
NO. 021 | APRIL 1986

Governmental Accounting Standards Series

Statement No. 3 of the
Governmental Accounting
Standards Board

**Deposits with Financial
Institutions, Investments
(including Repurchase
Agreements), and Reverse
Repurchase Agreements**



Governmental Accounting Standards Board
of the Financial Accounting Foundation

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

Order Department
Governmental Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116
Telephone Orders: 1-800-748-0659

Please ask for our Product Code No. GS3

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

Summary

This Statement requires certain note disclosures about governmental entities' deposits with financial institutions, investments (including repurchase agreements), and reverse repurchase agreements. The required disclosures should generally be made for the entity as a whole, but additional or separate disclosures for component units, pension trust funds, or other funds or fund types should be made in certain circumstances. This Statement also provides guidance on accounting for repurchase and reverse repurchase agreements.

Disclosure of the types of investments authorized by legal or contractual provisions is required, as well as disclosure of significant violations during the period of legal or contractual provisions related to deposits and investments.

Disclosures required for the deposit and investment portfolio as of the balance sheet date will provide users with information about credit and market risks. These disclosures include the carrying amounts and market values of investments by investment type and in total and information about the level of credit risk associated with deposits and investments. Credit risk is affected by insurance coverage and registration of securities in the name of the governmental entity and, in the absence of insurance coverage or registration, by the custodial arrangements for investments, securities underlying repurchase agreements, and collateral on deposits. Entities are also required to disclose situations that resulted in significantly greater credit risk during the period than that existing as of the balance sheet date.

For reverse repurchase agreements, this Statement requires disclosure of the source of authorization for their use, significant violations during the period of legal or contractual provisions related to the agreements, and summary information about the credit risk associated with the agreements as of the balance sheet date.

Liabilities resulting from reverse repurchase and fixed coupon reverse repurchase agreements are required to be shown as "Obligations under reverse repurchase agreements" and should not be netted with the related assets on the balance sheet. Interest costs associated with reverse repurchase and fixed coupon reverse repurchase agreements are required to be shown as interest expenditure/expense and are not to be netted with the interest income from the related investments. Income from repurchase and fixed coupon repurchase agreements is required to be shown as interest income. Yield maintenance repurchase and reverse repurchase agreements are required to be accounted for as purchases and sales of investments, with gains or losses on those investments recognized.

Unless otherwise specified, pronouncements of the GASB apply to financial reports of all state and local governmental entities, including public benefit corporations and authorities, public employee retirement systems, and governmental utilities, hospitals, colleges, and universities.

Statement No. 3 of the
Governmental Accounting
Standards Board

Deposits with Financial
Institutions, Investments
(including Repurchase
Agreements), and Reverse
Repurchase Agreements

April 1986



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

Copyright © 1986 by Governmental Accounting Standards Board. All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of the Governmental Accounting Standards Board.

Statement No. 3 of the Governmental Accounting Standards Board

Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements

April 1986

CONTENTS

| | Paragraph Numbers |
|---|------------------------------|
| Introduction and Background Information..... | 1- 62 |
| Standards of Governmental Accounting and Financial Reporting | 63- 83 |
| Effective Date and Transition | 84 |
| Appendix A: Basis for Conclusions | 85-113 |
| Appendix B: Illustration of Note Disclosure for Deposits, Investments, and Reverse Repurchase Agreements | 114 |
| Appendix C: Illustration of Note Disclosure for Deposits and Investments | 115 |
| Appendix D: Glossary | 116 |
| Appendix E: Codification Instructions..... | 117 |

Statement No. 3 of the Governmental Accounting Standards Board

Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements

April 1986

INTRODUCTION AND BACKGROUND INFORMATION

Scope of This Statement

1. This Statement provides guidance for disclosures by governmental entities about deposits with financial institutions, investments, and reverse repurchase agreements. It also provides accounting and financial reporting guidance for repurchase and reverse repurchase agreements.

Background

2. Accounting and financial reporting for repurchase and reverse repurchase agreements was placed on the Governmental Accounting Standards Board's (GASB) agenda because use of those agreements entails risks that have resulted in significant financial losses for some governmental entities. The GASB considered whether disclosure guidance for these transactions is needed so that those risks may be assessed by financial statement users. During its consideration of these transactions, the GASB concluded that the types of risks inherent in repurchase agreements are also inherent in deposits with financial institutions and investments other than repurchase agreements. Furthermore, deposits and investments often represent the largest assets on governmental balance sheets. Accordingly, this Statement establishes disclosure standards for deposits with financial institutions, investments, and reverse repurchase agreements.

Deposits with Financial Institutions and Investments

3. Governmental entities frequently have cash available for short-, intermediate-, and long-term investment. For example, the general fund may have cash available for short periods of time pending disbursement for operating needs, the capital projects funds may have bond proceeds available for intermediate-term investment pending disbursement for construction costs, and fiduciary funds may have cash available for long-term investment.

Investment pools used by several funds within a single entity or by several entities may have cash available for investment for varying terms.

4. The deposit and investment authority of governmental entities is often prescribed in statutes. These statutes may specify (a) the types of deposits and investments that may be made, (b) financial institutions with which deposits may be made, (c) **collateral*** requirements for deposits with financial institutions, and (d) liquidity requirements. Deposit and investment activity may also be affected by local ordinance, written policy, bond covenant, or management practice.

Types of Deposits and Investments

5. Deposit and investment statutes usually authorize entities to make deposits with financial institutions (such as demand deposit accounts and certificates of deposit) and direct investments in U.S. government and federal agency and instrumentality obligations. Other types of investments, such as **bankers' acceptances** and **commercial paper**, may also be authorized by statutes.

6. In some states, statutes may authorize governmental entities to pool the monies of several funds to improve investment efficiency and yield. Some entities may also be authorized to participate in an external deposit and investment pool. In this case, the monies of local entities are usually entrusted to a state official, such as the state treasurer, for investing. Statute may require the treasurer to administer the pool under the same terms and conditions, including collateral requirements, as prescribed for other funds invested by the treasurer. An entity participating in an external pool usually does not own identifiable investment securities of the pool; rather, it participates as a shareholder of the pool. The entity's share in external pools may be based on the market value of the pool's investments or on some other basis used by the pool, such as amortized cost for fixed-income securities.

Deposit Placement

7. Statutes may prescribe the types of financial institutions with which deposits may be made. For example, an entity may be restricted to making deposits with banks in its state.

*Terms that are found in the glossary are shown in boldface type the first time they appear.

Collateralization

8. Statutes often require some level of collateral for deposits when the deposits exceed **depository insurance** (uninsured deposits). Statutes may also specify the types of collateral required. For example, collateral may be limited to securities in which the entity itself may invest. Statutes may require the market value of collateral to be equal to or greater than the amount of the uninsured deposit; others may require only a percentage of the uninsured deposit to be collateralized. In some states, collateral requirements vary depending on the financial institution holding the deposit.

9. A number of state statutes require collateral to equal 100 to 110 percent of uninsured deposits. Because pledging collateral to each public depositor may reduce the interest paid on deposits, some states have developed alternatives to separately collateralized deposits. Two of those alternatives are both called “collateral pools,” but they are fundamentally different.

10. In one type of pool, a single financial institution **collateral pool**, a financial institution pledges a pool of collateral against all the public deposits it holds. The market value of the securities in the pool is generally required by statutes to be at least equal to the financial institution’s total uninsured public deposits. This type of collateral pool provides the same level of protection as if each uninsured deposit were separately collateralized but allows the financial institution to provide collateral at a lower cost because of reduced monitoring and record keeping.

