NO. 216-A | MARCH 2003

Governmental Accounting Standards Series

Statement No. 40 of the Governmental Accounting Standards Board

Deposit and Investment Risk Disclosures

an amendment of GASB Statement No. 3



For additional copies of this Statement and information on applicable prices and discount rates, contact:

Order Department
Governmental Accounting Standards Board
401 Merritt 7
PO Box 5116

Norwalk, CT 06856-5116

Telephone Orders: 1-800-748-0659

Please ask for our Product Code No. GS40.

The GASB website can be accessed at www.gasb.org.

Summary

The deposits and investments of state and local governments are exposed to risks that have the potential to result in losses. This Statement addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. As an element of interest rate risk, this Statement requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. Deposit and investment policies related to the risks identified in this Statement also should be disclosed.

The Board reconsidered the disclosures required by Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements.* Portions of that Statement are modified or eliminated. The custodial credit risk disclosures of Statement 3 are modified to limit required disclosures to:

- Deposits that are not covered by depository insurance and are (a) uncollateralized, (b) collateralized with securities held by the pledging financial institution, or (c) collateralized with securities held by the pledging financial institution's trust department or agent but not in the depositor-government's name
- Investment securities that are uninsured, are not registered in the name of the government, and are held by either (a) the counterparty or (b) the counterparty's trust department or agent but not in the government's name.

Statement 3 disclosures generally referred to as category 1 and 2 deposits and investments are eliminated. However, this Statement does not change the required disclosure of authorized investments or the requirements for reporting certain repurchase agreements and reverse repurchase agreements, and it maintains, with modification, the level-of-detail disclosure requirements of Statement 3.

The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2004. Earlier application is encouraged.

How the Changes in This Statement Improve Financial Reporting

Deposit and investment resources often represent significant assets of governmental, proprietary, and fiduciary funds. These resources are necessary for the delivery of governmental services and programs, or to carry out fiduciary responsibilities. This Statement is designed to inform financial statement users about deposit and investment risks that could affect a government's ability to provide services and meet its obligations as they become due. The Board believes that there are risks inherent in all deposits and investments, and it believes that the disclosures required by this Statement provide users of governmental financial statements with information to assess common risks inherent in deposit and investment transactions.

The Board adopted fair value accounting for most investments in Statement No. 31, Accounting and Financial Reporting for Certain Investments and for External Investment Pools. Fair value portrays the market's estimate of the net future cash flows of investments, discounted to reflect both time value and risk. In order to understand the measurement of investments at fair value, the timing of cash flows (including investment time horizons) and investment risks need to be communicated.

This Statement results from the Board's formal reviews of its existing standards. These reviews—part of the Board's strategic plan—are designed to evaluate the continuing usefulness of current requirements. The reduction of existing custodial credit risk disclosures follows from federal banking reforms adopted since the release of Statement 3.

Unless otherwise specified, pronouncements of the GASB apply to financial reports of all state and local governmental entities, including general purpose governments; public benefit corporations and authorities; public employee retirement systems; and public utilities, hospitals and other healthcare providers, and colleges and universities. Paragraph 2 discusses the applicability of this Statement.

Statement No. 40 of the Governmental Accounting Standards Board

Deposit and Investment Risk Disclosures

an amendment of GASB Statement No. 3

March 2003



Governmental Accounting Standards Board of the Financial Accounting Foundation 401 Merritt 7, PO Box 5116, Norwalk, Connecticut 06856-5116



Statement No. 40 of the Governmental Accounting Standards Board

Deposit and Investment Risk Disclosures

an amendment of GASB Statement No. 3

March 2003

CONTENTS

	Paragraph
	Numbers
Introduction	1
Standards of Governmental Accounting and Financial Reporting	2–17
Scope and Applicability of This Statement	2-3
General Disclosure Principles	4-6
Level of Detail	
Deposit and Investment Policies	6
Disclosures for Specific Risks	
Credit Risk	7
Additional Amendments to Statement 3	
Amendment to Statement 28	10
Concentration of Credit Risk	11–13
Interest Rate Risk	14–16
Foreign Currency Risk	17
Effective Date	
Glossary	19
Appendix A: Background	20–27
Appendix B: Basis for Conclusions	28–66
Appendix C: Illustrations	67
Appendix D: Codification Instructions	68

Statement No. 40 of the Governmental Accounting Standards Board

Deposit and Investment Risk Disclosures

an amendment of GASB Statement No. 3

March 2003

INTRODUCTION

. State and local governments have deposits and investments that are subject to

various risks. The GASB previously addressed certain deposit and investment risk

disclosures in Statement No. 3, Deposits with Financial Institutions, Investments

(including Repurchase Agreements), and Reverse Repurchase Agreements, and to a

limited extent in Statements No. 28, Accounting and Financial Reporting for Securities

Lending Transactions, and No. 31, Accounting and Financial Reporting for Certain

Investments and for External Investment Pools. Risk disclosures in Statement 3 focused

on **credit risk**¹ including **custodial credit risk**. The objective of this Statement is to

update the custodial credit risk disclosure requirements of Statement 3 and to establish

more comprehensive disclosure requirements addressing other common risks of the

deposits and investments of state and local governments.

STANDARDS OF GOVERNMENTAL ACCOUNTING AND FINANCIAL

REPORTING

Scope and Applicability of This Statement

2. This Statement establishes and modifies disclosure requirements related to

investment risks: credit risk (including custodial credit risk and concentrations of credit

¹Terms that are defined in the Glossary are shown in **boldface type** the first time they appear in this

Statement.

1

risk), interest rate risk, and foreign currency risk. This Statement also establishes and modifies disclosure requirements for deposit risks: custodial credit risk and foreign currency risk. This Statement applies to all state and local governments.

3. This Statement supersedes the level of note disclosure detail requirements in paragraph 64 of Statement 3. It also rescinds paragraphs 70, 71, 73, and 74 of Statement 3 and amends glossary paragraph 116 of that Statement. It also supersedes the custodial credit risk disclosure requirements in paragraphs 67 through 69 of Statement 3 and paragraph 16 of Statement 28. In addition, it supersedes paragraphs 32d and 41c of Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*.

General Disclosure Principles

4. Unless otherwise required, investment disclosures should be organized by investment type, such as U.S. Treasuries, corporate bonds, or commercial paper. Dissimilar investments, such as U.S. Treasury bills and U.S. Treasury strips, should not be aggregated into a single investment type.

Level of Detail

5. Paragraph 64 of Statement 3 is superseded by the following:

The disclosures required by this Statement generally should be made for the primary government, including its blended component units. Risk disclosures should also be made for governmental and business-type activities, individual major funds, nonmajor funds in the aggregate, or fiduciary fund types when the risk exposures are significantly greater than the deposit and investment risks of the primary government. For example, a primary government's total investments may not be exposed to concentration risk. However, if the government's capital projects fund has all of its investments in one issuer of corporate bonds, disclosure should be made for the capital projects fund's exposure to a concentration of credit risk.

Deposit and Investment Policies

6. Governments should briefly describe their deposit or investment policies that are related to the risks this Statement requires to be disclosed. For example, if a government has an exposure to a concentration of credit risk, an investment policy disclosure regarding concentration of credit risk is required. Likewise, if a government has an investment denominated in a foreign currency, an investment policy disclosure regarding foreign investments is required. If a government has no deposit or investment policy that addresses a specific type of risk that it is exposed to, the disclosure should indicate that fact.

Disclosures for Specific Risks

Credit Risk

7. Governments should provide information about the credit risk associated with their investments by disclosing the credit quality ratings of investments in debt securities as described by nationally recognized statistical rating organizations—rating agencies—as of the date of their financial statements (for example, by aggregating the amount of investments by rating categories). Unless there is information to the contrary, obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality. Governments should disclose the credit quality ratings of external investment pools, money market funds, bond mutual funds, and other pooled investments of fixed-income securities in which they invest. If a credit quality disclosure is required and the investment is unrated, the disclosure should indicate that fact.

Additional Amendments to Statement 3

8. Paragraph 67 of Statement 3, with its related heading, is superseded by the following:

Custodial Credit Risk

Deposits are exposed to custodial credit risk if they are not covered by **depository insurance** and the deposits are:

- a. Uncollateralized,
- b. Collateralized with securities held by the pledging financial institution, or
- c. Collateralized with securities held by the pledging financial institution's trust department or agent but not in the depositor-government's name.

If a government has deposits at the end of the period that are exposed to custodial credit risk, it should disclose the amount of those bank balances, the fact that the balances are uninsured, and whether the balances are exposed on the basis of either a, b, or c above.

9. Paragraphs 68 and 69 and their related footnotes are superseded by the following:

Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the government, and are held by either:

- a. The **counterparty** or
- b. The counterparty's trust department or agent but not in the government's name.

If a government has investment securities at the end of the period that are exposed to custodial credit risk, it should disclose the investments' type, the reported amount, and how the investments are held. Investments in external investment pools and in openend mutual funds are not exposed to custodial credit risk because their existence is not evidenced by securities that exist in physical or book entry form. Securities underlying reverse repurchase agreements are not exposed to custodial credit risk because they are held by the buyer-lender. The term *securities* as used in this paragraph includes securities underlying repurchase agreements and investment securities.

Amendment to Statement 28

10. Paragraph 16 of Statement 28 is superseded by the following:

Disclosures required by paragraph 9 of Statement No. 40, *Deposit and Investment Risk Disclosures*, should be made for securities lending collateral that is reported in the statement of net assets* and for the underlying securities, as discussed in this

paragraph. Therefore, the reported amounts of these investments should be disclosed by type of investment and amount, as required by paragraph 4 of Statement 40.¹³

- a. Collateral that is reported in the statement of net assets should follow the custodial credit risk disclosure requirements of paragraph 9 of Statement 40, unless it has been invested in a securities lending collateral investment pool or another type of investment that is not exposed to custodial credit risk, as provided in that same paragraph.
- b. Underlying securities are not subject to custodial credit risk disclosure requirements if the collateral for those loans is reported in the statement of net assets.
- c. Underlying securities should follow the custodial credit risk disclosure requirements of paragraph 9 of Statement 40 if the collateral for those loans is not reported in the statement of net assets. This disclosure should be based on the type of collateral and the custodial arrangements for the collateral securities.

Concentration of Credit Risk

11. Governments should provide information about the concentration of credit risk associated with their investments by disclosing, by amount and **issuer**, investments in any one issuer that represent 5 percent or more of total investments based on the level of detail prescribed in paragraph 5. Investments issued or explicitly guaranteed by the U.S. government and investments in mutual funds, external investment pools, and other pooled investments are excluded from this requirement.

12. Paragraph 32d of Statement 25 is superseded by the following:

d. Concentration of credit risk—Identification, by amount and issuer, of investments in any one issuer that represent 5 percent or more of plan net assets. Investments issued or explicitly guaranteed by the U.S. government and investments in mutual funds, external investment pools, and other pooled investments are excluded from this requirement.

^{*}For the purposes of this Statement, the statement of net assets also refers to the balance sheet.

¹³Cash collateral in deposit accounts with financial institutions is subject to the provisions of paragraph 8 of Statement 40.

- 13. Paragraph 41c of Statement 25 is superseded by the following:
 - c. Concentration of credit risk—Identification, by amount and issuer, of investments in any one issuer that represent 5 percent or more of plan net assets. Investments issued or explicitly guaranteed by the U.S. government and investments in mutual funds, external investment pools, and other pooled investments are excluded from this requirement.

Interest Rate Risk

- 14. Governments should disclose information about the interest rate risk of their debt investments by using a disclosure method described in paragraph 15. Governments also should disclose the terms of investments with fair values that are highly sensitive to changes in interest rates.
- 15. Interest rate risk information should be organized by investment type and amount using one of the following methods:
- a. **Segmented time distribution**
- b. **Specific identification**
- c. Weighted average maturity
- d. **Duration**
- e. Simulation model.

Governments are encouraged to select the disclosure method that is most consistent with the method they use to identify and manage interest rate risk. If a method requires an assumption regarding timing of cash flows (for example, whether an investment is or is not assumed to be called), interest rate changes, or other factors that affect interest rate risk information, that assumption should be disclosed. Governments with investments in mutual funds, external investment pools, or other pooled investments that do not meet the definition of a 2a7-like pool should disclose interest rate risk information according to one of the methods above.

