CHAPTER 6

Accounting and Financial Reporting for Certain Investments and for External Investment Pools

Primary Pronouncements: GASB Statement 3, GASB Statement 31
Primary Codification Section References: I50, In5

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QUESTIONS AND ANSWERS

6.1 Introduction

6.2 Scope and Applicability of Statement 31, as Amended

6.3 Transactions Covered by Statement 31, as Amended


A—Statement 31, as amended, applies to all investments held by governmental external investment pools. For governmental entities other than external investment pools and defined benefit pension and other postemployment benefit (OPEB) plans, Statement 31, as amended, applies to investments in interest-earning investment contracts; external investment pools; open-end mutual funds; debt securities; and equity securities (including unit investment trusts and closed-end mutual funds), option contracts, stock warrants, and stock rights that have readily determinable fair values. Most of these types of investments are defined in the glossary in Appendix 6-1. Statement 31, as amended, provides additional valuation guidance for investments in securities subject to purchased put option contracts and written call option contracts, open-end mutual funds, external investment pools, and interest-earning investment contracts. Investments reported in defined benefit pension or OPEB plans have fair value investment standards in accordance with Statement No. 25, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans, Statement No. 67, Financial Reporting for Pension Plans, or Statement No. 43, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans, as applicable.

For investments that are investment derivative instruments, the provisions of Statement No. 53, Accounting and Financial Reporting for Derivative Instruments, also should be considered.

6.3.2. Q—What transactions are covered by the provisions of Statement 31? Specifically, what is meant by an investment? (Q&A31-2) [Amended 2004]

A—Statement 31 applies to those transactions that a government enters into primarily for the purpose of obtaining income or profit for the governmental entity or others. Generally, this includes purchases of debt and equity securities and other instruments that pay money to a government relating to the period over which that government holds the instrument. [Not used in GASBIG 20XX-1]

6.4 Transactions Not Covered by Statement 31, as Amended

6.4.1. Q—What investment-related transactions are not covered by Statement 31, as amended? (Q&A31-3) [Amended 2007, 2012, and 2013]

*Numbers in parentheses refer to the question numbers in the initial Implementation Guide. The original question number is preceded by a notation of the Implementation Guide (Q&A) in which the question was first published (for example, Q&A31-1 indicates that the question originally was Question 1 in the Implementation Guide to Statement 31). Questions that were not included in the initial Implementation Guide are noted by the year in which they first appeared in the Comprehensive Implementation Guide and the question number from that guide (for example, Q&A2003-6.7).
A—There are situations in which a government holds an instrument that pays money relating to the holding period that clearly are not intended to be covered by Statement 31, as amended. Although it is not feasible to list all investment-type transactions, the following are the more common transactions not covered by Statement 31, as amended. This list generally does not apply to investments reported by governmental external investment pools, defined benefit pension plans, or Internal Revenue Code (IRC) Section 457 deferred compensation plans. Pools that are 2a7-like generally report their investments at amortized cost. All other governmental external investment pools, defined benefit pension plans, and IRC Section 457 deferred compensation plans generally report their investments using fair value. (See Questions 6.4.2 and 6.40.1–6.40.3.)

- Seized debt securities that the government holds as evidence or as a potential fine
- Contractors’ deposits of debt securities
- Real estate held for investment purposes (Question 6.4.2)
- Equity interests in component units or joint ventures (Questions 6.4.3 and 6.36.1)
- Equity securities accounted for under the equity method (Question 6.4.3)
- Long-term securities placed in an irrevocable trust that meets the requirements of a legal or in-substance defeasance (Question 6.4.4)
- Interfund loans (Question 6.4.5)
- Loans receivable arising from real estate lending activities (Question 6.4.6)
- Securities and other instruments not held for investment purposes (Question 6.6.1)
- Receivables that do not meet the definition of a security
- Equity securities (including unit investment trusts and closed-end mutual funds), option contracts, stock warrants, and stock rights that do not have readily determinable fair values (Question 6.12.8)
- Short sales of securities (Question 6.21.1)
- Restricted stock (Question 6.4.2)
- Trade accounts receivable arising from sales on credit

6.4.2.  Q—Investments such as real estate and restricted stock generally are not subject to Statement 31, as amended. How should these and other types of investments not subject to Statement 31, as amended, be valued? (Q&A31-4) [Amended 2006, 2007, and 2013]

A—Some investments that are not subject to Statement 31, as amended, should be measured at fair value, including:

- Most investments, including real estate and restricted stock, held by defined benefit pension plans and OPEB plans should be reported at fair value (Statement 25, paragraph 24, as amended; Statement 67, paragraph 18; Statement 43, paragraph 22, as amended).
- Most investments held by external investment pools should be reported at fair value (Statement 31, paragraph 7, as amended; Question 6.40.1).
- Most investments held by IRC Section 457 deferred compensation plans should be reported at fair value (Statement No. 32, Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans).
- Land and other real estate held as investments by endowments should be reported at fair value (Statement No. 52, Land and Other Real Estate Held as Investments by Endowments, paragraph 4).
- Derivative instruments, except fully benefit-responsive synthetic guaranteed investment contracts, should be reported at fair value (Statement 53, paragraph 19, as amended).

Other investments that are not subject to Statement 31, as amended, should be measured using other measurement methods, including:

• Mortgage loans held for sale in governmental activities, business-type activities, and proprietary funds should be reported at lower of cost or fair value (Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, paragraph 453).

• Investments in life insurance should be reported at cash surrender value (Statement No. 67, *Financial Reporting for Pension Plans*, paragraph 18; Question 6.27.1).

• Investments in common stock held in governmental activities, business-type activities, and proprietary funds by entities other than governmental external investment pools, defined benefit pension or OPEB plans, or IRC Section 457 deferred compensation plans that do not have readily determinable fair values and that meet certain criteria in paragraphs 205–208 of Statement 62 should be reported using the equity method (Statement 62, paragraphs 202–210, as amended).

6.4.3. Q—Does Statement 31 apply to equity securities accounted for under the equity method or to equity interests in joint ventures? (Q&A31-5) [Amended 2012]


6.4.4. Q—How should a government report long-term securities that have been placed in trust to defease the government’s outstanding bonds? (Q&A31-6)

A—If legal or in-substance defeasance as defined by Statement No. 7, *Advance Refundings Resulting in Defeasance of Debt*, or No. 23, *Accounting and Financial Reporting for Refundings of Debt Reported by Proprietary Activities*, has been established, the debt and the related assets are not reported in the government’s financial statements. The securities would not be subject to the provisions of Statement 31, as amended. However, if the legal or in-substance provisions have not been met and the securities are still reported in the government’s financial statements, Statement 31, as amended, would apply.

6.4.5. Q—in order to finance its own equipment purchase, a city’s internal service fund issues a promissory note that is purchased by the city’s general fund. Should the general fund report the note as an investment, or should this transaction be reported as an interfund loan? (Q&A2003-6.7)

A—The general and internal service funds should report the transaction as an interfund loan in the fund financial statements.

6.4.6. Q—A state housing finance agency issues bonds and uses the proceeds to finance first-time home buyers’ mortgages. Are the mortgage loans considered debt securities and, therefore, investments according to Statement 31, as amended? (Q&A31-7) [Amended 2003 and 2013]

A—No. Housing finance agencies apply Statement 31, as amended, to those investments listed in paragraph 2 of the Statement, as amended—specifically, debt securities. Loan receivables arising from real estate lending activities are not considered debt securities and are not included in the scope of Statement 31, as amended. However, if the loans have been securitized, they are subject to Statement 31 and should be displayed at fair value. If the loans are not held for sale are reported...
6.4 Pension and Deferred Compensation Plans

6.5.1. Q—Why does Statement 31, as amended, apply to only certain types of investments of defined pension plans? (Q&A31-8) [Amended 2013]

A—At the time Statement 31 was issued, Statement 25 already provided fair-value-based financial reporting standards for the investments of defined benefit pension plans. The fair value provisions in that Statement are appropriate within the context of the fair value standard established in Statement 31. Certain standards established in Statement 31, such as those concerning how to report the value of positions in external investment pools, enhance the earlier fair value standards. Therefore, certain provisions of Statement 31, as amended, were extended to defined benefit pension plans. Statement 67 continues those provisions for defined benefit pension plans within its scope.

6.5.2. Q—How is the applicability of Statement 31 to IRC Section 457 deferred compensation plans affected by Statements 32 and 53? (Q&A31-9) [Amended 2009 and 2013]

A—Paragraph 5 of Statement 32 requires the application of the valuation provisions of Statement 31 for investments in interest-earning investment contracts; external investment pools; open-end mutual funds; debt securities; and equity securities, option contracts, stock warrants, and stock rights that have readily determinable fair values. Statement 32 requires other plan investments to be reported at fair value (paragraph 5). For deferred compensation plans that hold investments that are investment derivative instruments (for example, synthetic guaranteed investment contracts), the provisions of Statement 53, as amended, also should be considered.

6.5.3. Q—In what situations does Statement 31 require or allow defined benefit pension plans to report investments at cost or amortized cost? (Q&A31-10)

A—Defined benefit pension plans should follow the interest-earning investment contract guidance found in paragraph 8 of Statement 31, which indicates that nonparticipating contracts should be reported using a cost-based measure. They also can apply the provisions of paragraph 9 that allow for participating interest-earning investment contracts that have a remaining maturity at the time of purchase of one year or less to be reported at amortized cost, provided that the fair value of those investments is not significantly affected by the impairment of the credit standing of the issuer or by other factors. The paragraph 9 provisions that allow the reporting of money market investments at amortized cost do not apply to defined benefit pension plans.

6.6 Fiduciary Activities

6.6.1. Q—Statement 31 does not apply to securities and other instruments if they are not held by the governmental entity for investment purposes, either for itself or for parties for which it serves as investment manager or other fiduciary (paragraph 5). What are some examples of such situations? (Q&A31-11)

A—Examples of situations for which a government could be holding investment securities as a fiduciary, but not for investment purposes, include contractors’ performance deposits, securities held in trust as bank regulator, and workers’ compensation deposits held as protection against employer defaults. However, if the government actually manages investments for such deposits—for example,
a contractor provides cash as a performance deposit and the government places that cash into securities—those securities are considered investments that are subject to the provisions of Statement 31, as amended. (See Question 6.6.2.)

6.6.2.  Q—Under the terms of a construction contract, a county government withholds 5 percent of periodic progress payments due a contractor. The contract requires that the retainage should be accounted for in a separate fund or evidenced by a specific investment. This “retainage” is invested for the benefit of the contractor and is released upon completion of the contract. How should the retainage be reported? (Q&A31-12)

A—If a statute or contract requires the county to use a separate fund, the retainage should be reported in a private-purpose trust fund or, if held for a short period, an agency fund. Because the county has invested the retainage, the county should value and report that investment in accordance with Statement 31.

