides the plan for municipal finances. The municipality's mayor or manager, as the chief administrative officer, has the overall responsibility for establishing and administering procedures and controls that will ensure that the plan is carried out.

The clerk in a small city government is often also the treasurer. The clerk-treasurer commonly may serve as the municipality's purchasing agent, oversee bookkeeping, serve as the municipality's

agent on all sales and property tax related matters, assist in the preparation of the budget and monthly financial reports, and ensure that proper documentation required for bookkeeping is maintained by city personnel.

The municipality's attorney typically assists the administration in drafting contracts, which will help to protect it against unnecessary financial risks or liabilities, advises the municipality on legal rights in proposed programs, and represents the municipality in legal disputes related to financial matters.

The governing body approves taxes, contracts, investments, and borrowing; monitors operations through the monthly financial and other administrative reports; and makes financial decisions in response to problems as they arise.

Procedures and controls used in a financial management system typically include bookkeeping, purchasing, contracting, investing, borrowing, financial reporting, and auditing. An in-depth discussion of these complex elements that make up a sound financial management system is beyond the scope of this handbook; instead, this section presents an overview of several financial management concepts and procedures.

The topics introduced in this section are:

- Record keeping.
- Financial reporting.
- Evaluation of activities and adjustments.
- Internal control.
- Payroll records.
- Grant administration and records.
- Managing cash flow.
- Short-term and long-term borrowing.
- Investments.

Additional financial management topics are covered in other sections of this handbook – they are:

- Budgeting - Chapter 3, Section 2.
- Auditing - Chapter 3, Section 3.
- Purchasing - Chapter 3, Section 4.
- Contracting - Chapter 6, Section 2.
- Risk Management - Chapter 2, Section 2.

## **Planning and Budgeting**

A governing body uses a municipal budget as one of its main tools to achieve the objectives it sets for the local government. The municipal budget is the plan for what money will be received and how it will be spent (revenues and expenses). It is how the governing body assigns its money to accomplish its goals for the coming year. The budget is adopted as an appropriation ordinance and directs what a municipality can spend money on and limits how much can be spent. The next section in this chapter (Chapter 3, Section 2) discusses the budgeting process in more detail. The topic, "Financial Reporting," in this section, illustrates how the budget, along with monthly financial reports, allows the governing body to stay informed and manage municipal finances.

## **Record Keeping**

Keeping good financial records is very important for government and the public to make informed decisions. Without accurate records and timely financial reports, the governing body and the chief administrator will not be able to evaluate their efforts and decide whether they are meeting their goals.

The basis for accurate financial records is a good bookkeeping system that is properly maintained. A bookkeeping system records the transactions that affect the financial condition of a municipality. The bookkeeper or accountant is responsible for sorting, classifying and summarizing the events of a fiscal year to give a clear picture of the financial condition of the municipality. Since hundreds and sometimes thousands of small things must be tracked, the bookkeeper must be very careful to be sure that the records are both complete and accurate.

Bookkeeping is a system through which information flows. Disorganized information "enters" the system in the form of daily transactions represented by such things as tax collection, cancelled checks, payroll check stubs, bank statements, invoices, petty cash receipts, time sheets, and state revenue sharing receipts. The bookkeeper processes this information by recording, sorting, and summarizing it. After the information is processed, it is organized into statements or financial reports that summarize the transactions over a period of time. A system of bookkeeping identifies:

- Where money came from.
- Where money was deposited.
- Where money was spent.
- What money is available to be spent.

Bookkeeping is set up based on the budget approved by the governing body and provides the basis for preparing the reports that inform the governing body and administrators about how money is received and spent and what is going on with public assets (money or property).

## **1. The Bookkeeper (Or Accountant)**

The person assigned responsibility for collecting revenue and spending is known as the treasurer. The treasurer is guardian of, and responsible for keeping an itemized account of or record of, municipal funds (AS 29.20.390). Frequently, as authorized by AS 29.20.380(b), the municipal clerk serves as treasurer.

It is important for a municipality to hire competent people to do the actual bookkeeping. Not everyone is trained to do bookkeeping, which requires some specialized skills and knowledge.

## **2. Bookkeeping Systems**

There are two basic types of bookkeeping systems, the modified accrual system and the cash system.

