

USING GFOA BEST PRACTICES TO AVOID BECOMING THE PIÑATA

(AND TO BECOME THE BEST)

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A Mistake Occurs...



Press Finds Out...





The Yin and Yang of Best Practices

- Becoming the best is as much about:
 - avoiding the bad
 - as it is doing the good
- Because Murphy doesn't just have a law:
 - He has a weighting scale, and on his scale...
 - Bad always weighs more than an equal amount of good

16 oz of good



12 oz of bad

In Other Words...

- You Must **Survive** Before You Can **Thrive**

- and surviving in a public sector environment means keeping
 - you, your department, and your government

- from becoming the piñata
whether its with your:



- governing board, press, rating agencies, regulators, social media or all of the above

Session Objectives

- Familiarize participants resources available through GFOA best practices and advisories
- Indicate practical applications for best practices in improving financial operations and avoiding problems
- Discuss selected best practices and their recommendations



BACKGROUND

GFOA Best Practices
and
Advisories

1993 initiative

- Identify “recommended practices” in each of the major functional areas of public finance
 - Accounting, auditing, and financial reporting
 - Budgeting and fiscal policy
 - Debt management
 - Economic development and capital planning (added later)
 - Retirement and benefits administration
 - Treasury and investment management (renamed)

Continued Evolution

- From *recommended practices* to *best practices*
- Distinguish best practices from advisories
- Issued by one or more committees and approved by Executive Board
 - Overlapping topics will be coordinated with all affected committees
- On going review of current documents for needed revisions
 - Often more revisions to existing BPs, than brand new topics
- On going review of industry developments for needed guidance
- BP's are written to be both understandable and concise (about two pages) similar to an executive summary
- Available for free at: <http://www.gfoa.org/best-practices>

Best practice

- Definition
 - Identifies specific policies and procedures as contributing to improved government management. It aims to promote and facilitate positive change rather than merely to codify current accepted practice. Partial implementation is encouraged as progress toward a recognized goal.
- Emphasis
 - Change agent vs. codification of current practice
 - Partial implementation is encouraged

Advisory

- Definition
 - Identifies specific policies and procedures necessary to minimize a government's exposure to potential loss in connection with its financial management activities. It is not to be interpreted as GFOA sanctioning the underlying activity that gives rise to the exposure.
- Emphasis
 - Goal = minimize potential loss
 - Not an approval of the underlying activity

Piñata Prevention Tip

- Know which topics you deal with that have Advisories issued for them
- Proceed with extreme caution

This will solve that huge problem...



Whoops, maybe not...



We're far worse off than we were before...



Existing Advisories

- Commission Recapture Program (2010)
- Deferred Retirement Option Plan (2005)
- Electronic Vendor Fraud (2017)
- Ensuring the Safety of Reverse Repurchase Agreements (2010)
- Evaluating the Sale and Securitization of Property Tax Liens (1997)
- Modified Approach for Infrastructure Reporting (2005)
- Offering Statements and the Auditor's Role (2006)
- Other Post Employment Benefit (OPEB) Obligation Bonds (2016)
- Pension Obligation Bonds (2015)
- Public Private Partnerships (P3) (2015)
- Responsible Management and Design Practices for Defined Benefit Pension Plans (2010)

Existing Advisories (continued)

- Securities Lending Programs for Non-Pension Fund Portfolios (2010)
- Selecting Investment Advisors for Pension Fund Assets (2000)
- Special Revenue Funds Used for Budgeting but not Financial Reporting (2012)
- Underwriter Disclaimers in Financial Statements (2000)
- Use of Debt-Related Derivative Products (2015)
- Use of Derivatives and Structured Investments by SLG for Non-Pension Fund Investment Portfolios (2010)
- Using Alternative Investments for PERS and OPEB Established Trusts (2009)
- Using Commercial Paper in Investment Portfolios (2009)

Practical Uses for Best Practices

- Best practices can be used to:
 - Create credibility with elected officials and top management through knowledge of and adherence to BPs
 - Advocate for policy changes or justify actions when challenged
 - Identify areas needing improvement in existing operations
 - Train staff in new areas
 - Identify emerging issues
 - Avoid problem areas