6.6.3.  Q—A school district acting in a fiduciary capacity holds moneys that were contributed for scholarship purposes. Are investments of those moneys covered by Statement 31? (Q&A31-13)

A—Yes. The scholarship moneys are being invested for income or profit for the entity for which the district serves as a fiduciary.

6.7 Governments That Follow FASB or AICPA Guidance

6.7.1.  (Q&A31-14) [Amended 2003; deleted 2012] [Not used in GASBIG 20XX-1]

6.7.2.  Q—How does Statement 31, as amended, apply when a qualified governmental entity follows the provisions of the regulated operations guidance in paragraphs 476–500 of Statement 62, as amended? (Q&A31-15) [Amended 2003 and 2012]

A—Statement 31, as amended, applies to regulated entities just as do all other GASB pronouncements. Regulated operations guidance in Statement 62 may be applied to activities of entities that meet the criteria in paragraph 476 of that Statement. If the entity’s regulator concludes that fair value increases and decreases should not affect utility rates, those increases and decreases should be reported as required by Statement 31. They should then be reversed at the end of the change statement (for example, statement of revenues, expenses, and changes in net position) using a heading such as “Net costs to be recovered from future billings” and the applicable provisions of paragraphs 480–483 of Statement 62, as amended, should be applied.

6.7.3.  (Q&A31-16) [Deleted 2003] [Not used in GASBIG 20XX-1]

6.7.4.  (Q&A31-17) [Deleted 2003] [Not used in GASBIG 20XX-1]

6.8 Public Entity Risk Pools


A—Statement 31 amends the Statement 10 standards. Statement 10 required public entity risk pools to use cost-based reporting for debt securities and preferred stocks that by their provisions are required to be redeemed by the issuer if the entity had the ability and intent to hold the investments to maturity or redemption, respectively. It also required pools to use fair value reporting of debt securities that would not be held to maturity and common and nonredeemable preferred stocks, with
changes in those values reported as unrealized gains and losses. Statement 10 required unrealized gains and losses on those investments to be reported at fair value as a separate component of net position until realized. All of those provisions were amended by the fair value standards of Statement 31.[Not used in GASBIG 20XX-1]

6.9 Restricted Assets, Sinking Funds, and Reserve Funds

6.9.1. Q—Are investments that are reported as restricted assets or in sinking or reserve funds covered by Statement 31? (Q&A31-19)

A—Yes. Statement 31 applies to restricted assets, sinking funds, and reserve funds that include securities or other assets acquired for income or profit, even if specifically purchased for a dedicated purpose, such as a debt service obligation. (See also Question 6.4.4.)

6.9.2. Q—Bonds can be issued with covenants that are at variance with Statement 31—for example, covenants that require cash-basis or amortized-cost accounting. How should Statement 31 be applied when determining compliance with those covenants? (Q&A31-20) [Amended 2003]

A—Statement 31 applies to financial statements prepared in conformity with generally accepted accounting principles (GAAP). Bond covenants commonly apply to matters such as amounts placed on deposit in reserve funds or coverage ratios (that is, the level of cash-basis operating revenues as a ratio of debt service payments). Compliance with those bond covenants should be interpreted with the assistance of bond counsel. When a specific basis is not prescribed, some preparers and auditors believe that GAAP in existence at the time the bonds were issued determines the appropriate accounting principles for determining compliance with bond covenants. In any event, those matters should be resolved in light of all relevant circumstances.

In some cases, additional schedules or narrative explanations can be necessary to report legal compliance responsibilities and accountabilities.

6.10 Investments That Carry “Below-Market” Yields

6.10.1. Q—To support economic development, a city purchases tax-exempt bonds of an industrial development authority that is not a component unit of the city. These bonds carry a lower yield than if they were taxable. The city is a tax-exempt entity and thus is unable to take advantage of the tax-exempt status of the bonds. Are these bonds investments for purposes of Statement 31? (Q&A31-21)

A—Yes. Even though the bonds carry a “below-market” rate of interest, they still meet the definition of an investment. Statement 31 makes no exception for economically targeted investments. (See Questions 6.12.5 and 6.16.1 for valuation guidance.)

6.11 Definition of and Determining Fair Value

6.11.1. Q—What is meant by fair value? (Q&A31-22)

A—Statement 31, paragraph 7, as amended, defines fair value as the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. If a market price is available, fair value equals market value. Otherwise, fair values are estimated or calculated. Fair value does not require that an investment be traded on a market.
6.11.2. Q—When is the fair value of an equity security, option contract, stock warrant, or stock right readily determinable? (Q&A31-23)

A—Paragraph 3 of Statement 31 provides that the fair values of those instruments are readily determinable if the sales prices or bid-and-asked quotations are currently available (1) on an exchange registered with the Securities and Exchange Commission (SEC), (2) in an over-the-counter market that is publicly reported by the National Association of Securities Dealers Automated Quotation (NASDAQ) systems or by the National Quotation Bureau, or (3) in a foreign market that is of a breadth and scope comparable to the preceding two U.S. markets. [Not used in GASBIG 20XX-1]

6.11.3. Q—What are the possible sources of fair value information for investments that are market traded, such as debt and equity securities, option contracts, stock warrants, and stock rights? (Q&A31-24)

A—Prices of securities are published in the financial press from data provided by the exchanges, the National Association of Securities Dealers’ National Market System (for NASDAQ securities), and other authoritative sources. Prices also may be obtained from computerized pricing sources, which get their data from the same original sources. Securities custodians or third-party investment managers/advisers also may be able to provide prices. [Not used in GASBIG 20XX-1]

6.11.4. Q—If the fair value of a debt security is not readily determinable or actively traded, should a government attempt to calculate fair value, or can it use a cost-based method? (Q&A31-25)

A—A thinly traded market should not prevent the government from estimating the fair value of those securities. Question 6.12.5 discusses methods for estimating fair value.

6.11.5. Q—If a government has a significant investment in particular securities and believes that an attempt to sell the entire investment at one time would significantly affect the security’s market price, should the size of the investment be considered in determining the fair value of the security? (Q&A31-26)

A—No. Quoted market prices should be used in this situation. The sale of a significant number of securities that would significantly diminish market prices is considered to be a forced or liquidation sale and is specifically excluded from the definition of fair value in Statement 31, paragraph 7, as amended.

6.11.6. Q—During a trading day, a security trades at different prices. It also trades at different prices in different exchanges, both domestically and overseas, during the trading day. How does fair value accounting treat these issues? (Q&A31-27) [Amended 2003]

A—Statement 31 does not address this specific issue. However, preparers and auditors could consider the guidance in the 2007 edition of the American Institute of Certified Public Accountants’ (AICPA) Audit and Accounting Guide, Investment Companies, paragraph 2.30, which states:

Valuing securities listed and traded on one or more securities exchanges, or unlisted securities traded regularly in over-the-counter (OTC) markets (for example, U.S. Treasury bonds, notes and bills or stocks traded in the National Market System [NMS] of the NASDAQ Stock Market), ordinarily is not difficult, because quotations of completed transactions are published daily, or price quotations are readily obtainable from financial reporting services or individual broker-dealers. A security traded in an active market on
the valuation date is valued at the last quoted sales price except in rare situations). A security listed on more than one national securities exchange should be valued at the last quoted sales price at the time of valuation on the exchange on which the security is principally traded; securities traded both on a national exchange and in the over-the-counter market should be valued based on the price in the market in which the security is principally traded. If the security was not traded in the principal market on the valuation date, the security should be valued at the last quoted sales price on the next most active market, if management determines that price to be representative of fair value. If the price is determined not to be representative of fair value, the security should be valued based on quotations readily available from principal-to-principal markets, financial publications, or recognized pricing services, or a good-faith estimate of fair value should be made. [Footnotes omitted.]

See also Question 6.12.5. [Not used in GASBIG 20XX-1]

6.11.7. Q—A bid price represents the price a willing buyer will pay; an asked price represents the price the seller would like to receive. If actual sales prices are not available when determining fair value, should bid or asked prices be used? (Q&A31-28) [Amended 2003 and 2013]

A—Generally, governments use bid prices, because they are the amounts at which transactions presumably will be completed.

6.12 Valuation of Investments

6.12.1. Q—What is the “one-year option” for money market investments and participating interest-earning investment contracts? How does the one-year option affect the valuation of these investments? (Q&A31-29) [Amended 2013]

A—The “one-year option” in paragraph 9 of Statement 31 relates to money market investments and participating interest-earning investment contracts that have a remaining maturity at time of purchase of one year or less, provided that the fair value of those investments is not significantly affected by the impairment of the credit standing of the issuer or by other factors. Statement 31 allows those investments to be reported at amortized cost. Governmental external investment pools are prohibited from applying the “one-year option” for money market investments and participating interest-earning investment contracts (Question 6.40.3). Defined benefit pension plans may apply the “one-year option” for participating interest-earning investment contracts with a remaining maturity at the time of purchase of one year or less, but not for money market investments (Question 6.5.3).

6.12.2. Q—How does Statement 31 address investments with impaired values? How should these investments be reported? (Q&A31-30) [Amended 2003 and 2013]

A—For investments that are reported at fair value, that valuation already considers potential impairments. For other investments covered by Statement 31, as amended, and that are reported using cost-based measures, valuation should consider whether the fair value of the investment is significantly affected by the impairment of the credit standing of the issuer or by other factors. Although Statement 31 implies that the unrealized loss represented by the impairment should be recognized, it does not specifically require it. In fact, paragraph 76 of the Basis for Conclusions states that when there is an impairment, the cost-based measure should be reevaluated. Therefore, professional judgment should be applied in determining the amount and timing of a write-down. For investments that are not covered by Statement 31, as amended, the American Institute of Certified Public Accountants (AICPA) Audit and Accounting Guide, State and Local Governments, provides guidance. It states:
If declines in the fair value of investments are reported using cost-based measures, an unrealized loss may have to be recorded if the decline is not due to a temporary condition. For example, a government’s liquidity needs may require the sales of investments at losses after the reporting date. That circumstance may represent a subsequent event that might be recognized in the current-period financial statements.

6.12.3. Q—Would a change in one credit quality grade for commercial paper be considered an impairment significant enough to adjust the cost basis of the investment? (Q&A31-31)

A—Generally not. Routine changes in ratings do not necessarily indicate impairment. However, there may be situations—for example, a downgrade of a security to below investment grade—in which a preparer might consider one change in credit quality grade to be an impairment significant enough to require an adjustment. For example, if a government is required by statute to carry securities above a certain grade and a specific security falls below that grade, that security could be required to be liquidated.

6.12.4. Q—An internal investment pool has investments that mature in less than one year from the date of purchase. Can these investments be reported at fair value? (Q&A31-32)

A—It depends on the types of investments in the pool. All of the money market investments and participating interest-earning investment contracts may be reported at fair value. However, nonparticipating interest-earning investment contracts should be reported using cost-based measures. (See Question 6.17.3.)