### **Modified Accrual System**

Under the modified accrual system, revenues are generally recorded when received with the exception that any taxes due to the municipality and any charges for services are recorded as revenue when owed. This bookkeeping system also requires that expenditures be recorded when owed, rather than when paid. For example, payment for fuel oil is recorded as an expense when the bill is received and approved for payment, whether actual cash payment is made at that time or 60 days later. There are potential problems with this system because sometimes people don't pay, so the record doesn't reflect the reality.

### **Cash System**

Under the cash system, money is recorded as revenue when it is received. For example, money owed the municipality for a utility bill is not recorded as revenue until the bill is actually paid and received. Under this system, expenditures are recorded when paid. For example, the purchase of fuel oil would be recorded as an expense when the fuel bill is paid.

Neither system is necessarily better than the other is. However, the modified accrual system is complex and requires a bookkeeper with more training and experience than is necessary for the cash system. Also, the cash system directly provides a record of cash available for city business while an accrual method does not. The cash system is the most widely used by rural municipalities in Alaska.

### 3. Bookkeeping Records

Regardless of which bookkeeping system is used, the system is based on a logical and systematic approach to recording and summarizing transactions. Records are primary sources of bookkeeping information. There are three basic records used for the cash basis system of bookkeeping:

- Source documents
- Journals
- Ledgers

#### Source Documents

Source documents are the original record of a financial transaction. Examples include:

- Cash receipts.
- Sales tax returns.
- Deposit slips.
- Cancelled checks.
- Invoices.
- Purchase orders.
- City council authorizing ordinances.

Source documents are used to verify bookkeeping records and are often relied upon by auditors to reconstruct the books of a municipality that have not been properly kept. It is important to keep source documents in an organized fashion.

#### Journals

Based on the source documents, transactions are first recorded in one of several journals. The journal, or 'book of original entry', is a day-by-day record of transactions. A journal records all the information about any one transaction in one place.

There are four journals that form part of the basic record keeping system:

- **Cash Disbursement Journal** is used to record deposits and checks written and which accounts to charge.
- **Cash Receipts Journal** is used to record all cash received and where it came from.
- **Payroll Journal** to record all paychecks and payroll deductions, and which accounts to charge.
- **General Journal** to record other accounting transactions or adjustments that does not properly belong in the other three journals.

## **Ledger**

The journals are supported by source documents, and, in turn, support postings in the general ledger. The general ledger is used to record total revenues and expenditures relating to a particular service or account. By totaling expenses monthly from the journals and recording them in the general ledger, the treasurer has an up-to-date record of expenses for each account. Without a ledger, the treasurer would have to add up each individual expense from the journals every time it was necessary to determine the cost of a service or account.

The transfer of information to the general ledger from the journals is referred to as **posting**. This posting is based upon established accounts as identified in the **chart of accounts**. A chart of accounts is a labeling system used to organize information for the various asset, liability, equity, revenue, and expenditure accounts, which is created based on the revenues and expenditures identified in the budget. This is essentially a listing of the items identified in the budget

Ledger bookkeeping is a step by step process that requires training in the system being used to arrive at year-to-date totals. Most small rural municipalities with relatively few activities do not maintain general ledgers.

An understanding of the total system from source documents to annual budget reports is necessary for anyone involved in the bookkeeping system. DCED publishes the Model Financial Record Keeping System, which provides a very good overview of a record keeping system that works well for small rural communities. This is a manual system, meaning most transactions are hand written, rather than using a computer. It also serves as a good introduction and overview for municipalities that are using a computerized record keeping system.

## **Financial Reporting**

AS 29.20.500 requires that the municipality's chief administrator -- the mayor or manager, -- make monthly financial reports to the governing body.

These monthly financial reports inform the council on where money is being spent, what revenues are being received, the effectiveness of the municipality's administration in carrying out the goals of the governing body and how well it is following the budget, and generally, the financial health of the municipality.

To accomplish these monthly reports administrative staff:

1. Balance the checkbook each month and reconcile it against the bank statement to ensure that no bookkeeping errors have been made in the checkbook or by the bank.
2. Summarize the financial activities for the month. All revenues and expenditures should be totaled and itemized in a written report. The report should provide a monthly comparison of the actual dollars received and spent, against budget figures. It can also provide a sense of how well the budget is progressing.

The example below shows a quarterly report that includes a variance analysis. The example shows second-quarter budget estimates for each expense item in the "2nd Quarter Budgeted" column. Actual expenditures are subtracted from estimated budgeted expenditures to calculate the **variance**, or how much actual expenditures are greater or less than budgeted expenditures.