- 16. The terms of a debt investment may cause its fair value to be highly sensitive to interest rate changes. To the extent investment terms are not considered in the interest rate risk disclosure requirements of paragraph 15, the terms and fair value of that investment should be disclosed. Terms include such information as coupon multipliers, benchmark indexes, **reset dates**, and **embedded options**. Disclosure information for similar investments may be aggregated. Examples of highly sensitive investments and required disclosures are as follows:
- a. A **variable-rate investment**'s coupon amount enhances or amplifies the effects of interest rate changes by greater than a one-to-one basis, such as 1.25 times the three-month London Interbank Offered Rate (LIBOR). The multiplier makes this investment's fair value highly sensitive to interest rate changes. This investment's fair value, its coupon's multiplier and benchmark index (1.25 times three-month LIBOR), and the frequency of the coupon's reset date should be disclosed.
- b. A variable-rate investment's coupon amount varies *inversely* with a benchmark index, such as 4 percent minus the three-month LIBOR with a floor of 1 percent. This investment's fair value, its coupon's multiplier and benchmark index (4 percent minus the three-month LIBOR with a floor of 1 percent), and the frequency of the coupon's reset dates should be disclosed.
- c. An asset-backed investment has repayments that are expected to significantly vary with interest rate changes. The variance may present itself in terms of variable repayment amounts, uncertain early or extended repayments, or in some cases, the possibility of no repayments. Interest-only and residual tranches of collateralized mortgage obligations are specific examples of such investments. This investment's fair value, the nature of its underlying assets, and the existence of the repayment option should be disclosed.

Foreign Currency Risk

17. If a government's deposits or investments are exposed to foreign currency risk, the government should disclose the U.S. dollar balances of such deposits or investments, organized by currency denomination and, if applicable, investment type.

EFFECTIVE DATE

18. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2004. Earlier application is encouraged.

The provisions of this Statement need not be applied to immaterial items.

This Statement was issued by unanimous vote of the seven members of the Governmental Accounting Standards Board:

Tom L. Allen, *Chairman* Cynthia B. Green William W. Holder Edward J. Mazur Paul R. Reilly Richard C. Tracy James M. Williams

GLOSSARY

19. This paragraph contains definitions of certain terms *as they are used in this Statement;* the terms may have different meanings in other contexts.

Concentration of credit risk

The risk of loss attributed to the magnitude of a government's investment in a single issuer.

Counterparty

The party that pledges collateral or repurchase agreement securities to the government or that sells investments to or buys them for the government.

Credit risk

The risk that an issuer or other counterparty to an investment will not fulfill its obligations.

Custodial credit risk

The custodial credit risk for *deposits* is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for *investments* is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party.

Depository insurance

Depository insurance includes:

a. Federal depository insurance funds, such as those maintained by the Federal Deposit Insurance Corporation.

- b. State depository insurance funds.
- c. Multiple financial institution collateral pools that insure public deposits. In such a pool, a group of financial institutions holding public funds pledge collateral to a common pool.

Duration

A measure of a debt investment's exposure to fair value changes arising from changing interest rates. It uses the present value of cash flows, weighted for those cash flows as a percentage of the investment's full price.

Embedded option

A provision or term in a financial instrument that allows one party to change the timing or amount of one or more cash flows associated with that instrument. Examples include prepayment options on asset-backed securities.

Federal Deposit Insurance Corporation

A corporation created by the federal government that insures deposits in banks and savings associations.

Foreign currency risk

The risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit.

Interest rate risk

The risk that changes in interest rates will adversely affect the fair value of an investment.

Issuer

An issuer is the entity that has the authority to distribute a security or other investment. A *bond issuer* is the entity that is legally obligated to make principal and interest payments to bond holders. In the case of mutual funds, external investment

pools, and other pooled investments, *issuer* refers to the entity invested in, not the investment company-manager or pool sponsor.

Reset date

The time, frequently quarterly or semiannually, that a bond's variable coupon is repriced to reflect changes in a benchmark index.

Segmented time distributions

Segmented time distributions group investment cash flows into sequential time periods in tabular form.

Simulation models

Simulation models estimate changes in an investment's or a portfolio's fair value, given hypothetical changes in interest rates. Various models or techniques may be used, such as "shock tests" or value-at-risk.

Specific identification

In the context of interest rate risk disclosures, the specific identification method does not compute a disclosure measure but presents a list of each investment, its amount, its maturity date, and any call options.

Uncollateralized deposit

An uncollateralized deposit does not have securities pledged to the depositor-government.

Variable-rate investment

An investment with terms that provide for the adjustment of its interest rate on set dates (such as the last day of a month or calendar quarter) and that, upon each adjustment until the final maturity of the instrument or the period remaining until the principal amount can be recovered through demand, can reasonably be expected to have a fair value that will be unaffected by interest rate changes.

Weighted average maturity

A weighted average maturity measure expresses investment time horizons—the time when investments become due and payable—in years or months, weighted to reflect the dollar size of individual investments within an investment type.

Appendix A

BACKGROUND

- 20. As part of its strategic plan, the Board is periodically reevaluating existing pronouncements to determine whether they continue to meet the pronouncements' objectives and user needs with relevant information. Statement 3 was the first Statement selected for reevaluation. It requires governments to make custodial credit risk and other risk disclosures.
- 21. Statement 3 primarily addresses custodial credit risk. Since the publication of that Statement in 1986, the regulatory environment and investment practices have changed. In addition, deposits and investments are exposed to a number of other risks that have not been comprehensively examined. In the Basis for Conclusions of Statement 31 (paragraph 26), the Board indicated that it would continue to examine various issues related to financial instruments.
- 22. This project was initially considered a part of the Note Disclosures project that resulted in Statement No. 38, *Certain Financial Statement Note Disclosures*. When it became apparent that the time needed to research deposit and investment risks would delay that Statement's Exposure Draft, a separate project on deposit and investment risk disclosures was added to the technical agenda in January 2001.

Research

23. During the fall of 1999 and the spring of 2000, fifteen interviews with financial statement users were conducted. Interview topics included the usefulness of custodial credit risk and reverse repurchase agreement disclosures, usefulness of other investment

disclosures, and identification, without prompting, by the interviewees of potential additional disclosures that could be useful. The Board was briefed on the results of this research at its November 2000 meeting.

24. In the fall of 2000, on-site interviews were conducted with sixteen agencies in six governments and an investment management company. The agencies ranged from the main treasury investment pools to pension funds and enterprise fund operations. The interviews were conducted with investment portfolio managers. Managers were asked about their risk management strategies that control credit risk, interest rate risk, and other risks. The effect on investment operations of custodial credit risk was discussed. Management reports and investment policies were examined.

Task Force Meeting

25. In September 2001, a task force meeting was held. The task force members discussed the continued relevance of custodial credit risk disclosures, other risk disclosures required by Statement 3, and credit and interest rate risks. The potential for disclosure of other risks was also discussed. This meeting and the previously described interviews with financial statement users suggested that several areas of disclosure required by Statement 3 should be evaluated for revision or elimination, and additional reporting requirements now could be considered.

Field Test

26. In early 2002, the Board's tentative conclusions were the basis of a field test. Twelve governments completed the materials or filed a response. The test included a proforma application of the Board's tentative conclusions to the participants' latest financial statement disclosures. Participants were also asked to respond to questions regarding staff

time and system changes (both ongoing and one-time) to prepare the pro forma disclosure, whether the disclosure requirements were consistent with internal investment management, and other issues. The results of the field test were used to develop this standard.

Exposure Draft

27. In June 2002, the Board issued an Exposure Draft (ED), *Deposit and Investment Risk Disclosures*—an amendment of GASB Statement No. 3. Fifty-seven organizations and individuals responded to the ED. In October 2002, the Board held a public hearing on the proposals put forth in the ED.

Appendix B

BASIS FOR CONCLUSIONS

- 28. This appendix summarizes factors considered significant by the Board members in reaching the conclusions in this Statement. It includes discussion of alternatives considered and the Board's reasons for accepting some and rejecting others. Individual Board members gave greater weight to some factors than to others.
- 29. The Board adopted a fair value accounting standard for investments in Statement 31. Fair value is an estimate of the net future cash flows of investments, discounted to reflect both time value and risk (Statement 31, Basis for Conclusions, paragraph 49). The Board believes that in order to understand the measurements of investments at fair value, the timing of cash flows and risk also needs to be communicated.
- 30. Deposit and investment resources often represent significant assets of governmental, proprietary, and fiduciary funds. These resources are necessary for the delivery of governmental services and programs, or to carry out fiduciary responsibilities. This Statement is designed to inform financial statement users about deposit and investment risks that could affect a government's ability to provide services and meet its obligations as they become due. The Board believes that there are risks inherent in all deposits and investments, and it believes that the disclosures required by this Statement provide users of governmental financial statements with information to assess common risks inherent in deposit and investment transactions.
- 31. Concepts Statement No. 1, *Objectives of Financial Reporting*, addresses risk disclosures: "Financial reporting should disclose . . . risks of potential loss of resources"

(paragraph 79c). Further, under the heading of assessing financial condition and results of operation, the Concepts Statement indicates that financial reports are used to assess a government's "financial position and its ability to continue to provide services and meet its obligations as they come due" (paragraph 34). Deposit and investment risks have the potential to affect a government's ability to provide services and meet its obligations. Likewise, a government's ability to fulfill its fiduciary responsibilities can be affected by deposit and investment risks.

32. The Board has been guided by the principle that disclosures should be essential to understanding financial position and changes in financial position. The Board's tentative definition and criteria for notes to financial statements are described in the Basis for Conclusions of Statement 38:

Tentative Definition

Notes to financial statements are information appended to financial statements that is *essential* to a user's understanding of the financial position and changes in financial position of the reporting unit, but that either does not meet the criteria for recognition in a financial statement or provides more detail about recognized amounts than can appropriately be included in the body of a financial statement. Notes are usually in narrative form but may be quantitative, with appropriate explanations, including measures other than dollars. Notes may include up to two prior years of similar information, for comparative purposes. [paragraph 34]

The paragraph further explains that *essential* means "so important as to be indispensable to a user with a reasonable knowledge of (a) the financial activities of governments, (b) basic accounting principles, and (c) the basic terminology of governmental finance and accounting, and who is willing to study the information with reasonable diligence."

- 33. As a means of effectively communicating financial information, Concepts Statement 1 requires financial statements to be reliable and free from bias, faithfully representing what they purport to represent (paragraph 64). The financial statements are representationally faithful when they omit nothing material. Reliability is affected by uncertainties inherent in what is being measured. In the context of this project, uncertainties include variabilities due to changes in interest rates or foreign currency exchange rates, the exercise of embedded options, changing cash flows arising from changing indexes, and uncertainties regarding the performance of counterparties and debtors.
- 34. GASB Concepts Statement 1, footnote 4, refers to Financial Accounting Standards Board (FASB) Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information*, for a detailed discussion of the characteristics of accounting information. FASB Concepts Statement 2 indicates that information that improves the ability to predict or to confirm earlier expectations is relevant to users. The FASB Concepts Statement describes how, "[w]ithout a knowledge of the past, the basis for a prediction will usually be lacking" (paragraph 51). "[I]nformation is relevant to a situation if it can reduce uncertainty about the situation. Information that was not known previously about a past activity clearly reduces uncertainty about its outcome, and information about past activities is usually an indispensable point of departure for attempts to foresee the consequences of related future activities" (paragraph 52). That Concepts Statement explains that accounting information is not a prediction, but has predictive value (paragraph 53). The Board believes that risk information regarding deposits and

investments held at the end of the reporting period does provide predictive information that is relevant to users.

- 35. A report by the American Institute of Certified Public Accountants' Special Committee on Financial Reporting—the Jenkins Committee report—also provides a basis for risk disclosures. One charge of the committee was to determine what information companies should provide to users and investors. The committee found that to meet users' needs, business reporting should provide more information about risks and uncertainties. Business reporting should also better align information reported externally with the information reported to senior management to manage the business.²
- 36. Although it is not possible to identify all risks, the Board has defined and identified in this Statement the risks to which deposits and investments are commonly exposed. The Board also believes that there are risks inherent in all deposits and investments; and it believes that the disclosures required by this Statement will provide users of governmental financial statements with information to assess the most common risks inherent in deposit and investment transactions. The Board encourages the disclosure of risks that are not specifically identified in this Statement.

Scope of This Statement

37. The scope of this Statement is limited to deposits, investments, and investment derivatives. This Statement's scope does not include investment performance. Although the Board considers this a valid issue for examination, the Board believes that a

-

²Comprehensive Report of the Special Committee on Financial Reporting, *Improving Business Reporting—A Customer Focus, Meeting the Information Needs of Investors and Creditors* (New York: AICPA, 1994), pp. 1 and 5.

comprehensive evaluation of performance measurement and reporting is necessary before the Board addresses it.