6.12.5. Q—How should a government determine the fair value of an investment when quoted market prices are not available? (Q&A31-33) [Amended 2003, 2009, and 2013]

A—In this situation, the investment’s value should be estimated. As with all estimates, this calculation requires professional judgment. A government should estimate fair value by considering market prices for similar investments or by using other valuation techniques. Other valuation techniques include:

- The present value of estimated future cash flows using a discount rate commensurate with the risks involved
- Matrix pricing
- Option-pricing models
- Option-adjusted spread models
- The zero-coupon method
- The par-value method
- Fundamental analysis.

Matrix pricing is a mathematical technique used principally to value debt securities by relying on the securities’ relationship to other benchmark quoted securities without relying exclusively on quoted market prices for the specific securities. It estimates the debt security’s fair value by considering coupon interest rates, maturity, credit rating, and market indexes as they relate to the security being valued and to similar issues for which quoted prices are available. Option-pricing models include the Black–Scholes model. This model considers probabilities, volatilities, an option’s return, the risk-free interest rate, the time remaining until the option expires, and the relationship of the underlying financial instrument’s price to the strike price of the option. Option-adjusted spread models measure the spread provided from a financial instrument that is an option or includes an option. Using a benchmarked yield curve, separate cash flows are discounted according to their maturity. The result
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is a spread when compared to yields for risk-free investments. The zero-coupon method estimates future net settlement payments—for example, by an interest rate swap—by assuming that the forward rates implied by a yield curve will be the future spot interest rates. These expected payments are then discounted using the expected spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement payment. The par-value method compares, for example, the fixed rate on an interest rate swap with the current fixed rates that could be achieved in the marketplace should the swap be terminated. Fundamental analysis considers assets, liabilities, operating statement performance, management, and economic environment of the issuer in estimating a fair value.

6.12.6. Q—Treasury bills and commercial paper do not pay interest but instead are purchased at a discount. How does fair value accounting treat income from non-interest-bearing investments? (Q&A31-34)

A—Fair value accounting limits interest income to an investment’s stated interest or coupon rate. Once such an investment is fair-valued, the market takes into account accreted discounts. Accordingly, accretion or amortization of discounts¹ is not necessary; amortization has already been considered in the net increase (decrease) in the fair value of investments. Notwithstanding the foregoing, Statement 31 allows many of those investments to be reported at amortized cost. Amortized cost issues are covered in Questions 6.14.1–6.14.3.

6.12.7. Q—When an interest-bearing bond is fair-valued between interest payment dates, how does fair value consider the accrued interest? (Q&A31-35)

A—Industry practice is not to consider accrued interest in quotations. For example, consider a bond selling at 102 that is purchased between its semiannual interest payment dates. The purchaser would be expected to pay the counterparty 102, plus the amount of accrued interest the counterparty is entitled to. This purchased interest will be received by the purchaser of the bond on the next interest payment date.

6.12.8. Q—What is the measurement basis for option contracts, stock warrants, stock rights, and equity securities that do not have readily determinable fair values? (Q&A31-36) [Amended 2003, 2009, and 2012]

A—Option contracts, stock warrants, and stock rights that are derivative instruments should be reported according to the provisions of Statement 53, as amended. Governmental external investment pools (except 2a7-like pools), defined benefit pension plans, and IRC Section 457 deferred compensation plans should measure equity securities, option contracts, stock warrants, and stock rights at fair value. Although those investments do not have readily determinable values, other estimating procedures are available. (See Question 6.12.5.) Equity securities that do not have readily determinable fair values and are not required to be accounted for by the equity method generally are measured at cost. Statement 62, paragraphs 202–210, describes the cost method and the equity method of accounting for investments in common stock and specifies the criteria for determining when to use the equity method.

6.12.9. Q—in its securities lending program, a government receives cash as collateral. With the cash collateral, the government purchases additional securities and invests in a securities lending pool. How should the investments arising from investing the cash collateral be measured? (Q&A2009-6.12.9)

¹The accounting literature uses amortization of discounts and accretion interchangeably. In this chapter, amortization of discounts is used.
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A—Collateral in the form of investments that arise from invested cash collateral should be measured according to Statement 31. In most cases, securities lending transactions’ invested collateral should be measured at fair value.

6.12.10. Q—When estimating the fair value of investments, is a government required to apply the provisions of Financial Accounting Standards Board (FASB) Statement No. 157, Fair Value Measurements? (Q&A2009-6.12.10) [Amended 2013]

A—No. FASB Statement 157 is nonauthoritative literature and should only be considered when another applicable GASB pronouncement requires measurement at fair value but does not provide measurement guidance. Statement 31, paragraphs 7, 10, and 11, provides the primary guidance for measuring fair value for investments within its scope. Therefore, FASB Statement 157 is not required to be applied. However, governments may apply the approach to determining fair value presented in FASB Statement 157 as a method of applying the definition of fair value in Statement 31.—[Not used in GASBIG 20XX-1]

6.12.11. Q—How should the reporting of investments at fair value be applied to zero-coupon bonds? (Q&A2013-6.12.11)

A—The bonds should be reported at their fair value at the reporting date, and any change in fair value should be reported as a change in net position. The fair value of the bonds ultimately will approach face value—the amount of the proceeds that will be received—as the maturity date nears.

6.13 Marking-to-Market

6.13.1. Q—The process of determining the fair value of an investment is known as marking-to-market. How often should investments be marked-to-market? (Q&A31-37) [Amended 2012]

A—Statement 31 applies to financial statements prepared in accordance with GAAP. At a minimum, investments should be marked-to-market as of the date of the statement of net position/balance sheet. Depending on a government’s investment horizon, the volatility of the investment portfolio, the size of the portfolio, and the interests of financial statement users—including management and any investment pool participants—investments often are marked-to-market more frequently. However, Statement 31 does not require this. Pools that are 2a7-like have special considerations; valuations should be guided by the Securities and Exchange Commission (SEC) regulations concerning the frequency of marking-to-market.

6.13.2. Q—If investments are reported at fair value, can accounting records be kept on the cost (or amortized cost) basis, with financial statement adjustments for fair value? (Q&A31-38)

A—Yes. There is no requirement to journalize fair value adjustments or to keep accounting records based on fair value. Cost-based records are acceptable, provided that adjustments to fair value are made when financial statements are prepared.

6.14 Amortized Cost

6.14.1. Q—Statement 31 permits certain investments to be reported using cost-based measures. Examples are money market investments that have a remaining maturity at the time of purchase of 1 year or less (paragraph 9 of Statement 31) and debt security investments with remaining maturities of up to 90 days at the date of the financial statements (paragraph 16 of Statement 31, as amended). Is the display of realized gains and losses, and amortization of discounts and premiums in the change statement, permitted in these cases? (Q&A31-39) [Amended 2013]
Accounting and Financial Reporting for Certain Investments and for External Investment Pools

A—Although Statement 31 adopts fair value for reporting many investments, cost-based measures are allowed for certain types of investments. As amended, paragraph 13 of Statement 31, including footnote 7, describes how to report fair value changes in the financial statements; realized gains and losses generally should not be displayed separately from the net increase (decrease) in the fair value of investments. Premiums and discounts generally should not be amortized. However, those provisions apply only to investments that are reported using fair value. Paragraph 13, as amended, does not modify current reporting practices for investments that are reported using cost-based measures, including the reporting of realized gains and losses and the amortization of premiums and discounts. If that presentation for cost-based investment income is retained, the financial statements should clearly indicate that this presentation applies only to securities reported at amortized cost.

6.14.2. Q—Entities other than governmental external investment pools and defined benefit pension plans may report money market investments or participating interest-earning investment contracts at amortized cost if they have remaining maturities of one year or less at the time of purchase. If such an investment has a remaining maturity of one year or less at the statement of position date, can it be reported using amortized cost? (For example, a money market investment has a remaining maturity at date of purchase of 18 months, but only three months at the statement of position date.) (Q&A31-40)

A—No. The option in paragraph 9 of Statement 31 applies only to money market investments and participating interest-earning investment contracts that have a remaining maturity of one year or less at the time of purchase. Statement 31 does not provide for entities other than governmental external investment pools to change the valuation of a money market investment for financial statement purposes from fair value to a cost-based measure.

6.14.3. Q—A city purchases for its general fund a money market investment with a remaining maturity at the time of purchase of less than six months. This is not an interest-bearing investment; instead, it was purchased at a discount. The city reports this investment using amortized cost. If in the current year the city holds the investment for three months, should a proportionate amount of income be reported in the current year? (Q&A31-41)

A—Yes. The amortization of the discount should be recognized as revenue ratably over the period from purchase to maturity.

6.15 Specific Investment Instruments

6.16 Bonds with “Below-Market” Yields

6.16.1. Q—How should fair value be estimated for investments that carry a “below-market” interest rate (for example, an industrial revenue bond)? (Q&A31-42)

A—The estimate of fair value could consider market prices for similar investments. (See the description of this type of investment in Question 6.10.1.) An industrial revenue bond could be fair-valued by comparison to current values of similar industrial revenue bonds. Another approach could be to use discounted cash flows, using a current interest rate for comparable bonds.

6.17 Interest-Earning Investment Contracts

6.17.1. Q—What is an interest-earning investment contract? (Q&A31-43)

A—An interest-earning investment contract is a direct contract, other than a mortgage or other loan, that a government enters into as a creditor of a financial institution, broker-dealer, investment
company, insurance company, or other financial services company and for which it receives, directly or indirectly, interest payments. Interest-earning investment contracts include time deposits with financial institutions (such as certificates of deposit), repurchase agreements, guaranteed and bank investment contracts, and annuity contracts issued by insurance companies.

6.17.2. Q—Statement 31 provides different valuation standards for participating and nonparticipating interest-earning investment contracts. What is the difference between these two types of contracts? (Q&A31-44)

A—A participating contract can capture market (interest rate) changes through the investment’s negotiability or transferability, or through redemption terms that consider market rates. For example, a government may hold a guaranteed investment contract that has an interest rate that changes based on changes in the federal funds rate or some other index. A nonparticipating contract cannot be negotiated or transferred and its redemption terms do not consider market rates. A common example would be a term deposit with a bank—a certificate of deposit—that cannot be withdrawn before maturity without substantial penalty and with an interest rate that does not change during the term of the deposit.

6.17.3. Q—How should nonparticipating interest-earning investment contracts be valued? (Q&A31-45)

A—Paragraph 8 of Statement 31 requires all entities to report positions in nonparticipating interest-earning investment contracts using cost-based measures, provided that the fair value of those investments is not significantly affected by the impairment of the credit standing of the issuer or by other factors. As discussed in paragraph 43 of the Basis for Conclusions, this exception from reporting at fair value is provided because those contracts are not able to realize market-based increases or decreases in value under any circumstances.

6.17.4. Q—Are flex repurchase agreements (repos) considered nonparticipating interest-earning investment contracts? (Q&A31-46)

A—It depends on the terms of the repo. A flex repo is a term repurchase agreement that permits the investor to sell a portion of the collateral securities back to the counterparty before the final maturity date of the transaction. Flex repos frequently are used in construction projects when bond proceeds need to be invested until each portion of construction is required to be paid. A flex repo should be considered nonparticipating (and reported using cost-based measures) if it is neither negotiable nor transferable and if redemption terms do not consider market rates.