<b>EXCERPT FROM SAMPLE QUARTERLY FINANCIAL REPORT</b>				
Administration & Finance	2 <sup>nd</sup> Quarter <u>Budgeted</u>	2 <sup>nd</sup> Quarter <u>Expended</u>	2 <sup>nd</sup> Quarter <u>Variance</u>	Annual <u>Budget</u>
Salaries	12,125	10,515	+1,610	48,500
Payroll Taxes	1,054	934	+120	4,200
Travel & Per Diem	1,500	3,099	-1,599	5,000
Office Supplies	750	526	+224	3,000
Telephone	2,400	2,398	+2	6,000
Utilities	150	156	-6	600
Postage	190	207	-17	750
Insurance	1,000	1,378	-378	3,695
Rent	1,100	1,100	0	4,400
Professional Services	800	388	+412	10,000
Other	<u>1,125</u>	<u>408</u>	<u>+717</u>	<u>4,500</u>
<b>Total Administration &amp; Finance</b>	<b>\$22,194</b>	<b>\$21,109</b>	<b>\$1,085</b>	<b>\$90,645</b>

Council or assembly members, reviewing financial reports, may ask for an explanation of expenditure categories that have either high positive or negative variances. Using the example, the council might ask for an explanation of the variances for the "salaries", "per diem", and "other" expenditure categories.

### **Annual Financial Statement**

AS 29.20.640(a)(2) requires that a municipality file with DCED a copy of an annual audit, or, for a second class city, an audit or a statement of annual revenues and expenses. The statement should contain the same basic information and accounts as the treasurer's monthly report. A statement of revenues and expenditures requires a resolution from the city council certifying that the information is true and complete to the best of its knowledge.

The entire bookkeeping system is maintained for the purpose of providing accurate financial information. Management must rely on financial reports to aid them in daily decision making as well as in planning for the future. In addition, the successful preparation and operation of municipal budgets depends upon correct and accurate financial data from the accounting system.

## **Evaluating and Reading Financial Reports**

Financial reports provide information on the organizations finances and how well the budget plan is being followed.

Financial reports are used to analyze variances and make corrections if needed. Many things can happen that change the financial situation after the budget is adopted For example, Revenue Sharing or sales taxes are less than expected, or unexpected equipment repairs or labor costs result in more expenses than expected.

With monthly financial reports the administration can adjust the budget and avoid problems that could be very costly if something is not done. As an example, money may need to be moved from one fund to another, or the level of services may need to be reduced, or investments may need to be postponed to avoid cash shortages. Without an accurate financial report, the administration would not be aware that something needs to be done to avoid financial problems.

Financial reports use the same general categories or funds as the budget to report expenses and revenues. This makes it easier to compare the actual levels of activity with the planned levels in the budget. Monthly financial reports should also be accompanied by a written analysis that alerts the governing body to any problems that need attention. The analysis should describe any possible problems and allow a reasonable amount of time to develop a solution.

### **Special Topics**

#### **1. Internal Control**

Internal controls are procedures used in financial transactions and record keeping that:

- Protect the public assets (money and property); and
- Ensure accurate record keeping.

The chance of error increases with the size of the budget and the risk of error becomes greater with a larger more complex municipal staff. The purpose of internal control is to ensure that all assets (including cash, buildings, land, and equipment) that belong to the municipality are properly recorded, safely protected, and properly disbursed. Systems of internal control operate on the idea that one person should not handle all phases of a transaction from beginning to end. For example, the person receiving the cash should not, whenever possible, be the person who verifies that the cash was received. This; however, isn't always possible so these controls must be built into the record keeping system through a system of receipting revenues, approving expenditures, and limiting authority.

The chief administrative officer is responsible for developing and implementing a system of internal controls. Typically, a system provides for:

- A clear-cut organization plan that defines staff responsibilities for finance and bookkeeping.



- Separation of job duties between authorizing activities (such as check writing) and record keeping (such as recording checks written) to provide a system of checks that detects errors as they occur.
- Use of forms, documents, and procedures that control and provide for proper approval.
- Verification or audit of the records to determine if the municipality's policies, procedures, and bookkeeping practices are being properly followed.

The following discussion illustrates some internal controls used in common transactions of a municipality.

### **Control of Receipts**

A municipality should have some procedures for handling incoming cash and checks. A relatively simple procedure is to have a cash receipt system that involves documenting the receipt of payments as soon as they occur, depositing regularly, and reconciling the bank statements regularly. This system establishes internal control of cash receipts by providing careful documentation and crosschecking the accuracy of the records.

