

# ACCOUNTING GUIDANCE

## Overview of the Administrative System

### *Objectives*

A district's administrative system includes its accounting system, the maintenance of non-accounting records, employee and consultant relations, and other management concerns. An effective administrative and management system for districts includes four important functions:

- safeguarding of assets
- planning and control
- demonstrating legal compliance
- timely reporting

### **Safeguarding of Assets**

Your Board is responsible for the stewardship and protection of your district's assets. The assets may include cash, accounts receivable, investments, inventories, supplies, equipment, buildings, and infrastructure. Your district's administrative system must identify and quantify those assets to ensure accountability. Your Board must also ensure that the district's assets are not used unnecessarily or for non-district purposes.

### **Planning and Control**

An efficient administrative system makes it easier for the district to manage its resources and plan for future events. Your district's accounting system should provide meaningful and accurate reports for the Board's use in controlling operations. Records should be available to inform the Board of past operations, contract provisions, and historical trends. Employee guidelines should provide for employee accountability. The duties of consultants should be specified by contract and monitored on a periodic basis. As mentioned in this *Guide's* Chapter on General Financial Guidance, we recommend that a district issue RFPs on its consultants every five years.

TWC Section 49.199(a)(6)(A) requires the adoption of a formal budget by your Board before the fiscal year begins. The formal budget should be used to help control expenditures and as a reference for decision making. It may also be used as a spending limitation for your staff and consultants should your Board determine that a spending limitation is in the district's best interest. Refer to **Annual Budget** section on page 1-6.

### **Demonstrating Legal Compliance**

A primary concern of your district is compliance with the many state statutes, federal laws and mandates, contractual provisions (including bond orders), and district board resolutions. Your district's record keeping system must retain key records and ensure that those records are readily accessible. Your

district's accounting system must ensure that the funds are separated and used according to the authorizations. The district's personnel and consultant management system must be able to document compliance with federal mandates and contractual agreements.

### **Timely Reporting**

Each district is accountable to the public, state agencies, and its bondholders. Your district's administrative system must ensure that the data required for the annual audit and other reports are captured by the accounting system and that procedures are in place to submit these required reports on a timely basis.

## **Overview of the Accounting System**

### **Checks and Balances**

Your district's accounting system must capture and quantify each change in assets, liabilities, and fund balance. This is done by a double-entry system of bookkeeping which ensures that for each transaction, the affect on assets is balanced by a corresponding effect on liabilities or fund balance; or, for every debit entry there is a corresponding credit entry.

There are a variety of accounting systems and methods, both in manual and automated formats. An accounting system has the following books:

- a general ledger
- general and/or specialized journals (or transaction register)
- a chart of accounts

These books provide the foundation for your district's system of recording, classifying, and reporting accounting information.

### **The Accounting Cycle**

The accounting system gathers and summarizes your district's complete financial data in a clear, concise manner with the intent to organize the information to enable your district's personnel to better perform their duties.

The foundation of an accounting system is the **Chart of Accounts** (Refer to **Appendix B** for a sample Chart of Accounts). This document determines how data is classified and summarized for future reporting. If your district's expenditure accounts are defined as "other" and "miscellaneous" significant details would be lost as many different types of transactions will be merged together in the summaries.

The Chart of Accounts should provide a balance in the level of detail. A very detailed system of accounts will provide more information on specific transactions. However, working with a large number of accounts may be too unwieldy. Most systems provide for summary accounts which consolidate a

number of defined accounts. In this way the details are not lost and the summaries can be used for reporting purposes.

The Chart of Accounts should be accessible to all employees involved in authorizing, classifying, and recording the district's financial data so their use of each account remains consistent throughout the district's records.

The financial data come from many **source documents**. The source documents provide supporting or underlying evidence for all of your district's financial transactions. Examples include: purchase invoices, billing stubs, and cash receipt slips. Since source documents are often the only evidence of a financial transaction, they should be filed in the district's records in a consistent and logical manner for future reference.

Source documents received from or verified by outside parties provide more reliable evidence of accounting transactions than internally generated documents. When it is not possible to obtain external evidence of a transaction, a statement as to the nature of the transaction, the authorization, and the contact person should be included in the district's records and cross-referenced in the journals.

The original book of entry of a transaction into your district's accounting system is usually in a journal (or a **transaction register** for computerized systems). The journals may be highly specialized for the specific type of transaction, or they may be more generic to capture a variety of transactions. The purpose of the journal is to provide a chronological listing of all transactions and how the transactions are classified into accounts, with sufficient references to the source documents. The journals allow for common transactions to be summarized on a periodic basis before posting to the General Ledger.

The total cash received should match the total on the deposit slip recorded by the bank. The increase in cash (a debit) is posted to the **General Ledger** to the appropriate cash account, and the decrease in accounts receivable from the customer (a credit) is posted to the General Ledger account which summarizes the individual account balance.

A check register can act as a **Cash Disbursements Journal** if it is sufficiently detailed to provide a cross-reference to the source document and to the accounts affected by the transaction. The account totals are periodically summarized and posted to the General Ledger. The posting frequency should be according to your district's accounting policies and procedures as documented in your district's manual.

The **General Ledger's** purpose is to organize and summarize the individual transactions listed in the journals. The General Ledger is broken down into the account categories which are listed in your district's Chart of Accounts. The summary totals from the journals are posted to the General Ledger so

that the effect of transactions on each account category can be determined. The General Ledger should cross-reference the journals so you can trace the transaction back to the source.

The General Ledger provides the basis for reporting financial information. All transactions recorded in the journals or by other means should be summarized in the General Ledger under the appropriate account category.

At the end of your district's accounting cycle, the General Ledger is balanced to ensure that the debits and credits are equal. This helps to determine any errors in accounting or data entry; however, a "balanced" set of books **does not** ensure that all transactions have been entered; that the transactions have been correctly classified; or, that the transactions were properly authorized.

### **Authorization**

The most common district transaction is the receipt and disbursement of funds. It is imperative that a formal authorization process be adopted to control the inflow and outflow of district funds. Access to the district's cash (receipts and disbursements) should be limited. In addition, the ability of an individual to both initiate and complete a transaction should be avoided, where possible.

The authority to disburse funds or to credit accounts should be traceable to your Board. This could be in form of direct authorization by the Board of every expenditure or a Board resolution authorizing a person to disburse funds of **up to a set amount**. All direct or indirect authorizations should be a result of board action at an open board meeting and noted in the Board's meeting minutes.

**Vouchers** are often used to indicate the authorization and classification of a disbursement. Vouchers are a form attached to the source document to capture key information necessary to process a disbursement, such as vendor name, vendor code, authorizing initials or signatures, and the transaction classification by account codes. Your Board can use this form to indicate the date of the board meeting where the Board approved the expenditure or other transaction information.