Current Status (September 2017)

- Best practices – 157* Advisories – 19*

• Financial Policies	(9/0)
• Accounting, Auditing and Financial Reporting	(31/4)
• Auditing	(4/1)
• Accounting	(12/1)
• Internal Controls	(6/0)
• Financial Reporting	(9/2)
• Budgeting and Fiscal Policy	(30/0)
• Debt Management	(23/5)
• Economic Development and Capital Budgeting	(25/1)
• Financial Management	(22/0)
• Retirement and Benefit Administration	(37/9)
• Technology	(2/0)
• Treasury and Investment Management	(28/5)

* Certain BPs/Advisories are assigned to more than one category resulting in subtotals exceeding 157/19

Recent Best Practices (September 2016 & January 2017)

- **Cash Flow Analysis**-Treasury and Investment Management
- **Investment Policy**-Treasury and Investment Management
- **Establishing and Administering an OPEB Trust**-Retirement and Benefit Administration
- **OPEB Governance and Administration**-Retirement and Benefit Administration
- **Educating Employees about the Adequacy of Retirement Benefits**-Retirement and Benefit Administration
- **Hybrid Retirement Plan Design**-Retirement and Benefit Administration
- **Electronic Payments**-Treasury and Investment Management
- **Refunding Municipal Bonds**-Governmental Debt Management

Hot Off the Press (September 2017)

- **Negotiating Economic Development Agreements-** Economic Development and Capital Budgeting
- **Developing and Economic Development Policy-** Economic Development and Capital Budgeting
- **Investment Policies for Defined Benefit Plans-** Retirement and Benefit Administration
- **Investment Policies for Tax Deferred Retirement Savings Plans-** Retirement and Benefit Administration
- **Post-Issuance Policies and Procedures-** Debt
- **Primary Market Disclosure-** Debt
- **Electronic Vendor Fraud- Advisory-** Treasury and Investment Management

PIÑATA PREVENTION

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Don't Be This Guy



Internal Controls and Management Involvement

- Ties both the safeguarding of assets and the reporting of financial information back to our ethical responsibilities as government finance officers and GFOA's Code of Professional Conduct
- **These ethical responsibilities cannot be met without a sound system of internal controls**
- Specific Recommendations:
 - Managers should obtain the training and knowledge of COSO's internal control framework to be able to take responsibility.
 - Managers should also ensure that staff is adequately trained and informed to fulfill their duties.
 - Internal controls should be documented in writing
 - Internal controls should be periodically evaluated for needed changes
 - Identified weaknesses should be corrected on a timely basis.

Internal Control Framework

- Provides background on 2013 COSO update
 - Five elements (control environment, risk assessment, control activities, information and communication and monitoring)
 - 17 principles
 - Numerous points of focus
- GFOA recommends adoption of the 2013 Integrated framework as a conceptual basis to ensure adequate controls by:
 - Establishing a framework that contains each of the five elements
 - Using the related principles to ensure that each of the elements is functioning properly
 - Ensuring that the individual elements complement each other operate effectively together

Internal Control Environment

- With the 2013 update of COSO's internal control framework which provided principles for each internal control element, GFOA is providing a best practice for each element with this being the first.
- GFOA recommendations:
 - Governing body and all levels of management should demonstrate a commitment to internal control environment
 - The governing body should oversee internal control by
 - Actively overseeing implementation of the framework
 - Actively monitoring performance of the framework
 - Establishing an audit committee
 - Obtaining expert advice
 - Management should:
 - Organizational structure for accomplishing its objectives
 - Develop written control procedures adequate to address risks
 - Ensure competent, trained personnel
 - Enforce accountability for carrying out expectations