### **Control of Disbursements**

It is important to ensure that payment (disbursement) records are accurate. Generally, all payments should be approved in writing by the person formally authorized to do this (usually the mayor, manager, or in some cases the governing body).

In a lot of cases, this is a simple voucher system where the bookkeeper prepares a voucher after verifying the accuracy of a bill. The financial officer or chief administrator makes sure the payment is justified and, if so, approves the voucher. The check, as an additional control measure, should be signed by more than one person, for example two members of the governing body or the chief administrator in addition to the treasurer.

### **Petty Cash**

The voucher system is not practical for small day-to-day expenses. Cash for postage, small amounts of supplies, light bulbs, and other miscellaneous items, should be disbursed through a petty cash fund.

In this procedure, a check is made out to a designated petty cashier, which is cashed and used to set up the petty cash fund. If an employee needs a small amount of cash to make a purchase for the municipality fills out a petty cash voucher, gets it approved by the appropriate supervisor, and presents it to the petty cashier who gives the employee the needed cash. The employee must get a receipt for any purchases and return it to the cashier. When money in the petty cash fund drops below a certain level, the cashier requests that a check be drawn in the total amount of all the paid petty cash vouchers to replenish the petty cash fund to its original level. It is always a good idea to have two people count the cash at least monthly and sign off on the amount.

## **Bank Accounts**

Except for small petty cash purchases under \$15.00, all financial transactions must be done by check in order to document the transaction and provide a paper trail. Using the monthly bank statement of transactions and all cancelled checks paid by the bank, the bookkeeper can check the municipality's books against the bank statement to be sure they agree. Following is a summary of the procedure.

To the bank statement balance do the following:

- Add deposits not yet recorded by the bank.
- Subtract outstanding checks.

To the checkbook balance do the following:

- Add amounts that have been paid automatically by the bank (interest, notes, etc.) but not recorded in the checkbook.
- Subtract bank charges not yet recorded in the checkbook (service charges, non-sufficient funds charges, etc.).

If the two totals agree, the account is reconciled. If the totals do not agree, steps may be needed to identify the reason.

Reconciling an account will show whether the bank or the municipality has made any errors in the account and protects against unauthorized use of public money.

## **2. Payroll Records**

Payroll records track wages paid to an employee, authorized payroll tax deductions the municipality is required by law to withhold from gross wages, and other authorized deductions. The following withholding tax records must be kept:

- Federal Income Tax.
- Social Security Tax (Federal Insurance Contribution Act).
- Medicare.
- Unemployment Insurance Tax (Employment Security Contribution).

The municipality should maintain, the following records to comply with the information required by state and federal agencies:

- Payroll Journal -- A payroll journal records gross pay, all required and authorized deductions, and net pay for all employees for each payroll period.
- Individual Pay Record -- An individual pay record is a document used to record the earnings and deductions of an individual employee for each payroll period and for the entire year.

- Time Cards -- Time cards must be filled out by all employees. Time cards are reviewed and approved by the employee's immediate supervisor, and submitted to the person doing payroll. The amount to be paid and deductions are calculated from the individual pay record. A check is prepared and issued in accordance with payroll disbursement procedures. File and keep time cards.

If the municipality has legal and financial problems with state and federal governments based on payroll deductions or non-payment of taxes, complete and accurate records may help resolve the problem. The Internal Revenue Service requires payroll records of each employee be kept for at least four years following either the tax due date or the date the tax was paid, whichever is later. Some may decide to keep tax records for at least seven years, since an audit may be required that might reach back that far.

### **Payroll Accounting**

A good payroll accounting system assures employees are paid accurately and federal and state taxes are paid correctly and on time. A basic payroll system includes:

- Procedures and rules to follow to comply with federal and state tax laws.
- Procedures for summarizing or totaling the various earnings and deductions of all employees to complete required quarterly payroll reports.
- Organized records for accurately preparing payroll tax returns and deposits.

### **3. Grants Records and Administration**

State and federal grants significantly impact a small municipality. Grants provide money for construction projects, programs, and services that would not otherwise be possible. However, along with the receipt of grant funds, the municipality accepts the responsibility for using the grant only for specified purposes and for keeping accurate and up-to-date records to document the use of these funds.

It is possible to track grant funds and general funds without having separate checking accounts. Usually, grants are kept in a fund separate from the general fund to avoid commingling funds awarded to the municipality for specific purposes. Often the grantor agency will require that such funds be kept in a separate account.