General Disclosure Principles

Investment Types

38. The requirement to disclose investments by type has derived from the custodial credit risk requirements of Statement 3. Because this Statement has deleted the relevant paragraphs of Statement 3, the Board found it necessary to make investment-type disclosure to be a general disclosure principle. In so doing, the Board considered whether investment types should be prescribed, but was persuaded that because of the diversity in investments—some carrying similar terminology but with diverse risks—any required list had the potential for misleading the reader. Accordingly, this Statement indicates that investments should be aggregated by type, with consideration for the potential for aggregating dissimilar investments. This principle is further developed in the specific risk disclosures required by this Statement. For example, similar investment types may have diverse exposures to interest rate risk. Thus, this Statement requires disclosure of investment maturities and further requires specific disclosures for certain investments that are highly sensitive to interest rate changes. Likewise, similar corporate investments may have diverse exposure to credit risk. Thus, this Statement requires disclosure of the credit quality of corporate debt investments.

Level of Detail

39. In the Exposure Draft, the Board considered whether information presented by governmental activities, business-type activities, major funds, nonmajor governmental and enterprise funds in the aggregate, internal service funds, or fiduciary funds was relevant for deposit and investment disclosures when those assets were not pooled. For component

units, level-of-detail requirements established in paragraph 64 of Statement 3, as amended by Statements No. 14, *The Financial Reporting Entity*, and No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, and other Statements, continue in effect and therefore are not modified.

40. The level-of-detail proposal received several comments from respondents, some of whom requested that the proposal be modified primarily because of the duplicative disclosures required by the proposed standard. The Board reconsidered its position and adopted a disclosure requirement similar to that found in Statement 3. That is, disclosures should be made for the primary government, including blended component units, as a whole, except when deposit or investment risks are not apparent because of other deposit or investment balances. The Board believes that this change should not have a substantive effect on actual risk disclosures and, therefore, is in keeping with previous level-of-detail guidance.

Deposit and Investment Policies

41. When there is a risk requiring disclosure, associated deposit or investment policies also should be disclosed. The Board believes that disclosing the relevant deposit or investment policy communicates a government's tolerance for risk. Because the Board was concerned about their potential length, relevance, and usefulness, *complete* deposit or investment policy disclosures are not required. Further, because of diversity in practice, the Board has not specifically defined *deposit or investment policy*. However, the Board expects for the purposes of this Statement that a deposit or investment policy is one that has been formally adopted and limits a government's allowable deposits or investments. For example, although state law might limit allowable corporate investments to the top

two credit quality ratings, a formal investment policy that limits a government's allowable investments to the top rating should be disclosed. A government's investment practices or informal policies are not a required disclosure. The Board also considered and rejected requiring governments to disclose the objectives and strategies of their investment programs. Investment objectives and strategies were considered topics within the scope of other Board research projects.

Disclosures for Specific Risks

Credit Risk

- 42. Many governments' investments are limited to those allowable by statute (so-called legal lists), commonly expressed in terms of the credit ratings issued by nationally recognized statistical rating organizations. In the process of disclosing investments authorized by legal or contractual provisions (required by Statement 3, paragraph 65), many governments describe the credit quality of their investments at time of purchase. As credit quality can fluctuate over time, a highly rated investment at time of purchase can suffer subsequent downgrades. This Statement requires disclosure of credit quality as of the date of the financial statements. Credit quality at that time is a more current depiction of potential variable cash flows and credit risk. Other governments are limited by the prudent-person rule. Credit risk as communicated in terms of credit quality is equally applicable to those governments.
- 43. Many governments place large portions of their investments in external investment pools, either voluntarily or involuntarily. The credit risk in these pools may be substantial. When it is available, the Board believes that the credit quality of these pools as communicated in credit ratings should be a required disclosure. Although several

respondents to the ED indicated concern regarding the disclosure requirement for unrated commingled products or other pooled investments, the Board believes that the absence of such a disclosure could be misleading.

Custodial Credit Risk

44. One of the objectives of the Statement 3 reevaluation was consideration of the usefulness of custodial credit risk disclosures. Statement 3 established three custodial credit risk categories. Deposits and investments each had similar, parallel categories:

Category	<u>Deposits</u>	<u>Investments</u>
1	Insured or collateralized with securities held by the government or by its agent in the government's name	Insured or registered, or securities held by the government or its agent in the government's name
2	Collateralized with securities held by the pledging financial institution's trust department or agent in the government's name	Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the government's name
3	Uncollateralized (This includes any bank balance that is collateralized with securities held by the pledging financial institution, or by its trust department or agent but not in the government's name.)	Uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the government's name (This includes the portion of the carrying amount of any repurchase agreement that exceeds the market value of the underlying securities.)

45. The Board considered the changing financial environment in order to assess whether the currently required disclosures should be continued, modified, or eliminated. The key changes in the environment result from the impact of the Government Securities Act of 1986 (GSA), deposit and investment practice guidance issued by national associations, similar requirements of other standards setters, and the repeal of the Glass–Steagall Act by the Financial Modernization Act of 1999 (Graham, Leach, Bliley Act). The GSA brought federal oversight to all government securities dealers. Dealer investment practices were

improved and all dealers are now regulated. Professional associations, such as the Government Finance Officers Association and the Municipal Treasurers Association of the U.S. and Canada on the national level, and many state agencies, such as state auditors and treasurers, have communicated recommended investment practices. External investment pools—many sponsored by state agencies—have been established to provide local governments an investment vehicle that offers economies of scale and expert investment management.

46. Within this changing environment, the GASB's research indicates that losses in investments and deposits classified as category 1 have not occurred recently. The distinguishing characteristic of these instruments is that these deposits and investments are insured, collateralized, or registered and are held in the government's own name, which significantly reduces the prospect of custodial credit risk losses. In October 1990, a federal study of the effectiveness of the GSA reported that "although some government securities brokers or dealers have failed or discontinued business since the inception of the GSA regulations, no customers have lost any funds or securities as a result of such occurrences." For these reasons, the Board concluded that custodial credit risk disclosures for investments and deposits classified in Statement 3 as category 1 are no longer necessary and should be eliminated.

_

³Department of the Treasury, Securities and Exchange Commission, and the Board of Governors of the Federal Reserve System, *Study of the Effectiveness of the Implementation of the Government Securities Act of 1986* (October 1990), p. iv.

47. The Board considered whether disclosures of custodial credit risk for deposits or investments in the Statement 3 category 2 should also be eliminated. Category 2 deposits and investments involve the relationship of the counterparty and either a bank's trust department or, in the case of a holding company, a bank acting as trustee on behalf of an affiliated broker-dealer. Category 2 investments are uninsured and unregistered investments held by the counterparty's trust department or agent in the government's name. The Board evaluated whether these circumstances mitigate the risk of future losses and therefore would eliminate the need for continuing this required disclosure. The decision turned on the assessment of the degree of separation between the trustee and its affiliate. The Board examined conflicting information. Some information indicated little separation; other information indicated significant separation. A specific question on the proposed elimination of category 2 was posed in the ED; commentators provided supportive comments. After considering these views and the results of research findings that also indicated that losses in this category have not occurred recently, the Board was persuaded to eliminate this disclosure as well.

48. Notwithstanding the changing environment and significantly reduced losses associated with custodial credit risk, such losses have not been eliminated. Instead, the Board notes that custodial credit risk continues to be a significant risk for certain investments and deposits. Recent losses have been experienced in category 3 investments. These investments were not issued or held in the government's name and did not involve a third-party custodian or trust department. Governments with uninsured and uncollateralized deposits have also experienced losses. Thus, governments continue to face the risk of not recovering the value of their investments and deposits upon the failure of a counterparty.

The Board notes that federal regulators caution supervised financial institutions regarding custodianship of securities. Deposits also continue to be at risk. Category 3 deposits have experienced recent losses. The existence of depository insurance, state-sponsored collateral pools, and actual depository losses support the continued need for custodial credit risk disclosures for this group. For these reasons, the Board concluded that category 3 disclosures continue to be necessary.

- 49. Although disclosure for category 3 deposits and investments is still required, this Statement modifies Statement 3 by creating an exception-based standard. The Board believes that a limited custodial credit risk disclosure requirement is justified because only limited custodial credit risk losses have occurred since the passage of the GSA. The Board acknowledges that limiting required disclosure to category 3 is a return to the exception-based disclosure that had been proposed in the Statement 3 ED issued in June 1985. In due process, the Board was persuaded at that time that an exception-based disclosure could influence behavior. Statement 3 was issued with a disclosure requirement that provides for custodial credit disclosures for all deposits and investments. However, given the more recent experience and the current regulatory environment, the Board now believes an exception-based disclosure is justified.
- 50. This Statement eliminates required disclosure of custodial credit risk that was greater during the year than as of the end of the reporting period, rescinding the requirements found in paragraph 73 of Statement 3. Likewise, required disclosure of types of investments made during the year but not as of the end of the reporting period, found in paragraph 74 of Statement 3, is eliminated. The Board also considered and rejected expanding this type of disclosure to other risks present during the year, but not present as

of the end of the reporting period, such as a concentration of credit risk. The Board believes that the value of risk information is its predictive value for potential loss of resources. In the Board's view, risks that are not present at the end of the reporting period do not offer that predictive value. The Board also was concerned about the costs to prepare and audit such additional disclosures. The argument for inclusion of this information is the concern over "window dressing." That is, a government may on a day-to-day basis be willing to assume significantly greater risks during the year. But it may take action to eliminate those risks at the end of the reporting period, thus avoiding disclosure. The Board acknowledges that this may be a valid concern and notes that this was a concern during the development of Statement 3, but does not believe it rises to the level of an essential disclosure.

51. Some respondents to the ED expressed concern regarding a potential inconsistency between the proposed elimination of such disclosures and the requirements of Statement 38, paragraph 12, regarding the disclosure of short-term debt issued and redeemed during the year. In Statement 38, the Board acknowledged that borrowings and repayments of short-term debt are transactions on the statement of net assets that are not reflected elsewhere in the financial statements. Disclosure of such transactions is necessary to inform users about the activities that have occurred within those accounts during the reporting period. Investment and deposit risks are not balance sheet transactions; accordingly, the Board does not believe that they warrant similar disclosures.

Concentration of Credit Risk

52. Although investments intrinsically carry credit risk, when investments are concentrated in one issuer, this concentration presents a heightened risk of potential loss.

There is no specific percentage that identifies when concentration risk is present. In Statement 25, the Board used an investment of more than 5 percent of net assets in any one issuer as its threshold (paragraph 32d). Because there is minimal credit risk associated with investments issued by the U.S. government, Statement 25 excludes U.S. government issues and U.S.-guaranteed obligations. The Board considered the 5 percent concentration risk threshold established in Statement 25 and the application of the 5 percent test to the totals for the primary government, including blended component units, or to another level of detail. Although many governments internally pool investments, thus diminishing the issue, other governments invest discretely on behalf of their various funds. In that context, the level of detail may require disclosure of concentration risk for governmental activities, business-type activities, major funds, nonmajor funds in the aggregate, or fiduciary fund types. For example, a state government's financing authority (a major fund) may invest independently of the state treasurer, resulting in the authority's investments exposing the authority to concentration risk. In this case, the disclosure should describe the financing authority's exposure to concentration risk.

53. Consistent with the disclosure requirements set forth in Statement 25, the ED provided a credit risk disclosure exemption for those investments issued or guaranteed by the U.S. government. Whether the exemption was limited to investments with the explicit guarantee of the U.S. government was not specifically addressed. A number of respondents to the ED indicated concern over the potential exemption of government-sponsored enterprises (those with *implicit* guarantees) from credit risk disclosures. To clarify the requirements of the standard, the Board agreed that those obligations with only

the *explicit* guarantee of the U.S. government should be exempt from the concentration-of-credit-risk disclosure requirements.

54. Several ED respondents requested that the Board provide guidance regarding concentration risk disclosures related to mutual funds, external investment pools, and other pooled investments. The Board believes that, given an investment pool's natural diversification and the diversification required for mutual funds by the Securities and Exchange Commission, this Statement should exempt mutual funds and other pooled investments from concentration of credit risk disclosures.

Interest Rate Risk

55. Interest rate information provides users of financial statements with disclosures about potential fair value losses from future changes in prevailing market interest rates. Investments with interest rates that are fixed for longer periods are likely to be subject to more variability in their fair values as a result of future changes in interest rates. As a means of communicating interest rate risk, this Statement requires that one of the following methods be selected for disclosure: specific identification, segmented time distribution, weighted average maturity, duration, or a simulation model. The Board's research indicates that these methods are commonly used in practice. The methods range in sophistication from the simple—specific identification—to the complex—simulation models. Specific identification, weighted average maturity, and segmented time distribution methods are easily prepared and communicate maturity information to most users regardless of sophistication. Research indicates that duration and simulation models are more commonly developed with specialized investment software. Simulation models express potential loss of fair values or changes to cash flows resulting from one or more

selected hypothetical changes in interest rates over a selected period of time. Although the prescription of one method could possibly enhance comparability among governments, the Board believes that encouraging governments, within the methods described, to select the method most consistent with their own management practices serves to enhance the transparency of financial reporting and, as such, represents a more important consideration.