6.18 Money Market Investments

6.18.1. Q—What are money market investments? (Q&A31-47) [Amended 2009]

A—Money market investments are short-term, highly liquid debt instruments, including commercial paper, bankers’ acceptances, and U.S. Treasury and agency obligations. Asset-backed securities, derivative instruments, and structured notes, including notes with call options, are not included in this definition. Investments with call features are discussed in Question 6.19.2.

6.19 Derivative Instruments

Issues associated with implementation of the measurement and disclosure provisions of Statement 53 are addressed in Chapter 10.
6.19.1. (Q&A31-48) [Amended 2003 and 2004; deleted 2009]. [Not used in GASBIG 20XX-1]

6.19.2. Q—A Federal Home Loan Bank note maturing in two years has an option that makes the note callable in six months. Does this investment qualify as a money market investment that can be reported at amortized cost in accordance with paragraph 9 of Statement 31? (Q&A31-49) [Amended 2009]

A—No. The call feature is an embedded derivative instrument that makes the investment a structured note. Statement 31 does not consider structured notes to be money market investments, and therefore the one-year option as discussed in Question 6.12.1 does not apply to the note.

6.19.3. (Q&A31-50) [Deleted 2009]. [Not used in GASBIG 20XX-1]

6.20 Real Estate

6.20.1. Q—Should real estate held as an investment be reported at cost or fair value? (Q&A31-51) [Amended 2009]

A—Real estate held as an investment by governmental external investment pools, defined benefit pension plans, IRC Section 457 deferred compensation plans, or endowments should be reported at fair value. Real estate held as an investment by other entities or funds should be reported at cost, subject to the provisions for other-than-temporary declines in value as described in the AICPA Audit and Accounting Guide, State and Local Governments, and discussed in Question 6.12.2 of this chapter.

6.20.2. Q—How are the fair values of real estate investments determined? (Q&A31-52)

A—The fair value of real estate investments often is determined by a periodic appraisal of the property by a certified real estate appraiser. Some entities do not have their real estate investments appraised annually. If a property has not been appraised recently, the government should consider the extent to which changes in the real estate market may have affected the value of its properties since the last appraisal and adjust the reported fair value accordingly. Methods other than appraisal also may be used to determine the fair value of real estate—for example, an estimate of fair value based on the present value of estimated expected future cash flows.

6.20.3. Q—When investments in real estate are reported at fair value, what income and expenses are recognized? (Q&A31-53)

A—All rental, lease, and other fees are recognized as revenue. In addition, fair value increases and decreases are recognized in revenue. No depreciation or amortization is recognized on the property. Investment expenses would include those arising from managing the property.

6.21 Short Security Positions

6.21.1. Q—Are short sales of securities covered by Statement 31? (Q&A31-54)

A—No. A short sale is the sale of a security not owned by the seller. The seller borrows the security, sells it, and then buys it at a later time to close the transaction. Short sales represent obligations to deliver securities, not investments.
6.22 Positions in External Investment Pools

6.22.1. Q—How should investment positions in 2a7-like pools be valued? (Q&A31-55) [Amended 2011 and 2013]

A—Investment positions in 2a7-like pools, whether sponsored by a governmental or a nongovernmental entity, should be measured at the net asset value per share provided by the pool. Because of the constraints provided by Statement 31, as amended, on when a pool is classified as 2a7-like, the net asset value per share of an entity’s position in a 2a7-like pool approximates its fair value.

6.22.2. Q—How does a government determine whether the non-SEC-registered pools in which it invests are 2a7-like? (Q&A31-56)

A—The government should obtain this information from the pool sponsor. It also could review a recent financial statement of the pool. If the pool is a governmental entity, Statement 31, as amended, requires that it provide information in its financial statements that would permit governmental entities to determine whether it is 2a7-like. Financial statements from nongovernmental pool sponsors also can provide information to verify a pool’s representation about its 2a7-like status.

6.22.3. Q—The Office of the Comptroller of the Currency (OCC) prescribes a cost-based money market fund for the banks that it regulates that is similar to the SEC’s Rule 2a7. Can the OCC’s structure allow pool participants to value their investment positions in these types of pools using net asset value per share? (Q&A31-57) [Amended 2013]

A—No. The SEC’s Rule 2a7 was selected as the sole structure for participants to value their positions using net asset value per share. A pool that complies with the OCC requirements also would need to be 2a7-like for the participants to value their positions using net asset value per share.

6.22.4. Q—If a pool has a legally binding guarantee to support its shares, can a participating government report its investment in the pool using the pool’s net asset value per share even though the pool is not 2a7-like? (Q&A31-58) [Amended 2009 and 2013]

A—It depends on the nature and amount of the guarantee. Paragraph 71 of the Basis for Conclusions of Statement 31 describes legally binding guarantees. One example is an irrevocable bank letter of credit that supports share value when the fair value of the pool’s investments is affected. An insurance policy would be a similar guarantee. Also, some pool sponsors may state a guaranteed share value. However, paragraph 71 indicates that to meet the requirements of Statement 31, the guarantee would have to be a stated legal obligation and be evaluated in light of the creditworthiness of the pool sponsor. Also, the fair value of the investments in the pool supplemented by the amount of the guarantee would have to fully support the share price. If the guarantee is a wrap contract associated with a synthetic guaranteed investment contract, the provisions of paragraphs 20 and 67 of Statement 53 should be applied.

6.22.5. Q—A local government invests $100,000 in an external investment pool on January 15, receiving 100,000 shares or units in the pool. The pool is not a 2a7-like pool and does not have a legally binding guarantee for its share price. However, the pool seeks to maintain a stable $1.00 net asset value as a matter of day-to-day operations; participants enter and exit the pool using the $1.00 net asset value. On June 30, the end of the local government’s fiscal year, the pool sponsor reports that pool participants should fair-value their pool position at $1.05 per share. On October 15, the local
government withdraws its investment in the pool, using the $1.00 net asset value. How does the participant report its investment in the pool at June 30? (Q&A31-59)

A—On January 15, the investment should be valued at $100,000, its fair value on the date acquired. As of June 30, the investment should be valued at $105,000 in the financial statements. The $5,000 increase should be included on the participant’s change statement in investment income as an increase in the fair value of investments. On October 15 when the investment is withdrawn, investments are reduced by $105,000. The change in the fair value of investments is charged $5,000 because the fair value change is reversed.

Journal entries, in addition to any interest paid to the participant, would be as follows:

<table>
<thead>
<tr>
<th>Date</th>
<th>Account</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>January 15</td>
<td>Investments</td>
<td>100,000</td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td>100,000</td>
</tr>
<tr>
<td></td>
<td>(To record initial investment in external investment pool)</td>
<td></td>
</tr>
<tr>
<td>June 30</td>
<td>Investments</td>
<td>5,000</td>
</tr>
<tr>
<td></td>
<td>Change in the fair value of investments</td>
<td>5,000</td>
</tr>
<tr>
<td></td>
<td>(To report fair value increase)</td>
<td></td>
</tr>
<tr>
<td>October 15</td>
<td>Cash</td>
<td>100,000</td>
</tr>
<tr>
<td>March 15</td>
<td>Change in the fair value of investments</td>
<td>5,000</td>
</tr>
<tr>
<td>March 15</td>
<td>Investments</td>
<td>105,000</td>
</tr>
<tr>
<td>March 15</td>
<td>(To record withdrawal from external investment pool)</td>
<td></td>
</tr>
</tbody>
</table>

How a governmental external investment pool reports this information, using the above example, is discussed in Question 6.43.3. [Not used in GASB20XX-1]

6.22.6 Q—If a government cannot obtain information from a pool sponsor to allow it to determine the fair value of its investment in a non-2a7-like external investment pool, what information might it use to make its best estimate of fair value? (Q&A31-60)

A—The participant in such a pool could obtain the latest available financial statements of the pool. If those statements disclose carrying amount and fair value and the types of investments being held, the participant could use that information and knowledge about changes in fair values of different types of investments since the date of the financial statements to project the current fair value of the pool’s investments. However, to the extent possible, participants should contact pool sponsors to obtain current information about fair value.

6.23 Open-End Mutual Funds

6.23.1. Q—What is an open-end mutual fund? (Q&A31-61)

A—An open-end mutual fund is an SEC-registered investment company that issues shares of its stock to investors, invests in an investment portfolio on the shareholders’ behalf, and stands ready to redeem its shares for an amount based on its current share price. An open-end mutual fund creates new shares to meet investor demand. The value of an investment in the fund depends directly on the value of the underlying portfolio. Open-end mutual funds include governmental external investment pools that are registered as investment companies with the SEC and that operate as open-end funds. [Not used in GASB20XX-1]
6.23.2. **Q**—How are the fair values of positions in open-end mutual funds determined? (Q&A31-62)

**A**—Statement 31, paragraph 10, provides that the fair value of a position in an open-end mutual fund should be based on the fund’s share price. [Not used in GASBIG 20XX-1]

6.24 **Equity Securities**

6.24.1. **Q**—When an equity security is reported at fair value, how are declared dividends recognized for financial reporting purposes? (Q&A31-63)

**A**—Dividends receivable and revenue are recognized at the ex-dividend date—that is, the first date on which the securities trade without the declared dividends attached. Between the date the dividend is declared and the ex-dividend date, the market price (fair value) of the equity security includes the value of the declared dividends. Because the equity security is reported at fair value, recognizing the dividends receivable and revenue for financial reporting purposes before the ex-dividend date would duplicate the transaction.

6.25 **Option Contracts**

6.25.1. **Q**—Statement 31 provides that if a government has purchased put option contracts or written call option contracts on securities and it has those same securities among its investments, it should consider those contracts in determining the fair value of those securities to the extent that it does not report those contracts at fair value (paragraph 7). When should this provision be applied? (Q&A31-64) [Amended 2009]

**A**—This provision should be applied only if the written call or the purchased put are not separately reported and measured at fair value. Because call and put options are derivative instruments or contain an embedded derivative instrument, the provisions of Statement 53 should be applied before consideration of paragraph 7 of Statement 31. [Not used in GASBIG 20XX-1]

6.26 **Reverse Repurchase Agreements**

6.26.1. **Q**—Paragraph 81 of Statement 3 requires the separate display of assets and liabilities arising from reverse repurchase agreements. How is this applied if a government pools moneys from several funds for investment purposes in an internal investment pool and it is the pool, rather than individual funds, that has the reverse repurchase agreements? (Q&A3-119) [Amended 2003]

**A**—A pro rata allocation of the assets and liabilities arising from reverse repurchase agreements should be made to the various funds with equity in the pool. See also Interpretation No. 3, *Financial Reporting for Reverse Repurchase Agreements*, as amended.

