

# **PERFORMANCE AUDIT REPORT**

## **Reviewing Certain Investment Transactions Of the Municipal Investment Pool**

**A Report to the Legislative Post Audit Committee  
By the Legislative Division of Post Audit  
State of Kansas  
June 1995**

# **Legislative Post Audit Committee**

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## **Legislative Division of Post Audit**

**THE LEGISLATIVE POST** Audit Committee and its audit agency, the Legislative Division of Post Audit, are the audit arm of Kansas government. The programs and activities of State government now cost about \$6 billion a year. As legislators and administrators try increasingly to allocate tax dollars effectively and make government work more efficiently, they need information to evaluate the work of governmental agencies. The audit work performed by Legislative Post Audit helps provide that information.

We conduct our audit work in accordance with applicable government auditing standards set forth by the U.S. General Accounting Office. These standards pertain to the auditor's professional qualifications, the quality of the audit work, and the characteristics of professional and meaningful reports. The standards also have been endorsed by the American Institute of Certified Public Accountants and adopted by the Legislative Post Audit Committee.

The Legislative Post Audit Committee is a bipartisan committee comprising five senators and five representatives. Of the Senate members, three are appointed by the President of the Senate and two are appointed by the Senate Minority Leader. Of the Representatives, three are appointed by the Speaker of the House and two are appointed by the Minority Leader.

Audits are performed at the direction of the Legislative Post Audit Committee. Legislators or

committees should make their requests for performance audits through the Chairman or any other member of the Committee. Copies of all completed performance audits are available from the Division's office.

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# **PERFORMANCE AUDIT REPORT**

## **REVIEWING CERTAIN INVESTMENT TRANSACTIONS OF THE MUNICIPAL INVESTMENT POOL**

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### **OBTAINING AUDIT INFORMATION**

This performance audit was conducted by Berberich Trahan & Co., P.A., a certified public accounting firm under contract with the Legislative Division of Post Audit.

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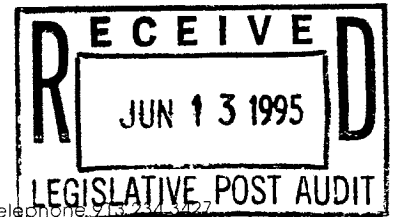




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## PERFORMANCE AUDIT REPORT

### REVIEWING CERTAIN INVESTMENT TRANSACTIONS OF THE MUNICIPAL INVESTMENT POOL

To Legislative Post Audit Committee:

We were contracted to perform a performance audit in regard to the treatment of certain exchanges of securities between the Municipal Investment Pool and the State of Kansas' idle funds portfolio. The questions to be addressed in this work were as follows:

1. Was there an equitable exchange of value based on securities exchanged between the Municipal Investment Pool and the State's idle funds portfolio?
2. If the exchange was not equitable, why not and what was the difference in values for each fund?

#### Background Information

In January 1995, the Legislative Division of Post Audit (Post Audit) issued a performance audit entitled, "Examining the Investment Practices of the Municipal Investment Pool". In that report, Post Audit noted that the State Treasurer's office (Treasurer) had on several occasions exchanged securities between the Municipal Investment Pool and the State's idle funds portfolio to increase the liquidity of the Municipal Investment Pool. Post Audit noted that at the time of the exchanges, the market value of the securities coming from the State idle funds was \$ 117.7 million, while the market value of the securities coming from the Municipal Investment Pool was \$ 115.7 million. Post Audit concluded that the exchange of securities did not result in an equal exchange of value and that the State's idle funds portfolio lost \$ 2 million as a result of the exchanges.

The Treasurer disputed this conclusion and maintained that both funds were treated equitably during the exchanges and that there was no loss to the State's idle funds portfolio. The Treasurer had computed the value of the securities to be exchanged based on the use of present values of cash flows of the securities to be exchanged rather than market values. Subsequent to the completion of the performance audit, certain revisions were made to the calculations of present value of cash flows which resulted in additional securities being transferred to the State's idle funds portfolio and narrowing the \$ 2 million difference to \$ 950 thousand.

In response to the performance audit, the Treasurer proposed that these transactions be reviewed in the course of the statewide audit and agreed to follow the recommendations coming out of such review. Because the scope of the statewide audit would not necessarily include a detailed review of these transactions, Post Audit decided to contract with our firm to conduct this performance audit work.



### Scope of Work

In conducting this work, we followed applicable government auditing standards set forth by the U.S. General Accounting Office. Our work included:

- Discussion and review of applicable workpapers and documentation in regard to the rationale, methods and calculations used by Post Audit in arriving at its conclusion. As previously noted, Post Audit used a market value approach and calculations were based on market values supplied by an investment service (Blomberg).
- Discussion and review of applicable workpapers and documentation used by Treasurer in arriving at its exchange values. As previously noted, Treasurer computed its exchange values based on the present values of cash flows. Part of the rationale was that present values would be more realistic and eliminate some of the potential vagaries of using market value on a particular day especially considering the market volatility during the latter part of 1994.
- Review of the research material supplied or referenced. Generally accepted accounting principles basically indicate that published market values are the first consideration in non-monetary transactions. However, if circumstances make market values unrealistic or unreliable then another method may be applicable.
- Reviewed the assumptions used by Treasurer in computing the present values and determined that the calculations needed further refinement in terms of level of detail and rates used. We then recalculated the present values using several iterations including using a daily convention versus monthly and variable interest rates based on a security's maturity versus the Treasurer's use of a standard rate of 6.5% for all securities. The purpose of this recalculation was to see if the \$ 950 thousand difference would be narrowed using such, which would then indicate that a market value approach could be considered realistic and reliable in these circumstances.

### Results of Work

Our recalculations of present values indicated that the new refined present values approximated the market values previously determined. This further supported that the use of market values was realistic and reliable for these exchanges. Therefore, based on the above work, we believe that the market value approach would be applicable in the circumstances and thus an inequitable exchange had taken place. As previously mentioned, the State idle funds portfolio had received \$ 950 thousand less in terms of market value in the exchanges.

*Berberich Trahan & Co., P.A.*

May 25, 1995