Investments with Fair Values That Are Highly Sensitive to Interest Rate Changes

56. Investments may contain terms that increase the sensitivity of their fair values to increasing interest rates—for example, terms embedded in variable-rate investments such as reset dates, benchmark indexes, and coupon multipliers. The Board observes that when investments contain such terms, they have been a source of financial losses; therefore, the Board believes that such terms and conditions should be disclosed. The disclosures required by paragraph 16 may be reduced because of the interest rate risk disclosure method selected according to paragraph 15. Some methods listed in paragraph 15 may incorporate sufficient information required of highly sensitive investments that additional disclosures are not considered necessary. For example, if the simulation model method is selected, a disclosure that describes the effects of interest rate changes on aggregate portfolio values in both increasing and decreasing interest rate assumptions may include many, if not all, of the investment terms that paragraph 16 would require to be disclosed. Likewise, an investment may have a fair value that is highly sensitive to interest rate changes as a consequence of a long term to maturity—for example, 30 years. Because such an investment's maturity information would have been disclosed in the basic interest rate risk disclosure (paragraph 15), no additional disclosure as a highly sensitive investment would be necessary.

- 57. Some investments' sensitivity to changing interest rates may derive from prepayment options embedded in an investment. An example would be asset-backed securities, which include mortgage-backed or collateralized mortgage obligations. Asset-backed securities are issued by credit providers, such as banks, in which the security represents an interest in the cash flows of a collection of receivables, notes, or mortgages. Prepayments arise when, for example, mortgage holders redeem their mortgages early. The investor's investment is returned early or, in extreme cases (such as interest-only tranches), is not returned at all. Asset-backed securities may be considered to be investments with terms that may cause their fair values to be highly sensitive to interest rate changes. Again, disclosure should be made in consideration of the interest rate disclosure method selected according to paragraph 15.
- 58. Because of the information that would be disclosed as a result of applying the methods set forth in paragraph 15, the Board also believes that requiring the disclosure of various call features would provide limited useful information. The Board notes that interest rate risk disclosure methods can adequately communicate the effects of call options with the exception of the specific identification method. The Board therefore requires disclosure of call options when this method is used. The segmented time distribution, weighted average maturity, and simulation model methods all require maturity assumptions. Effective duration considers the likelihood that an investment will be called. Once again, the amount of disclosure should be made in light of the interest rate risk disclosure method selected according to paragraph 15.

Foreign Currency Risk

59. The Board believes that for deposits and investments denominated in foreign currencies, the potential risk of loss arising from changes in exchange rates can be significant. This Statement also requires disclosure of the investment types, amounts, and currency denominations of foreign investments and, when applicable, the time horizons and credit risk of those exposures.

Risks for Which No Additional Disclosures Are Required

Legal Risk

60. Not all risks that the Board studied resulted in additional disclosures. The Board examined whether legal risk should be a required disclosure. Legal risk is the risk that an investment is prohibited by law, regulation, or contract. As a practical matter, a legal risk disclosure communicates that a given investment has been in violation of a law, regulation, or contract. The Board notes that such a disclosure is already required (Statement 3, paragraph 66). In addition, Statement 38 requires that when there are violations of finance-related legal or contractual provisions, governments identify actions taken to address such violations (paragraph 9). The Board believes such disclosures continue to be relevant and in this Statement has neither changed nor added to those disclosure requirements.

Inflation and Liquidity Risks

61. Inflation risk affects all financial instruments, not just deposits and investments. Inflation disclosures are possible. FASB Statement No. 33, *Financial Reporting and Changing Prices*, was issued in September 1979 during a period of rising price levels. The Statement had required disclosure of restated financial statements on a current-cost basis but was rescinded in December 1986. Although the Board acknowledges that changing

price levels—increasing *or* decreasing—may affect the usefulness of financial statements, the Board found no reason at this time to require any inflation disclosure.

62. Governments address liquidity and liquidity risk based on total cash inflows and outflows. Because this Statement is limited to deposit and investment risks, the need for liquidity risk disclosure is diminished. Nevertheless, the interest rate risk disclosures and credit quality disclosures provide liquidity information. For those reasons, the Board did not find a basis for additional liquidity risk disclosure requirements.

Statement 3 Reexamination—Remaining Issues

63. As already described, the Board evaluated the disclosure requirements of Statement 3 for usefulness and relevance. Statement 3 contains disclosure requirements for legal and contractual provisions and for yield maintenance agreements, and for reporting and disclosing reverse repurchase agreements. The Board's research found no information that suggested that these requirements should be changed. On the other hand, this Statement substantively changes the custodial credit risk disclosure requirements of Statement 3. It also rescinds the requirement to disclose unrealized investment losses found in paragraph 71 of that Statement. Because Statement 31 requires most investments to be reported at fair value, the notion of unrealized investment losses is no longer relevant.

Implementation Cost

64. Throughout the development of this Statement, the Board has been careful to consider cost impacts to preparers. The interest in reducing custodial credit risk disclosures and consequently reducing costs was a consideration in the development of the Statement. The Board's research indicates that investment managers commonly, but not universally, consider the risks covered in this Statement.

65. In its field test, the GASB asked participants to estimate costs—both one-time and ongoing. The results of the field test suggest that implementation costs are not significant. Given the improvement to financial reporting, the Board believes that the costs to prepare this information are outweighed by the benefits. The Board also notes that the reduction of custodial credit risk disclosures also reduces costs to preparers and auditors. Accordingly, the costs to elevate this information to a note disclosure should be minimal.

Effective Date

66. The effective date of this Statement is for financial statements for periods beginning after June 15, 2004. Earlier application is encouraged. The Board sees no conflict with implementation of Statement 34 and its phase-in periods. The effective date allows more than one year for the development of any procedures to capture necessary information.

Appendix C

ILLUSTRATIONS

67. The facts assumed in these examples are illustrative only and are not intended to modify or limit the requirements of this Statement or to indicate the Board's endorsement of the situations or methods illustrated. Application of the provisions of this Statement may require assessment of facts and circumstances other than those illustrated here. Unless otherwise indicated, each illustration is independent of the others. The purpose of each illustration is limited to its content; omission of a disclosure does not mean it was not applicable. Unless otherwise indicated, all disclosures are assumed to be part of the deposits and investments note. The Statement does not specify investment types. Accordingly, the illustrations vary in their characterizations and aggregations. Because these illustrations also replace the illustrations in Statements 3 and 28, these illustrations contain disclosures required by those Statements and are not addressed in this Statement. For example, the authorized investment disclosures and reverse repurchase agreement disclosures are requirements of Statement 3.

CONTENTS

Number		Page <u>Number</u>
1	Credit Risk, Custodial Credit Risk, and Interest Rate Risk—	
	Segmented Time Distribution and Callable Bonds	37
2	Credit Risk, Concentration of Credit Risk, and Interest Rate Risk—	
	Specific Identification, No Investment Policy	40
3	Credit Risk; Interest Rate Risk—Weighted Average Maturity and	
	Variable-Rate Coupons	43
4	Interest Rate Risk—Duration; Credit Risk	46
5	Interest Rate Risk—Simulation Model	50
6	Custodial Credit Risk—Deposits	52
7	Investments with Fair Values That Are Highly Sensitive to Interest	
	Rate Changes	53
8	Foreign Currency Risk	57
9	Reverse Repurchase Agreements	59
10	Custodial Credit Risk—Securities Lending	62

Illustration 1

Credit Risk, Custodial Credit Risk, and Interest Rate Risk—Segmented Time Distribution and Callable Bonds

Assumptions

As of December 31, 2004, a city had the following investments in its internal investment pool. (Amounts are in thousands.)

<u>Investment</u>	Maturities	<u>Fair Value</u>
Repurchase agreements	January 2005	\$ 15,000
U.S. Treasury	July 2005	62,000
U.S. Treasury	January–July 2006	42,864
U.S. Treasury	July 2011	15,000
U.S. agencies	Callable July 2005, scheduled	
	maturity July 2009	15,000
U.S. agencies	November 2011	8,614
Commercial paper	March–September 2005	50,697
Corporate bonds	October 2006	10,000
Corporate bonds	July 2010–July 2012	20,493
Corporate bonds	July 2016	5,000
Mutual bond fund	Average maturity of the fund's	
	portfolio: 9.5 months	74,420
Bankers' acceptances	June 2005	1,000
Total		<u>\$320,088</u>

As a means of limiting its exposure to fair value losses arising from rising interest rates, the city's investment policy limits at least half of the city's investment portfolio to maturities of less than one year. Investments with the following maturities are limited as follows:

Maturity	Maximum Investment		
One to five years	35%		
Six to ten years	15%		
More than ten years	5%		

The city assumes that its callable investments will not be called.

State law limits investments in commercial paper, corporate bonds, and mutual bond funds to the top two ratings issued by nationally recognized statistical rating organizations (NRSROs). It is the city's policy to limit its investments in these investment types to the top rating issued by NRSROs. All investments met these requirements. The city's investments in U.S. agencies all carry the explicit guarantee of the U.S. government.

Of the city's investments in repurchase agreements, underlying securities of \$2 million are held by the investment's counterparty, not in the name of the city. The city's investment policy limits securities underlying repurchase agreements to be held by counterparties to less than \$5 million.

Disclosures

As of December 31, 2004, the city had the following investments and maturities. (Amounts are in thousands.)

		Investment Maturities (in Years)			
<u>Investment Type</u>	Fair <u>Value</u>	Less <u>Than 1</u>	<u>1–5</u>	<u>6–10</u>	More <u>Than 10</u>
Repurchase agreements	\$ 15,000	\$ 15,000			
U.S. Treasuries	119,864	62,000	\$42,864	\$15,000	
U.S. agencies	23,614		15,000*	8,614	
Commercial paper	50,697	50,697			
Corporate bonds	35,493		10,000	20,493	\$5,000
Mutual bond fund	74,420	74,420			
Bankers' acceptances	1,000		1,000		
Total	<u>\$320,088</u>	<u>\$202,117</u>	<u>\$68,864</u>	<u>\$44,107</u>	<u>\$5,000</u>

^{*}These bonds mature July 2009, but are callable July 2005.

Interest Rate Risk. As a means of limiting its exposure to fair value losses arising from rising interest rates, the city's investment policy limits at least half of the city's

investment portfolio to maturities of less than one year. Investment maturities are limited as follows:

Maturity <u>Maximum Investment</u>

One to five years	35%
Six to ten years	15%
More than ten years	5%

Because the mutual bond fund as of December 31, 2004, had a weighted average maturity of 9.5 months, it was presented as an investment with a maturity of less than one year.

Credit Risk. State law limits investments in commercial paper and corporate bonds to the top two ratings issued by nationally recognized statistical rating organizations (NRSROs). It is the city's policy to limit its investments in these investment types to the top rating issued by NRSROs. As of December 31, 2004, the city's investments in commercial paper were rated A1 by Standard & Poor's, F-1 by Fitch Ratings, and P-1 by Moody's Investors Service. The city's investments in corporate bonds were rated AAA by Standard & Poor's and Fitch Ratings, and Aaa by Moody's Investors Service. The city's mutual bond fund investments were rated AAAf by Standard & Poor's and Aaa by Moody's Investors Service.

Custodial Credit Risk. For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the city will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. Of the city's \$15 million investment in repurchase agreements, \$2 million of underlying securities are held by the investment's counterparty, not in the name of the city. The city's investment policy limits holding of securities by counterparties to no more than \$5 million.

Illustration 2
Credit Risk, Concentration of Credit Risk, and Interest Rate Risk—Specific Identification, No Investment Policy

Assumptions

A school district has few investments and chooses to disclose its investments by specifically identifying each. Except for its investments in LEF Corporation bonds reported in the Capital Projects Fund, the district's investments are internally pooled. The district has not adopted a formal investment policy. As of December 31, 2004, the district's investments were as follows:

<u>Investment</u>	Maturities	Fair Value
State investment pool	6.5 months average	\$1,506,980
U.S. Treasury bills	1/31/2005	452,980
Federal National Mortgage		
Association	3/31/2005	282,230
ABC Corporation commercial paper	1/31/2005	350,000
LEF Corporation bonds	3/31/2009*	50,000
Total		<u>\$2,642,190</u>

^{*}March 1, 2006 is the bond's call date.