11. In another type of collateral pool, a multiple financial institution collateral pool, all financial institutions holding public funds pledge collateral to a common pool. Statutes authorizing these pools specify that the collateral pledged by each financial institution must equal a certain percentage of the uninsured public deposits it holds. If any member financial institution fails, the entire collateral pool becomes available to satisfy the claims of governmental entities. If the value of the pool’s collateral is inadequate to cover a loss, additional amounts would be assessed on a pro rata basis to the members of the pool. The ability to make additional assessments, provided either by the pooling agreement or by statutes, ensures that there will be no loss of public funds. As a result, a multiple financial institution collateral pool that provides for additional assessments is similar to depository insurance. If a multiple financial institution collateral pool cannot make additional assessments, deposits should be considered collateralized rather than insured. The extent to which the pool collateralizes those deposits is determined by comparing each member

financial institution's total uninsured public deposits with the market value of the pool's assets. For example, if the pool's value exceeds the total uninsured public deposits of a member financial institution, all uninsured public deposits with that financial institution should be considered fully collateralized. If, however, the pool's value is only 50 percent of the total uninsured public deposits of a member financial institution, each of that financial institution's uninsured public deposits would be only 50 percent collateralized.

12. Statutes may also specify the party authorized to hold and safeguard collateral for uninsured deposits. In some cases, this may be the governmental entity or its independent third-party agent. In other cases, the trust department of the financial institution pledging the collateral may be authorized to hold the collateral. However, if the collateral is held by other than the governmental entity or its independent third-party agent, statutes may require that the collateral be clearly held in the name of and for the benefit of the entity.

Liquidity

13. Some statutes may specify liquidity requirements for deposits and investments; for example, they may require that investments be made in securities that mature within one year from the purchase date. Liquidity is important to governmental entities because various factors may limit their ability to borrow. Liquidity is also generally more important in governmental funds than in proprietary and fiduciary funds. A general fund, for example, may need cash to pay salaries weekly. However, a pension fund may invest in long-term securities because an immediate need for a substantial amount of cash may not exist.

Deposit and Investment Risks and Safeguards

14. Depositors and investors face several types of risks. The major risks are **credit risk** and **market risk**. Credit risk is the risk that another party to a deposit or investment transaction (**counterparty**) will not fulfill its obligations; for example, the issuer of a debt instrument may not redeem the instrument at maturity. Credit risk can be associated with the issuer of a security, with a financial institution holding deposits, or with the custodian of securities or collateral. Credit risk exposure can be affected by a concentration of deposits or investments in any one investment type or with any one counterparty.

15. Market risk is the risk that the market value of an investment, collateral protecting a deposit, or securities underlying a **repurchase agreement** will decline. Market risk is

affected by the length to maturity of a security, the need to liquidate a security before maturity, the extent that collateral exceeds the amount invested, and the frequency with which the amount of collateral is adjusted for changes in market values. For example, if interest rates have risen since an entity purchased long-term U.S. government obligations, the market value of those securities will be below their **carrying amount** and the entity will realize a loss if the securities must be liquidated while their market value is in decline.

Deposits

16. A depositor's risks are primarily credit risks. Many public depositors have procedures to minimize the risks associated with deposits, for example, investigating the creditworthiness of the financial institutions holding their deposits and of the custodian of collateral, having uninsured deposits collateralized, and clearly establishing their rights to an adequate level of collateral. When using any of these techniques, depositors usually balance the cost of applying the procedure against the benefit derived.

17. Depositors may take various steps to become satisfied with the creditworthiness of financial institutions with which they do business. Among other procedures, they review up-to-date audited financial statements and other financial information filed with regulatory agencies. Although some depositors forgo these procedures for large or local financial institutions, other depositors use them because they believe that neither size nor accessibility of a financial institution guarantees financial stability. Also, because many depositors believe above-market interest rates may signal higher risks, they assess the causes of those higher rates.

18. There are several measures depositors take to ensure that the collateral they require on uninsured deposits protects those deposits. They may establish, through written contract with the financial institution pledging the collateral, their unconditional rights to the collateral. These rights generally include the right to liquidate the collateral in the event of default of the financial institution and the right to additional collateral if the market value of the collateral falls below the required level.

19. Depositors may also review (reprice) the market value of the collateral periodically to make sure it has not fallen below the required level. If a decline occurs, additional collateral is obtained or part of the deposit is recovered. The frequency of repricing takes into consideration the price volatility of the collateral.

20. The degree of credit risk associated with uninsured deposits varies depending on who holds the collateral.¹ If the collateral is held by the pledging financial institution, or by its trust department or agent but not in the name of the depositor, the depositor's access to the collateral and its rights to liquidate it may not be clear in the event of default by the financial institution.² There is less risk associated with collateral held by the financial institution's trust department or agent in the depositor's name, and even less risk associated with collateral held by the depositor or by an independent third-party agent of the depositor in the depositor's name.

21. Depositors may also take steps to become satisfied with the financial condition of the custodians of their collateral, for example, by reviewing the custodian's up-to-date audited financial statements. Further, a depositor may have a written contract, called a **custodial agreement**, that specifies the custodian's responsibilities to the depositor and the rights of the depositor to the collateral. A written contract may specify the custodian's responsibilities to:

- a. Obtain additional collateral if the market value of the collateral goes below the required level
- b. Hold the collateral separate from its own assets
- c. Report periodically to the depositor on the market value of the collateral.

¹Collateral can be held either physically or through a **book entry** system. Book entry is a system that eliminates the need for physically transferring bearer-form paper or registering securities by using a central depository facility. Many U.S. government and federal agency debt securities, an increasing number of state and local government debt securities, and many corporate stocks are handled through book entry systems. For example, many U.S. government and federal agency debt securities do not exist in definitive (paper) form; they exist only in computerized files maintained by the Federal Reserve Banks. This book entry system permits electronic transfer of securities between the accounts of Federal Reserve Bank customers, principally financial institutions. Many governmental entities have their book entry securities held by their custodial bank in the bank's custodial (safekeeping) account at a Federal Reserve Bank. In January 1986, the U.S. Treasury and Federal Reserve Board agreed to allow state governments to open their own custodial accounts with Federal Reserve Banks for the safekeeping of their securities and those of their local governments.

²Generally, a **perfected security interest** is better than an unperfected security interest. Under Article 8 of the Uniform Commercial Code (UCC), a security interest is perfected through a "transfer" of the security. For the purposes of the UCC, this transfer usually occurs with possession of the security by the secured party or its agent. However, a transfer can be made without taking possession of the security. For this type of transfer to occur, the transferor must have signed a security agreement that contains a description of the collateral, and the secured party must pay for the investment. Such a security interest is perfected for a period of 21 days. However, the secured party risks the loss or impairment of its security interest during the 21-day period, because the UCC provides that a holder in due course of a negotiable instrument or a bona fide purchaser of the instrument will take priority over the secured party. After 21 days, the security interest becomes unperfected unless the secured party takes possession of the security.

Investments

22. Governmental entities generally make direct investments in U.S. government and federal agency and instrumentality obligations and other types of securities. Ways in which they safeguard their investments include having the securities held by their custodian or **registered** in their name, having broker-dealer insurance coverage, and investigating the creditworthiness of issuing and custodial counterparties.

23. Investors may hold securities themselves or have them held by the broker-dealer, its agent or trust department, or by an independent third-party custodian. As explained in paragraph 20, the degree of credit risk associated with the transaction is affected by who holds the securities and whether the securities are held in the name of the investor.

24. An investor may safeguard its ownership of securities by having the securities registered in its name. If securities are not registered or have been endorsed in blank by the registered owner, they become negotiable by anyone who has them. Having securities in these forms makes transactions easier because they can be bought, sold, or transferred in less time and with less paperwork. However, because they are so easily negotiable, the risks associated with them increase.