### **Classification**

Classifying transactions is a key component in an accounting system. Transactions should be classified according to the Chart of Accounts (**Appendix B**) by the person most familiar with the nature of the transaction. All personnel who initiate or supervise disbursements should be familiar with your district's Chart of Accounts codes so they can properly identify and classify the transaction.

## Segregation of Duties

Your district's accounting system should include a system of checks and balances, including those precautions mentioned above and procedures detailing a segregation of duties, where possible. A good example of segregation of duties is the separation of operational responsibility from recording responsibility. A bookkeeper should not handle cash nor should the cashier have access to the ledger account records.

Segregation of duties and a formal authorization procedure are examples of elements of internal control. As the size and complexity of your district's accounting system increases so should the district's internal control procedures.

## Internal Control

The topics addressed above form your district's **internal control** procedures. The purpose of an internal control procedure is to provide for the prevention and detection of errors and irregularities occurring in the normal course of business. A sample checklist of internal control procedures is in this chapter's section on **Financial Procedures and Accounting Controls** on page 2-22.

Your auditor is a valuable source of information on your district's internal control system. He may provide your Board with an evaluation of the district's system of internal controls and suggest recommendations for improvement. This information may be given verbally or documented in the audit report's **management letter** (Refer to Auditing Guidance Chapter and **Appendix N8**). It is your Board's responsibility to consider the recommendations in your auditor's management letter and to require any changes where appropriate.

## ***Basics of Fund Accounting***

### **Fund Definition**

A fund is an accounting entity created by a government for the purpose of tracking the finances of a particular activity or group of activities. Each fund has a self-balancing set of accounts containing only those asset, liability, fund balance, revenue, and expenditure accounts needed to track the financial results of the activity or group of activities. A fund has only those accounts that are necessary to reflect your district's specific operations for which the fund is established.

### **Major Funds**

Major funds include:

- the General Fund,
- any governmental or enterprise fund whose assets, liabilities, revenues, or expenditures/expenses are at least 10 percent of the

corresponding total (assets, liabilities, revenues, expenditures/ expenses) for all funds of that type, and at least 5 percent of the corresponding total for all governmental and enterprise funds combined, and

- any other governmental or enterprise fund that the district believes is important to financial statement users.

## Fund Types

- **Governmental** funds track the finances of the district's basic services.
- **Proprietary** funds track the district's activities that are operated like a private business, by charging its customers a fee in return for goods or services.
- **Fiduciary** funds track activities in which the district acts as trustee or agent for resources that belong to others.

## Governmental Funds

As governmental entities, most districts can perform several functions including:

- water treatment and distribution services
- sewage collection and treatment services
- fire protection
- construction and maintenance of recreational areas

To properly account for its varied activities, your district may need to use several governmental funds. However, districts should establish only the minimum number of funds consistent with its operating requirements, legal requirements, and fund purposes. Too many funds can make your district's financial accounting and reporting unduly complex.

The focus for governmental funds is on the sources, uses, and balances of current financial resources and often has a budgetary perspective. The following briefly describes the purpose of each governmental fund.

**General Fund** accounts for all financial resources except those required to be reported in another fund. This fund accounts for most of your district's general revenues, expenses, current assets, and current liabilities.

**Special Revenue Fund** accounts for revenues that are legally restricted to be used for specific purposes.

**Capital Projects Fund** accounts for financial resources, including general obligation bond proceeds, to be used to acquire or construct major capital facilities.

**Debt Service Fund** accounts for resources to be used to pay long-term debt. Debt Service Funds are required if the district is accumulating resources to

pay principal and interest maturing in future years. Other Debt Service Fund expenditures include the cost of:

- assessing property values
- levying and collecting taxes
- fiscal agent fees

Bond orders, an integral part of every bond issue, contain provisions and resolutions dictating how bond proceeds are to be used and how revenues are to be generated. It is important that your Board seek professional guidance on issues concerning the district's bonded debt.

Typically, your district's actual collection of taxes is performed by a tax collector. The Debt Service Fund entries may occur monthly or at year end, subsequent to receiving the information from the tax collector.

*Permanent Funds* account for resources that are legally restricted so that only earnings, and not principal, may be used to support the district's activities.

### **Proprietary Funds**

The focus for proprietary funds is on the determination of operating income, changes in net assets (or cost recovery), financial position, and cash flows. Proprietary funds are used for activities similar to those found in the private sector. The following briefly describes the purpose of each proprietary fund.

*Enterprise Fund* accounts for activities that the district charges fees to users for goods and services. Generally fees are set high enough to cover most or all of the costs of providing the goods and services.

Enterprise funds are permitted for any activity that a fee is charged to users for goods and services. Enterprise funds are *required* if any of the following conditions are met when applied in context of the activity's principal revenue sources:

- The activity's net revenues from fees and services are the only security for the activity's debt, even though the debt may be secured in part by a portion of the debt's proceeds. If the debt is also secured by the full faith and credit of a related primary government or component unit, the use of an Enterprise Fund is not required.
- Laws or regulations require the activity's costs of services, including capital costs (such as depreciation or debt service), be recovered through fees and charges, rather than with taxes or similar revenues.
- Fees and charges are designed to recover the district's costs, including capital costs (depreciation or debt service).

Most districts will not meet any of the conditions above and will use only governmental funds. While some districts may have activities that would permit (but not require) the use of Enterprise Funds, we recommend your district use governmental funds when possible. We think governmental funds are more appropriate for activities that are supported by taxes or similar revenues. The information and examples in this *Guide* are focused on a typical district that uses only governmental fund accounting. If your district uses proprietary funds accounting, you will need to modify the information in this *Guide* to fit your district's needs.

***Internal Service Fund*** accounts for activities that provide goods or services to other district funds or departments, or to other governments on a cost-reimbursement basis if the district is the primary participant in the activity.

## **Fiduciary Funds**

The focus of fiduciary funds is on net assets and changes in net assets. Fiduciary funds are held in trust for others and cannot be used to finance the district's own programs. Districts should use fiduciary funds if they have activities that meet the criteria for using those funds. The following briefly describes the purpose of each fiduciary fund.

***Pension Trust Fund*** accounts for resources held in trust for members and beneficiaries of benefit and pension plans.

***Investment Trust Fund*** accounts for the portion of the district's investment pool that belongs to other governments.

***Private-Purpose Trust Fund*** accounts for trust arrangements where the principal and income benefits individuals, private organizations, or other governments.