Purchasing Card Programs

- Describes the advantages of purchasing cards
- Describes the disadvantages of purchasing cards
- GFOA recommends:
 - Careful procurement process to ensure vendor provides all necessary tools to administer program and is the best value to the government
 - Written policies and procedures for the program
 - Stressing employee and department responsibility
 - Clear expectations on proper purchases and required documentation
 - Appropriate card limits
 - Continued segregation of duties and approval
 - Regular reviews of spending



OTHER SELECTED BEST PRACTICE GUIDANCE

Accounting, Auditing, and Financial Reporting

Capital assets (1/2)

- Capitalization thresholds
 - Never less than \$5,000
 - Apply to individual items rather than to groups
- Maintaining control over items under threshold
 - Focus
 - Object of legal compliance
 - Potentially detrimental to public safety
 - Heightened risk of theft (“walk away” items)
 - Primary control – departmental level
 - Oversight – finance department

Capital assets (2/2)

- Physical inventories
 - At least ever five years
- Determining estimated useful life
 - Best source: own past experience
 - Alternative: experience of others
 - Adjust for particular circumstances
 - Quality
 - Application
 - Environment
 - Circumstances mitigated or exacerbated by maintenance program

Fund accounting

- Distinguishing “funds” used for internal purposes from funds used for financial reporting purposes
- Educating elected officials regarding the proper use of funds
- Establish criteria for external funds
- Periodically review application of criteria
- Common combinations
 - Debt service funds
 - Capital projects funds
 - Grants for similar purposes

Budgetary comparisons

- Present budgetary comparisons for general fund and major special revenue funds within the basic financial statements
 - Maintains strong link between financial reporting and budgeting
 - Enhances credibility of both

Use of website

- Primary means of communicating financial information
- Specific guidelines
 - Formatting
 - Technological infrastructure
 - Electronic financial reporting language
 - Distribution
 - Information disclaimer
 - Historical information

Popular reports (1/2)

- Should be used to supplement the comprehensive annual financial report (CAFR)
 - Issue within 6 months
- Characteristics
 - Refer to the CAFR*
 - Attract and hold interest
 - Be easy to understand
 - Use simple and attractive format
 - Be written clearly and concisely
 - Avoid jargon
 - Make appropriate use of graphics

Popular reports (2/2)

- Characteristics (cont.)
 - Explain items of special importance*
 - Offer comparative data to help identify trends
 - Be distributed appropriately*
 - Be creative
 - Invite feedback
 - Be balanced and objective*

Timely financial reporting

- Timeliness essential
 - Minor gains in precision cannot justify indefinite delay
 - Better to proceed based on estimates
- Recommendations
 - Record transactions throughout the year
 - Implement GASB standards early
 - Electronic distribution
 - Include dates in contracts for professional services

Appropriate level of fund balance in general fund (1/4)

- Goal – mitigate current and future risks
- Focus on *unrestricted fund balance*
 - Committed fund balance
 - Assigned fund balance
 - Unassigned fund balance
- Formal policy
 - Target level
 - Framework and process to increase or decrease over time
 - How to replenish if below target level

Appropriate level of fund balance in general fund (2/4)

- Appropriate level
 - Minimum = 2 months of
 - Regular operating revenues
 - Regular operating expenditures
 - Factors that may require higher levels
 - Predictability of revenues
 - Volatility of expenditures
 - Exposure to one-time outlays
 - Potential drain from other funds
 - Potential impact on bond ratings and cost of borrowing
 - Commitments and assignments
 - Special case of largest governments

Appropriate level of fund balance in general fund (3/4)

- Use and replenishment
 - Time period and contingencies for use
 - Adjustments to revenues and expenditures
 - Time period and means of replenishment

Appropriate level of fund balance in general fund (4/4)

- Replenishment 1-3 years, adjusted for
 - Budgetary reasons behind the fund balance targets
 - Recovering from an extreme event
 - Political continuity
 - Financial planning time horizons
 - Long-term forecasts and economic conditions
 - External financing expectations
- Revenue sources
 - Nonrecurring revenues
 - Budget surpluses
 - Excess resources in other funds

Appropriate level of working capital in enterprise funds (1/2)

