

RESERVE FUND

Scope

The Legislative Audit Council has been asked to answer a series of questions relating to the Reserve Fund of the State General Fund. A copy of the original written request is attached as Appendix One. Other inquiries concerning the Reserve Fund have been received from Legislators by telephone.

This report is based in part on interviews with the State Treasurer's Office, the Office of the Comptroller General and the State Auditor's Office. Reviews also were conducted of the applicable statutes and the accounting documents maintained by the State Treasurer and the Comptroller General.

Review of Applicable Statutes

Section 12, Part 2, the Permanent Provisions of the Appropriations Act for FY 77-78, defines the General Fund Reserve, its purpose, and how it is to be maintained. (A photocopy is attached as Appendix Two.) This section repealed the provisions of Section 11-9-520 of the 1976 Code as it pertains to the General Fund Reserve. The purpose of the Reserve is "In the event of a year-end operating deficit, so much of the Reserve Fund as may be necessary shall be used to cover the deficit...".

The repealed law, 11-9-520, provided for two categories of reserve. One was titled the General Fund Stabilization Reserve. The second category was titled General Fund Reserve. The total of these accounts in FY 75-76 was \$21,567,979.12 which is cited in Appendices Three and Four as the General Fund Reserve for FY 75-76.

The State Treasurer's Office by law is responsible for the investment of State funds and ensuring that adequate funds are available to meet the various fiscal obligations incurred by the State. The Reserve Fund is defined as "5% of the General Fund Revenue of the latest completed fiscal year." In the event that monies must be taken from the Reserve Fund to cover a year-end deficit, the Act also contains provisions for restoring the balance to its intended 5% level.

Management of The General Fund Reserve

The balance of the Reserve Fund is used by the Treasurer's Office as a restricted part of the Reserve Fund investment pool. Last year the cash balance of the Reserve Fund was placed into its own Restricted Account in order to keep a convenient detailed record of the volume of its earnings from its various investments. Investments from the Reserve Fund are made only in the Federal Government and Federal Government agencies. None of the Reserve Fund is allowed to be deposited in any bank or savings and loan institution.

The State Treasurer, however, does maintain monies in every banking institution in the State from the State's cash assets as part of the State's cash management program. Banks are required to provide collateral to the State for whatever amounts the State has deposited in a bank. All monies in the banks are in the form of interest bearing certificates except for the cash which is required to cover outstanding checks. The Treasurer's Office monitors the cash flow to ensure that cash money on deposit does not exceed the outstanding checks. No brokerage fees or other handling fees are charged to the State.

The Treasurer's Office maintains a comprehensive cash management program for the State. A senior staff member serves as an investment officer who receives a daily report showing the status of the State's cash assets and liabilities in detail as of the close of the previous banking day. The first priority is to ensure that all of the current obligations are met from the General Fund's cash assets. If the cash assets on hand are not sufficient to meet that day's immediate obligations, the investment officer will sell selectively enough of the State's investment securities to meet the obligations. This daily activity allows the State to do what is called "over investing" or "playing the float." This is a standard practice among States and large organizations which have a large capital base and large cash flow. It is accomplished through a complex set of clearing accounts and agreements with banking institutions. A very simple hypothetical example will help to illustrate how this practice works. The State has \$10.00 invested. The State incurs a \$1.00 expense and must issue a check to cover that expense. On the State's "checkbook" we would then see a \$9.00 balance as of the date the check was written, assuming no deposits were made to the account. However, until the recipient of the check cashes it and the bank honors it, the State will still possess the \$10.00. If the State waits until the last possible minute to honor the check, it will have been able to keep the \$10.00 invested (and earning interest) although the State's "checkbook" shows a \$9.00 balance from the date of the encumbrance. The term "over investment" comes from the fact that of the \$9.00 balance shown on the books the State actually has \$10.00 invested. This then is considered as an "over investment" of 110%. On most days the State of South Carolina is able to maintain an over investment of 104% to 108%. Earnings from

its investments are approximately the fifth largest source of revenue for the State.

The Comptroller General maintains a set of books which is a duplicate of the Treasurer's records. The Comptroller General's Daily Trial Balance provides a convenient means of verifying the State's debits and credits and reviewing the reconciliation between the Comptroller General's books and the Treasurer's books.