***Agency Fund*** accounts for resources held by the district in a purely custodial capacity.

## ***Financial Reporting Model—A General View***

GASB 34 revised the financial reporting model to provide more understandable and useful financial information that will result in greater accountability to your citizens.

### **Accountability**

Accountability is a broad concept but it describes the process and procedures to hold an organization responsible for its performance. GASB has recognized accountability as the primary objective of government financial reporting.

In the past, government financial statements focused on:

- fiscal accountability for governmental activities
- operational accountability for business type and certain fiduciary activities

***Fiscal Accountability*** is ensuring that current period actions have complied with public decisions on the raising and spending of public monies in the short term.

***Operational Accountability*** is reporting the extent to which services are being provided efficiently and effectively, using all resources available for that purpose, and whether the government can meet its objectives in the future.

The new financial reporting model combines the traditional focus of government fund financial statements (fiscal accountability and the modified accrual basis of accounting) with new forms of reporting to meet the need for longer-term financial information and to improve the operational accountability of governments. The new financial statements will provide information by fund as well as on the entire government as an economic entity.

The revised model:

- creates new information and restructures old information
- integrates traditional modified accrual accounting with new forms of governmental financial reporting
- requires a reformatted financial report
- requires financial managers (your Board) to share their insight

### **GASB 34 Financial Statement Elements**

An overview of the financial statement elements of the revised financial reporting model include:

- Management's Discussion and Analysis (MD&A)
- Basic Financial Statements
  - Government-Wide Statements
    - Statement of Net Assets
    - Statement of Activities
  - Fund Financial Statements
    - Governmental Funds Financial Statements
      - Balance Sheet
      - Statement of Revenues, Expenditures, and Changes in Fund Balances
      - Required Reconciliation Schedules
    - Proprietary Funds Financial Statements
      - Statement of Net Assets

- Statement of Revenues, Expenses, and Changes in Fund Net Assets
- Required Reconciliation Schedules
- Statement of Cash Flows
- Fiduciary Funds Financial Statements
  - Statement of Fiduciary Net Assets
  - Statement of Changes in Fiduciary Net Assets
- Notes to the Financial Statements
- Required Supplementary Information (RSI) other than MD&A

## Management's Discussion and Analysis

The MD&A is *required supplementary information* (RSI) that comes before the financial statements. The MD&A is an objective, easily read analytical overview of your district's financial activities, including its overall financial position and the results of its operations. Your Board should work with its auditor, financial advisor, attorney, and other district consultants and staff in preparing your district's MD&A and supporting information. See **Appendix N3's** outline on page N-4 for the MD&A's required elements.

## Basic Financial Statements

The basic financial statements are the heart of your district's annual financial report. These statements contain the principal information about your district's finances and include: the government-wide statements, the fund financial statements, and the notes to the financial statements.

## Government-Wide Financial Statements

The government-wide financial statements provide comprehensive financial information about your district's activities. The purpose is to present the district's financial position and the results of its operations taken as a whole. The government-wide financial statements do not include fiduciary activities.

The government-wide financial statements are the Statement of Net Assets and Statement of Activities. They are prepared using the *economic resources measurement focus* and the *accrual basis of accounting* (**Appendix P**).

*The Statement of Net Assets* presents the district's financial position and includes all financial and capital resources. This statement tells you about what your district owns and owes at its fiscal year end. All assets and liabilities are presented in a *net assets format* (assets minus liabilities equal net assets) or in a *balance sheet format* (assets equal liabilities plus net assets). GASB encourages your district to use the net assets format. We prefer that format for consistency in reporting for all districts.

*The Statement of Activities* tracks your district's yearly revenues, expenses, and transactions that increase or decrease net assets in a format that reports the net revenue (expense) of individual functions. This statement's purpose is to:

- report the relative financial burden of each of the district's functions to the taxpayers
- identify whether each function is supported by the district's general revenues or is self-financing through user fees.

## **Fund Financial Statements**

The fund financial statements provide a more detailed look at your district's major programs and present information on the district's management and control of its short term financial resources. They also provide fiscal accountability information to assess whether monies raised for a particular purpose were used for that purpose.

The government-wide financial statements present both short- and long-term activities that include assets, liabilities, revenues, and expenses related to the district's functions. The fund financial statements present a more detailed short-term view of district functions that include only the most readily available assets, presently due liabilities, and the resources that flow into and out of the district during the year or shortly thereafter.

## **Governmental Fund Financial Statements**

The governmental fund financial statements present the sources, uses, and balances of current financial resources for the district's basic services. These statements are prepared using the *current financial resources measurement focus* and the *modified accrual basis of accounting* (**Appendix P**). Required governmental fund statements are the balance sheet and the statement of revenues, expenditures, and changes in fund balances.

*The Balance Sheet* presents information on the assets, liabilities, and fund balances for each major governmental fund in separate columns and for all nonmajor governmental funds totaled in a single column. Assets, liabilities, and fund balances are shown in a *balance sheet format* (assets equal liabilities plus fund balances).

*The Statement of Revenues, Expenditures, and Changes in Fund Balances* presents information on the inflows, outflows, and balances of current financial resources of each major governmental fund in separate columns and for the nonmajor governmental funds in total.

**Required Reconciliation Schedules.** Two reconciliations are required:

- Net assets to fund balance
- Change in net assets to change in fund balance

The purpose of the reconciliation schedules is to provide an explanation for the differences between:

- fund balances in the fund financial statements and net assets in the government-wide financial statements
- the net change in fund balances of governmental funds in the fund financial statements and the change in net assets in the government-wide statements (the effect of long-term accruals not reported in the funds)

Other differences are the result of the difference in the measurement focus and basis of accounting between the government-wide financial statements and the fund financial statements and the possible inclusion of internal service funds in the governmental activities in the government-wide presentation. The reconciliations should be presented at the bottom of the fund financial statements or in separate schedules.

### **Proprietary Fund Financial Statements**

The proprietary fund financial statements present the district's financial activities that operate similarly to a private business with the focus on operating income, changes in net assets (cost recovery), financial position, and cash flows. Proprietary fund financial statements are prepared using the *economic resources measurement focus* and the *accrual basis of accounting* (**Appendix P**). Remember that this *Guide* focuses on a small general-law single-purpose district that uses only governmental fund accounting.

*The Statement of Net Assets* presents the financial information for each major enterprise fund in a separate column. Nonmajor enterprise funds should be totaled and displayed in a single column, and a combined total column should be presented for all enterprise funds.

Assets and liabilities should be presented in a *classified format* to distinguish between current and long-term assets and liabilities.

*The Statement of Revenues, Expenses, and Changes in Fund Net Assets* presents the revenues, expenses, and changes in proprietary fund net assets.