25. Cash and securities held in customer accounts by **Securities and Exchange Commission (SEC) registered broker-dealers** may be insured by the **Securities Investor Protection Corporation (SIPC)**. If a member broker-dealer fails, SIPC provides protection for customer accounts by returning securities registered in the name of the investor, distributing all remaining customer assets on a pro rata basis, and providing SIPC funds for all remaining claims of each customer up to a maximum of \$500,000, including up to \$100,000 on claims for cash. Also, many broker-dealers have additional insurance above SIPC coverage.

26. Many investors also take steps to become satisfied with the financial condition of the issuer of the investment securities. Differences in the credit risk associated with various issuers are usually reflected in differences in the interest rates paid on the investments. In addition to making their own investigation of an issuer's creditworthiness, many investors rely on credit ratings made by rating services.

Types of Investments

27. Governmental entities frequently invest in commercial paper. Commercial paper is an unsecured promissory note issued primarily by corporations for a specific amount and maturing on a specific day. The maximum maturity for commercial paper is 270 days, but most is sold with maturities of up to 30 days. Almost all commercial paper is rated as to credit risk by rating services. Commercial paper is typically issued in bearer form but can be issued in registered form.

28. Bankers' acceptances are another type of investment used by governmental entities. Generally, bankers' acceptances are created based on a letter of credit issued in a foreign trade transaction and issued in bearer form. For example, a U.S. corporation will order goods from a foreign country and have its bank issue a letter of credit to the foreign supplier in the amount of the purchase price. The foreign vendor, on shipping the goods, then draws a time draft on the U.S. importer's bank and discounts the draft at its local bank. In this manner, the supplier receives immediate payment for its shipment. The foreign bank then sends the draft to the U.S. bank and the draft is stamped "accepted." This banker's acceptance indicates that the U.S. bank guarantees payment of the draft at maturity. The foreign bank may hold the acceptance to maturity or sell it to the accepting bank. The U.S. bank may hold the acceptance or sell it to another party, such as a governmental entity.

29. A mutual fund is an open-end management investment company registered with the SEC under the Investment Company Act of 1940. An investment company sells its shares of stock to investors and invests, on the shareholders' behalf, in a diversified portfolio of securities. An open-end company is one that continuously offers its shares for sale to the public, compared with a closed-end company, which may issue only a limited number of shares. Mutual funds generally do not issue share certificates; instead, they send out periodic statements showing deposits, withdrawals, and dividends credited to the investor's account.

30. The mutual funds that governmental entities invest in most frequently invest solely in money market instruments (such as U.S. government and federal agency and instrumentality securities, commercial paper, bankers' acceptances, and repurchase agreements). These funds have relatively high and consistent yields at minimum risk as their primary objective. Although the portfolios of these funds may contain insured or guaranteed deposits and investments, the fund shares are not insured or guaranteed. The

degree of investment risk depends on the fund's underlying portfolio. Investors who participate in mutual funds may review the fund prospectus to determine the fund's investment policies and practices, including the maturity terms of securities it may purchase and the degree of risk it may accept.

31. Many local governmental entities participate in pooled investment funds managed by the state treasurer. Like mutual funds, the degree of investment risk depends on the pool's underlying portfolio. Many entities participating in a pool review state law and information provided by the pool's manager to determine the degree of risk permitted by the pool's investment policies. In addition, the investors may review the state's financial statements to obtain information about the pool's investment balances and risks.

Repurchase and Reverse Repurchase Agreements

32. Governmental entities sometimes invest in repurchase agreements. In a repurchase agreement transaction, the governmental entity (buyer-lender) transfers cash to a broker-dealer or financial institution (seller-borrower); the broker-dealer or financial institution transfers securities to the governmental entity and promises to repay the cash plus interest in exchange for the return of the *same* securities.³

33. Governmental entities sometimes enter into reverse repurchase agreements when they want to temporarily convert securities in their portfolios to cash. In these transactions, the entity is the seller-borrower, transfers securities to the buyer-lender for cash, and promises to repay cash plus interest in exchange for the return of the *same* securities.⁴ The cash obtained in these transactions is often used for operating or capital purposes or is invested in other securities to improve yield.

34. Repurchase and **reverse repurchase agreement** transactions may also take the form of **dollar repurchase and dollar reverse repurchase agreements**, which are transactions usually involving the transfer of securities of the same issuer but not the same certificates. **Fixed coupon and yield maintenance agreements** are the most common types of dollar agreements:

³This transaction is called a repurchase agreement by governmental entities, broker-dealers, and banks. A savings and loan institution that is the seller-borrower in the transaction calls it a reverse repurchase agreement.

⁴A broker-dealer or bank that is the buyer-lender also calls this transaction a reverse repurchase agreement; however, a savings and loan institution that is the buyer-lender calls it a repurchase agreement.

- a. In a fixed coupon agreement transaction, the securities returned have the same stated interest rate as, and maturities similar to, the securities transferred.
 - b. In a yield maintenance agreement transaction, the securities returned provide the seller-borrower with a yield specified in the agreement.
35. Repurchase and reverse repurchase agreements, including dollar agreements, have maturities of varying lengths:
- a. Overnight agreements mature in one day. For the buyer-lender, overnight agreements provide a single day's interest on the amount invested overnight.
 - b. Term agreements mature in a period of more than one day. Entities use term repurchase agreements to provide a bridge between maturing investments and the date cash is needed for disbursement. Some cash managers use term repurchase agreements with a common maturity date to earn interest on smaller amounts of cash until sufficient funds are accumulated to purchase longer term securities. For the seller-borrower, term agreements provide cash that can be invested in higher yielding securities without selling long-term investments.
 - c. Open (on-demand) agreements have no specified maturity date. The amount and interest rate of the agreement may be changed daily and either party may terminate the transaction at any time.

Nature of Repurchase and Reverse Repurchase Agreements

36. There is substantial controversy as to whether repurchase and reverse repurchase agreements are simultaneous “borrow-and-lend” transactions or “buy-and-sell” transactions. In substance, repurchase and fixed coupon repurchase agreements are similar to collateralized loans. The characteristics that make them similar are:
- a. The buyer-lender earns interest on the agreement amount and at the agreement rate, not on the amount or at the rate of the **underlying securities**.
 - b. The buyer-lender is not affected by changes in the market value of the underlying securities.
 - c. If the market value of the underlying securities declines, the seller-borrower may have a contractual obligation to increase the amount of the underlying securities.
 - d. In the event of liquidation of the underlying securities, any excess proceeds over the repurchase amount are usually returned to the seller-borrower.
37. Repurchase and fixed coupon repurchase agreements are also similar to collateralized deposits. Both repurchase agreements and collateralized deposits involve giving cash to another party who (a) promises to return the cash plus interest, (b) pledges securities as collateral for the promise, and (c) may give those securities to the entity or another party to secure that promise.

38. Many governmental entities, however, interpret repurchase and fixed coupon repurchase agreements as buy-and-sell transactions because governing statutes may not specifically permit investment in repurchase agreements and, further, may not permit lending of government monies to private parties. However, statutes usually allow investment in the securities underlying the agreements, and, for these reasons, many entities interpret the transactions as legal investments.

39. Yield maintenance agreements are generally viewed as buy-and-sell transactions. American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 85-2, “Accounting for Dollar Repurchase-Dollar Reverse Repurchase Agreements by Sellers-Borrowers,” concludes that they should be accounted for as sales transactions, because “. . . the seller-borrower has surrendered control over the future economic benefits relating to the original certificate and has obtained the right to acquire a different asset.”⁵

Government Securities Environment

40. While many governmental entities have benefited from the use of repurchase agreements, some have suffered significant financial losses. The agreements carry risks because of the environment of the federal government securities industry and certain practices associated with the transactions.