Establishing a reputation for good grant administration is important when seeking grants. Agencies are more likely to fund communities that are competent and conscientious about administering a project.

The following guidelines will help assure proper grant administration:

Keep grant funds in a separate account for:

- Ease in tracking expenditures.
- Ease in locating information needed for reports.
- Ease in auditing.

Provide all reports on time:

- Record all deadlines and reporting requirements on your desk calendar at the beginning of the project.

Make sure reports are complete:

- Ask for assistance whenever necessary.

Document everything relating to the grant:

- Keep phone logs of all conversations.
- File all notes, correspondence, and summaries of phone conversations and meetings relating to the project.
- Keep and file all invoices and records of project-related financial transactions.

Ask for assistance:

- All agencies expect some questions or problems during the course of a project.
- Express your need for assistance as soon as you decide it is needed. Agencies want to solve problems before they get out of hand.

Get management assistance if it is required:

- Make sure you have enough project-related experience to carry out the project. If the municipality feels that expert help is needed, ask for it.

Review policies and procedures with the granting agency:

- Make sure all local procedures will comply with the granting agency's requirements.
- Get granting agency's recommendations in writing for any changes in the scope of the grant.

#### **4. Managing Cash Flow**

**Cash flow** is a term that refers to the timing of money coming into the municipality's accounts (accounts receivable) and the amount going out (accounts payable). A municipality's financial condition may be good but may have a "cash flow" problem in that at times there is not enough money in the bank to pay bills. This situation is a cash flow problem.

Following are guidelines to help alleviate cash flow problems:

- Prepare a month-by-month cash flow schedule of expected revenue and expenses.
- Plan for and maintain extra money in accounts to cover emergencies and other unexpected expenses.
- Refer to the cash flow schedule before authorizing any new expenditure.
- Revise the cash flow schedule when necessary to make sure it accurately reflects the revenue and expenditure projections.
- Follow approved administrative procedures to make sure all controls for obligating and spending money are followed.

## **5. Borrowing Money**

For smaller Alaskan municipalities, borrowing money is not practical. Long-term borrowing has conditions that most second class cities, and some first class cities, simply cannot meet. Short-term borrowing may be possible, but it should only be used in special circumstances and should be tightly controlled.

### **Short-term Borrowing**

Occasionally, a municipality finds itself in a situation where it is unable to meet current financial obligations because. This is usually because money that was planned for has not been received. For example, a city may expect a revenue sharing check on January 1, which did not arrive until March 1. Between January and March, the city still has financial obligations but, because it has not received the expected funds, it is unable to pay its obligations. As discussed earlier, this is referred to as a cash-flow problem. The city might decide to get a short-term loan to meet current obligations with the short-term loan backed by guaranteed revenues, such as the revenue sharing check due the city. This is known as a revenue anticipation note.

### **Revenue Anticipation Notes**

State law, AS 29.47.010, allows a municipality to borrow in anticipation of revenues for that year, but all money must be paid back before the end of the next fiscal year.

Revenue anticipation notes obligate a municipality's resources and require a pledge of the "full faith, credit " of the municipality issuing them. A municipality considering revenue anticipation notes should get professional advice.

### **Equipment Purchases requiring short-term Financing.**

Municipalities occasionally find themselves in need of equipment that they are unable to pay cash for. In these instances, it may be necessary to get a loan. Usually, the equipment being purchased is used to guarantee the loan. Professional advice is usually not necessary when considering this type of loan. However, it is a good practice to consult an attorney before entering into any contract that obligates municipal resources.

## **Long-Term Borrowing (Bonds)**

Bonds are used to finance capital improvements, facilities, or equipment that because of their high cost require long-term financing. When a municipality issues bonds it issues a legal note to an individual, group, or corporation in exchange for money. The note, as issued, promises to repay the money borrowed over a specified period of time. Like loans from a bank, bonds pay interest to those who purchase them from the municipality.

**Revenue Bonds.** Revenue bonds are bonds issued and repaid from money earned by charging the users of a particular facility or service. Examples of facilities or services financed might include water or sewer service systems, electrical utilities, or public buildings that may be supported from leases or other income.

**General Obligation Bonds.** General obligation bonds are sometimes referred to as G.O. bonds. G.O. bonds are bonds issued by a local government with assurance that they will be repaid by money received from local taxes. The bond is a general obligation of the entire municipality issuing them. The full faith and credit of the municipality are pledged to pay back the principal and interest. AS 29.47.190 requires voter authorization before G.O. bonds may be issued.