*The Statement of Cash Flows* tracks the sources and uses of cash flows. This statement uses the direct method and includes cash flows from:

- operating activities
- non-capital financing activities
- capital and related financing activities
- investing activities

The direct method requires the reconciliation of operating income to cash provided by the district's operations.

## **Fiduciary Fund Statements**

The fiduciary fund statements present financial information for pension and other employee benefit trust funds, investment trust funds, private-purpose trust funds, and agency funds. Financial statements of fiduciary funds are reported using the *economic resources measurement focus* and the *accrual basis of accounting*, except for the recognition of certain liabilities of defined benefit pension plans and certain post-employment healthcare plans.

*The Statement of Fiduciary Net Assets* presents information about the assets, liabilities, and net assets for each fiduciary fund type.

*The Statement of Changes in Fiduciary Net Assets* presents information about the year's additions, deductions, and net increase (decrease) in net assets for each fiduciary fund type (except agency funds) and should provide information about significant year-to-year changes in net assets

## **Notes to the Financial Statements**

The notes to the financial statements communicate information essential for the fair presentation of the financial statements that is not displayed on the face of your district's financial statements and are an integral part of the financial statements. They provide information on your district's significant accounting policies, including the basis of accounting used, policies for capitalizing assets, and policies for estimating the useful lives of assets when calculating the district's depreciation expense.

*Required Disclosures for Capital Assets* by major asset class (land, infrastructure, buildings and improvements, vehicles, machinery and equipment, and construction in progress) include:

- Beginning and ending balances with accumulated depreciation shown separately from historical cost
- Capital acquisitions
- Sales or other dispositions
- Current-period depreciation expense, including the amounts charged to each of the functions in the Statement of Activities.

*Required Disclosures for Long-Term Liabilities* provide information for long-term debt instruments (bonds, notes, loans, and leases payable) and other long-term liabilities (compensated absences, claims, and judgments) including:

- Beginning and ending balances
- Increases and decreases (separately presented)
- The portions of each item that are due within one year of the statement date
- Information on the governmental funds typically used to liquidate long-term liabilities in prior years

## Required Supplementary Information Other Than MD&A

Required supplementary information to be presented with the district's financial statements include:

- Budgetary comparison schedules (required for the General Fund and major Special Revenue Funds with legally adopted budgets)
- Modified approach for reporting infrastructure when used

*Budgetary Comparison Schedules*, under GASB, are required for governments with legally adopted (appropriated) budgets. The schedules compare the original and final budgets for the reporting period to actual results (inflows, outflows, and balances). Most districts' operating budgets are non-appropriated.

Our rules require your district to adopt its annual operating budget prior to the start of your district's fiscal year and to include a budgetary comparison statement (actual, budget, and variances) in the financial statements or as supplementary information (Rule 293.97). The budgetary comparison schedule is required for all districts, including those using proprietary fund accounting.

*The Modified Approach for Reporting Infrastructure* requires disclosures on the assessed condition of your district's infrastructure assets. The modified approach is probably not feasible for most districts due to the effort involved in gathering the required information. Any district that uses the modified approach should consult the various AICPA and GASB publications for additional information.

## ***Financial Reporting—District-Specific***

### **Districts Engaged in a Single Program**

Districts engaged in a single governmental program may combine their fund financial statements with their government-wide statements by using a columnar format that reconciles individual line items of fund financial data to the government-wide data in a separate column. If a columnar format is used, a single-program district must provide the required reconciliation information between the fund financial data and the government-wide data. Descriptions of the reconciling items must be presented on the face of the financial statements, in an accompanying schedule, or in the notes to the financial statements.

Most districts are single-program governments since their one predominant function is to provide water related services; we view other activities as minor activities. While our general guidance is to view districts as special-purpose districts engaged in a single program, some districts will have characteristics or conditions that will not allow them to be viewed as single-program special-purpose governments. As such, we encourage districts to use

the columnar format for the financial statement presentation, unless a district is better served by another, generally accepted format.

A district may not be considered a single-program government if it budgets, manages, or accounts for its activities as multiple programs. Refer to various AICPA and GASB publications (**Appendix O**) for additional information on special-purpose governments, including those engaged only in business-type activities or only in fiduciary activities.

The focus of the following topic is the classified format financial statement presentation. If your district uses another financial statement presentation format it should adopt the essence of this topic to correspond with the format used.

## **Capital Assets**

Capital assets are tangible and intangible assets used in your district's operations that have useful lives of more than a year, including:

- Land and Land Improvements
- Infrastructure
- Buildings and Building Improvements
- Machinery and Equipment
- Vehicles
- Easements (rights of way)
- Water Rights

Capital assets are recorded at historic cost or estimated fair value at the date acquired. The cost of capital assets includes the purchase price or construction cost plus all costs necessary to place the asset in service. This includes all professional fees and other costs directly related to the installation of facilities.

When original cost information is not available, you can use the asset's current cost and deflate that amount back to when your district first acquired the asset or placed it in service. Your district must report its capital assets (including infrastructure assets) in the Statement of Net Assets at historic cost, net of accumulated depreciation.

***Capitalization Policy.*** We encourage your district to evaluate its assets and establish a capitalization policy. If an asset is capitalized, then it would be depreciated.

Value thresholds for assets would be useful and could vary according to district size. Asset grouping to identify groups that comprise at least 80% of the total system value would provide some of the same advantages as thresholds. We encourage your Board to group or classify its assets to simplify the accounting and reporting process. A sample capital asset classification for districts is in **Appendix A**.

Different classes of assets can have different capitalization policies and different thresholds can be set for management control purposes or for compliance with laws and regulations. Your district is required to disclose its capitalization policy, including the dollar value above which your district's asset acquisitions are added to the district's capital accounts. We recognize that not all capital outlays will be capitalized. Your Board's capitalization threshold will define what will be capitalized.

***Infrastructure Assets*** are long-lived capital assets that are usually stationary and can be preserved for many more years than other capital assets (water, sewer, and drainage systems, dams, tunnels, roads, and bridges). Your district must begin capitalizing and reporting its major general infrastructure assets when it implements GASB 34. GASB 34 requires retroactive implementation back to your fiscal year ending after June 30, 1980. However, we encourage your district to research its records to capitalize and report all major general infrastructure assets regardless of when each asset was first acquired or placed in service so that your district's overall financial position is fairly presented.

***Modified Approach for Reporting Infrastructure.*** The financial reporting model allows for the use of a modified approach for reporting infrastructure assets. Your district has the option of using the modified approach; however, your Board and its consultants must consider the additional requirements and related costs. Any district that uses the modified approach should consult the various AICPA and GASB publications for additional information. We recommend your district use the traditional capitalization and depreciation approach to account for and report on its infrastructure assets.