6.27 **Recognition and Reporting**

6.27.1. **Q**—A government employer purchases life insurance covering the lives of employees and former employees with vested benefits for which the government is the beneficiary. At what amount should the government recognize its investment in life insurance for financial reporting purposes? (Q&A2010S-6.27.1) [Amended 2012]

**A**—The government employer should recognize as an investment asset the amount that could be realized by that employer under the insurance contract—cash surrender value—as of the date of the statement of net position. The government employer should recognize death benefits as income only
upon the actual death of an insured; income from death benefits should not be recognized on an actuarially expected or projected basis.

6.28 Display in the Change Statement

6.28.1. Q—Should investment transactions be accounted for based on the trade date (the date the order to buy or sell the investment is placed) or the settlement date (the date that the cash and investment instrument are exchanged)? (Q&A31-66) [Amended 2013]

A—Investment transactions should be accounted for based on the trade date. The trade date is the date on which the transaction occurred and is the date the government is exposed to (or released from) the rights and obligations of the ownership of the instrument. This guidance is consistent with paragraph 20 of Statement 25, as amended, and paragraph 18 of Statement 67.

6.28.2. Q—Can the change in fair value of investments in the statement of revenues, expenditures, and changes in fund balances of a governmental fund be reported below the excess of revenues over expenditures? (Q&A31-67)

A—No. Statement 31 requires the change in fair value to be reported as revenue. Consideration was given to allowing the change to be reported in the statement of revenues, expenditures, and changes in fund balances below excess of revenues over expenditures; however, it was determined that the nature of fair value changes is not intrinsically different from, and that it should not be separated from, other elements of investment income.

6.28.3. Q—Can a proprietary fund report the change in fair value of investments in the statement of revenues, expenses, and changes in net position as a nonoperating revenue? (Q&A31-68) [Amended 2012]

A—Yes. The change in the fair value of investments should be reported in the same manner as other investment income, which generally is nonoperating revenue.

6.28.4. Q—Except for the separate reports of governmental external investment pools, why does Statement 31 prohibit the separate display of realized gains and losses on investments that are reported at fair value? (Q&A31-69)

A—The prohibition against the display of realized gains and losses apart from the net increase or decrease in the fair value of investments was initially provided in Statement 25. In that Statement, it was concluded that separate display mixes two different measurement bases, is inconsistent with reporting assets at fair value, and can be misleading. This prohibition was continued in Statement 31. [Not used in GASBIG 20XX-1]

6.28.5. Q—Can all investment income—interest, dividends, and changes in fair value—be aggregated and reported as investment income in the change statement, or should the elements of investment income be reported separately? (Q&A31-70) [Amended 2003 and 2013]

A—All elements of investment income may be presented as an aggregate amount, even for defined benefit pension plans, as provided for in footnote 11 of Statement 25 or paragraph 23 of Statement 67, as applicable.

6.28.6. Q—If overall investment income for the year is negative, how should that amount be reported on the change statement? (Q&A31-71)
6.29 Display in the Statement of Net Position/Balance Sheet

6.29.1. (Q&A31-65) [Deleted 2010] [Not used in GASBIG 20XX-1]  (See Question Z.54.3.)

6.29.2. Q—In the statement of net position/balance sheet, can cost-based investment information be presented parenthetically? (Q&A31-72) [Amended 2012]

A—Yes. Cost-based information can be presented in this manner.

6.29.3. Q—Can a government report the entire position of its internal investment pool as cash and cash equivalents in the general fund, with an amount due to other funds for those other funds’ positions in the pool? (Q&A31-73) [Amended 2003 and 2013]

A—No. Paragraph 14 of Statement 31, as amended, provides that the equity position of each fund or component unit in an internal investment pool should be reported as assets in those funds and component units. Therefore, each fund with a position in the internal investment pool should report its position as, for example, equity in cash management pool, equity in internal investment pool, cash and cash equivalents, or investments. Reporting the entire position of the pool in the general fund, with corresponding interfund receivables and payables for the other funds’ equity positions, misrepresents the nature of the positions. Likewise, an agency fund should not report internally pooled investments, with payables to participating funds.

6.30 Display in the Statement of Cash Flows

See Chapter 2.

6.31 Assignment of Interest

6.31.1. Q—Statement 31 requires that when investment income is assigned to another fund because of other than legal or contractual provisions, the income should be recognized in the fund reporting the investments. What is meant by legal or contractual provisions? (Q&A31-75)

A—Legal or contractual provisions means the assignment of investment income by an authority greater than management decision. An example is a state law that requires all amounts earned by all investing activities of the state treasurer to be accrued as revenue to the general fund.

6.31.2. Q—A city operates an internal investment pool. Certain grant funds, because of untimely reimbursements, operate in a deficit cash position. Does Statement 31 require that the allocation of interest income consider these deficit positions as de facto loans and, accordingly, that an interest charge be assessed? (Q&A31-76)

A—No. When one fund overdraws its share of the pool, that fund should report an interfund liability to the fund that management deems to have lent that amount to the overdrawn fund. Paragraph 14 of Statement 31, as amended, requires only investment income to be allocated. However, there may be federal, state, local, or contractual requirements that would require such an interest charge, or management may believe that an interest charge is appropriate.

6.31.3. Q—A school district trust fund is reported in a permanent fund. Dividends and interest income received on the investments in that fund are transferred, per state statute, to a special needs
Accoun\nting and Financial Reporting for Certain Investments and for External Investment Pools

program accounted for in a special revenue fund in which it will supplement state grants also restricted to that purpose. However, because the transferred income is calculated on a basis other than fair value, there are differences between the amount the trust fund recognizes as investment income and the amount actually transferred to the special needs program. How does the trust report the difference? (Q&A31-77) [Amended 2004 and 2010]

A—Because this trust agreement does not provide for the spending of net appreciation, any unrealized gains should be included in the same fund balance classification as the investments—in this case, nonspendable. If the trust agreement does provide for spending some or all of the net appreciation, and the amount transferred to the special revenue fund is less than the total permitted, the undistributed amount should be classified as restricted.

6.32 Disclosures

See Chapter 1.

6.33 External Investment Pools

6.34 Definition of External Investment Pools

6.34.1. Q—What is an external investment pool? (Q&A31-88)

A—An external investment pool is an arrangement that commingles (pools) the moneys of more than one legally separate entity and invests, on the participants’ behalf, in an investment portfolio. An external investment pool can be sponsored by an individual government, jointly by more than one government, or by a nongovernmental entity. In a governmental external investment pool, one or more of the participants are not part of the sponsor’s reporting entity. For purposes of Statement 31, a governmental investment pool that includes participation both by legally separate entities that are part of the sponsor’s reporting entity and by those that are not is an external investment pool. If a government-sponsored pool includes only the primary government and its component units, it is an internal investment pool and is not subject to the provisions of the Statement that apply to external investment pools. [Not used in GASB 20XX-1]

6.34.2. Q—A local government has an investment account at a local bank. That bank pools moneys from various local governments in investments that are authorized by state law. Is this an external investment pool? (Q&A31-89)

A—Yes. An external investment pool may be administered by a nongovernmental entity. If the pool is an SEC-registered open-end mutual fund, participants should value their positions in the pool accordingly. (See Question 6.23.2.)

6.34.3. Q—A local government sponsors an investment pool for special-purpose governments in its jurisdiction. Participation is open to legally separate entities that are not component units of the local government. During the year, non-component-unit entities invested in the pool, but at the reporting date the only participants are component units. Should the pooling that occurred during the year be reported as an external investment pool? (Q&A31-90) [Amended 2012 and 2013]

A—Yes. The pool should be reported as an external investment pool. If non-component-unit entities invested in the pool during the year, the external activity should be reported in the sponsoring government’s financial statements in an investment trust fund. This would be the case even though
that trust fund would report zero balances in its statement of fiduciary net position as of the reporting
date.

6.34.4. Q—A county collects property taxes on behalf of special-purpose districts within the county. Following the month of collection, the proceeds are remitted to the appropriate districts. While the county holds the proceeds, the moneys are invested in the county’s external investment pool. The districts receive investment income but do not participate in investment losses of the pool. Are the districts participants in a governmental external investment pool? (Q&A31-91) [Amended 2008 and 2013]

A—No. In the view of the districts, the moneys held by the county are a receivable, not an investment. Receivables are not covered by Statement 31, as amended. See paragraph 2, as amended, and the definition of debt security in paragraph 22 of the Statement. Whether the districts receive any investment income on their invested balances does not affect this analysis. The county should report in an agency fund a liability to the districts and should value the investments purchased with the districts’ moneys according to Statement 31, as amended. If the values of the investments fall below the county’s liability, the county should evaluate its liability in the context of its legal responsibilities.

6.34.5. Q—A county treasurer, per statute, acts as the official treasurer for special-purpose districts within the county. The districts are not component units of the county. Moneys are pooled and invested by the treasurer. Are the districts participants in a governmental external investment pool? (Q&A31-92) [Amended 2013]

A—It depends on which entity benefits from the investment. An external investment pool invests for the benefit of participants. If the districts participate in the investment income of the pooled investments, they have a position in a governmental external investment pool. Their positions in the pool should be valued according to share value after considering any legally binding guarantee by the pool sponsor—the county. Investment positions in 2a7-like pools should be determined by the pool’s net asset value per share. (See Statement 31, paragraph 11, and Statement No. 59, Financial Instruments Omnibus, paragraph 5.)

If the districts do not participate in the investment income (or the possibility of loss) of the pooled investments, the districts do not have a position in a governmental external investment pool. This could be the case if, for example, the districts’ moneys are invested for the benefit of the county’s general fund in an assignment of income and the districts are protected from loss. From the perspective of the districts, this structure more closely resembles a demand account. The county should follow the assignment-of-income provisions of Statement 31, paragraphs 14 and 15, as amended.

6.35 Colleges and Universities

6.35.1. (Q&A31-93) [Deleted 2003] [Not used in GASBIG 20XX-1]

6.35.2. (Q&A31-94) [Deleted 2003] [Not used in GASBIG 20XX-1]

6.36 Joint Ventures

6.36.1. Q—A governmental joint venture is established to construct and operate a sewage treatment plant. In its initial design and construction phase, the joint venture realizes significant income from the
investment of unspent construction money. Is this joint venture an external investment pool? (Q&A31-95)

A—No. Statement 31 indicates that an external investment pool is organized to commingle the moneys of participants in an investment portfolio. The joint venture described was not established to operate as an investment vehicle; the investment function is incidental to the purposes of the organization. The accounting provisions of Statement 14, as amended, should be followed. However, the joint venture should apply the provisions of Statement 31 when reporting its investments.

6.37 Public Entity Risk Pools

6.37.1. Q—A risk management pool is established among local governments to manage liability exposures. The pool holds substantial investments. Is this risk pool also an external investment pool? (Q&A31-96)

A—No. The risk pool was not organized to be an investment vehicle and should not be considered an external investment pool. Risk pools should follow the investment requirements of Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, as amended by Statement 31. (See Question 6.8.1.)