- Working capital plays role similar to fund balance
- Establishing a target
 - Baseline – 90 days
 - No lower than 45 days
- Factors affecting selection of target level
 - Support from general government
 - Transfers out
 - Cash cycles
 - Consumer concentration
 - Demand for services

Appropriate level of working capital in enterprise funds (2/2)

- Factors affecting selection of target level (cont.)
 - Control over rates and revenues
 - Asset age and condition
 - Volatility of expenses
 - Control over expenses
 - Management plans for working capital
 - Separate targets for operating and capital needs
 - Debt position

Trend data

- Analysis
 - Consider percentage relationship among data elements over time
 - Use no less than five and no more than ten years of data
 - Take into account items that might distort trends

Comparative data

- Analysis – consider:
 - Level and type of government
 - Scope and quality of service
 - Number served
 - Definitions of categories
 - Inter-regional comparability
 - Potential effect of depreciation
 - Using trend data

Tax abatement transparency (1/2)

- Needed context for GASB disclosure
- Location = letter of transmittal
- Contents
 - How to access other documents (budget, economic development plan, board minutes) for complete cost/benefit analysis
 - How handled in the budget process
 - What the government hopes to achieve and how return on investment is determined
 - Those responsible for monitoring compliance

Tax abatement transparency (2/2)

- Contents (cont.)
 - Relationship between tax abatements and the government's goals set forth in its strategic plan;
 - Five-year chart of benefits anticipated and received due to the abatement (both financial and other)

Documenting accounting policies and procedures

- Promulgated at appropriate level to emphasize importance and authority
- Updated on predetermined schedule
 - Changes also made as they occur
 - Employee assigned for this purpose
 - Management to oversee performance
- Documentation should be
 - Be readily available (e.g., electronic)
 - Delineate authority and responsibility
 - Present actual v. ideal controls
 - Explain design and purpose of controls

Audit committees (1/2)

- Purpose
 - Practical means for governing body to meet its responsibility
 - Needed to ensure direct communication between governing body and auditors
- Every government formally establish an audit committee
 - Document
 - Periodically review
- Auditors report directly to the audit committee

Audit committees (2/2)

- Committee members
 - Should be members of the governing body
 - Need only a basic understanding of accounting and auditing
 - Should be educated as to responsibilities
 - Should have support of a “financial expert”
- Audit committee should
 - Have adequate funding
 - Review and oversee financial reporting processes, internal controls and independent auditors
 - Make an annual report



OTHER SELECTED BEST PRACTICE GUIDANCE

Budgeting

Financial policies (1/6)

- Central to a strategic, long-term approach to financial management
- Arguments for formal, written financial policies
 - Institutionalize good practices
 - Clarify and crystallize strategic intent
 - Define boundaries
 - Support good bond ratings
 - Promote long-term and strategic thinking
 - Manage risks to financial condition
 - Comply with public management best practices

Financial policies (2/6)

- Basic categories of financial policies
 - General fund reserves & reserves in other funds
 - Grants
 - Debt
 - Investments
 - Economic development
 - Accounting, auditing, and financial reporting
 - Risk management and internal control

Financial policies (3/6)

- Basic categories of financial policies (cont.)
 - Procurement
 - Long-term financial planning
 - Structurally balanced budget
 - Capital
 - Revenues
 - Expenditures
 - Operating budget

Adopting financial policies (4/6)

- Development
 - Define the problem
 - Draft the policy
 - Be aware of legal requirements and consider public comments
 - Look at the experience of peer governments
 - Review and present to government officials
 - Formally consider and adopt policy
 - Implement policy
 - Make sure staff and officials are aware of policies.

Adopting financial policies (5/6)

- Design
 - Written form.
 - Understandable to the intended audiences.
 - Available to all stakeholders
 - Published in more than one medium with multiple means of access.
 - Address all relevant issues and risks in a concise fashion.

Adopting financial policies (6/6)

- Presentation
 - All financial policies placed in the same section of the budget document.
 - Original and revision dates shown for individual policies.