***Facilities Map.*** We strongly encourage your district to develop a facilities map as the base for the inventory of its system's infrastructure assets. Like all governments, your district will experience turnover in its governing Board, consultants, and personnel. Relying on the historical memories of involved parties can be spotty at best. It is our opinion that a map documenting your system's various components is critical to the district's overall fiscal, managerial, and operational health.

The facilities map could be an electronic scaled diagram that accurately shows all aboveground and below-ground system components (property lines, streams, pipelines, tanks). The distribution and collection lines would be shown by size and location. We have seen many situations in past years where a map of a district's facilities would have saved the day. We recommend that additional inventory information be added to a district's facility map, including asset installation date and original cost, to ensure the map will provide the information necessary for the capitalization and depreciation of your district's infrastructure assets.

***Intangible Assets—Easements and Water Rights.*** Easements are intangible assets characterized as rights that were granted, purchased, or acquired by

eminent domain. If they are recorded in your county's records and held in perpetuity, they attach to the land and transfer with the land if the land is sold. As a part of the land they are inexhaustible and not depreciable.

Easements that are not recorded in your county's records are exhaustible and, if the purchase price exceeds your district's capitalization threshold, it is depreciated over the lesser of its useful life (as determined by your Board's capitalization policy) or 40 years. If it is acquired by a grant or by condemnation procedures it will appear on your district's books at zero cost.

Water rights are also intangible assets characterized as rights that have been granted or purchased. If the purchase price exceeds your district's capitalization threshold they are depreciated over the lesser of their useful life or 40 years. Water rights appear to be inexhaustible, but since they are bought and sold, they are a depreciable asset. If acquired by a grant, they will appear on your district's books at zero cost to properly record the existence of the water right.

### **Depreciation of Capital Assets**

Capital assets are depreciated over their estimated useful lives unless they are inexhaustible. An inexhaustible capital asset is one whose economic benefit or service is used up so slowly that its estimated useful life is extraordinarily long. Depreciable capital assets should be reported in the Statement of Net Assets at historical cost, net of accumulated depreciation. Net assets should be displayed in three components including:

- invested in capital assets, net of related debt
- restricted
- unrestricted

Non depreciable capital assets that are inexhaustible (land) are reported as a separate line item on the Statement of Net Assets. Construction-in-progress should be included with the nondepreciable capital assets in the Statement of Net Assets.

Accumulated depreciation is reported in the Statement of Net Assets on the face of the statement. Regardless of the presentation in the Statement of Net Assets, the notes to the financial statements should disclose accumulated depreciation separately in addition to changes in accumulated depreciation (see **Required Disclosures for Capital Assets** on page 2-13). Depreciation expense for capital assets is reported in the Statement of Activities.

### **Accounting for Bonds**

Most districts can issue three types of bonds:

- general obligation bonds
- revenue bonds
- a combination of tax and revenue bonds

General obligation bonds are secured by your district's taxing authority. Revenue bonds are secured by a lien on the revenues generated when your district provides services to its customers. Combination tax and revenue bonds are secured by both the district's taxing authority and a lien on the district's service revenues.

Accounting for general obligation bonds requires the use of multiple funds. Separate funds are needed to account for these separate functions of your district: bonded indebtedness; capital assets; construction of capital assets; debt service payments; district operations; and any special revenues. Accounting for revenue bonds requires only a single fund be used. All activities accounted for in that fund are used to pay off your district's bonded debt.

Combination tax and revenue bonds are similar to general obligation bonds as the primary security is your district's taxing authority. Repayment of the bonds and the interest expense comes from the district's service revenues. When the service revenues cannot meet your district's debt obligations, your Board can use district tax revenues to extinguish its debt.

Districts with Industrial Development or Pollution Control Bonds should follow the State Auditor's financial reporting guidelines in **Appendix L**.

### **Property Taxes**

For governmental funds, only those property taxes collected within the current period or soon thereafter (not to exceed 60 days after fiscal year end) to pay the district's current liabilities should be reported in your district's revenues. The uncollected property taxes and taxes collected in advance must be reported as deferred revenue.

### **Inventory of Materials, Supplies, and Prepaid Expenditures**

Your district may report its supplies, insurance, and other expenditures using the *consumption method* or it may report these amounts as expenditures when acquired under the *purchase method*. Your district must report significant amounts (in your Board's opinion) of ending inventory on its balance sheet.

### **Debt Issue Proceeds**

Long-term debt proceeds must be reported as a financing source. Short-term borrowing must be reported as a liability to the applicable fund.

### **Capital Outlay**

Capital outlay includes all costs incurred for construction of facilities and related direct costs which are presumed to benefit both your district's current and future fiscal years. This includes:

- upgrading facilities
- adding to facilities
- major overhauls of equipment

Not all capital outlay expenses are transferred to capital assets, only those that are for general government purposes. Specific fund assets are accounted for in their respective funds. Not all capital outlays will be capitalized. Your Board's capitalization threshold will define what will be capitalized.

### **Reserves**

In a governmental fund, use of the term *reserve* should be limited to that portion of the fund balance that is not available for expenditure or is legally reserved for a specific future use. If part of the fund balance is reserved, the remainder should be reported as a *designated* or an *unreserved* fund balance.

## **Accounting System**

A district's accounting may be done by a computerized or a manual system. Whichever method is chosen, the accounting records should be maintained using GAAP and the guidelines set forth in this *Guide*. While the *Guide*'s information and examples are focused on small single-purpose districts that use only governmental funds, the *Guide* is applicable to all districts including large multipurpose districts that use proprietary funds. **The goal of this *Guide* is not to prescribe rigid accounting procedures, but to establish general guidelines.**

### ***Records Needed***

All accounting records described in the *Guide* should be maintained according to your district's fiscal year. Your district's accounting system will include many accounting records, journals, registers, and source documents. Depending on your district's activities and needs, its accounting system may use journals and registers beyond these basic records:

- Chart of Accounts
- Special Journals
- General Journal
- General Ledger
- Capital Asset Register
- Check Register
- Bank Statements
- Source Documents

### **Chart of Accounts**

Your district's Chart of Accounts establishes the capability to classify accounting transactions in a variety of combinations pertinent to the operating and reporting requirements of the district. Any item posted to your district's records will be coded to an account found on the district's Chart of Accounts. An example of a Chart of Accounts with appropriate account descriptions is provided in **Appendix B**.