6.38 Venture Capital Limited Partnerships

6.38.1. (Q&A31-97) [Deleted 2006]. [Not used in GASBIG 20XX-1]

6.39 2a7-Like Pools

6.39.1. (Q&A31-98) [Deleted 2011]. [Not used in GASBIG 20XX-1]

6.39.2. (Q&A31-99) [Amended 2010; deleted 2011]. [Not used in GASBIG 20XX-1]

6.40 Valuation of Governmental External Investment Pool Investments

6.40.1. Q—Should a governmental external investment pool that is not 2a7-like measure its debt investments using fair value or amortized cost? (Q&A31-100) [Amended 2009]

A—Most investments should be reported using fair value (paragraph 7 of Statement 31, as amended). Nonparticipating interest-earning investment contracts should be reported using cost-based measures. (See Question 6.17.3.) Debt securities with a remaining maturity of 90 days or less at the date of the financial statements may be reported at amortized cost (paragraph 16 of Statement 31). Fully benefit-responsive synthetic guaranteed investment contracts—the combination of the underlying investments and the wrap contract—should be reported at contract value based on the guidance provided in paragraph 67 of Statement 53.

6.40.2. Q—A governmental external investment pool has held a U.S. Treasury bond for several years and has reported it at fair value. At the pool’s current year-end, that bond has only 75 days remaining to maturity, and the pool reports short-term debt investments with a remaining maturity of 90 days or less at amortized cost. What is the value of that bond for determining its cost basis at the current reporting date? (Q&A31-101)
A—The fair value of the investment on the date it becomes short term (for example, when it has 90 days remaining to maturity) becomes its new cost basis. Any difference between that new cost basis and the face value of the investment is amortized over the remaining 90 days to maturity.

6.40.3. Q—Statement 31 provides different accounting requirements for money market investments and participating interest-earning investment contracts that are held by governmental entities other than external investment pools. If a governmental external investment pool includes internal moneys belonging to the pool’s sponsor, should the accounting guidance applicable to governmental external investment pools be followed for the entire pool? (Q&A31-102)

A—Yes. This pool should follow the governmental external investment pool guidance for money market investments and participating interest-earning investment contracts. Short-term debt investments with remaining maturities of up to 90 days at the date of the financial statements may be reported at amortized cost, provided that the fair value of those investments is not significantly affected by the impairment of the credit standing of the issuer or by other factors. (See Statement 31, paragraph 16.) The pool is not permitted to follow the cost-based standards for money market investments and participating interest-earning investment contracts, even though a portion of the pool represents internal moneys. (See Statement 31, footnote 3.)

6.41 Reporting Governmental External Investment Pools

6.42 Separate or Stand-Alone Financial Reports

6.42.1. Q—Statement 31, paragraph 17, provides that all applicable GASB pronouncements should be applied in the separate or stand-alone financial reports of governmental external investment pools. What are the other GASB pronouncements that most likely apply? (Q&A31-103) [Amended 2004, 2009, and 2013]

A—The other GASB pronouncements most likely to apply to governmental external investment pools are:

- Statement No. 3, Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements, as amended
- Statement No. 28, Accounting and Financial Reporting for Securities Lending Transactions, as amended
- Statement No. 34, Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments, as amended
- Statement No. 37, Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments: Omnibus, as amended
- Statement No. 38, Certain Financial Statement Note Disclosures, as amended
- Statement No. 40, Deposit and Investment Risk Disclosures, as amended
- Statement 53, as amended
- Statement 62, as amended
- Interpretation 3, as amended.

However, there might be other transactions or balances subject to GASB pronouncements. All GASB pronouncements should be reviewed for applicability.
Accounting and Financial Reporting for Certain Investments and for External Investment Pools

6.42.3. (Q&A31-105) [Deleted 2004] [Not used in GASBIG 20XX-1]

6.42.4. Q—A governmental external investment pool includes moneys of external entities as well as moneys of the sponsoring government. For the separate or stand-alone financial reports of the pool, should only those positions belonging to the external entities be reported? (Q&A31-106)

A—No. The separate or stand-alone financial report should include all assets under management, including those that represent positions that belong to the sponsoring government.

6.42.5. Q—Statement 31 requires governmental external investment pools to disclose information about regulatory oversight and the frequency of determining the fair value of pool investments. What are examples of this type of information? (Q&A31-107)

A—Examples are the existence of state agency oversight, the existence of a board of directors, and the frequency of marking-to-market. Research for this project revealed that the nature of a pool’s operations and portfolio was not always evident in materials that were distributed to participants, including financial reports. These disclosures will provide that information to pool participants and other users of pool financial statements, permitting them to make more informed decisions about the pool.

6.42.6. Q—Statement 31, paragraph 17, as amended, requires governmental external investment pools to disclose, among other information, a summary of the fair value and carrying amount (if different from fair value) of each major investment classification. Does this disclosure requirement apply to 2a7-like pools? (Q&A31-108)

A—Yes. Such information is as important for the financial reports of 2a7-like pools as it is for non-2a7-like pools.

6.43 Sponsor Reporting

6.43.1. Q—A state government sponsors an investment pool for its own moneys and moneys of legally separate entities that are not component units. What are the requirements for presenting this pool in the state’s annual financial report? (Q&A31-109) [Amended 2003]

A—The state should report the external portion of the pool (that is, the portion belonging to the non-component-unit participants) as an investment trust fund in the fiduciary fund financial statements. (See Exhibits 41 and 42 in nonauthoritative Appendix 7-1.)

6.43.2. Q—A governmental external investment pool is included in the statement of fiduciary net position of the sponsoring government. How should the equity account net position held in trust for pool participants be reported? (Q&A31-110) [Amended 2012 and 2013]

A—In the statement of fiduciary net position—fiduciary funds, this account should be presented in net position as, for example, held for external investment pool participants.

6.43.3. Q—What are the disclosure requirements for the financial statements of a government that sponsors an external investment pool? (Q&A31-111) [Amended 2012 and 2013]

A—If a separate financial report is issued for the pool, the financial statements of the sponsoring government need only disclose how to obtain that report. If a separate report is not issued, the sponsor’s financial statements should include the disclosures required by Statement 31, paragraph
Chapter 6

17, as amended, for such a separate report. Those disclosures include the frequency of determining the fair value of investments, the method used to determine the participants’ share sold and redeemed, and other disclosures. In addition, the sponsoring government’s financial statements should make the disclosures required by Statements 3 and 28, as amended, and other cash and investment standards separately for the pool. (See Question 6.43.4.) Finally, the sponsor’s financial statements should disclose condensed statements of fiduciary net position and changes in fiduciary net position for the pool. If the pool includes both internal and external investors (a “mixed pool”), those condensed financial statements should include, in total, the net position held in trust for all pool participants, and the equity of participants should distinguish between internal and external portions. If the government sponsors more than one external investment pool, the disclosures are required for each pool. (See Statement 31, paragraph 19, as amended.)

6.43.4. Q—Statement 40, paragraphs 8 and 9, requires governments to disclose information about custodial credit risk of deposits and investments. How is a sponsoring government’s disclosure of deposits and investments under Statement 40 affected by whether the sponsoring government issues a separate report for its external investment pool? (Q&A31-87) [Amended 2004 and 2013]

A—If the sponsoring government issues a separate report for its external investment pool, the custodial credit risk disclosure in the sponsoring government’s report could aggregate all deposits and investments into a single disclosure, including those of the pool. (Such aggregation is subject to the provisions of Statements 3 and 40 for disaggregation in certain situations—see paragraph 65 of Statement 3, as amended, and paragraph 5 of Statement 40.) However, disaggregation is acceptable.

If the sponsoring government does not issue a separate report for its external investment pool, Statement 31 requires a separate custodial credit risk disclosure in the sponsoring government’s report for the deposits and investments of the pool as a whole. This is the same disclosure as would have been presented under the requirement of paragraph 19 of Statement 31 if the pool had issued a separate report. In this situation, Statement 31 does not specify whether the sponsoring government’s “general” custodial credit risk disclosure should include all, some, or none of the pool’s deposits and investments. Sponsoring governments should select the presentation that they believe best presents the required information and should disclose what is included in the presentation. Any presentation should consider the provisions of Statement 3, paragraph 65, as amended, and Statement 40, paragraph 5, for disaggregation.

6.43.5 Q—Can individual investment accounts be combined with a governmental external investment pool for reporting purposes? (Q&A31-112)

A—No. The individual investment accounts should be reported as one or more separate investment trust funds. (See Questions 6.45.1–6.45.3.) Combining individual investment accounts with the investment pool might obscure information that is needed by users of the pool’s financial statements.

6.44 Pool Reporting Compared to Pool Management

6.44.1. Q—Does Statement 31 require governmental external investment pools to use the same accounting method for valuing participant shares as is used for financial reporting? (Q&A31-113) [Amended 2013]

A—No. Statement 31 addresses external financial reporting. It does not provide standards for the management of an external investment pool. The valuation of participant shares is the determination of the pool sponsor. Regardless of the method the pool sponsor uses to value shares, participants
should report their positions either at fair value or, if the pool is a 2a7-like pool, at the pool’s net asset value per share.

6.44.2. Q—Does Statement 31 mandate the manner, method, or frequency of the distribution of investment income? (Q&A31-114) [Amended 2013]

A—No. The distribution of investment income is the determination of the pool sponsor in conjunction with pool participants. Regardless of the distribution of investment income, however, pool participants should value their position in the pool using fair value. The only exceptions are investment positions in open-end mutual funds and in 2a7-like pools, which are reported using the fund’s share price or pool’s net asset value per share because it approximates fair value.

6.44.3. Q—A governmental external investment pool distributes investment income on an amortized cost basis. Amortized discounts and premiums, accrued interest, and realized gains and losses, net of expenses, are paid in cash to participants on a quarterly basis. The pool is not a 2a7-like pool. How does the pool sponsor report fair value information and participants’ equity in the pool’s financial statements? (Q&A31-115) [Amended 2012 and 2013]

A—Statement 31, as amended, applies to the valuation of investments and does not apply to the method the pool uses to value the participants’ equity. Pool investments should be reported at fair value. Participants’ equity in the pool is determined by the amount of participant deposits, adjusted for withdrawals and distributed income. Undistributed and unrealized gains and losses can be captioned as such in the net position portion of the statement of fiduciary net position. See Illustration 2 in nonauthoritative Appendix 6-3. See Illustration 1 in nonauthoritative Appendix 6-3 for participants’ reporting of their position in an external investment pool. For example, suppose an external investment pool has a fair value at the end of the year of $10,500,000 and had managed participant equity on an “amortized cost” basis, resulting in $10,000,000 of nominal or stated participants’ equity. The pool financial statements (in part) could be presented as follows:

<table>
<thead>
<tr>
<th>Net position consists of:</th>
<th>$ 10,500,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Participant units outstanding ($1.00 par)</td>
<td>10,000,000</td>
</tr>
<tr>
<td>Undistributed and unrealized gains</td>
<td>500,000</td>
</tr>
<tr>
<td>Net position</td>
<td>$ 10,500,000</td>
</tr>
<tr>
<td>Participant net asset value at fair value price per share</td>
<td>$ 1.05</td>
</tr>
</tbody>
</table>

($10,500,000 + 10,000,000 units)

How participants report their positions in an external investment pool, using the above example, is discussed in Question 6.22.5.