41. Risks due to the government securities environment stem from a lack of regulation in some parts of the industry. Some government securities dealers are either financial institutions or SEC-registered broker-dealers, operating their government securities business as part of their regulated business. However, many dealers, including some affiliates of SEC-registered broker-dealers, are unregulated entities.

42. Some government securities dealers are **primary dealers**. Primary dealers are a group of government securities dealers included in the “List of Government Securities Dealers Reporting to the Market Reports Division of the Federal Reserve Bank of New York [NY Fed].” These dealers submit daily reports of market activity and positions and monthly financial statements to the NY Fed and are subject to its informal oversight. Primary dealers include SEC-registered broker-dealers, banks, and a few unregulated firms.

⁵SOP 85-2, paragraph 17.

43. If government securities dealers are not financial institutions, do not conduct their government securities activity in an SEC-registered business, or do not report to the NY Fed, then they are not subject to any governmental regulation or oversight. As a result, they are not required to meet capital adequacy standards.

Repurchase Agreement Safeguards

44. There are several measures a buyer-lender in a repurchase agreement may take to safeguard its investment, for example, evaluating the creditworthiness of the seller-borrower, structuring the agreement to avoid the automatic stay provisions of the Federal Bankruptcy Code, having the underlying securities held by an independent third-party custodian, evaluating the creditworthiness of the custodian, having the market value of underlying securities exceed the amount invested, and using written agreements with the seller-borrower and custodian to clearly establish its rights to the underlying securities.

Know your dealer

45. When selecting a dealer with which to enter into a repurchase agreement, buyer-lenders may take steps to become satisfied with the dealer's creditworthiness. This can be done by reviewing the dealer's financial condition and corporate structure, such as whether it is an affiliate of a larger corporation, a stand-alone corporation, and so forth. A buyer-lender can review up-to-date audited financial statements and prospectus information of the dealer, paying attention to the adequacy of its capital, the scope of its business, its profitability in recent years, the types of transactions it handles, whether it takes large speculative positions, and its management's experience and background. Although some buyer-lenders may forgo an assessment of creditworthiness for large SEC-registered or primary government securities dealers, others make that assessment, believing that neither size nor relationship with regulatory or oversight bodies guarantees financial stability.

46. Many buyer-lenders assess the causes for above-market rates of return offered on repurchase agreements, believing higher rates may signal higher risks. Some also assess any procedures the dealer may insist on that are not normal and customary in the industry, believing this too signals a higher risk.

Federal Bankruptcy Code protection

47. Another precaution that can be taken by a buyer-lender involved in a repurchase agreement with a government securities dealer is to structure the transaction so that, under the provisions of the Federal Bankruptcy Code (Code), the underlying securities can quickly be liquidated by the buyer-lender. To be a repurchase agreement as defined in the Code, the underlying securities must be transferred to the buyer-lender and must be “certificates of deposit, eligible bankers’ acceptances, or securities that are direct obligations of, or that are fully guaranteed as to principal and interest by, the United States or any agency of the United States. . .”⁶ The Code further states that the transfer of securities back to the seller-borrower must be agreed to be for “a date certain not later than one year after [the initial transfer] or on demand.”⁷ The Code exempts these repurchase agreements from its automatic stay provision, which otherwise prevents creditors from liquidating the assets of the bankrupt without the approval of the bankruptcy court. In this way, the Code provides the buyer-lender of a qualifying repurchase agreement the opportunity to immediately sell the underlying securities and offset the proceeds against the liability of the seller-borrower.

48. Securities dealers that are members of SIPC are covered under special provisions of the Code. In a SIPC liquidation, there is a possibility the bankruptcy trustee would seek to stay the buyer-lender’s liquidation of the underlying securities. The buyer-lender would then have to obtain the approval of the trustee to liquidate the securities. Absent some question about the buyer-lender’s interest in the securities, this approval is usually given within a short time.

Location and market value of underlying securities

49. Most buyer-lenders consider the risks associated with the location of the securities underlying repurchase agreements. As explained in paragraph 20, who holds the securities and whether the securities are held in the name of the buyer-lender affect the degree of credit risk associated with the transactions. Many buyer-lenders also assess the creditworthiness of the party they select to hold the securities.

50. Another precaution that may be taken by a buyer-lender of a repurchase agreement is to make sure the market value of the underlying securities is always more than the cash

⁶Public Law 98-353, July 10, 1984, Subtitle F, "Amendments regarding Repurchase Agreements," Sec. 391.

⁷Public Law 98-353, Sec. 391.

paid. It is common practice for an excess of market value over the cash paid, called a **margin**, to be built into the agreement to protect against declines in the market value of the underlying securities. Some buyer-lenders may even require that the market value of the underlying securities exceed the amount to be received at the end of the agreement to protect both principal and interest. The size of the margin built into the agreement usually takes into consideration the price volatility of the underlying securities, the frequency of repricing, and the term of the repurchase agreement.

51. Buyer-lenders may also review (reprice) the market value of the underlying securities periodically to make sure it has not fallen below an acceptable level, thereby placing part of the principal and interest at risk. If a decline in value occurs, additional securities may be obtained or part of the principal may be recovered.

Written contracts

52. A buyer-lender may also protect itself by establishing its rights in the transaction by entering into a written repurchase agreement contract with the seller-borrower. A contract may specify, among other things, the right of the buyer-lender to liquidate the underlying securities in the event of default by the seller-borrower and directions for having the securities held by the buyer-lender's custodian. The contract may take the form of a **master agreement** covering all future transactions or a transaction agreement covering only a single repurchase agreement transaction.

53. A buyer-lender may also have a written contract with its custodian, called a custodial agreement, specifying the responsibilities of the custodian to the buyer-lender and the rights of the buyer-lender to the underlying securities. A written contract may specify the custodian's responsibilities to:

- a. Disburse cash for repurchase agreements only on receipt of the underlying securities
- b. Obtain additional securities if the required margin on the agreement is not maintained
- c. Hold the securities separate from its own assets
- d. Report periodically to the buyer-lender on the market value of the securities.

54. When making recurring repurchase agreement transactions with the same dealer, some buyer-lenders choose to use the bank or trust company that services the dealer as their custodian. Such arrangements may be governed by a three-party custodial agreement. This agreement specifies the bank or trust company's responsibilities in the repurchase transaction, including control of cash and securities and the rights of the buyer-

lender to sell the underlying securities in the event of default by the seller-borrower. In this situation, the custodian is contractually obligated as an agent of the buyer-lender.

Repurchase agreements with financial institutions

55. Governmental entities may also enter into repurchase agreements with banks and savings and loan associations. These financial institutions are subject to the regulatory oversight of several governmental agencies but are not subject to the Federal Bankruptcy Code.

56. In October 1984, the Federal Home Loan Bank Board (FHLBB) adopted a resolution for **Federal Savings and Loan Insurance Corporation (FSLIC)** insured institutions. This resolution indicates that it is the FHLBB's policy not to limit contractual rights of the buyer-lender to sell securities underlying repurchase agreements except in cases of fraud or other extraordinary circumstances. The **Federal Deposit Insurance Corporation (FDIC)** has not adopted a similar resolution for FDIC-insured institutions, but its practices to date have been consistent with those formally adopted by the FHLBB.

57. As a result, precautions taken to protect a buyer-lender's investment in a repurchase agreement with a government securities dealer would also protect an investment in a repurchase agreement with an FSLIC-insured institution as long as the FHLBB maintains its policy. While the same precautions may not protect an investment in a repurchase agreement with an FDIC-insured institution, they continue to be prudent practices.