## Special Journals

Special journals are used for efficiently recording transactions that occur frequently. The number of special journals maintained by your district depends on the extent and nature of your district's activities. In computerized systems, the journals may take various forms and may be integrated with the check register (Cash Disbursements Journal); however in any system there must be a listing of transactions and accounts to which the transactions were classified, and each transaction must be entered with equal debits and credits. See **Appendices D, H, and I**.

## General Journal

The General Journal is also called the *book of original entry*. This journal's purpose is to record unique or infrequent transactions that are not appropriately recorded in any of the special journals (including adjusting journal entries).

All entries to the General Journal should:

- classify the transaction by account
- appear in chronological order
- include an explanation for the entry with supporting documentation and approval by a responsible person

## General Ledger

The ledger's purpose is to summarize transactions according to your district's account classifications. Column totals from the journals are tallied and transferred to the appropriate accounts in the General Ledger. If the governmental accounting method is chosen, the General Ledger is organized by fund. All General Ledger accounts within a given fund are in account number sequence according to your district's Chart of Accounts.

## Capital Asset Register

The Capital Asset Register (formerly known as General Fixed Asset Account Group) maintains a list of infrastructure and other capital assets purchased/constructed by the district (**Appendix A**). Each recorded asset should include:

- a description
- identification number
- the purchase or construction date
- the source document details
- columns for purchased/constructed costs, the annual and accumulated depreciation, and the asset's total cost

Ideally, the Capital Asset Register would be combined with an electronic facilities map to record information on the district's capital assets (see **Facilities Map** on page 2-16).

## Check Register

A check register must be maintained for each checking account. All account transactions (cash disbursements, cash receipts, and other transactions) must be recorded in your district's check registers. Your check register must be reconciled upon receipt of your bank statement.

## Bank Statement

A bank statement should be received for each account maintained. The statement may be received monthly, quarterly, or annually depending on each account's activity or type. The bank statement should be reconciled to your district's check register.

## Source Documents

The source documents provide the support for the accounting entry. They include:

- the cash receipts source document
- the cash disbursements source document
- the journal voucher

***Cash Receipts.*** These source documents include all cash receipt transactions regardless of their origin, including:

- service charge receipts
- receipts from the sale or redemption of investments
- tap connection fees
- proceeds from bond sales
- all other cash receipts

***Cash Disbursements.*** These source documents include all cash disbursement transactions, including:

- debt service payments to your district's paying agent
- all operating and nonoperating expenditures
- purchases of land and rights-of-way
- improvements to land
- constructing and purchasing capital assets
- all other disbursements made by your district

***Journal Vouchers.*** The Journal Voucher source documents are used to record all transactions not included in cash receipts or cash disbursements, including:

- all adjusting and closing entries
- all other transactions not involving cash received or disbursed

## **Cash Transactions**

The cash transactions of a General or Enterprise Fund begin with recording the current billing to Revenue and Accounts Receivable accounts. Expenditures are reported to the proper expense account and to the Cash account. The sample Chart of Accounts in **Appendix B** has some expense classifications that your district can use. The receipt of cash payments is recorded to the Cash and the Accounts Receivable accounts and the receipt should be logged into the Cash Receipts Journal.

The General Ledger provides an important control over transaction entries as it summarizes all changes in cash. The reconciled cash balance should be the same amount for the account listed in the General Ledger.

## **Accounting for Other Transactions**

### **Tap and Other Fees**

Tap fees should be collected with a tap fee application. The application may contain:

- the legal description of the lot
- the physical address
- the lot's square footage
- the meter size
- the name of the person requesting the tap
- the amount of the tap fee

Once your district confirms the application is complete, the district should accept the tap fee payment and record the receipt in its Tap Fee Journal. Remember to include the check number and the work order number assigned to each tap in the Journal.

### **Tax Assessment**

Tax assessments are recorded as *Property Tax Revenue* and *Taxes Receivable* at the beginning of the year. The General Fund and the Debt Service Fund each record its proportional share of *Taxes Receivable* and *Property Tax Revenue* according to the tax assessment. **Appendix C** provides examples of fund accounting entries.

## **Financial Procedures and Accounting Controls**

Accounting controls should be incorporated into all phases of your district's accounting system. A short list of useful financial control procedures follows.

### **Cash Receipts**

As your district's most liquid asset, cash requires the most supervision. A standard method to account for cash receipts is to use prenumbered receipts that contain:

- the customer's name
- the customer's account number
- the payment amount
- the payment date
- the period for which the payment is made

A receipt should be given to your customer. Your district should retain one copy of the receipt with the clerk receiving the cash and one copy in the district's accounting department. Payments received in the mail are accounted for in a similar fashion and the same information that is included on a cash receipt should be found on the remittance notice.

Whether the receipt of cash is by mail or in person, each day's total of all cash receipts and remittance notices should equal the total of cash and checks collected that day. A daily reconciliation of receipts to the amount of deposits should be performed. Most important, all checks should be restrictively endorsed **For Deposit Only**.

### **Bank Statements**

Bank statements should be reviewed and reconciled by someone other than the person responsible for preparing checks. The reconciliation should be reviewed by a third person; the third person could be a district board member if your district does not have many employees or contracted consultants.

### **Journal Entries**

Journal entries should have appropriate backup documentation to explain the entry being made. The entry should be approved by either a board member, consultant, or third party.

### **Invoices**

Invoices received requesting payment should be reviewed by your district's general manager or authorized representative. Upon authorization of the invoice, he should indicate:

- the amount to be paid
- the date of approval
- the account to be charged

These authorized invoices should then be recorded in the Accounts Payable system and filed in an open invoice file before the next regularly scheduled board meeting.

During the next regular board meeting, all authorized invoices should be submitted to your Board for their approval, along with the prepared checks. After your Board has approved the invoices and signed the checks, the invoices should be stamped **Paid**. Then, make a copy of each check, attach the copy to the invoice (or, record the check number and date paid on the

invoice), and file it in your district's paid invoice file. Finally, mail the check to the payee with a copy of the invoice your district is paying.

We recommend that your Board consider approving all transactions that the general manager has authorized under the your Board's delegated authority (TWC Section 49.151) at each regular board meeting to ensure that your Board is aware of all financial transactions and to provide an additional control measure for the district's funds.

### **Accounts Receivable**

General Ledger amounts for Accounts Receivable must be reconciled to the customer billing ledger on a regular cycle. Differences must be investigated and, where appropriate, an adjusting entry should be made to reconcile any differences.

### **Customer Deposits**

The customer deposit accounts must be reconciled to the total of customer deposits recorded in the billing ledger. Any differences should be investigated and appropriate action taken.

### **Tax Collections**

The entry to record tax collections must originate with the report of taxes collected by your district's tax assessor/collector. It is important that the amounts collected and reported by the tax collector reconcile with the Taxes Receivable records kept by your district so your Board is aware of the amount and percentage of taxes collected.