Establishment of strategic plans (1/3)

- To provide a long-term perspective for service delivery and budgeting, thus establishing logical links between authorized spending and broad organizational goals

Establishment of strategic plans (2/3)

- Steps in the process
 - Initiate the strategic planning process
 - Prepare a mission statement
 - Assess environmental factors
 - Identify critical issues
 - Agree on a small number of broad goals
 - Develop strategies to achieve broad goals

Establishment of strategic plans (3/3)

- Steps in the process (cont.)
 - Create an action plan
 - Develop measurable objectives
 - Incorporate performance measures
 - Obtain approval of the plan
 - Implement the plan
 - Monitor progress
 - Reassess the strategic plan

Charges and fees (1/2)

- Consider applicable laws and statutes
- Adopt formal policies regarding charges and fees
 - Justify any departure from full-cost recovery
 - Need to regulate demand
 - Desire to subsidize
 - Competition with private businesses
 - Economic development
 - Elasticity of demand
 - Visibility of the service to the community.
- Calculate the full cost of providing a service to provide a basis for setting the charge or fee

Charges and fees (2/2)

- Review and update charges and fees periodically
 - Impact of inflation
 - Other cost increases
 - Adequacy of cost recovery
 - Use of services
 - Competitiveness of current rates.
- Utilize long-term forecasting to anticipate future costs in providing the service
- Provide information on charges and fees to the public



OTHER SELECTED BEST PRACTICE GUIDANCE

Pension and benefit administration

Core elements of a DB funding policy (1/4)

1. Obtain an actuarially determined contribution (ADC) to serve as the basis for contributions
2. Calculate ADC in a manner that balances goals of 1) keeping contributions relatively stable and 2) equitably allocating costs over' active service
3. Commit to fund the full amount of the ADC each period (reasonable transition period may be needed)
4. Communicate information necessary for assessing progress toward meeting pension funding objectives.

Core elements of a DB funding policy (2/4)

- Practical effect of balancing goals
 - A. Selection of actuarial cost method
 - B. Asset smoothing method
 - C. Amortization policy

Core elements of a DB funding policy (3/4)

A. Selection of actuarial cost method

- Entry age normal (level percentage of pay) especially suitable

B. Asset smoothing method

- Unbiased relative to market
 - Same period for gains and losses
 - Market corridors should be symmetrical
- Smoothing over fixed period
 - Ideally less than 5 years
 - Corridor if more than 5 years
 - Never more than 10 years

Core elements of a DB funding policy (4/4)

C. Amortization policy

- Ideally fall in the 15-20 year range
- Never exceed 25 years
- Layered approach (separately tracks different components to be amortized) that produces either
 - A level percentage of member compensation
 - Level dollar amount

Sustainable funding for pensions and OPEB for defined benefit plans

- Adopt a funding policy with a target funded ratio of 100 percent or more (full funding)
- Select funding and amortization method most closely aligned to funding policy
- Pay contributions regularly
- Have actuarial valuation performed at least biennially
- Have experience study performed at least once every five year
- Independent actuarial audit every 5-8 years
- Prepare a plan CAFR and summary information for participants

Electronic Vendor Fraud

•Background

- Vendor fraud is submission of fake documents to change the bank account numbers for electronic vendor payment deposits.
- Fraudsters might hack e-mail or use a fake e-mail domain to make themselves look like legitimate representatives of a vendor.

•Recommendation

- Put safeguards and internal controls in place to mitigate the risk including:
 - Independently verify vendor change requests
 - Determine whether entity has adequate cyber fraud insurance coverage
 - Ensure IT has adequate controls (firewalls, virus software, spam filters etc)
 - If outside service organization processes payments-has SOC report been obtained?
 - Communicate risks to all employees
 - Empower employees
 - Understand fraudster tactics and stay up with shifts in strategies
 - Supervisor approval of vendor file changes

Future developments

- Reclassification
 - Best practices
 - Specific recommendations
 - Widespread applicability
 - Other resources
 - Specific recommendations on topics of less widespread applicability
 - Factors to be considered in making certain decisions
 - Tools (model policies, checklists)