SIPC position on coverage for repurchase agreements

58. Because SIPC does not consider repurchase agreement participants to be customers of its member broker-dealers, SIPC insurance does not extend to repurchase agreements.

Market risk associated with yield maintenance repurchase agreements

59. If a governmental entity is a buyer-lender in a yield maintenance repurchase agreement, it buys securities at their market value and agrees to resell securities that will give the seller-borrower a specific yield. Because the entity guarantees a yield that is agreed on at the time the transaction originates, regardless of what the market value may be on the date the securities are to be resold, the entity assumes a market risk. If the entity has to obtain the securities or already holds the securities at an amount in excess of the resale price, a loss on the resale will be realized.

Reverse Repurchase Agreement Risks and Safeguards

60. The major risk with reverse repurchase agreement transactions is credit risk, which results from the margin built into the agreement. If, for some reason, the buyer-lender in a reverse repurchase agreement transaction cannot or will not return the securities or their value at the end of the agreement, the seller-borrower may lose all or part of the margin. The credit risk, expressed in economic terms, is the difference between the market value of the underlying securities (including accrued interest) and the amount of the reverse repurchase agreement obligation (including accrued interest).⁸

61. Another risk with reverse repurchase agreements concerns how the seller-borrower uses the proceeds received from the agreement. The seller-borrower may use the proceeds to invest in securities that provide a higher yield than the interest to be paid on the agreement. If the proceeds are invested in securities that mature at or almost at the same time as the reverse repurchase agreement and the proceeds from those securities will be used to liquidate the agreement, there is a **matched position**. With a matched position there is minimal market risk because the seller-borrower will hold the securities to maturity and liquidate them at face value. If securities will be sold and used to liquidate the agreement but the maturities are not matched, the entity is at risk that the market value of the securities when sold may be less than the carrying amount and a loss will be realized.

62. The seller-borrower in a reverse repurchase agreement also assumes a risk that the market value of the securities to be repurchased may change. In a yield maintenance reverse repurchase agreement, the seller-borrower sells securities at their market value and agrees to repurchase different securities at a price that will produce a specific yield. Because the yield is agreed on at the time the transaction originates, the seller-borrower

⁸An economic loss on a reverse repurchase agreement may differ from an accounting loss because an accounting loss is the difference between the carrying amount of the underlying securities including accrued interest and the amount of the agreement obligation including accrued interest. For example, if, at year-end, securities with a carrying amount, including accrued interest, of \$2 million have been sold under a reverse repurchase agreement, the securities have a market value of \$1.9 million, the obligation including accrued interest is \$1.8 million, and the buyer-lender defaults on that day, the economic loss is only \$100,000 (\$1.9 million less \$1.8 million) although the accounting loss is \$200,000 (\$2 million less \$1.8 million). Alternatively, if the facts were the same except the carrying amount including accrued interest of the securities is \$1.6 million, the entity would record a gain of \$200,000 (\$1.8 million less \$1.6 million), despite the \$100,000 economic loss.

takes the risk that interest rates will rise and the securities will be repurchased at a price in excess of their market value.

STANDARDS OF GOVERNMENTAL ACCOUNTING AND FINANCIAL REPORTING

Required Note Disclosures for Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements

63. Disclosures about deposits with financial institutions, investments (including repurchase agreements), and reverse repurchase agreements help users of state and local governmental financial statements assess the risks an entity takes in investing public funds. As explained more fully below, entities should make certain disclosures about:

- a. Legal or contractual provisions for deposits and investments, including repurchase agreements
- b. Deposits and investments, including repurchase agreements, as of the balance sheet date and during the period
- c. Legal or contractual provisions for reverse repurchase agreements
- d. Reverse repurchase agreements as of the balance sheet date.

64. The disclosures required by this Statement should generally be made for the entity as a whole. Additional or separate disclosures for component units, pension trust funds, or other funds or fund types should be made in certain circumstances as discussed in paragraphs 65, 70, and 71. However, additional or separate presentation by fund or fund type is not precluded for any other disclosures required by this Statement.

Legal or Contractual Provisions for Deposits and Investments, including Repurchase Agreements

65. The entity should briefly describe in the notes to financial statements the types of investments authorized by legal or contractual provisions.⁹ If the types of investments authorized for different funds, fund types, or component units differ significantly from those authorized for the oversight unit and those funds, fund types, or component units have material investment activity compared with the combined entity's investment activity, the differences in authorized investment types should be disclosed.

⁹According to the GASB's November 1, 1984 *Codification of Governmental Accounting and Financial Reporting Standards*, Section 1200, "Generally Accepted Accounting Principles and Legal Compliance," paragraph .104, legal provisions include those arising from constitutions, charters, ordinances, resolutions, governing body orders, and intergovernmental grant or contract regulations.

66. Significant violations during the period of legal or contractual provisions for deposits and investments (including provisions other than those disclosed in accordance with paragraph 65) should also be disclosed. For example, if state statutes require collateral on deposits to be held by the entity's independent third-party agent but the collateral was usually held by the pledging financial institution's trust department, that should be disclosed.

Deposits and Investments, including Repurchase Agreements, as of the Balance Sheet Date and during the Period

67. If the bank balances of deposits as of the balance sheet date are entirely insured¹⁰ or collateralized with securities held by the entity or by its agent in the entity's name, that fact should be stated. If not, these disclosures should be made:

- a. Carrying amount of total deposits, if not separately displayed on the balance sheet
- b. The amount of total bank balance classified in these three categories of credit risk:
 - (1) Insured or collateralized with securities held by the entity or by its agent in the entity's name
 - (2) Collateralized with securities held by the pledging financial institution's trust department or agent in the entity's name
 - (3) Uncollateralized. (This includes any bank balance that is collateralized with securities held by the pledging financial institution, or by its trust department or agent but not in the entity's name.)

68. The carrying amount and market value¹¹ of investments (including repurchase agreements) as of the balance sheet date should be disclosed in total and for each type of

¹⁰For purposes of this Statement, depository insurance includes:

- a. Federal depository insurance funds, such as those maintained by the FDIC and the FSLIC. The FDIC and the FSLIC currently insure up to \$100,000 per deposit. However, separately named accounts of a governmental entity in a single financial institution may not necessarily be treated as separate deposits for purposes of applying the \$100,000 limit. Because the amount of insurance coverage depends on the nature and purpose of the entity's separate accounts, the entity should investigate the extent to which it is covered by federal depository insurance at each financial institution.
- b. State depository insurance funds.
- c. Multiple financial institution collateral pools that insure public deposits. (See paragraph 11.)

¹¹If the governmental entity has invested in a pool managed by another government, such as city monies in a state treasurer's investment pool, no disclosure of the individual deposits and investments of the pool is required by this Statement unless the entity owns specific, identifiable investment securities of the pool. Instead, the investment in the pool should be treated as a type of investment with a market value equal to the net realizable value of the entity's share of the pool based on the pool's valuation method.

investment. The disclosure of carrying amounts by type of investment should be classified in these three categories of credit risk:

- a. Insured (see paragraph 25) or registered,¹² or securities held by the entity or its agent in the entity's name
- b. Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the entity's name
- c. Uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the entity's name. (This includes the portion of the carrying amount of any repurchase agreement that exceeds the market value of the underlying securities.)

The term *securities* as used in this paragraph includes securities underlying repurchase agreements and investment securities.

69. The categories in paragraph 68 may not apply to all types of investments. In general, investments in pools managed by other governments or in mutual funds should be disclosed but not categorized because they are not evidenced by securities that exist in physical or book entry form. Securities underlying reverse repurchase agreements should also be disclosed but not categorized, because they are held by the buyer-lender.