State law limits investments in commercial paper and corporate bonds to the top two ratings issued by nationally recognized statistical rating organizations. The district has no investment policy that would further limit its investment choices. As of December 31, 2004, the district's investment in the state investment pool was rated AAAm by Standard & Poor's and Aaa by Moody's Investors Service. The district's investment in ABC Corporation commercial paper was rated F-1 by Fitch Ratings, A1 by Standard & Poor's, and P-1 by Moody's Investors Service. The district's investments in Federal National Mortgage Association and LEF Corporation bonds were rated Aaa by Moody's Investors Service and AAA by Standard & Poor's and Fitch Ratings.

Disclosures

As of December 31, 2004, the district had the following investments. Except for the investment in LEF Corporation bonds, all investments are in an internal investment pool.

<u>Investment</u>	Maturities	Fair Value
State investment pool	6.5 months average	\$1,506,980
U.S. Treasury bills	1/31/2005	452,980
Federal National Mortgage Association	3/31/2005	282,230
ABC Corporation commercial paper	1/31/2005	350,000
LEF Corporation bonds	3/31/2009*	50,000
Total		<u>\$2,642,190</u>

^{*}March 1, 2006 is the bond's call date.

Interest Rate Risk. The district does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit Risk. State law limits investments in commercial paper, corporate bonds, and mutual bond funds to the top two ratings issued by nationally recognized statistical rating organizations. The district has no investment policy that would further limit its investment choices. As of December 31, 2004, the district's investment in the state investment pool was rated AAAm by Standard & Poor's and Aaa by Moody's Investors Service. The district's investment in ABC Corporation commercial paper was rated F-1 by Fitch Ratings, A1 by Standard & Poor's, and P-1 by Moody's Investors Service. The district's investments in Federal National Mortgage Association and LEF Corporation bonds were rated Aaa by Moody's Investors Service and AAA by Standard & Poor's and Fitch Ratings.

Concentration of Credit Risk. The district places no limit on the amount the district may invest in any one issuer. More than 5 percent of the district's investments are in ABC commercial paper and the Federal National Mortgage Association. These investments are 13.25% and 10.68%, respectively, of the district's total investments. All of the investments reported in the district's Capital Projects Fund are LEF Corporation bonds.

Illustration 3 Credit Risk; Interest Rate Risk—Weighted Average Maturity and Variable-Rate Coupons

The weighted average maturity (WAM) method expresses investment time horizons—the time when investments become due and payable—in years or months, weighted to reflect the dollar size of individual investments within an investment type. In this illustration, WAMs are computed for each investment type. The portfolio's WAM is derived by dollar-weighting the WAM for each investment type.

Assumptions

As of December 31, 2004, a city had the following investments in its internal investment pool:

<u>Investment</u>	<u>Fair Value</u>
Repurchase agreements	\$215,000
U.S. Treasuries	119,864
U.S. agencies	23,614
Commercial paper	55,493
Corporate bonds	160,500
Total	\$574,471

The city manages its investment time horizons by averaging investment maturities and chooses to present its exposure to interest rate changes using the weighted average maturity method. In accordance with its investment policy, the city manages its interest rate risk by limiting the weighted average maturity of its investment portfolio to less than ten months.

An illustrative calculation of weighted average maturity for its corporate bond investments is as follows. Bond D carries a variable coupon that resets every quarter. Although the bond has a stated maturity of December 31, 2006, the city considers its

maturity for interest rate risk purposes to be the length of time to its next reset date, three months.

Bond	Maturity Date	Time to Maturity (Years)	Maturity <u>Amount</u>	<u>Calculation</u>
A	6/30/2007	2.50	\$30,000	0.47*
В	9/30/2008	3.75	15,000	0.35
C	12/31/2009	5.00	15,500	0.48
D	3/31/2005	0.25	100,000	0.16
Total			<u>\$160,500</u>	<u>1.46</u>

^{*}Calculated: $2.50 \times (\$30,000/\$160,500)$.

All of the city's investments in U.S. agencies carry the explicit guarantee of the U.S. government. State law limits investments in corporate debt to the top two ratings issued by nationally recognized statistical rating organizations. The city's corporate debt at December 31, 2004, is rated within the top ratings, consistent with the city's investment policy.

Disclosure

As of December 31, 2004, the city had the following investments:

<u>Investment Type</u>	<u>Fair Value</u>	Weighted Average <u>Maturity (Years)</u>
Repurchase agreements	\$215,000	0.02
U.S. Treasuries	119,864	0.35
U.S. agencies	23,614	0.27
Commercial paper	55,493	0.52
Corporate bonds	160,500	1.46
Total fair value	<u>\$574,471</u>	
Portfolio weighted average maturity		0.55

Interest Rate Risk. In accordance with its investment policy, the city manages its exposure to declines in fair values by limiting the weighted average maturity of its investment portfolio to less than ten months.

Credit Risk. State law limits investments in corporate debt to the top two ratings issued by nationally recognized statistical rating organizations. However, the city's investment policy limits its corporate debt investments to the top rating. The city's corporate bonds at December 31, 2004, are rated AAA by Fitch Ratings and Standard & Poor's, and Aaa by Moody's Investors Service. Its investments in commercial paper are rated P-1 by Moody's Investors Service, F-1 by Fitch Ratings, and A-1 by Standard & Poor's.

Illustration 4 Interest Rate Risk—Duration; Credit Risk

Duration is a measure of a fixed income's cash flows using present values, weighted for cash flows as a percentage of the investment's full price. Analytical software commonly includes duration functions. Macaulay duration—named after its developer—is the basic calculation developed for a portfolio of bonds assembled to fund a fixed liability. Modified duration—based on Macaulay duration—estimates the sensitivity of a bond's price to interest rate changes. Effective duration makes assumptions regarding the most likely timing and amounts of variable cash flows arising from such investments as callable bonds, prepayments, and variable-rate debt. This Statement does not specify which form of duration method is to be used.

Assumptions

As of December 31, 2004, a city had the following investments in its internal investment pool. (Amounts are in thousands. Modified duration is in years.)

<u>Investment</u>	Fair Value	Modified <u>Duration</u>
Repurchase agreements	\$250,000	0.21
U.S. Treasuries	119,864	1.24
U.S. agencies	23,614	3.21
Taxable state bonds	10,000	1.83
Corporate bonds	90,500	0.68
Total fair value	<u>\$493,978</u>	
Portfolio modified duration		0.72

The city uses a duration methodology to construct a portfolio of bonds to fund its future cash needs. For reporting purposes, it selects modified duration to disclose the portfolio's exposure to changes in interest rates.

Macaulay duration is calculated as illustrated in the following example: On December 31, 2004, a government has a \$100 bond that matures on December 31, 2006. It carries a 7.5 percent coupon and has a yield-to-maturity of 7.5 percent.

Cash <u>Flow Date</u>	<u>Term</u>	<u>Cash Flows</u>	Present Value	Term × Present Value
6/30/2005	0.50	\$ 3.75	\$3.61	1.81
12/31/2005	1.00	3.75	3.48	3.48
6/30/2006	1.50	3.75	3.36	5.04
12/31/2006	2.00	103.75	<u>89.54</u>	<u>179.08</u>
			\$100.00*	<u>189.41</u>

^{*}Rounded.

Macaulay duration equals the sum of discounted time-weighted cash flows divided by the bond price:

$$189.41/\$100 = 1.89 \text{ years}$$

Modified duration is calculated as follows: Macaulay duration/(1 + yield-to-maturity/number of coupon payments per year). Continuing the example, modified duration would be:

$$1.8941/(1 + .075/2) = 1.83$$

Note: If the city's bonds carried call options, the city could consider the use of effective duration to allow for the consequences of variable cash flows.

As a charter city, the city's general investment policy is to apply the prudent-person rule: Investments are made as a prudent person would be expected to act, with discretion and intelligence, to seek reasonable income, preserve capital, and, in general, avoid speculative investments. The city's investment policy limits investments in corporate bonds to the top two ratings issued by nationally recognized statistical rating

organizations. Through its investment policy, the city manages its exposure to fair value losses arising from increasing interest rates by limiting the modified duration of its investment portfolio to less than nine months (0.75 years).

The city's investment in the bonds of U.S. agencies was rated AAA by Standard & Poor's and Fitch Ratings, and Aaa by Moody's Investors Service. The taxable state bonds were rated AAA/Aaa. Of the city's investments in corporate bonds, \$80,500,000 was rated AAA/Aaa. The remaining corporate bond investment, \$10 million, was rated AA/Aa.

Disclosure

As of December 31, 2004, the city had the following investments. (Amounts are in thousands. Modified duration is in years.)

Investment Type	<u>Fair Value</u>	Modified <u>Duration</u>
Repurchase agreements	\$250,000	0.21
U.S. Treasuries	119,864	1.24
U.S. agencies	23,614	3.21
Taxable state bonds	10,000	1.83
Corporate bonds	90,500	0.68
Total fair value	<u>\$493,978</u>	
Portfolio modified duration		0.72

Interest Rate Risk. Through its investment policy, the city manages its exposure to fair value losses arising from increasing interest rates by limiting the modified duration of its investment portfolio to less than nine months (0.75 years).

Credit Risk. As a charter city, the city's general investment policy is to apply the prudent-person rule: Investments are made as a prudent person would be expected to act, with discretion and intelligence, to seek reasonable income, preserve capital, and, in general, avoid speculative investments. The city's investment policy limits investments in corporate bonds to the top two ratings issued by nationally recognized statistical rating

organizations. The city's investments in the bonds of U.S. agencies were rated AAA by Standard & Poor's and Fitch Ratings, and Aaa by Moody's Investors Service. The taxable state bonds were rated AAA/Aaa. Of the city's investments in corporate bonds, \$80,500,000 was rated AAA/Aaa. The remaining corporate bond investment, \$10 million, was rated AA/Aa.

Illustration 5

Interest Rate Risk—Simulation Model

Simulation models estimate changes in an investment's or a portfolio's fair value, given hypothetical changes in interest rates. Various models and techniques may be used. The following example assumes that an adverse change in interest rates arises from an increase in interest rates. If the characteristics of the portfolio were such that a decrease in rates adversely affected fair value, then that scenario would be disclosed.

Assumptions

The following example illustrates the basic technique of using simulation models to value an investment or a portfolio. It assumes a change of interest rates of 100, 200, and 300 basis points; it also assumes that interest rate changes occur on January 1, 2005.

The following bonds, purchased December 31, 2004, mature in three years and were purchased at par. All coupon payments are made semiannually. The conventional bond has a coupon payment of 3 percent. The variable-rate bond resets at the London Interbank Offered Rate (LIBOR) quarterly. The inverse variable-rate bond's coupon varies by the difference of 6 percent minus LIBOR. For purposes of the variable-rate and inverse variable-rate bonds, the timing differences attributable to the reset date are not considered.

			Impact on Fair Value of Basis Point Increase of:		
	Fair Value	<u>Cash</u>	100 Points	200 Points	300 Points
		Flows			
Conventional					
bond:					
3%	\$1,000,000	\$1,090,000			
4%	971,993	1,090,000	\$ 971,993		
5%	944,919	1,090,000		\$ 944,919	
6%	918,742	1,090,000			\$ 918,742
Variable-rate bond:					
3%	1,000,000	1,090,000			
4%	1,000,000	1,120,000	1,000,000		
5%	1,000,000	1,150,000		1,000,000	
6%	1,000,000	1,180,000			1,000,000
Inverse variable-					
rate bond:					
3%	1,000,000	1,090,000			
4%	943,986	1,060,000	943,986		
5%	889,837	1,030,000		889,837	
6%	837,484	1,000,000			837,484
			<u>\$2,915,979</u>	<u>\$2,834,756</u>	\$2,756,226

Disclosure

Interest Rate Risk. The following table summarizes the estimated effects of hypothetical increases in interest rates on investment fair values. It assumes that the increases occur immediately and uniformly to each type of investment. The hypothetical changes in market interest rates do not reflect what could be deemed best- or worst-case scenarios. Variations in market interest rates could produce significant changes in the timing of repayments due to any prepayment options. For these reasons, actual results might differ from those reflected in the table.

	<u>Fair Value</u>
December 31, 2004	\$3,000,000
Fair value of portfolio after basis point increase of:	
100 points	2,915,979
200 points	2,834,756
300 points	2,756,226

Other disclosures would be required. For example, a schedule of investments by type, investment policies, and credit risk disclosures are not included in Illustration 5.

Illustration 6

Custodial Credit Risk—Deposits

Assumptions

A special-purpose government had the following depository accounts. All deposits are carried at cost plus accrued interest. The government does not have a deposit policy.