The State Auditor conducts an annual audit of the State Treasurer's Office and its accounting and investment practices. In past years the State Auditor has not encountered any problems which required the issuance of a "management letter" to the Treasurer.

Balances and Earnings of the General Fund Reserve

The General Fund Reserve for FY 78-79 is \$63,865,290.49. The projected earning on this amount, using a 7% estimating factor, is \$4,470,570.33. This estimate assumes that the current balance will remain constant. Appendix Three and Appendix Four contain histories of the General Fund, its earnings, and the earnings on the General Fund Reserve. According to a written statement from the State Treasurer in September, 1978, the General Fund Reserve was 5% of the previous year's revenues as is intended in the statute. In addition, the Treasurer showed for that date, that \$9,421,506.42 in excess of the Reserve was in surplus.

Conclusion

The Audit Council was not asked to conduct a comprehensive management review of the operation of the Treasurer's Office. Instead, it has sought to achieve an understanding of the Treasurer's accounting

and investment practices which would produce a knowledgeable response to the questions presented to the Council regarding the Reserve Fund. The accounting procedures and investment practices of the Treasurer's Office involving the General Fund and the General Fund Reserve appear from our inquiry to be maintained in accordance with generally accepted accounting and management practices.



South Carolina House of Representatives

P.O. BOX 11867 • COLUMBIA, S.C. 29211 • TELEPHONE 758-5240

August 9, 1978

Mr. Robert S. Small, Jr.
Chairman
Legislative Audit Council
Bankers Trust Tower
Columbia, South Carolina 29201

Dear Mr. Small:

During the 1978 session, the General Assembly passed a joint Resolution (S330, R833) calling for a Constitutional Amendment creating a State Reserve Fund to be submitted to the voters of this State at the next general election. This amendment would require a reserve fund "equal to five percent of the general fund revenue of the latest completed fiscal year." This fund may be used to offset future operating deficits but must be restored to, and maintain at, the five percent level following such expenditures.

Since 1975, South Carolina has employed a similar mechanism (the "General Fund Stabilization Reserve") to maintain a five percent reserve fund "for the sole purpose of covering any unforeseen deficit that may occur in the General Fund at the end of a fiscal year." (S. C. Code 11-9-50) We would like you to examine the activities of this fund to determine:

- 1) How it has been used;
2) Where funds are deposited;
3) Earnings on these funds; and
4) Such other information as appropriate to this inquiry.

We would appreciate it greatly if this request could be considered at your earliest convenience. Thank you.

Sincerely,

Robert J. Sheheen
Rep. Robert J. Sheheen

Jean H. Toal
Rep. Jean H. Toal

Wade R. Crow
Rep. Wade R. Crow

Palmer Freeman, Jr.
Rep. Palmer Freeman, Jr.

Alex Sanders
Senator Alex Sanders

Nancy Stevenson
Rep. Nancy Stevenson

Harriet H. Keyserling
Rep. Harriet H. Keyserling

Ralph King Anderson
Rep. Ralph King Anderson

John G. Felder
Rep. John G. Felder

Robert L. McFadden
Rep. Robert L. McFadden

Tom Smith
Senator Tom Smith

the entire expense of operating the Consumer Finance Division of the Board of Financial Institutions for the period ending on the last day of the current calendar year. Such fee shall be computed on the outstanding loan balance of the applicant for license at the end of the last previous calendar year.

SECTION 10

To Modify Provisions Pertaining to Duration and Annual Fees of Licenses Issued Under the Consumer Finance Law

Amend Act 686 of 1976 by striking Section 59.

SECTION 11

Allocation of Funds by State Department of Social Services

Section 71-16, Code of Laws of S. C., 1962, is hereby amended by striking the entire section.

SECTION 12

Limitations on Annual Appropriations

The General Assembly recognizes (1) that uncertainties of the future will always make it impossible to accurately project revenues upon which appropriations are made; (2) that fluctuations in economic conditions are difficult to anticipate to the extent necessary to avoid financing problems; (3) that in the interest of stability and financial prudence, some control and limit be imposed upon the appropriations process that will insure and secure a reserve fund as provided for herein. The limitations upon the appropriations process as herein provided are intended to express the intent of the General Assembly to stabilize the budgetary process and prevent year-end deficits.