70. If the credit risk to the oversight unit is not apparent because (a) the deposit or investment balances of component units, pension trust funds, or other funds are significant and (b) the mix of credit risk categories for those units or funds is significantly different from that of the oversight unit, additional or separate disclosures concerning credit risk categories should be made for those units or funds.

71. One of the requirements of paragraph 68 is disclosure of the carrying amount and market value of total investments of the combined entity as of the balance sheet date. However, unrealized investment losses in one or more component units or funds may not be apparent because of unrealized investment gains in the remaining funds. In those cases, for those component units or funds with unrealized investment losses, the carrying amount and market value of that unit's or fund's total investments should be disclosed.

72. For commitments as of the balance sheet date to resell securities under yield maintenance repurchase agreements, the carrying amount (if applicable) and market value

¹²Securities are considered registered for purposes of this Statement only if registered in the name of the governmental entity.

as of the balance sheet date of the securities to be resold and a description of the terms of the agreements (such as settlement price ranges, agreed-on yields, maturity dates, and so forth) should be disclosed.

73. If the amount of an entity's "Uncollateralized" deposits (paragraph 67b(3)) or "Uninsured, unregistered securities held by the counterparty, or by its trust department or agent but not in the entity's name" (paragraph 68c) during the period significantly exceeded the amounts in those categories as of the balance sheet date, that fact and the causes should be briefly stated. The amounts in those categories during the period could have exceeded those as of the balance sheet date because of increased amounts of deposits or investments, changes in practices, changes in the mix of investment types, or for other reasons. For example, disclosure is required if it is an entity's practice to leave securities underlying overnight repurchase agreements with the seller-borrower and the entity had a significant investment in these agreements at midyear due to peak cash flows but few investments involving similar risks at year-end.¹³

74. The entity should also disclose the types of investments made during the period but not owned as of the balance sheet date. For example, if the entity invested in repurchase agreements throughout the period but had none as of the balance sheet date, that fact should be disclosed.

75. The entity should disclose losses recognized during the period due to default by counterparties to deposit or investment transactions and amounts recovered from prior-period losses if not separately displayed on the operating statement.

Legal or Contractual Provisions for Reverse Repurchase Agreements

76. If reverse repurchase agreements were used during the period, the entity should state the source of legal or contractual authorization for the use of those agreements.

77. Significant violations during the period of legal or contractual provisions for reverse repurchase agreements should be disclosed. For example, if state statutes require the proceeds from the agreements to be used only for investment purposes and the entity routinely uses the proceeds to finance operations, that fact should be disclosed.

¹³In this situation, the entity would disclose that, due to significantly higher cash flows at certain times during the year, the entity's investment in overnight repurchase agreements for which the underlying securities were held by the counterparty increased significantly; as a result, the amounts that were "Uninsured and unregistered, with securities held by the counterparty, or its trust department or agent but not in the entity's name" at those times were substantially higher.

Reverse Repurchase Agreements as of the Balance Sheet Date

78. For reverse repurchase agreements other than yield maintenance agreements outstanding as of the balance sheet date, the credit risk related to the agreements should be disclosed. Credit risk is calculated by comparing the aggregate amount of the reverse repurchase agreement obligations including accrued interest with the aggregate market value of the securities underlying those agreements including accrued interest.

79. For commitments as of the balance sheet date to repurchase securities under yield maintenance agreements, the market value as of the balance sheet date of the securities to be repurchased and a description of the terms of the agreements (such as settlement price ranges, agreed-on yields, maturity dates, and so forth) should be disclosed.

80. The entity should also disclose losses recognized during the period due to default by counterparties to reverse repurchase agreements and amounts recovered from prior-period losses if not separately displayed on the operating statement.

Accounting and Reporting Guidance for Repurchase and Reverse Repurchase Agreements

81. The assets and liabilities arising from reverse repurchase and fixed coupon reverse repurchase agreements should not be netted on the balance sheet. These agreements should be reported as a fund liability captioned “Obligations under reverse repurchase agreements,” and the underlying securities should be reported as “Investments.”

82. Income from repurchase and fixed coupon repurchase agreements should be shown as interest income. The interest cost of reverse repurchase and fixed coupon reverse repurchase agreements should be reported as interest expenditure/expense. The interest cost associated with reverse repurchase or fixed coupon reverse repurchase agreements should not be netted with interest earned on any related investments.

83. Yield maintenance repurchase and reverse repurchase agreements should be accounted for as purchases and sales, and sales and purchases, of securities, respectively, and gains or losses should be recognized.

EFFECTIVE DATE AND TRANSITION

84. The provisions of this Statement are effective for financial statements issued for periods ending after December 15, 1986. However, earlier application is encouraged.

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

This Statement was adopted by the unanimous vote of the five members of the Governmental Accounting Standards Board:

James F. Antonio, *Chairman*
Martin Ives, *Vice-Chairman*
Philip L. Defliese
W. Gary Harmer
Elmer B. Staats

Appendix A

BASIS FOR CONCLUSIONS

85. This appendix discusses factors considered significant by Board members in reaching the conclusions in this Statement. It includes descriptions of the various alternatives considered and the Board's reasons for accepting some and rejecting others. Individual Board members gave greater weight to some factors than to others.

86. In recent years, several failures of government securities dealers have resulted in significant losses to some of those who invested in repurchase agreements, including state and local governmental entities. Some governmental entities have also suffered losses related to the use of reverse repurchase agreements. Shortly after ESM Government Securities Inc. collapsed in March 1985, the GASB added a project to its agenda to address accounting and financial reporting for repurchase and reverse repurchase agreements by state and local governmental entities. The project was expanded to include deposits with financial institutions and other investments when the Board concluded that those transactions involve the same types of risks as those inherent in repurchase and reverse repurchase agreements. In particular, the Board was concerned about the potential for losses on uninsured deposits due to the continuing decline of many financial institutions. The Board believes that the disclosures required by this Statement will heighten the awareness of users and preparers of governmental financial statements to the risks inherent in deposit and investment transactions.

87. A task force of 11 persons from government, public accounting, the investment community, and regulatory bodies met on May 1, 1985 to counsel the Board in preparation of an Exposure Draft (ED) on the issues. On June 28, 1985, the Board issued an ED, *Accounting and Financial Reporting for Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*. The GASB received 92 responses to the ED and on September 24, 1985 held a public hearing at which 8 presentations were made. Many respondents believed the proposed disclosure requirements were excessive and many offered suggestions for reducing them.

88. The task force was reassembled on November 4, 1985; six new members, chosen from among the respondents to the ED, were added. Based on the counsel of the task force members and the suggestions received from the respondents and testifiers, the Board revised the ED. A revised draft Statement was submitted to the task force members before

it was finalized. The draft Statement was also sent to the 92 ED respondents and other interested parties for a “fatal flaw” review. The GASB received 14 responses to that draft Statement, most of which were substantially in agreement with it.

89. The Board believes there are risks inherent in all types of deposit and investment transactions. It defines the major risks as (a) credit risk, that is, the risk that the counterparty to a transaction will not fulfill its obligations, and (b) market risk, that is, the risk that the market value of securities purchased, underlying a repurchase agreement, or collateralizing a deposit will decline. Concerns about market risk associated with securities collateralizing deposits and underlying repurchase agreements become even more significant if the credit risk associated with the counterparty is high.

90. The Board believes that governmental officials owe a greater degree of accountability to their constituents than exists in the private sector. This accountability includes demonstrating the prudent use and management of the resources provided by involuntary providers, the taxpayers. Deposits and investments often represent the largest assets on governmental balance sheets. The Board believes the disclosures required by this Statement are necessary to help financial statement users assess the nature of risks assumed and their potential effects.