<u>Depository Account</u>	Bank <u>Balance</u>
Insured	\$ 200,000
Collateralized:	
Collateral held by city's agent in the city's name	3,015,000
Collateral held by pledging bank's trust department in the	
city's name	4,380,000
Collateral held by pledging bank's trust	
department not in the city's name	500,000
Uninsured and uncollateralized	1,683,000
Total deposits	<u>\$9,778,000</u>

Disclosure

Custodial Credit Risk—Deposits. Custodial credit risk is the risk that in the event of a bank failure, the government's deposits may not be returned to it. The government does not have a deposit policy for custodial credit risk. As of December 31, 2004, \$2,183,000 of the government's bank balance of \$9,778,000 was exposed to custodial credit risk as follows:

Uninsured and uncollateralized	\$1,683,000
Uninsured and collateral held by pledging bank's trust department not in	
the city's name	500,000
Total	<u>\$2,183,000</u>

Illustration 7

Investments with Fair Values That Are Highly Sensitive to Interest Rate Changes

The disclosures illustrated here also include those required by Technical Bulletin No. 94-1, *Disclosures about Derivatives and Similar Debt and Investment Transactions*. Other disclosures may be required, such as credit risk and concentration of credit risk. Depending on the method used to communicate interest rate risk—for example, duration (paragraphs 14 and 15 of this Statement)—additional disclosures may be necessary.

Assumptions

In accordance with state investment laws, a county's external investment pool and pension system invest in various mortgage-backed securities, such as collateralized mortgage obligations, interest-only strips, and principal-only strips. The pension system also invests in investments that have coupon payments that vary inversely with changes in interest rates—inverse variable-rate investments—or vary according to changes in benchmark rates in greater than a one-for-one basis. These securities are reported at fair value in the statement of net assets.

As of December 31, 2004, the portfolios include the following investments that have fair values highly sensitive to interest rate changes.

Collateralized Mortgage Obligations. The pension system holds interest-only strips (\$30,000,000 of the county's mortgage-backed securities position of \$74,420,000) in part to maximize yields and as protection against a rise in interest rates. These securities are based on cash flows from interest payments on underlying mortgages. Therefore, they are sensitive to prepayments by mortgages, which may result from a decline in interest rates. The county's external investment pool holds principal-only strips (\$45,580,000 of the

pool's mortgage-backed securities position of \$65,890,000) to reduce the price sensitivity of its fixed-income portfolio to changes in interest rates. These principal-only strips are sensitive to interest rate increases that may result from decreasing mortgage prepayments, thus increasing the average maturity of this investment.

Inverse Variable-Rate Note. The pension system invested \$10 million in a structured note issued by the Federal National Mortgage Association. It was purchased at par on December 31, 2003, and matures December 31, 2006. The note's coupon payment varies inversely with movements in a benchmark rate. As interest rates increase, the coupon paid declines. The amount of the semiannual coupon is calculated at 7.25 percent minus the London Interbank Offered Rate (LIBOR). At December 31, 2004, the note had a fair value of \$8,937,692. The following table summarizes changes in LIBOR and coupon payment:

		Coupon	
<u>Date</u>	<u>LIBOR</u>	Annual Rate	Amount
12/31/2003	3.625%	3.625%*	\$181,250
12/31/2004	6.500%	0.750%	37,500

^{*}Computed: 7.25% - 3.625% = 3.625%.

Variable-Coupon Note with Multiplier. The pension system invested \$10 million in a structured note issued by the Federal Home Loan Bank. It was purchased on December 31, 2003, and matures December 31, 2006. The amount of the semiannual coupon is calculated at 1.25 times LIBOR plus 3 percent. The system's investment policy permits such investments with multipliers up to 1.50 times LIBOR or other index. At December 31, 2004, the note had a fair value of \$10,854,465. The following table summarizes changes in LIBOR and the effect on the coupon payment:

		Coupon	
<u>Date</u>	<u>LIBOR</u>	Rate	<u>Amount</u>
12/31/2003 12/31/2004	3.625% 6.500%	7.531%* 11.125%	\$376,550 556,250

^{*}Computed: $(3.625\% \times 1.25) + 3\%$.

Disclosures

In accordance with state investment laws, the county's external investment pool and pension system invest in various mortgage-backed securities, such as collateralized mortgage obligations, interest-only strips, and principal-only strips. The pension system also invests in securities with coupon payments that vary inversely with changes in interest rates—inverse variable-rate securities—or vary according to changes in benchmark rates in greater than a one-for-one basis. These securities are reported at fair value in the statement of net assets.

Interest rate risk

Collateralized Mortgage Obligations. The pension system invests in interest-only strips (\$30,000,000 of the system's mortgage-backed securities position of \$74,420,000). These securities are based on cash flows from interest payments on underlying mortgages. Therefore, they are sensitive to prepayments by mortgagees, which may result from a decline in interest rates. The county's investment pool holds principal-only strips (\$45,580,000 of the system's mortgage-backed securities position of \$65,890,000). These principal-only strips are sensitive to interest rate increases that may result from decreasing mortgage prepayments, thus increasing the average maturity of this investment.

Inverse Variable-Rate Note. The pension system invested \$10 million in a structured note issued by the Federal National Mortgage Association. It was purchased at par on December 31, 2003, and matures December 31, 2006. The amount of the semiannual coupon is calculated at 7.25 percent minus LIBOR. As interest rates increase, the coupon paid declines. At December 31, 2004, the note had a fair value of \$8,937,692.

Variable-Coupon Note with Multiplier. The pension system purchased a \$10 million structured note issued by the Federal Home Loan Bank. It was purchased on December 31, 2003, and matures December 31, 2006. The amount of the semiannual coupon is calculated at 1.25 times LIBOR plus 3 percent. The pool's investment policy permits such investments with multipliers up to 1.50 times LIBOR or other index. A variable coupon varies directly with movements in interest rates. At December 31, 2004, the note had a fair value of \$10,854,465.

Illustration 8

Foreign Currency Risk

Assumptions

A pension system's exposure to foreign currency risk derives from its positions in foreign currency–denominated fixed-income investments and one investment in Canadian timberlands. The system's investment policy permits it to invest up to 9 percent of total investments in foreign currency–denominated investments. The system's investments in foreign currency–denominated corporate bonds were rated AAA by Standard & Poor's and Fitch Ratings, and Aaa by Moody's Investors Service. The system's exposure to foreign currency risk is as follows:

<u>Investment</u>	Currency	Maturity	Fair Value
XYZ Corporation bond	British pound	05/31/2005	\$ 35,394,051
PQR Canadian government bond	Canadian dollar	01/04/2025	28,500,000
Timberlands	Canadian dollar	Not applicable	12,500,750
GHI Corporation bond	Swiss franc	11/01/2008	22,350,450
JKL Corporation bond	European euro	12/07/2008	19,211,000
MNO Corporation bond	Japanese yen	11/22/2006	15,500,000
Total			<u>\$133,456,251</u>

If the system has entered into derivatives to manage its risks, additional disclosures may be required.

Disclosures

The system's exposure to foreign currency risk is as follows:

<u>Investment</u>	Currency	Maturity	Fair Value
XYZ Corporation bond	British pound	05/31/2005	\$35,394,051
PQR Canadian government bond	Canadian dollar	01/04/2025	28,500,000
Timberlands	Canadian dollar	Not applicable	12,500,750
GHI Corporation bond	Swiss franc	11/01/2008	22,350,450
JKL Corporation bond	European euro	12/07/2008	19,211,000
MNO Corporation bond	Japanese yen	11/22/2006	15,500,000
Total	-		<u>\$133,456,251</u>

The system's investments in foreign currency–denominated corporate bonds were rated AAA by Standard & Poor's and Fitch Ratings, and Aaa by Moody's Investors Service. The system's investment policy permits it to invest up to 9 percent of total investments in foreign currency–denominated investments. The system's current position is 6.5 percent.

Not presented in this illustration, among other investment disclosures, is the pension system's schedule of investments by type and by credit risk disclosures.

Illustration 9

Reverse Repurchase Agreements

The following example replaces the reverse repurchase agreement illustration in Statement 3, Appendix B.

Assumptions

State statutes permit the city to enter into reverse repurchase agreements. All sales of investments under reverse repurchase agreements are for fixed terms. In investing the proceeds of reverse repurchase agreements, city policy calls for the term to maturity of the investment to be the same as the term of the reverse repurchase agreement. Such matching existed at year-end.

As of December 31, 2004, outstanding reverse repurchase agreements were as follows. (All amounts are fair values.)

	Agreement	Underlying Securities	Reinvestment
1.	\$41,399,000 received, to be repaid with interest of 2.49% on 1/20/2006	U.S. Treasury bond (USTB) 5 3/8% maturing 2/20/2006, \$41,903,000	\$41,399,000 repurchase agreements (\$18,500,000), commercial paper (\$13,000,000), and bankers' acceptances maturing 1/20/2006 (\$9,899,000)
2.	\$18,591,000 received, to be repaid with interest of 3.45% on 12/18/2005	Federal Home Loan Mortgage Corporation (FHLMC) 5½% maturing 5/1/2009, \$7,313,000; FHLMC 9¼% maturing 10/1/2008, \$12,160,000	\$18,591,000 corporate bonds maturing 12/18/2005
3.	\$9,102,000 received, to be repaid with interest of 3.50% on 12/31/2005	FHLMC 4 ¹ / ₄ % maturing 7/1/2008, \$9,456,000	\$9,102,000 corporate bonds maturing 12/31/2005

The fair values of the underlying securities are as follows:

Agreement	<u>Underlying Securities</u>	<u>Fair Value</u>
1	USTB	\$41,903,000
2	FHLMC 5 ½% 5/1/2009	7,313,000
	FHLMC 4 1/4% 10/1/2008	12,160,000
3	FHLMC 4 1/4% 7/1/2008	9,456,000
	Total FHLMC	28,929,000
Total underly	ying securities	70,832,000
Accrued interest		252,000
Fair value plus accrued interest		\$71,084,000

The proceeds and subsequent reinvestments from these agreements are summarized as follows:

Agreement	Reinvestments	Total Agreements		
1	Repurchase agreements	\$18,500,000		
	Commercial paper	13,000,000		
	Bankers' acceptances	<u>9,899,000</u>		
Total Agreement 1	-	41,399,000		
2	Corporate bonds	18,591,000		
3	Corporate bonds	9,102,000		
Proceeds	-	69,092,000		
Accrued interest		453,000		
Obligation		\$69,545,000		
The city's credit exposure is as follows:				
Underlying securitie	\$71,084,000			
Reinvestments: fair	69,545,000			
Credit exposure \$1,539,000				

At the end of the reporting period, the city's investments are as follows. This schedule depicts investments not participating in the city's reverse repurchase agreement program, underlying securities used in reverse repurchase activities, and reinvestments that arise from proceeds of reverse repurchase agreements.

<u>Investment</u>	Not <u>Participating</u>	Underlying Securities	Reinvestment	<u>Total</u>
Repurchase				
agreements	\$52,800,000	_	\$18,500,000	\$71,300,000
U.S. Treasury				
bonds	85,300,000	\$41,903,000		127,203,000
U.S. government				
agencies	32,459,000	28,929,000	_	61,388,000
Bankers' acceptances	15,088,000	_	9,899,000	24,987,000
Commercial paper	25,654,000	_	13,000,000	38,654,000
Corporate bonds	_38,357,000		27,693,000	66,050,000
Total	\$249,658,000	\$70,832,000	\$69,092,000	\$389,582,000

Disclosure

As of December 31, 2004, the city's investments were as follows:

<u>Investment</u>	<u>Fair Value</u>
D 1	ф. 71 200 000
Repurchase agreements	\$ 71,300,000
U.S. Treasury bonds	127,203,000
U.S. government agencies	61,388,000
Bankers' acceptances	24,987,000
Commercial paper	38,654,000
Corporate bonds	66,050,000
Total	<u>\$389,582,000</u>

Reverse Repurchase Agreements. State statutes permit the city to enter into reverse repurchase agreements. The credit exposure at year-end related to these agreements was \$1,539,000. All sales of investments under reverse repurchase agreements are for fixed terms. In investing the proceeds of reverse repurchase agreements, city policy is for the term to maturity of the investment to be the same as the term of the reverse repurchase agreement. Such matching existed at year-end.

Not presented in this illustration, among other investment disclosures, are the city's interest rate and credit risk disclosures.

Illustration 10

Custodial Credit Risk—Securities Lending

The following three examples replace the illustrations in Statement 28, Appendixes C, D, and E.

Example A: Note Disclosure for Securities Lending Transactions—Cash Received as Collateral Assumptions

A state employee retirement system administers two pension plans that have pooled domestic and international investment portfolios. Securities lending, which is authorized by state statutes and board of trustees policies, is managed by separate portfolio custodians, both of which are bank trust departments. All loans can be terminated on demand by either the system or the borrowers, although the average loan term is one week.