6.44.4. Q—Given the preceding question and answer—In Question 6.44.3, what disclosures would be appropriate about the difference between the fair value of the pool’s investments and the amortized cost share value? (Q&A31-116) [Amended 2012 and 2013]

A—Note disclosures should indicate that distributions to participants are made on an amortized cost basis, which differs from a fair value basis, and that the difference between the two methods is reported in the net position section on the statement of fiduciary net position as undistributed and unrealized gains (losses). See Illustration 2 in nonauthoritative Appendix 6-3. For example, a disclosure for the pool could be as follows:

---

**Net position**

<table>
<thead>
<tr>
<th>Participant units outstanding ($1.00 par)</th>
<th>$ 10,000,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Undistributed and unrealized gains</td>
<td>500,000</td>
</tr>
<tr>
<td><strong>Net position</strong></td>
<td>$ 10,500,000</td>
</tr>
<tr>
<td>Participant net asset value at fair value price per share</td>
<td>$ 1.05</td>
</tr>
</tbody>
</table>

($10,500,000 + 10,000,000 units)

---
The pool values participants’ shares on an amortized cost basis. Specifically, the pool distributes income to participants on a quarterly basis based on their relative participation during the quarter that is calculated based on (1) realized investment gains and losses calculated on an amortized cost basis, (2) interest income based on stated rates (both paid and accrued), (3) amortization of discounts and premiums on a straight-line basis, and (4) investment and administrative expenses. This method differs from the fair value method used to value investments in these financial statements because the amortized cost method is not designed to distribute to participants all unrealized gains and losses in the fair values of the pool’s investments. The total difference between the fair values of the investments in the pool and the values distributed to the pool participants using the amortized cost method described above is reported in the equity section of the statement of net position/balance sheet as undistributed and unrealized gains.

6.45 Individual Investment Accounts

6.45.1. Q—Statement 31, paragraph 20, requires governments to report as separate investment trust funds the individual investment accounts that they manage for legally separate entities that are not component units. What are individual investment accounts? (Q&A31-117)

A—Some governmental entities provide investment services to other entities on other than a pooled basis. For example, a state treasurer may maintain individual investment accounts for the municipal governments in the state. Specific investments are acquired for the individual municipalities, and the income from and changes in the value of those investments affect only the municipality for which they were acquired. Sometimes, such individual accounts are offered as an alternative to the sponsoring government’s external investment pool; in other cases, only individual investment accounts are provided.

6.45.2. Q—Does Statement 31 require separate annual financial reports or special disclosure by governments sponsoring individual investment accounts? (Q&A31-118)

A—No. An individual investor’s position is not affected by all investments in individual accounts, but only by those investments in its own account. Therefore, separate reports and disclosures are not required from the sponsor.

6.45.3. Q—A county government provides individual investment accounts to other, legally separate special-purpose governments. Those governments are not part of the county’s reporting entity. In the combining and individual fund financial statements, can the county aggregate all individual investment accounts for these governments? (Q&A31-119)

A—Yes. In the combining and individual fund financial statements, all individual investment accounts may be aggregated as a single investment trust fund and be presented as one column.

6.46 Transition

6.46.1. (Q&A31-120) [Deleted 2003] [Not included in GASB/IG 20XX-1]

6.46.2. (Q&A31-121) [Deleted 2003] [Not included in GASB/IG 20XX-1]

6.46.3. (Q&A31-122) [Deleted 2003] [Not included in GASB/IG 20XX-1]
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Appendix 6-1

GLOSSARY

This glossary contains definitions of certain terms as they are used in Statement 31, as amended, and in this chapter; the terms may have different meanings in other contexts. Terms marked with an asterisk (*) have not been defined in Statement 31.

Amortized cost*
A method of calculating an investment’s value by adjusting its acquisition cost for the amortization of discount or premium over the period from purchase to maturity.

Asset-backed securities
Assets that are composed of, or collateralized by, loans or receivables. Collateralization can consist of liens on real property, leases, or credit card debt.

Change in the fair value of investments
The difference between the fair value of investments at the beginning of the period† and at the end of the period, taking into consideration investment purchases, sales, and redemptions.

Closed-end mutual fund
An SEC-registered investment company that issues a limited number of shares to investors which are then traded as an equity security on a stock exchange. See also Open-end mutual fund.

Debt security
Any security that represents a creditor relationship with an entity. It also includes (a) preferred stock that either is required to be redeemed by the issuing entity or is redeemable at the option of the investor and (b) a collateralized mortgage obligation (CMO) or other instrument that is issued in equity form but is accounted for as a nonequity instrument. However, it excludes option contracts, financial futures contracts, and forward contracts.

Thus, the term debt security includes, among other items, U.S. Treasury securities, U.S. government agency securities, municipal securities, corporate bonds, convertible debt, commercial paper, negotiable certificates of deposit, securitized debt instruments (such as collateralized mortgage obligations—CMOs—and real estate mortgage investment conduits—REMICs—and interest-only and principal-only strips).

Trade accounts receivable arising from sales on credit and loans receivable arising from real estate lending activities of proprietary activities are examples of receivables that do not meet the definition of a security; thus, those receivables are not debt securities. (If, however, they have been securitized, they would then meet the definition.)

Derivative instrument*
A derivative instrument is a financial instrument or other contract that has all of the following characteristics:

a. Settlement factors. It has (1) one or more reference rates and (2) one or more notional amounts or payment provisions or both. Those terms determine the amount of the settlement or settlements and, in some cases, whether or not a settlement is required.

†Period changed from year in Statement 31.
b. Leverage. It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.

c. Net settlement. Its terms require or permit net settlement, it can readily be settled net by a means outside the contract, or it provides for delivery of an asset that puts the recipient in a position not substantially different from net settlement.

Equity security
Any security that represents an ownership interest in an entity, including common, preferred, or other capital stock; unit investment trusts; and closed-end mutual funds. However, the term equity security does not include convertible debt or preferred stock that either is required to be redeemed by the issuing entity or is redeemable at the option of the investor.

External investment pool
An arrangement that commingles (pools) the moneys of more than one legally separate entity and invests, on the participants’ behalf, in an investment portfolio; one or more of the participants is not part of the sponsor’s reporting entity. An external investment pool can be sponsored by an individual government, jointly by more than one government, or by a nongovernmental entity. An investment pool that is sponsored by an individual state or local government is an external investment pool if it includes participation by a legally separate entity that is not part of the same reporting entity as the sponsoring government. If a government-sponsored pool includes only the primary government and its component units, it is an internal investment pool and not an external investment pool.

Fair value
The amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Flex repo*
A term repurchase agreement that permits the investor to sell a portion of the collateral securities back to the counterparty before the stated, final maturity date of the transaction. (That is, it is “flexible.”)

Impairment*
When an investment is reported using cost-based measures, events or changes in circumstances that indicate the carrying amount of the investment may not be recoverable. An investment is impaired when a decline in its fair value below the amortized cost basis is other than temporary.

Individual investment accounts
An investment service provided by a governmental entity for other, legally separate entities that are not part of the same reporting entity. With individual investment accounts, specific investments are acquired for individual entities, and the income from and changes in the value of those investments affect only the entity for which they were acquired.

Interest-earning investment contract
A direct contract, other than a mortgage or other loan, that a government enters into as a creditor of a financial institution, broker-dealer, investment company, insurance company, or other financial services company and for which it receives, directly or indirectly, interest payments. Interest-earning investment contracts include time deposits with financial institutions (such as certificates of deposit), repurchase agreements, and guaranteed and bank investment contracts (GICs and BICs).
Internal investment pool
An arrangement that commingles (pools) the moneys of more than one fund or component unit of a reporting entity. Investment pools that include participation by legally separate entities that are not part of the same reporting entity as the pool sponsor are not internal investment pools, but rather are external investment pools.

Investment
A security or other asset acquired primarily for the purpose of obtaining income or profit.

Mixed pool*
An investment pool that commingles moneys of a fund or component unit of a reporting entity, and legally separate entities that are not part of the same reporting entity.

Money market fund*
An open-end mutual fund that complies with the SEC’s Rule 2a7 of the Investment Company Act of 1940 (17 Code of Federal Regulations §270.2a7).

Money market investment
A short-term, highly liquid debt instrument, including commercial paper, banker’s acceptances, and U.S. Treasury and agency obligations. Asset-backed securities, derivative instruments, and structured notes are not included in this term.

Open-end mutual fund
An SEC-registered investment company that issues shares of its stock to investors, invests in an investment portfolio on the shareholders’ behalf, and stands ready to redeem its shares for an amount based on its current share price. An open-end mutual fund creates new shares to meet investor demand, and the value of an investment in the fund depends directly on the value of the underlying portfolio. Open-end mutual funds include governmental external investment pools that are registered as investment companies with the SEC and that operate as open-end funds.

Option contract
A contract giving the buyer (owner) the right, but not the obligation, to purchase from (call option) or sell to (put option) the seller (writer) of the contract a fixed number of items (such as shares of equity securities) at a fixed or determinable “strike” price on a given date or at any time on or before a given date.

Participation
The ability of an investment to capture market (interest rate) changes through the investment’s negotiability or transferability, or redemption terms that consider market rates.

Restricted stock
Equity securities whose sale is restricted at acquisition by legal or contractual provisions (other than in connection with being pledged as collateral) except if that restriction terminates within one year or if the holder has the power by contract or otherwise to cause the requirement to be met within one year. Any portion of the security that can reasonably be expected to qualify for sale within one year, such as may be the case under SEC Rule 144 (17 Code of Federal Regulations §230.144) or similar rules of the SEC, is not considered restricted.

Security
A transferable financial instrument that evidences ownership or creditorship, whether in physical or book entry form.
Sponsoring government
A governmental entity that provides investment services—whether an investment pool or individual investment accounts—to other entities and that therefore has a fiduciary responsibility for those investments.

Stock rights
Rights given to existing stockholders to purchase newly issued shares in proportion to their holdings at a specific date.

Stock warrants
Certificates entitling the holder to acquire shares of stock at a certain price within a stated period. Warrants often are made part of the issuance of bonds or preferred or common stock.

Structured notes
Debt securities whose cash flow characteristics (coupon, redemption amount, or stated maturity) depend on one or more indexes, or that have embedded forwards or options.
ILLUSTRATION OF FAIR VALUE ACCOUNTING FOR INVESTMENTS FROM STATEMENT 31

This nonauthoritative appendix illustrates how to calculate, display, and disclose the increase or decrease in the fair value of investments as required by Statement 31. The facts assumed in this example are illustrative only and are not intended to modify or limit the requirements of the Statement or to indicate the GASB’s endorsement of the situations or specific methods illustrated. Application of the provisions of the Statement may require calculations other than those illustrated here.