Background Information

91. In its ED, the Board presented an extensive background discussion before the “Standards” section explaining deposit and investment environment, types, risks, and safeguards. Many respondents believed that, although this information was informative and necessary, it would quickly become outdated, making its placement in the “Introduction and Background Information” section and inclusion in the GASB’s *Codification of Governmental Accounting and Financial Reporting Standards (Codification)* inappropriate. They suggested it be placed in an appendix or a separate document. The Board decided, however, to leave this discussion in the “Introduction and Background Information” section and the *Codification*. The Board believes that, due to the complexities of the issues, this section is necessary to understand the guidance given in the “Standards” section.

Level of Disclosure

92. In its ED, the Board proposed that certain disclosures be made for the entity as a whole and others by fund type. To reduce the amount of disclosure to that considered absolutely necessary, this Statement generally requires disclosures for the entity as a whole.

93. The Board recognizes, however, that there will be cases in which disclosure for the entity as a whole may not adequately convey the nature and extent of the risks assumed by different funds or fund types and the oversight unit. For example, certain fiduciary funds and component units may be able to assume a greater degree of risk than governmental funds, and deposit and investment losses incurred by those funds and component units may not affect the finances of the oversight unit. Therefore, this Statement requires additional or separate disclosures for component units or other funds or fund types in certain circumstances. Further, this Statement does not preclude additional or separate presentation by fund or fund type for any other required disclosures.

Disclosures of Policies and Violations

94. The ED had proposed disclosure of several major elements of deposit and investment policy, including the types of deposits and investments authorized, collateral requirements, limitations on counterparties, custodial requirements, and the use of written contracts. Many respondents to the ED noted that these policies should not be required disclosures in the notes to financial statements. Some argued that management policies should not be disclosed because they are subject to change; those respondents believed that only policies established by law should be disclosed. Some opposed disclosure of deposit and investment policies because they believed such disclosure is not necessary for fair presentation of the financial statements. Some respondents argued against the disclosure, saying it would make the notes too long and confusing. Others opposed disclosure of those policies when, in the opinion of management, there is minimal risk of a material loss.

95. The Board believes that disclosure of deposit and investment policies would provide a useful background for assessing risks taken during the period and future risks. However, the Board agreed with those respondents who expressed concern that the detail might distract from other, more significant matters pertaining to the governmental entity's financial position and sought a simpler means of achieving its original objectives. The

Board concluded that sufficient information about actual and future deposit and investment risks could be provided by requiring disclosures that show practice as of the balance sheet date, supplemented by (a) a description of those situations in which credit risk during the period significantly exceeded credit risk as of the balance sheet date, (b) the types of investments made during the period but not owned as of the balance sheet date, and (c) the types of investments authorized by legal or contractual provisions. As a result, the policy disclosures proposed in the ED, except that noted in (c), have been eliminated. The Board continues to believe, however, that the policies that would have been disclosed in accordance with the ED are important internal controls and governmental entities should consider implementing them. For this reason, discussion about them has been retained in the “Introduction and Background Information” section of this Statement.

96. The ED also proposed disclosure of policies related to control of risk associated with reverse repurchase agreements. Some respondents opposed these disclosures for the same reasons they opposed the policy disclosures discussed above. The Board agreed to eliminate most of the reverse repurchase agreement policy disclosures, concluding that, if reverse repurchase agreements are used, disclosures that show practice as of the balance sheet date, together with disclosure of the source of legal or contractual authorization for the use of the agreements, will provide sufficient information about reverse repurchase agreement risk exposure.

97. This Statement also requires disclosure of significant violations during the period of legal and contractual provisions for deposits, investments, and reverse repurchase agreements. This disclosure is already required by *Codification* Section 2300, “Notes to Financial Statements,” paragraph .104f, but the Board believes that it should be repeated in this Statement due to its importance. Several respondents were concerned that the ED would require disclosure of insignificant violations. The Board had not intended that insignificant items be disclosed; to clarify the matter, this Statement limits disclosure to *significant* violations.

Disclosures as of the Balance Sheet Date

98. In the ED, the Board proposed disclosure of the carrying amount and market value of an entity’s portfolio by type of investment to give users an idea of the structure of and risks in the portfolio. Most respondents agreed with this disclosure, and it has been retained in the Statement.

99. The Board had proposed quantifying certain deposit and investment credit risks as of the balance sheet date on an exception basis; that is, it would have established a point at which it believed a governmental entity faced potential credit risk and proposed that all situations with that level of risk or greater be disclosed. Disclosure was proposed for (a) any excess of uninsured deposits over market value of collateral held by the entity or its independent third-party agent, (b) any excess of repurchase agreement principal plus accrued interest over the market value of underlying securities held by the entity or its independent third-party agent, and (c) any uninsured, unregistered investment securities purchased but not held by the entity or its independent third-party agent. Many respondents to the ED took exception to this approach:

- a. Some respondents believed the requirement would have the effect of dictating management policy. They indicated that if disclosure were required only in certain situations, it would mean that only those situations were at risk and, to avoid this disclosure, changes in policies or practices would result.
- b. Several respondents objected to the GASB's proposed position that a trust department of a financial institution that is the counterparty to a deposit or investment transaction should not be considered an independent third-party agent of the entity for purposes of determining credit risk. Those respondents indicated that specific laws enacted in certain states, government regulations, and fiduciary law supported their belief. Other respondents, however, agreed with the Board's position that the independence of those trust departments was, in some situations, not sufficiently certain as to make disclosure of the condition a reasonable requirement in all cases.

100. On considering the comments of the respondents, the Board decided to require disclosure of deposits and investments by category of credit risk. Paragraphs 67 and 68 of this Statement require disclosure in three categories of risk. The Board continues to believe that the relationship between a financial institution and its trust department is sufficiently different from the relationship between a financial institution and a third party to require separate categorization.

101. Certain types of investments cannot be categorized because securities are not used as evidence of the investment. For example, investments in external investment pools and mutual funds cannot be categorized because the entity is not issued securities but rather is a registered shareholder. Also, securities underlying reverse repurchase agreements that are held by the agreement counterparty should not be categorized.

102. This Statement requires minimal disclosure if the uninsured bank balance of an entity's deposits is collateralized with securities held by the entity or in its name by its

agent. The Board believes this approach will eliminate needless detail because many governments will be in that position. If that position does not exist, the Statement requires summary disclosure of the bank balance by category of credit risk and the carrying amount of deposits. Disclosure of the bank balance minimizes practical problems associated with the differences between the carrying amount of deposits (book balance) and the bank balance of the same accounts.

103. In the ED, the Board proposed disclosure of the carrying amount, market value, weighted-average maturity, and weighted-average interest rate for all deposits and investments with a maturity of more than one year for each governmental and proprietary fund type. This proposed disclosure was intended to inform financial statement users of the possibility that long-term investments might have to be liquidated at a loss. The disclosure was not required for fiduciary funds because long-term investing in those funds is normal. The Board replaced this proposed disclosure with paragraph 71, which requires disclosure of carrying amount and market value of the total investments of any component unit or fund in which (a) carrying amount exceeds market value and (b) this unrealized investment loss is not apparent in other disclosures because of unrealized investment gains in the remaining funds. This disclosure is not required by type of investment. Precedent for note disclosure by fund is found in *Codification* Section 2300, “Notes to Financial Statements,” paragraph .104m, which requires disclosure of deficit fund balance or retained earnings of individual funds, and paragraph .105c, which requires disclosure of segment information for enterprise funds. The Board believes this disclosure will accomplish the objective of disclosing risks of market loss without burdening the notes with extraneous detail.

104. Disclosure of commitments as of the balance sheet date to resell securities under yield maintenance repurchase agreements is required because those commitments are not apparent from the classification of the securities and because the entity faces a market risk related to the securities to be resold. Disclosure of the settlement price ranges, agreed-on yields, maturity dates, and carrying amount (if applicable) and market value as of the balance sheet date of the securities to be resold will help users assess the economic and accounting effects of the commitments.