The tax accounts must be separate from your district's operating accounts. Take care to avoid the accumulation of a larger than necessary balance. You should transfer amounts out of this account and into the Debt Service and operating accounts according to your district's bond requirements and operating procedures.

### **Budgets**

The most effective tool to monitor and control your district's revenues and expenditures can be the Board's formally adopted budget (refer to the *Guide's Annual Budget* section of the General Financial Guidance Chapter on page 1-6). It is important that accurate and timely budget reports and other information be available to your board members on a regular basis to aid in their management of your district's affairs.

Budgets should be prepared before your district's fiscal year begins. Budget and accounting line items must be very similar to make comparisons meaningful and easily monitored. A budgeted to actual report, with monthly and year-to-date figures, should be generated monthly or quarterly and any variances investigated. Material differences that appear permanent usually require your Board to amend the district's existing formal budget.

## Reports to Your Board

Most boards meet regularly to pay the district's bills and to discuss important matters. Your Board may contract with various consultants to perform services for your district and report to the Board on their accomplishments. The following paragraphs describe the most common service providers and their responsibilities to your Board.

### ***Bookkeeper's Responsibilities and Reports***

With the continuing evolution of governmental accounting, your bookkeeper's position is more complex than in the past. Each fund has a particular function and your bookkeeper is responsible for ensuring that all accounts are kept "pure" with no intermingling of monies without the specific direction of your district's attorney or this Agency. Your bookkeeper maintains the district's accounting records and is charged with the responsibility of maintaining all records in conformity with GAAP.

***Board Treasurer.*** Your district may elect a board treasurer who may act with your district's investment officer to instruct the bookkeeper in investing the district's funds appropriately.

Most bookkeepers prepare the checks for approval and signature by your Board. Although not authorized to sign checks, your bookkeeper can transfer funds on the district's behalf. They must maintain adequate records to allow your district's auditor to perform his audit of the district's records.

Other bookkeeper duties include: making sure bond payments (due semiannually) are made in a timely manner; advising your Board of any financial problems which may arise due to inadequate or inaccurate rate structures; maintaining investment schedules to mature in a timely fashion to meet the district's monthly bills; submitting timely revenue and expenditure statements; and working closely with your district's attorney, engineer, tax collector, general manager, financial advisor, auditor, or other professionals.

***Cash Reports.*** A revenue and expenditure report for all funds should be prepared by your bookkeeper and submitted to your Board for its approval. The report may be presented to the Board at its regular meetings and should show beginning balances, cash received by all sources, disbursements to be approved, ending cash balances for all accounts, and a record of all investments so that the district's cash position, by fund, can be seen regularly.

The report also should reflect the current cash balances and balance to the check registers and/or the bank statements. Customer deposit liabilities for the period then ended, and information for the next principal and interest

payment on bonded indebtedness are examples of information often included in the bookkeeper's report.

**Budget.** We require all districts to prepare an annual budget for its operating funds utilizing quarterly or monthly budget comparisons. Usually, your bookkeeper will submit a proposed fiscal year budget to your Board. The Board may make changes to the budget before giving its approval; however, the following year's annual budget must be approved before the close of the current fiscal year (Rule 293.97b). This budget may be amended by your Board throughout the fiscal year.

**Budget Comparisons.** Operating fund comparisons should be presented to your Board quarterly or monthly and should indicate actual revenues and expenses compared to those budgeted.

**Bond Proceeds Comparison.** When bond proceeds are expended, a comparison should be presented to your Board to indicate the project items as approved by the Agency, the amounts expended for each item, and difference columns (over or under) of amounts expended to amounts authorized for each item.

**Developer Reimbursements.** Your bookkeeper may keep records of any developer reimbursements related to a bond issue. Districts must hire an independent auditor to determine the amount to be reimbursed to the developer from the sale of bonds approved by the Agency. Your bookkeeper will maintain all copies of invoices and related materials on these reimbursements.

A comparison report for your Board should show the amount of funds approved by the Agency compared to the actual amount of funds disbursed.

Capital improvements within the district are performed by your developer at his expense. Your district is not liable to reimburse the developer for these expenses until it sells bonds. Even then, your district's developer reimbursement amount is subject to Agency approval.

At times a bond sale may not bring in enough money to reimburse your district's developer the entire amount due. In this case, your developer must be reimbursed from a later bond issue.

**Audit Preparations.** The bookkeeper should compile all information and post the district's books. At the end of your district's fiscal year, the bookkeeper should timely reconcile all ledger accounts and prepare the books for the annual audit (see **Appendix I** for a bookkeeper's audit preparation checklist).

Other responsibilities may include:

- Setting up the necessary bank accounts, savings accounts, and investment accounts
- Maintaining all journals and ledgers pertaining to district funds according to GAAP and this *Guide*
- Issuing and filing the district's quarterly payroll tax returns and 1099s, 1096s, W2s, and W3s after each calendar year

## ***Tax Assessor/Collector's Responsibilities and Reports***

Your district's tax collector will calculate and collect the taxes levied by your district. He will also disburse all tax related expenditures and submit reports to your Board for their approval. The tax collector's report is also important to your district's bookkeeper, as the bookkeeper must post the tax related information to your district's books from these reports. Your bookkeeper may also pay bills and reconcile the district's bank statements for the tax accounts. The tax assessor/collector's report should contain:

- total taxes levied
  - Year
  - Rate (debt service and maintenance)
  - Levy amount
- amount currently outstanding
- current collections
- percent collected
- current period revenue
- current period disbursements (with documentation),
- beginning and ending cash balances
- accounts payable at year end
- any adjustments

Your Board should be able to determine the amount of tax revenues outstanding and collected for the district's operating year. By fiscal year end your tax collector should prepare a delinquent tax roll on all tax years with unpaid taxes.

## ***Operator's Responsibilities and Reports***

Your operator's responsibilities are similar to a city's water department. Your district's operator may also be responsible for billing and collecting for water, wastewater, and other services. Examples of his responsibilities include:

- meter reading
- routine transfers, turn-ons/turn-offs
- monthly billing and mailing
- bill collecting and accounting
- handling customer inquiries

- maintaining all records for audit purposes according to Agency regulations
- enforcing your district's delinquency policy

Your operator may collect all fees as billed and deposit the funds directly into your district's General Fund checking account or into a separate collection account. If the operator deposits into a collection account, your bookkeeper will periodically transfer to the district's checking account the amount needed to cover the district's operating expenses. An example of the operator's report is in **Appendix E**.