Year 1
Fair Value Analysis of Investment Activity—Specific Identification Method

<table>
<thead>
<tr>
<th>Security</th>
<th>Cost</th>
<th>Beginning Fair Value</th>
<th>Purchases</th>
<th>Sales</th>
<th>Subtotal</th>
<th>Ending Fair Value</th>
<th>Change in Fair Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$100</td>
<td>$100</td>
<td>—</td>
<td>—</td>
<td>$100</td>
<td>$120</td>
<td>$20</td>
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<tr>
<td>2</td>
<td>520</td>
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<td>—</td>
<td>540</td>
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<td>(30)</td>
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<tr>
<td>3</td>
<td>200</td>
<td>240</td>
<td>—</td>
<td>$250</td>
<td>(10)</td>
<td>0</td>
<td>10</td>
</tr>
<tr>
<td>4</td>
<td>330</td>
<td>—</td>
<td>$330</td>
<td>—</td>
<td>330</td>
<td>315</td>
<td>(15)</td>
</tr>
</tbody>
</table>

|             |       |                      |           |       |          | $945             | $(15)                |

$880        | $330  | $250                 | $960      |       | 315      |                 |                      |

\*Column D = Columns A + B - Column C.
\(^1\)Column F = Column E - Column D.

Calculation of the Net Increase in the Fair Value of Investments—Aggregate Method

Fair value at December 31, 20X1 $ 945
Add: Proceeds of investments sold in 20X1 250
Less: Cost of investments purchased in 20X1 (330)
Less: Fair value at December 31, 20X0 (880)
Change in fair value of investments $(15)
Year 2
Fair Value Analysis of Investment Activity—Specific Identification Method

<table>
<thead>
<tr>
<th>Security</th>
<th>Cost</th>
<th>Purchases</th>
<th>Sales</th>
<th>Subtotal*</th>
<th>Ending Fair Value</th>
<th>Change in Fair Value†</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$100</td>
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<td>$110</td>
<td>$10</td>
<td>$0</td>
<td>$(10)</td>
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<td>510</td>
<td>—</td>
<td>510</td>
<td>550</td>
<td>40</td>
</tr>
<tr>
<td>4</td>
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<td>315</td>
<td>—</td>
<td>330</td>
<td>0</td>
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<td></td>
<td>$945</td>
<td>$310</td>
<td>$440</td>
<td>$815</td>
<td>$850</td>
<td>$35</td>
</tr>
</tbody>
</table>

*Column D = Columns A + B – Column C.
†Column F = Column E – Column D.

Calculation of the Net Increase in the Fair Value of Investments during 20X2—Aggregate Method

Fair value at December 31, 20X2 $ 850
Add: Proceeds of investments sold in 20X2 440
Less: Cost of investments purchased in 20X2 (310)
Less: Fair value at December 31, 20X1 (945)
Change in fair value of investments during 20X2 $ 35

Cost-Based Analysis of Investment Activity*

<table>
<thead>
<tr>
<th>Security</th>
<th>Beginning of Year</th>
<th>Purchases</th>
<th>Sales</th>
<th>End of Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$100</td>
<td>—</td>
<td>$100</td>
<td>$0</td>
</tr>
<tr>
<td>2</td>
<td>520</td>
<td>—</td>
<td>—</td>
<td>520</td>
</tr>
<tr>
<td>4</td>
<td>330</td>
<td>—</td>
<td>330</td>
<td>0</td>
</tr>
<tr>
<td>5</td>
<td>—</td>
<td>$310</td>
<td>—</td>
<td>310</td>
</tr>
<tr>
<td>Total</td>
<td>$950</td>
<td>$310</td>
<td>$430</td>
<td>$830</td>
</tr>
</tbody>
</table>

*Only information for 20X2 is presented.

Calculation of Realized Gain during 20X2

<table>
<thead>
<tr>
<th>Security</th>
<th>Cost</th>
<th>Sale Price</th>
<th>Gain†</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$100</td>
<td>$110</td>
<td>$10</td>
</tr>
<tr>
<td>4</td>
<td>330</td>
<td>330</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>$430</td>
<td>$440</td>
<td>$10</td>
</tr>
</tbody>
</table>

†Note that realized gain is the difference between an investment’s sales price and its acquisition cost.
Calculation of the Unrealized Gain as of December 31, 20X2

<table>
<thead>
<tr>
<th>Security</th>
<th>Cost</th>
<th>Fair Value</th>
<th>Gain</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>$ 520</td>
<td>$ 550</td>
<td>$ 30</td>
</tr>
<tr>
<td>5</td>
<td>310</td>
<td>300</td>
<td>(10)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>830</strong></td>
<td><strong>850</strong></td>
<td><strong>20</strong></td>
</tr>
</tbody>
</table>

Optional Display and Disclosure Illustrations

Statement 31, paragraph 15, permits the optional disclosure of realized gains and losses in the notes to the financial statements. The following limited illustration depicts one method of note disclosure. If realized gains and losses are disclosed, many entities will find that the calculation of those gains and losses will require transaction accounting that includes cost-based and fair value information.

Optional Partial Operating Statement Display in a Governmental Fund (20X2)

<table>
<thead>
<tr>
<th>Investment income</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest</td>
<td>$XXX</td>
</tr>
<tr>
<td>Dividends</td>
<td>XXX</td>
</tr>
<tr>
<td>Net increase in the fair value of investments</td>
<td>35</td>
</tr>
<tr>
<td>Total investment income</td>
<td>$XXX</td>
</tr>
</tbody>
</table>

Optional Note Disclosure (20X2)

Note X: Deposits and Investments

During 20X2, the entity realized a net gain of $10 from the sale of investments. The calculation of realized gains is independent of the calculation of the net increase in the fair value of investments. Realized gains and losses on investments that had been held in more than one fiscal year and sold in the current year may have been recognized as an increase or decrease in the fair value of investments reported in the prior year. The net increase in the fair value of investments during 20X2 was $35. This amount takes into account all changes in fair value (including purchases and sales) that occurred during the year. The unrealized gain on investments held at year-end was $20.
ACCOUNTING AND FINANCIAL REPORTING FOR PARTICIPATION IN EXTERNAL INVESTMENT POOLS

This nonauthoritative appendix illustrates the accounting treatment for certain investments and external investment pools. The facts assumed in these examples are illustrative only and are not intended to modify or limit the requirements of Statement 31 or to indicate the GASB's endorsement of the policies or practices shown.

Illustration 1: Position in an External Investment Pool

Illustration 2: Position of External Participants in an External Investment Pool
Illustration 1: Position in an External Investment Pool

Assume the following facts:

• A local government invests $100,000 in an external investment pool on January 15, receiving 100,000 shares or units in the pool.
• The pool is not a 2a7-like pool and does not have a legally binding guarantee for its share price.
• The pool seeks to maintain a stable $1.00 net asset value as a matter of day-to-day operations.
• Participants enter and exit the pool using the $1.00 net asset value.
• On June 30, the end of the local government’s fiscal year, the pool sponsor reports that pool participants should fair-value their pool position at $1.05 per share.
• On October 15, the local government withdraws its investment in the pool, using the $1.00 net asset value.

Following is a summary for how the participant reports its investment in the pool at June 30.

On January 15, the investment should be valued at $100,000, its fair value on the date acquired. As of June 30, the investment should be valued at $105,000 in the financial statements. The $5,000 increase should be included on the participant’s change statement in investment income as an increase in the fair value of investments. On October 15 when the investment is withdrawn, investments are reduced by $105,000. The change in the fair value of investments is charged $5,000 because the fair value change is reversed.

Journal entries, in addition to any interest paid to the participant, would be as follows:

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>January 15</td>
<td>Investments</td>
<td>$100,000</td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td>$100,000</td>
</tr>
<tr>
<td></td>
<td>(To record initial investment in external investment pool)</td>
<td></td>
</tr>
<tr>
<td>June 30</td>
<td>Investments</td>
<td>5,000</td>
</tr>
<tr>
<td></td>
<td>Change in the fair value of investments</td>
<td>5,000</td>
</tr>
<tr>
<td></td>
<td>(To report fair value increase)</td>
<td></td>
</tr>
<tr>
<td>October 15</td>
<td>Cash</td>
<td>100,000</td>
</tr>
<tr>
<td></td>
<td>Change in the fair value of investments</td>
<td>5,000</td>
</tr>
<tr>
<td></td>
<td>Investments</td>
<td>105,000</td>
</tr>
<tr>
<td></td>
<td>(To record withdrawal from external investment pool)</td>
<td></td>
</tr>
</tbody>
</table>

How a governmental external investment pool reports this information, using the above example, is discussed in Illustration 2 of this nonauthoritative appendix.
Appendix 6-3

Illustration 2: Position of External Participants in an External Investment Pool

Assume the following facts:

- A governmental external investment pool distributes investment income on an amortized cost basis.
- Amortized discounts and premiums, accrued interest, and realized gains and losses, net of expenses, are paid in cash to participants on a quarterly basis.
- The pool is not a 2a7-like pool.
- The external investment pool has a fair value at the end of the year of $10,500,000.
- The external investment pool manages participant equity on an “amortized cost” basis, resulting in $10,000,000 of nominal or stated participants’ equity.

Following is a summary of the treatment for how the pool sponsor reports fair value information and participants’ equity in the pool’s financial statements.

The pool financial statements (in part) could be presented as follows:

<table>
<thead>
<tr>
<th>Net position</th>
<th>$ 10,500,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net position consists of:</td>
<td></td>
</tr>
<tr>
<td>Participant units outstanding ($1.00 par)</td>
<td>$ 10,000,000</td>
</tr>
<tr>
<td>Undistributed and unrealized gains</td>
<td>500,000</td>
</tr>
<tr>
<td>Net position</td>
<td>$ 10,500,000</td>
</tr>
<tr>
<td>Participant net asset value at fair value price per share ($10,500,000 ÷ 10,000,000 units)</td>
<td>$ 1.05</td>
</tr>
</tbody>
</table>

How participants report their positions in an external investment pool, using the above example, is discussed in Illustration 1 of this appendix.

Disclosure

Following is an example disclosure for the pool that addresses the difference between the fair value of the pool’s investments and the amortized cost share value.

The pool values participants’ shares on an amortized cost basis. Specifically, the pool distributes income to participants on a quarterly basis based on their relative participation during the quarter that is calculated based on (1) realized investment gains and losses calculated on an amortized cost basis, (2) interest income based on stated rates (both paid and accrued), (3) amortization of discounts and premiums on a straight-line basis, and (4) investment and administrative expenses. This method differs from the fair value method used to value investments in these financial statements because the amortized cost method is not designed to distribute to participants all unrealized gains and losses in the fair values of the pool’s investments. The total difference between the fair values of the investments in the pool and the values distributed to the pool participants using the amortized cost method described above is reported in the net position section of the statement of fiduciary net position as undistributed and unrealized gains.