

FLORIDA ASSOCIATION OF
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Steven Alexander, CCM
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Dear Steven:

Enclosed is a copy of Standard & Poor's (S&P) review of Florida's Local Government Investment Law. As the article shows, this law is truly a model statute. S&P Notes that "the Florida statute (Chapter 95-194, s 218.415) generally mirrors Standard & Poor's guidelines."

I feel that the S&P article is another confirmation of the importance of the investment law. Consequently, I would like to extend my thanks to you, Hon. Martha Haynie, and Jim Moye for all of your hard work and leadership in the development and implementation of this legislation.

Sincerely,

Kenneth A. Kent
Director of Management Services

Enclosure

Cc: Hon. Martha O. Haynie
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CREDITWEEK

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THE AUTHORITY ON CREDIT QUALITY

APRIL 8, 1996

FLORIDA LOCAL INVESTMENT LAW STRESSES SAFETY, LIQUIDITY

Florida has enacted legislation to heighten local governments' awareness of investment policies. The legislation—crafted in response to investment losses by several local governments, both nationally and in the state—stresses the safety of capital and liquidity of funds invested for operating purposes.

The impact of this legislation will not be known until the fiscal 1996 audits and investment reports are complete. However, Standard & Poor's expects that the additional investment reporting requirements will enhance the public credit market's ability to determine whether Florida issuers are following prudent investment policies for operating funds. The legislation does not impose requirements for funds invested for purposes other than operations—such as pension funds.

Under the legislation, written investment policies for operating funds are required for every local government that invests in instruments outside an approved list. Standard & Poor's general operating fund investment guidelines are based on what it considers "normal, prudent" investment policies and generally suggest that local governments' operating funds be placed in safe short-term and liquid investments.

The Florida statute (Chapter 95-194, s 218.415) generally mirrors Standard & Poor's guidelines. However, it does not require reporting to an outside monitor to ensure that the local investment policies guidelines are followed. Rather, annual investment reports must be made publicly available by the local government.

Standard & Poor's formal investment criteria historically have been directed at structured financings and debt service and reserve funds held in trust for various revenue bond securities. There are no formal rating requirements for investment of operating funds, as state and local government finance officers, by and large, tend to invest conservatively, based on internal policies or state legislated restrictions that emphasize the safety of principal and liquidity over the desire for higher yields. If losses occur on municipal investments, normal general-purpose govern-

ments and those charged with the operation of essential municipal enterprises still maintain control over taxation and rate setting to make up for investment shortfalls. Issuers that deviate from Standard & Poor's guidelines are examined individually to determine the impact, if any, their investment practices have on their credit ratings.

The statute was enacted in May 1995 and applies to cities, counties, court clerks, school boards, and special districts. It required each local government to adopt written investment policies by Oct. 1, 1995, if they invest in securities outside of the approved list defined in the legislation, and establish a written system of internal controls and operating procedures by Jan. 1, 1996. Fourteen standards were established for written investment policies. According to the results of a survey conducted before the legislation was enacted, only half of Florida's counties had policies for investing public operating funds.

The local government's chief financial officer must report annual investment results and the local government's auditor is required to verify adherence to the policy. If a local government invests in securities established in the approved list of instruments, a written investment policy is not required.

The approved list includes:

Local Government Surplus Funds Trust Fund, or any intergovernmental investment pool authorized through the Florida Interlocal Cooperation Act;

SEC-registered money market fund with the highest credit quality from a nationally recognized rating company;

Savings accounts in state-certified qualified public depositories;

Certificates of deposit in state-certified qualified public depositories;

Direct obligations of the U.S. Treasury; and Federal agencies and instrumentalities.

All funds should be invested according to known cash-flow needs, and maturities should match the requirements.

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The written policy must address the following 14 standards:

Scope. The investment policy applies to those funds that exceed the amount required to meet short-term expenses. It does not include the investment of pension or bond funds.

Investment objectives. The investment objectives include safety of capital, liquidity of funds, and investment income, in that order.

Performance measurement. The policies must develop the appropriate performance measurements, based on the size and nature of the government's public funds.

Prudence and ethical standards. The standards must include the Prudent Person Rule, defined as, "Investments should 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, for investment, considering the probable safety of their capital as well as the probable income to be derived from the investment."

Authorized investments. The investment policy shall list all authorized investments. The use of derivatives (defined as a financial instrument whose value depends on, or is derived from, the value of one or more underlying assets or index or assets values) must be specifically authorized and the unit of government's chief financial officer has sufficient understanding and expertise to manage them. The use of reverse repurchase agreements is prohibited or limited to transactions where the proceeds are intended to provide liquidity.

Maturity and liquidity requirements. The policy should be structured to provide sufficient liquidity to meet daily obligations. Therefore, to the extent possible, the maturities of investment should be made in accordance with known cash-flow needs.

Portfolio composition. Policies shall establish guidelines for investments and limits on security issues, issuers, and maturities. Guidelines will correspond to the unit of local government's size and nature of public funds.

Risk and diversification. The policy shall provide for appropriate diversification of the investment portfolio to control the risk of loss resulting from over-concentration of assets in a specific maturity, issuer, instrument, dealer, or bank. Diversification strategies shall be reviewed and revised periodically.

Authorized investment institutions and dealers. Policies should specify the authorized securities issuers, banks, and dealers from whom the unit of local government is able to purchase securities.

Third-party custodial agreements. Policies must include arrangements for the holding of securities assets by a third party designating that the held assets and/or collateral are those of the unit of local government. Securities must not be withdrawn by anyone except an authorized staff member of the local government. To ensure that the custodian will have the security or money at the conclusion of transactions, transactions between a custodian and a broker-dealer involving the sale or purchase of securities must be made on a delivery versus payment basis.

Master repurchase agreement. Policies must require all approved institutions and dealers involved in repurchase agreements to perform these transactions according to a master repurchase agreement.

Bid requirement. Policies must specify that after a local government has analyzed and selected one or more optimal types of investment, the security must be competitively bid, when feasible and appropriate.

Internal controls. Policies must provide for internal controls and operational procedures. The chief operating officer must establish a written system of internal controls and operational procedures by Jan. 1, 1996. Policies must include provisions for the review of such internal controls by independent auditors as part of any financial audit required by the local government. Internal controls should be designed to prevent the loss of funds by fraud, employee error, misrepresentations by third parties or imprudent action by employees of the local government.

Reporting. Policies shall include at a minimum annual reporting of investment results by the chief financial officer of the local government. Such reports are to include securities in the portfolio by class/type, book value, income earned and market value as of the date of the report and are made publicly available for review.

No comprehensive survey has been conducted to determine the impact of this legislation. However, it is expected that many local governments may amend existing investment policies to adhere to the new requirements and some may adopt written investment policies for the first time.

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