### ***Attorney's Responsibilities and Reports***

Your district's attorney acts as your Board's general legal counsel. Since districts are strictly regulated, your attorney's assistance is required for obtaining permits, drawing up contracts, annexation procedures, and many other duties. He is your principal negotiator and can handle any lawsuits. He must keep current on all laws and regulations applicable to districts. We recommend that every district have an attorney familiar with water district laws available to consult with regularly as timely, accurate advice will avoid unnecessary complications.

### ***Engineer's Responsibilities and Reports***

While your district is experiencing an active building program, your engineer should be present at the regular board meetings. As your district nears build-out, your engineer's participation will decrease.

After build-out has occurred, your engineer may perform studies to determine whether facility expansion is needed. With the district's attorney and financial advisor, your engineer can assist your Board in deciding whether an additional bond sale would be in your district's best interests.

### ***Financial Advisor's Responsibilities and Reports***

- ***Recommendation of Tax Rates.*** Your district's financial advisor may meet with your Board to recommend a tax rate for the operating year. Drastic changes in your district's tax rate should be avoided. Your financial advisor will recommend annual adjustments to minimize dramatic changes in your district's tax rate. Your financial advisor may present pro forma figures demonstrating the implementation of his recommendations.
- ***Establishment of Service Rates.*** Your financial advisor with the district's other consultants may provide advice on the district's service rates and tap fees.
- ***Explaining Current Financial Information.*** Your financial advisor can answer requests from investors and rating agencies for current financial information about your district.

- **Other Services.** Your financial advisor can assist in the review of audit report drafts and in your Board's preparation of information reports to be used with your district's bond elections. Upon request, your district's financial advisor can be represented at a board meeting where the district's financial matters are to be discussed.

## ***Auditor's Responsibilities and Reports***

Each year your district must have its records audited by an independent auditor. Additional work may also be required of an auditor on developer reimbursements. Refer to this *Guide's* Auditing Guidance Chapter for more information about your auditor's role.

## ***Investment Officer's Responsibilities and Reports***

Your district will need the services of an Investment Officer. Each district must designate an investment officer to invest the district's assets according to your district's investment policy and the law. Your investment officer must attend mandatory training on his responsibilities, including education in investment controls, security risks, strategy risks, market risks, and compliance with the Public Funds Investment Act (Government Code Chapter 2256, Subchapter A).

When your district's monies are invested, the law requires the securities to be pledged by the depository to ensure your district's investments are insured against that depository's failure. These activities require your investment officer to maintain regular contact with the investment community to obtain the best available rates. Refer to **Cash Management** below for additional information.

**Investment Reports.** Your district's investment officer must, at a minimum, issue quarterly written reports as required by the Public Funds Investment Act. Refer to the Public Funds Investment Act for the report's required elements (Government Code Chapter 2256, Subchapter A; see **Texas Statutes** in **Appendix O**).

# **Cash Management**

## ***Legal References***

TWC Section 49.156 (Depository), TWC Section 49.157 (Investments), TWC Section 49.1571 (Investment Officer), Government Code Chapter 2256, Subchapter A (Public Funds Investment Act), and Government Code Chapter 2257 (Public Funds Collateral Act) provide the background for the cash management practices discussed in this *Guide's* Accounting Guidance Chapter (Texas Statutes, **Appendix O**).

## ***Depository Accounts***

A district should have the depository accounts listed below:

- ***General Operating Account.*** To receive day-to-day operating receipts and to disburse normal operating expenditures. Receipts can include revenues from water, wastewater, maintenance taxes, standby fees, taps, wastewater inspections, interest, and developer advances. Disbursements include expenditures for the district's normal operations.
- ***Capital Projects Account.*** To receive bond issue proceeds and the district's investment earnings thereon. Expenditures can be made only according to bond resolutions or by Agency approval.
- ***Tax Account.*** To receive ad valorem tax collections, penalties, and interest. Disbursements are made for all tax collection costs. When appropriate, and after all collection costs, the funds can be transferred to the Debt Service Account or General Operating Account, as appropriate.
- ***Debt Service Account.*** To receive capitalized interest from bond sale, transfers of ad valorem taxes, and accrued interest on bonds at the date of sale for the purpose of paying the semiannual bond principal, interest, and paying agent fees.

## ***Investment Accounts***

A primary concern of your Board is the preservation and safety of the district's principal. District funds shall be invested to yield the best rate of return while protecting the principal. Your Board should consider the financial institution's strength and its ability to provide collateral, including compliance with laws and regulations (including arbitrage provisions), the procedures of the district's bond resolutions, and Board orders requiring yield restrictions. Your district's funds should be invested according to your Board's written investment policy.

Your Board should provide its investment officer the authorization necessary to allow him to transfer funds to and from the district's accounts.

- ***Escrow Agreements.*** Any funds that must be escrowed by Agency order must be invested consistent with the district's needs. The agreement should stipulate that the original escrow amount can only be released to the district by this Agency. The escrowed amount should be noted on the district's annual financial report.
- ***Arbitrage.*** Federal restrictions on bond proceeds may restrict the yield of investments in the Capital Projects Fund and the Debt Service Fund. Consult with your district's attorney and financial advisor for a discussion on the arbitrage rebate requirements.

## ***Security of Cash and Investments***

All of your district's cash and investments must be secured by deposit insurance from the Federal Deposit Insurance Corporation (FDIC) or by the Federal Savings and Loan Insurance Corporation (FSLIC) or by the eligible financial securities defined in the Texas Public Funds Collateral Act (Government Chapter 2257; **Appendix O**). If the cash and investments are secured by eligible financial securities, those securities should be identified in your district's investment policies.

Cash and investments held in the Debt Service Fund should be handled separately as to security. FDIC Regulation 330.15—Public Unit Accounts provides for full insurance coverage of an amount up to *\$100,000 per bondholder*.

We encourage your district to have safekeeping receipts from its Texas financial institution on the collateral pledged for each account. The safekeeping receipt should show the full description of the security (including CUSIP number), the name of the financial institution making the pledge, the location where the security is being held, and the district's name that is being secured.

## ***Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA)***

Under FIRREA Section 1823(e), a financial security agreement (including a pledge of collateral for a deposit) is not valid against the FDIC unless it is:

- in writing
- an official record of the depository institution as it was executed
- executed at the same time the district's asset is acquired by the depository institution
- approved by the depositing institution's board of directors or loan committee, **and** that approval is reflected in the depositing institution's board or loan committee minutes

If any of these provisions are not met, the FDIC avoids a perfected financial security interest and your district is only entitled to share with the depository's other creditors in a pro rata distribution of the depository's assets upon the depository's failure. Make sure your depository meets the requirements above to prevent jeopardizing your district's collateral.

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