The Budget and Control Board, Ways and Means Committee and Senate Finance Committee shall each year make and adopt the annual official revenue estimates not later than November 15, upon which the annual operating budget is proposed and approved. The revenue estimates shall be made in accordance with accepted economic and revenue forecasting methods and to the extent possible shall be accurate and realistic. In the event of changes in economic conditions by January 15 that will alter General Fund Revenue estimates, a new General Fund Revenue estimate may be adopted not later than January 15 by the Board and Committees as provided herein.

The Budget and Control Board shall not exceed 95% of the annual official revenue estimates in making its proposed annual General Fund Operating Budget to the General Assembly. The General Assembly shall not approve an annual General Fund Operating budget in excess of 95% of the annual official revenue estimates. Funds accumulating in excess of the annual operating expenditures shall be transferred to the General Fund Reserve and such transfer shall continue to be made in succeeding fiscal years until the accumulated total in this reserve reaches an amount equal to five percent (5%) of the General Fund Revenue of the latest completed fiscal year.

In the event of a year-end operating deficit, so much of the Reserve Fund as may be necessary shall be used to cover the deficit; and the amount so applied shall be restored to the Reserve Fund out of future revenues and surpluses as herein provided until the five percent (5%) maximum is again reached and actually maintained.

The 95% appropriations limitation shall apply annually so that 5% of the General Fund Revenue of the latest completed fiscal year is maintained and actually on hand. Each year after this requirement is met, recommendations and appropriations may be made in excess of 95% of the annual approved revenue estimates, but not in excess of 100% of such estimates: *Provided, However,* That for the fiscal year 1978-79, recommendations and appropriations may be made up to 99% of the annual official revenue estimates, and for 1979-80 and 1980-81 recommendations and appropriations may be made up to 98% of the annual official revenue estimates.

In the event of a year-end surplus accumulating in excess of 5% as herein provided, such surplus in excess of the 5% Reserve Fund shall be held and may be transferred to the Reserve Fund by the General Assembly or shall be appropriated by the General Assembly in the following priority order: (1) for capital improvements or other nonrecurring purposes; (2) for purposes for which bonds have been previously authorized but not yet issued, so as to eliminate the necessity of incurring such indebtedness; and (3) for such other purposes as are not directly related to recurring costs of the State Government.

Section 6, Part II, Act No. 237, 1975 Acts and Joint Resolutions and Sections 1-781, 1-782, 1-783, and 21-293 of the Code, as amended, relating to the disposition of surplus funds are hereby repealed.

APPENDIX THREE

STATE TREASURER'S OFFICE

GENERAL FUND RESERVE EARNINGS

FOR THE FISCAL YEARS INDICATED

<u>FISCAL YEAR</u>	<u>GENERAL FUND RESERVE</u>	<u>EARNINGS ON RESERVE</u>
1978-79	\$63,865,290.49	-0-
1977-78	21,061,440.75	\$1,145,321.15
1976-77	-0-	-0-
1975-76	21,567,979.12	1,952,764.83

Source: South Carolina State Treasurer



APPENDIX FOUR

GENERAL FUND RESERVE

FOR THE FISCAL YEARS INDICATED

<u>FISCAL YEAR</u>	<u>ACTUAL REVENUE</u>	<u>5% OF PRIOR YEAR'S REVENUE</u>	<u>* GENERAL FUND RESERVE</u>	<u>GAIN OR (LOSS)</u>	<u>* GENERAL FUND SURPLUS OR (DEFICIT)</u>
1978-79	-0-	63,865,290.49	63,865,290.49	-0-	9,421,506.42
1977-78	1,277,305,809.72	51,118,972.74	21,061,440.75	52,225,356.16	-0-
1976-77	1,022,379,454.89	46,706,461.56	-0-	37,370,884.43	(16,309,443.68)
1975-76	934,129,231.21	42,229,954.16	21,567,979.12	(37,877,422.80)	-0-

These figures reflect funds at the beginning of the fiscal year indicated.