One agent lends the plan's U.S. government and agency securities and domestic corporate fixed-income and equity securities for cash collateral of 102 percent. This agent invests the cash collateral in a collateral investment pool that has share values based on the amortized cost of the pool's investments. At year-end, the pool has a weighted average term to maturity of twenty-eight days.

The other agent lends international corporate equity securities for cash collateral of 105 percent. The cash collateral is invested in overnight repurchase agreements in a separate account for the retirement system. There are no restrictions on the amount of securities that can be lent at one time or to one borrower.

Before the lending transactions and the investment of the cash collateral, the plan's aggregate investments are as shown in the following table. These investments are reported

at fair value. Except for mutual funds, which are not subject to custodial credit risk, investments are held by the system's agent (which is not affiliated with or related to the investment brokers) in the system's name. (Amounts are in thousands.)

<u>Investment Type</u>	Fair Value
Mutual funds	\$ 122,000
Repurchase agreements	750,000
Commercial paper	59,200
U.S. government and agency securities	1,612,800
Domestic corporate fixed-income securities	840,000
Domestic equities	1,720,000
International equities	825,000
Total	<u>\$5,929,000</u>

The following represents the balances relating to the securities lending transactions as of December 31, 2004. (Amounts are in thousands; investments are reported at fair value.)

Securities Lent	Underlying <u>Securities</u>	Collateral <u>Received</u>	Collateral Investment <u>Value</u>	Type of Collateral
U.S. government and agency securities	\$514,000	\$525,000	\$525,000	Custodian's short- term investment pool
Domestic corporate fixed-income securities	34,000	35,000	35,000	Custodian's short- term investment pool Custodian's short- term investment
Domestic equities	65,000	67,000	67,000	pool Repurchase
International equities	215,000 \$828,000	226,000 \$853,000	226,050 \$853,050	agreements

Except for \$226,050,000 of collateral invested in repurchase agreements, collateral is invested in investment pools and is not exposed to custodial credit risk. For the

\$226,050,000 repurchase agreement, the underlying securities are held by the counterparty—the securities lending agent.

Both lending agents provide indemnification if the borrowers fail to return the underlying securities (and if the collateral is inadequate to replace the securities lent) or fail to pay income distributions on them. There were no significant violations of legal or contractual provisions, no borrower or lending agent default losses, and no recoveries of prior-period losses during the year. There are no income distributions owing on the securities lent.

For simplicity, this example presumes that all borrower rebates, agent fees, and lender's net earnings were fully paid at year-end.

Disclosures

Cash, investments, and securities lending

The following shows only the schedule of investments by type and the disclosures required for securities lending. Other disclosures required by Statement 3, as amended, or Statement 40 also would be made in this note. Explanation of the valuation of the carrying amount of deposits and investments and the accounting policy for securities lending transactions would be in the summary of significant accounting policies.

Investments as of December 31, 2004, are as follows. (Amounts are in thousands.)

<u>Investment Type</u>	Fair Value
Repurchase agreements	\$ 976,050
Commercial paper	59,200
U.S. government and agency securities	1,612,800
Domestic corporate fixed-income securities	840,000
Domestic equities	1,720,000
International equities	825,000
Securities lending short-term collateral investment pool	627,000
Mutual funds	122,000
Total	<u>\$6,782,050</u>

Securities Lending Transactions. State statutes and board of trustees investment policies permit the system to use investments of the two plans to enter into securities lending transactions—loans of securities to broker-dealers and other entities for collateral with a simultaneous agreement to return the collateral for the same securities in the future. The system's securities custodians are agents in lending the plans' domestic securities for cash collateral of 102 percent and international securities for cash collateral of 105 percent. At year-end, the system has no credit risk exposure to borrowers because the amounts the system owes the borrowers exceed the amounts the borrowers owe the system. Contracts with the lending agents require them to indemnify the system if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent) or fail to pay the system for income distributions by the securities' issuers while the securities are on loan.

All securities loans can be terminated on demand by either the system or the borrower, although the average term of the loans is one week. In lending international securities, the term to maturity of the securities loans is matched with the term to maturity of the investment of the cash collateral by investing only in overnight repurchase

agreements. Such matching existed at year-end. In lending domestic securities, cash collateral is invested in the lending agent's short-term investment pool, which at year-end has a weighted average maturity of twenty-eight days. The relationship between the maturities of the investment pool and the system's loans is affected by the maturities of the securities loans made by other entities that use the agent's pool, which the system cannot determine.

Custodial Credit Risk. Custodial credit risk is the risk that, in the event of the failure of the counterparty, the system will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. Consistent with the system's securities lending policy, \$226,050,000 was held by the counterparty that was acting as the system's agent in securities lending transactions.

Example B: Note Disclosures for Securities Lending Transactions—Securities and Letters of Credit Received as Collateral

Assumptions

Under the authority of state statutes, a state government uses the trust department of one of its custodial banks to lend its U.S. government and agency securities. Collateral is either U.S. government or agency securities or irrevocable letters of credit issued by approved banks. The custodial bank and its affiliates are prohibited from issuing the letters of credit that collateralize the securities loans, but they may be borrowers of the underlying securities. The securities lending contracts do not allow the state to pledge or sell collateral securities unless the borrower defaults. At initiation of the loan, the value of the collateral, whether securities or letters of credit, has to be at least 102 percent of the value of the securities lent. The custodial bank trust department holds the collateral in a segregated account in the name of the state and marks the collateral and securities lent to

market daily. If the value of the collateral is below 100 percent of the value of the securities lent, additional collateral has to be provided by the end of the next business day. No more than one-half of the fair value of the state's U.S. government and agency securities can be lent at one time.

Before the lending transactions, the state's portfolio is as shown in the following table. The state reports its investments at fair value. (Amounts are in thousands.)

<u>Investment Type</u>	Fair Value
Repurchase agreements	\$ 510,000
Commercial paper	58,000
Bankers' acceptances	121,500
U.S. government and agency securities	2,820,700
Domestic corporate fixed-income securities	780,000
Domestic equities	1,570,000
Total	\$5,860,200

The following represents the balances of the securities lending transactions at the balance sheet date, December 31, 2004. (Amounts are in thousands and are reported at fair value.)

	Underlying U.S. Government and	Collateral	Type of	Is the Borrower the Custodial Bank or an	Accrued Loan
Loan	Agency Securities	<u>Value</u>	<u>Collateral</u>	Affiliate?	<u>Premium</u>
1	\$ 220,000	\$ 221,000	Letter of credit	Yes	46
2	300,000	299,000	Securities	No	31
3	512,000	512,000	Securities	Yes	85
4	370,000	371,000	Securities	No	53
Total	\$1,402,000	\$1,403,000			

The state has total credit risk of \$1,116,000 on loans 2 and 3 because the borrowers owe the state more than the state owes the borrowers. On loan 2, the borrower owes the state \$300,031,000 (the fair value of the underlying securities plus the accrued loan premium), which is \$1,031,000 more than the \$299,000,000 the state owes the borrower (the fair value of the collateral securities). On loan 3, the borrower owes the state \$512,085,000, which is \$85,000 more than the \$512,000,000 the state owes the borrower. Loans 1 and 4 do not expose the state to credit risk because the underlying securities plus accrued interest are less than collateral value. Credit risk is summarized as follows. (Amounts are in thousands and include accrued interest.)

<u>Loan</u>	Borrower Owes	State/Lender Owes	Net <u>Exposure</u>	Credit <u>Risk</u>
1	\$220,500	\$221,000	\$ (500)	_
2	300,031	299,000	1,031	\$1,031
3	512,085	512,000	85	85
4	370,860	371,000	(150)	
Total credit risk			, ,	\$1,116

There are no provisions for agent indemnification on the securities lending transactions. There were no significant violations of legal or contractual provisions, no borrower or lending agent default losses, and no recoveries of prior-period losses during the year.

With regard to custodial credit risk, the state's investment in commercial paper (\$58,000,000) is held by the counterparty and is uninsured.

The borrower in loan 1 is the custodial bank or one of its affiliates. No custodial credit risk disclosure is required because an unaffiliated bank issues the letter of credit collateralizing the loan. No custodial credit risk disclosures are required for the securities

underlying loan 3 because the custodian of the collateral securities is the custodian's trust department and holds the securities in the state's name, and the borrower is one of the bank's affiliates or the commercial department of the custodial bank. If the borrower was the custodian's trust department or if the custody of the collateral securities was with the bank's commercial department, the underlying securities would be included as a custodial credit risk disclosure because the collateral would be held by the counterparty.

Disclosures

Cash, investments, and securities lending

The following shows only the schedule of investments by category and the disclosures required for securities lending. Other disclosures required by Statement 3, as amended, or Statement 40 also would be made in this note. Explanation of the valuation of the carrying amount of deposits and investments and the accounting policy for securities lending transactions would be in the summary of significant accounting policies.

Investments as of December 31, 2004, are as follows. (Amounts are in thousands.)

<u>Investment Type</u>	<u>Fair Value</u>
Repurchase agreements	\$ 510,000
Commercial paper	58,000
Bankers' acceptances	121,500
U.S. government and agency securities	2,820,700
Domestic corporate fixed-income securities	780,000
Domestic equities	1,570,000
Total	<u>\$5,860,200</u>

Securities Lending Transactions. Under the provisions of state statutes, the state lends securities to broker-dealers and other entities (borrowers) for collateral that will be returned for the same securities in the future. One of the state's custodial banks manages the securities lending program and receives securities or irrevocable bank letters of credit

as collateral. The collateral securities cannot be pledged or sold by the state unless the borrower defaults. Collateral securities and letters of credit are initially pledged at 102 percent of the fair value of the securities lent, and additional collateral has to be provided by the next business day if its value falls to less than 100 percent of the fair value of the securities lent. No more than 50 percent of the state's U.S. government and agency securities may be lent at one time.

At year-end, the state had \$1,116,000 in credit risk exposure to borrowers because the amounts they owed the state exceeded the amounts the state owed them. Additional collateral was provided the next business day, eliminating this exposure.

Custodial Credit Risk. Custodial credit risk is the risk that, in the event of the failure of the counterparty, the state will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. Consistent with the state's investment policy, the state's investment in commercial paper (\$58,000,000) is held by the counterparty and is not insured.

Example C: Note Disclosures for Securities Lending Transactions—Cash and Securities Received as Collateral

Assumptions

A retirement system is authorized by state statutes and board of trustees policies to lend its investment securities. The lending is managed by the system's custodial bank. All loans can be terminated on demand by either the system or the borrowers, although the average term of loans is one week. The custodial bank and its affiliates are prohibited from borrowing the system's securities.

The agent lends the system's U.S. government and agency securities and domestic corporate fixed-income and equity securities for securities or cash collateral of 102

percent. The securities lending contracts do not allow the system to pledge or sell any collateral securities unless the borrower defaults. All securities loans can be terminated on demand by either the system or the borrower, although the average term of the loans is one week. Cash collateral is invested in the agent's collateral investment pool, which has share values based on the amortized cost of the pool's investments. At year-end, the pool has a weighted average term to maturity of twenty-eight days. There are no restrictions on the amount of securities that can be lent at one time or to one borrower.

Before the lending transactions and the investment of the cash collateral, the system's investments are as shown in the following table. Except for mutual funds, the system's agent holds investment securities in the system's name. The system's agent is not affiliated or related to investment brokers. Accordingly, the system is not exposed to custodial credit risk. Investments in mutual funds are not subject to custodial credit risk. (Amounts are in thousands.)

<u>Investment Type</u>	<u>Fair Value</u>
Mutual funds	\$ 122,000
Repurchase agreements	750,000
Commercial paper	59,200
U.S. government and agency securities	1,612,800
Domestic corporate fixed-income securities	840,000
Domestic equities	2,545,000
Total	<u>\$5,929,000</u>

The following represents the balances relating to the securities lending transactions at December 31, 2004. (Amounts are reported in thousands and at fair value.)

Securities Lent	Underlying <u>Securities</u>	Securities Collateral <u>Value</u>	Cash Collateral <u>Investment Value</u>
Lent for cash collateral:			
U.S. government and			
agency securities	\$514,000	_	\$525,000
Domestic corporate fixed-			
income securities	34,000	_	35,000
Domestic equities	65,000	_	67,000
Lent for securities collateral:			
Domestic equities	215,000	\$220,000	<u> </u>
Total	<u>\$828,000</u>	<u>\$220,000</u>	<u>\$627,000</u>

The lending agent provides indemnification if the borrowers fail to return the underlying securities (and if the collateral is inadequate to replace the securities lent) or fails to pay income distributions on them. There were no significant violations of legal or contractual provisions, no borrower or lending agent default losses, and no recoveries of prior-period losses during the year. There are no income distributions owing on the securities lent.