Before entering into the bonding process it is strongly recommended, that the municipality employ the professional help of bond counsel (an attorney familiar with bonding practices).

## **The Alaska Municipal Bond Bank**

The goal of Department of Revenue's Alaska Municipal Bond Bank is to assist local governments with the financing of capital projects. The Bond Bank was established to assist Alaska municipalities that have difficulty financing capital improvement projects such as schools, water and sewer systems, public buildings, and harbors and docks. The Bond Bank is a public corporation, created through the passage of the Alaska Municipal Bond Bank Act (AS 44.85).

The Bond Bank was created because smaller communities or infrequent issuers of debt are often at a disadvantage in the financial markets. They may have low bond ratings or, although credit worthy, have not issued bonds or notes, have little outstanding debt, or are unfamiliar to investors. Because the Bond Bank has received an "A" rating from both Moody's and Standard & Poor's, it is able to borrow money at better interest rates.

Generally, the Bond Bank sells its bonds on the national market and uses the money from the bond sales to buy the bonds of Alaskan municipalities. This provides these municipalities with the funds for the construction or purchase of their capital projects. As municipalities pay principal and interest to the Bond Bank on their debt, the Bond Bank uses these payments to pay its debt to its bondholders.

The Bond Bank can be reached as follows:

Alaska Municipal Bond Bank Authority  
Deven Mitchell, Executive Director  
P.O. Box 110405  
Juneau, AK 99801  
Phone: (907) 465-2388  
Fax: (907) 465-2902  
E-Mail: AMBBA@revenue.state.ak.us

Physical address for express mail:  
Alaska Municipal Bond Bank Authority  
333 Willoughby Avenue, 11th Floor  
Juneau, AK 99801

## **6. Managing City Investments**

Some municipalities do not have the luxury of an excess of funds; however, some do have some money available for investing. Investing these excess funds essentially puts them to work to generate more revenue, rather than just maintaining the value.

There are many opportunities for investment of public funds. Some offer higher rates of return but often require the investor to accept more risk. Be careful not to be attracted to investments that promise high yields without thoroughly investigating the risks involved and the accuracy of statements made by the sales agent representing these investments.

Because there are so many choices, investing can be confusing. The following factors should be considered before making an investment:

### **Risk**

Risk refers to the chance of losing money as a result of the investment. An individual may be willing to take certain risks, even large risks, in hopes of making a lot of money in a short period of time. However, when investing public funds it is very important that risks be kept to a minimum.

### **Liquidity/Flexibility**

The liquidity, or flexibility, of an investment refers to the investor's ability to turn an investment into cash quickly. This is important if the money is needed for an unexpected expense. Some investments impose heavy penalties if money is taken out before a specified time. Some basic principles governing liquidity/flexibility are:

- More liquid investment has less chance of earning a lot of money quickly.
- Less liquid investments have more chance of earning a lot of money quickly, but they are more risky.

With these principles in mind, ask:

- Will the investment money possibly be needed on short notice?
- If so, can the municipality afford to lose some of the gain on the investment?

### **Yield/Income**

The yield of an investment refers to the amount of money it will return, or yield, over a given period of time, such as money that is earned in fixed interest or the appreciation (increase) of the value of the property. The two basic questions governing yield are:

- How long does the municipality want to invest the money?
- How much risk is the municipality willing to take?

The yield on investments will relate directly to the answers to these questions.

### **Savings Accounts**

Savings accounts are by far the most common way to invest funds. Usually, they yield a very small rate of interest compared to other investments. However, they do offer good liquidity and low risk to the investor.

Most municipalities maintain small savings accounts that are used as reserve accounts. Because other types of investments usually yield higher returns, savings accounts are not generally thought of as high yield investments.

### **Time Certificates of Deposit (TCD)**

Time certificates of deposit are an agreement between the depositor and the bank. The depositor agrees to leave a certain amount of money in the bank for a specific period of time. In turn, the bank agrees to pay a certain rate of interest to the depositor.

An advantage of the TCD is its low risk and guaranteed, relatively high yield, which is usually higher than the interest paid on savings accounts.

One disadvantage of TCDs is that they offer fixed rates of return during a set time period. Should you withdraw the money before the TCD matures, an interest penalty is assessed. They, therefore have little flexibility.