For simplicity, this example presumes that all borrower rebates, agent fees, and lender's net earnings were fully paid at year-end.

Disclosures

Cash, investments, and securities lending

The following shows only the schedule of investments by category and the disclosures required for securities lending. Other disclosures required by Statement 3, as amended, or Statement 40 also would be made in this note. Explanation of the valuation of the carrying amount of deposits and investments and the accounting policy for securities lending transactions would be in the summary of significant accounting policies.

Investments as of December 31, 2004, are as follows. (Amounts are in thousands.)

	<u>Fair Value</u>
Repurchase agreements	\$ 750,000
Commercial paper	59,200
U.S. government and agency securities	1,612,800
Domestic corporate fixed-income securities	840,000
Domestic equities	2,765,000
Securities lending short-term collateral investment pool	627,000
Mutual funds	122,000
Total	<u>\$6,776,000</u>

Securities Lending Transactions. State statutes and board of trustees policies permit the system to lend its securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. The system's custodian lends securities of the type on loan at year-end for collateral in the form of cash or other securities of 102 percent.

At year-end, the system has no credit risk exposure to borrowers because the amounts the system owes the borrowers exceed the amounts the borrowers owe the system. The contract with the system's custodian requires it to indemnify the system if the

borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent) or fail to pay the system for income distributions by the securities' issuers while the securities are on loan.

All securities loans can be terminated on demand by either the system or the borrower, although the average term of the loans is one week. Cash collateral is invested in the lending agent's short-term investment pool, which at year-end has a weighted average maturity of twenty-eight days. The relationship between the maturities of the investment pool and the system's loans is affected by the maturities of the securities loans made by other entities that use the agent's pool, which the system cannot determine. The system cannot pledge or sell collateral securities received unless the borrower defaults.

Appendix D

CODIFICATION INSTRUCTIONS

The sections that follow update the June 30, 2002, Codification of Governmental Accounting and Financial Reporting Standards (Statement 34 Edition) for the effects of this Statement. Only the paragraph number of this Statement is listed if the paragraph will be cited in full in the Codification.

* * *

CASH DEPOSITS WITH FINANCIAL INSTITUTIONS

SECTION C20

Sources: [Add the following:] GASB Statement 40

[Replace current paragraph .104 with the following two paragraphs. Renumber remaining paragraphs.]

Level of Detail

.104 [GASBS 40, ¶5] [Change Statement to section.]

.105 The disclosures required by this section should distinguish between the primary government and its discretely presented component units. The reporting government's financial statements should make those discretely presented component unit disclosures that are essential to fair presentation of the basic financial statements. Determining which component unit disclosures are essential to fair presentation is a matter of professional judgment and should be done on a component unit-by-component unit basis. A specific type of disclosure might be essential for one component unit but not for another depending on the component unit's significance relative to the total component units included in the component units column(s) and the individual component unit's relationship with the primary government. [GASBS 14, ¶11 and ¶63]

Legal or Contractual Provisions for Deposits

[Replace current paragraphs .106–.108, including the heading, with the following. Renumber current paragraph .109.]

Custodial Credit Risk

.107 [GASBS 40, ¶8]

Foreign Currency Risk

.108 If a government's deposits are exposed to **foreign currency risk**, the government should disclose the U.S. dollar balances of such deposits, organized by currency denomination. [GASBS 40, ¶17]

Deposit Policies

.109 Governments should briefly describe their deposit policies that are related to custodial credit risk, required to be disclosed by paragraph .108. If a government has no custodial credit risk policy, the disclosure should indicate that fact. [GASBS 40, ¶6]

* * *

INVESTMENTS SECTION I50

Sources: [Add the following:] GASB Statement 40

[Eliminate heading above paragraph .120.]

.120 [Eliminate *deposits with financial institutions and* in the first sentence.]

[Replace current paragraph .121 with the following three paragraphs. Renumber

remaining paragraphs.]

General Disclosure Principles

Level of Detail

.121 [GASBS 40, ¶5] [Change Statement to section.]

.122 The disclosures required by this section should distinguish between the primary

government and its discretely presented component units. The reporting government's

financial statements should make those discretely presented component unit disclosures

that are essential to fair presentation of the basic financial statements. Determining which

component unit disclosures are essential to fair presentation is a matter of professional

judgment and should be done on a component unit-by-component unit basis. A specific

type of disclosure might be essential for one component unit but not for another

depending on the component unit's significance relative to the total component units

included in the component units column(s) and the individual component unit's

relationship with the primary government. [GASBS 14, ¶11 and ¶63]

77

Investment Type Disclosures

.123 [GASBS 40, ¶4]

[Replace current paragraphs .124–.132, including the heading, with the following:]

Investment policies

.126 [Insert GASBS 40, ¶6, eliminating *deposit or* from the first and last sentences.] [Change *Statement* to *section*.]

Disclosures Required for Specific Risks

Credit Risk

.127 [GASBS 40, ¶7]

Custodial Credit Risk

.128 [GASBS 40, ¶9] [Change cross-references.]

Concentration of Credit Risk

.129 [GASBS 40, ¶11]

Interest Rate Risk

.130–.132 [GASBS 40, ¶14–¶16] [Change cross-reference.]

Foreign Currency Risk

.133 If a government's investments are exposed to **foreign currency risk**, the government should disclose the U.S. dollar balances of such investments, organized by currency denomination and investment type. [GASBS 40, ¶17]

Other Disclosures

.134–.135 [Insert current paragraphs .129 and .132.]

DEFINITIONS

[Insert new paragraph .510 as follows and renumber subsequent paragraphs.]

- .510 **Concentration of credit risk.** The risk of loss attributed to the magnitude of a government's investment in a single issuer. [GASBS 40, ¶19]
- .511 **Counterparty.** [Replace current definition with the following:] The party that pledges collateral or repurchase agreement securities to the government or that sells investments to or buys them for the government. [GASBS 40, ¶19]
- .512 **Credit risk.** [Replace current definition with the following:] The risk that an issuer or other counterparty to an investment will not fulfill its obligations. [GASBS 40, ¶19]

[Insert new paragraph .514 as follows and renumber subsequent paragraphs.]

.514 **Custodial credit risk.** The custodial credit risk for *deposits* is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for *investments* is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. [GASBS 40, ¶19]

[Replace and renumber current paragraph .514 as follows and renumber subsequent paragraphs.]

.516 **Depository Insurance.** Depository insurance includes:

- a. Federal depository insurance funds, such as those maintained by the Federal Deposit Insurance Corporation.
- b. State depository insurance funds.
- c. Multiple financial institution collateral pools that insure public deposits. In such a pool, a group of financial institutions holding public funds pledge collateral to a common pool.

[GASBS 40, ¶19]

[Insert new paragraphs .518 and .519 as follows and renumber subsequent paragraphs.]

- .518 **Duration.** A measure of a debt investment's exposure to fair value changes arising from changing interest rates. It uses the present value of cash flows, weighted for those cash flows as a percentage of the investment's full price. [GASBS 40, ¶19]
- .519 **Embedded option.** A provision or term in a financial instrument that allows one party to change the timing or amount of one or more cash flows associated with that instrument. Examples include prepayment options on asset-backed securities. [GASBS 40, ¶19]
- .523 [Replace current definition with the following:] **Federal Deposit Insurance Corporation.** A corporation created by the federal government that insures deposits in banks and savings associations. [GASBS 40, ¶19]

[Insert new paragraph .526 as follows and renumber subsequent paragraphs.]

.526 **Foreign currency risk.** The risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. [GASBS 40, ¶19]

[Insert new paragraph .529 as follows and renumber subsequent paragraphs.]

.529 **Interest rate risk.** The risk that changes in interest rates will adversely affect the fair value of an investment. [GASBS 40, ¶19]

[Insert new paragraph .532 as follows and renumber subsequent paragraphs.]

.532 **Issuer.** An issuer is the entity that has the authority to distribute a security or other investment. A *bond issuer* is the entity that is legally obligated to make principal and interest payments to bond holders. In the case of mutual funds, external investment pools, and other pooled investments, *issuer* refers to the entity invested in, not the investment company-manager or pool sponsor. [GASBS 40, ¶19]

[Insert new paragraph .546 as follows and renumber subsequent paragraphs.]

.546. **Reset date.** The time, frequently quarterly, that a bond's variable coupon is repriced to reflect changes in a benchmark index.

[Insert new paragraphs .552–.554 as follows and renumber subsequent paragraphs.]

- .552 **Segmented time distributions.** Segmented time distributions group investment cash flows into sequential time periods in tabular form. [GASBS 40, ¶19]
- .553 **Simulation models.** Simulation models estimate changes in an investment's or a portfolio's fair value, given hypothetical changes in interest rates. Various models or techniques are used, such as "shock tests" or value-at-risk. [GASBS 40, ¶19]
- .554 **Specific identification.** In the context of interest rate risk disclosures, the specific identification method does not compute a disclosure measure but presents a list of each investment, its amount, its maturity date, and any call options. [GASBS 40, ¶19]

[Insert new paragraph .561 as follows and renumber subsequent paragraphs.]

.561 **Uncollateralized deposit.** An uncollateralized deposit does not have securities pledged to the depositor-government. [GASBS 40, ¶19]

[Insert new paragraphs .563 and .564 as follows and renumber subsequent paragraphs.]

.563 Variable-rate investment. An investment with terms that provide for the adjustment of its interest rate on set dates (such as the last day of a month or calendar quarter) and that, upon each adjustment until the final maturity of the instrument or the period remaining until the principal amount can be recovered through demand, can reasonably be expected to have a fair value that will be unaffected by interest rate changes. [GASBS 40, ¶19]

.564 **Weighted average maturity.** A weighted average maturity measure expresses investment time horizons—the time when investments become due and payable—in years or months, weighted to reflect the dollar size of individual investments within an investment type. [GASBS 40, ¶19]

* * *

INVESTMENTS—REVERSE REPURCHASE AGREEMENTS SECTION 155

Sources: [Add the following:] GASB Statement 40

[Replace current paragraph .107 with the following two paragraphs. Renumber remaining

paragraphs.]

Level of Detail

.107 [GASBS 40, ¶5] [Change Statement to section.]

.108 The disclosures required by this section should distinguish between the primary

government and its discretely presented component units. The reporting government's

financial statements should make those discretely presented component unit disclosures

that are essential to fair presentation of the basic financial statements. Determining which

component unit disclosures are essential to fair presentation is a matter of professional

judgment and should be done on a component unit-by-component unit basis. A specific

type of disclosure might be essential for one component unit but not for another

depending on the component unit's significance relative to the total component units

included in the component units column(s) and the individual component unit's

relationship with the primary government. [GASBS 14, ¶11 and ¶63]

* * *

83

Sources: [Add the following:] GASB Statement 40

[Revise current paragraph .114 as follows:]

.114 Disclosures required by Section I50, paragraph .128, should be made for securities lending collateral that is reported in the statement of net assets¹³ and for the underlying securities. Therefore, the reported amounts of these investments should be disclosed by type of investment and amount, as required by paragraph .123 of that section.¹⁴

a. Collateral that is reported in the statement of net assets should follow the custodial credit risk disclosure requirements of paragraph .128 of that section, unless it has been invested in a securities lending **collateral investment pool** or another type of

paragraph.

b. Underlying securities are not subject to custodial credit risk disclosure requirements

investment that is not exposed to custodial credit risk, as provided in that same

if the collateral for those loans is reported in the statement of net assets.

c. Underlying securities should follow the custodial credit risk disclosure requirements of paragraph .128 of that section if the collateral for those loans is not reported in the statement of net assets. This disclosure should be based on the type of collateral and

the custodial arrangements for the collateral securities.

[GASBS 40, ¶10]

¹³For purposes of this section, the statement of net assets also refers to the balance sheet. [GASBS 40, ¶10] ¹⁴ Cash collateral in deposit accounts with financial institutions is subject to the provisions of paragraph .107

of Section C20, "Cash Deposits with Financial Institutions." [GASBS 40, ¶10]

DEFINITIONS

.507 Credit risk. [Replace current definition as follows:] The risk that an issuer or other

counterparty to an investment will not fulfill its obligations. For securities lending, the

aggregate of the lender's exposures to the borrowers of its securities. [GASBS 28, ¶18;

GASBS 40, ¶19]

* * *

84

PENSION PLANS—DEFINED BENEFIT

SECTION Pe5

Sources: [Add the following:] GASB Statement 40

.124d [Replace existing subparagraph as follows:]

d. [GASBS 40, ¶12]

* * *

PENSION PLANS—DEFINED CONTRIBUTION

SECTION Pe6

Sources: [Add the following:] GASB Statement 40

.104c [Replace existing subparagraph as follows:]

c. [GASBS 40, ¶13]