105. This Statement requires disclosures about reverse repurchase agreements as of the balance sheet date. The ED proposed detailed disclosure for each reverse repurchase agreement. On considering the comments of respondents, the Board concluded that

summary disclosures will be more informative to financial statement users because summary information can be focused to more clearly present the risks involved.

106. A governmental entity's credit risk in reverse repurchase and fixed coupon reverse repurchase agreements is equal to the margin on those agreements (the excess of the market value including accrued interest of the underlying securities over the amount of the agreement obligation plus accrued interest on the agreements). Therefore, this Statement requires disclosure of the total margin of the governmental entity's reverse repurchase and fixed coupon reverse repurchase agreements. This disclosure is not required for yield maintenance reverse repurchase agreements; no margin is given on those agreements because the securities have been sold.

107. Disclosure of commitments as of the balance sheet date to repurchase securities under yield maintenance reverse repurchase agreements is required because users of governmental financial statements generally are concerned with the nature of commitments and because the entity faces a market risk related to the securities to be repurchased. Disclosure of settlement price ranges, agreed-on yields, maturity dates, and market value as of the balance sheet date of securities to be repurchased will help users assess the economic effect of the commitments.

Activity Disclosures

108. In the ED, the Board proposed quantifying certain deposit and investment credit risks taken during the period to help users assess past and potential future risks. Some respondents to the ED believed that this quantification would not be cost beneficial and that, in many cases, the risk had already passed. This Statement requires narrative disclosure if, during the period, the amount of an entity's uninsured, uncollateralized deposits or uninsured, unregistered securities held by the counterparty, or by its trust department or agent but not in the entity's name, significantly exceeded the amount in those categories as of the balance sheet date. This requirement, together with disclosures that show practice as of the balance sheet date, replaces the ED's proposed requirement to disclose deposit and investment policies and to quantify deposit and investment risks taken during the period. This Statement also requires disclosure of the types of investments authorized and the types of investments made during the period but not owned as of the balance sheet date to provide information on past and potential future risks. Classification by investment type communicates information about the nature of

investments, their market risk, and, in some cases, the credit risk associated with their issuers.

109. The ED also proposed quantifying reverse repurchase agreement activity during the period. Some respondents to the ED opposed this for the same reasons they opposed quantifying deposit and investment risks taken during the period. The Board replaced the proposed activity disclosure with disclosures about the source of legal or contractual authorization for reverse repurchase agreements and practice as of the balance sheet date. These disclosures are required only if reverse repurchase agreements have been used during the period.

Accounting for Reverse Repurchase Agreements

110. As in the ED, this Statement requires separate line item presentation for liabilities of reverse repurchase and fixed coupon reverse repurchase agreements under the caption “Obligations under reverse repurchase agreements.” The related assets (the underlying securities) remain on the balance sheet in the investment account. The Board believes that these two items should not be netted on the balance sheet because there is no right of offset; that is, the liability is not satisfied by having the securities held by the counterparty to the reverse repurchase agreement.

111. Sales of investments should result in gain or loss recognition. The Board continues to believe that yield maintenance repurchase and reverse repurchase agreements are essentially purchase and sale transactions, and that securities purchased under those agreements should be initially recorded at cost and gains or losses recognized on sales.

112. Most respondents agreed with the accounting proposed in the ED. Further, the Statement’s accounting requirements are supported by the 1979 AICPA Audit and Accounting Guide, *Savings and Loan Associations* (Guide), APB Opinion No. 10, *Omnibus Opinion--1966*, and AICPA Statement of Position (SOP) 85-2, *Accounting for Dollar Repurchase–Dollar Reverse Repurchase Agreements by Sellers-Borrowers*. The Guide states that reverse repurchase agreements should be reported as liabilities and that any interest on reverse repurchase agreements should be reported as an expense and not shown net of interest income. Opinion 10 provides that it is a general principle of accounting that the offset of assets and liabilities in the balance sheet is improper unless a right of offset exists. The SOP requires fixed coupon agreements to be accounted for as financing (borrow-and-lend) transactions, with the liability arising from the agreement

displayed separately from the underlying security. It further requires yield maintenance agreements to be accounted for as investing (buy-and-sell) activities.

Effective Date

113. The Board extended the effective date proposed in the ED to periods ending after December 15, 1986. The Board believes this will give preparers adequate time to implement systems that enable compliance with the requirements of this Statement.

Appendix B

ILLUSTRATION OF NOTE DISCLOSURE FOR DEPOSITS, INVESTMENTS, AND REVERSE REPURCHASE AGREEMENTS

114. This appendix illustrates disclosures required by this Statement. The facts assumed in this example are illustrative only and are not intended to modify or limit the requirements of this Statement or to indicate the Board's endorsement of the policies or practices shown. Application of the provisions of this Statement may require disclosures and formats other than those illustrated here.

Assumptions

Balance Sheet. The captions on the combined balance sheet related to cash and investments and the amounts in the Total (Memorandum Only) column are as follows:

| | Total (Memorandum Only) |
|---------------------------------------|------------------------------------|
| Equity in pooled cash and investments | \$109,151,000 |
| Cash | 1,129,000 |
| Investments | <u>138,106,000</u> |
| | <u>\$248,386,000</u> |

Deposits. All deposits are in a single financial institution and are carried at cost plus accrued interest.

| | <u>Carrying Amount</u> | <u>Bank Balance</u> | <u>Fund</u> |
|---|-----------------------------------|--------------------------------|--------------------|
| Insured (FDIC) | \$ 100,000 | \$ 100,000 | Pool |
| Insured (FDIC) | 100,000 | 100,000 | Pension |
| Uninsured: | | | |
| Collateral held by City's agent in City's name | 3,015,000 | 3,015,000 | Pool |
| Collateral held by pledging bank's trust department in City's name | 4,810,000 | 4,380,000 | Pool |
| Uncollateralized | <u>1,029,000</u> | <u>1,683,000</u> | Pension |
| Total Deposits | <u>\$9,054,000</u> | <u>\$9,278,000</u> | |

Investments. Investments in the City’s cash and investment pool are stated at cost or amortized cost, plus accrued interest. Other investments are stated at cost or amortized cost with accrued interest shown under a separate caption on the balance sheet. Market values include accrued interest only if the carrying amounts do.

Assumptions (continued)

| | <u>Carrying Amount</u> | <u>Market Value</u> | <u>Fund</u> |
|---|----------------------------|-------------------------|------------------|
| Repurchase Agreements: | | | |
| Agreement Number 1: | | | |
| Securities held by City’s agent in City’s name | \$23,207,000 | \$23,207,000 | Pool |
| Agreement Number 2: | | | |
| Securities held by dealer bank’s trust department in City’s name | 5,004,000 | 5,004,000 | |
| No underlying securities | <u>997,000</u> | <u>997,000</u> | |
| Total Agreement Number 2 | <u>6,001,000</u> | <u>6,001,000</u> | Pool |
| Agreement Number 3: | | | |
| Securities held by dealer | <u>4,000,000</u> | <u>4,000,000</u> | Pension |
| Total Repurchase Agreements | <u>\$33,208,000</u> | <u>\$33,208,000</u> | |
| Other Investments: | | | |
| U.S. Treasury Bills: | | | |
| Held by broker-dealer under reverse repurchase agreements | \$ 41,649,000 | \$ 41,903,000 | Pool |
| U.S. Treasury Notes: | | | |
| Held by dealer, but subject to SIPC and other insurance | 1,716,000 | 1,789,000 | Debt service |
| | <u>5,149,000</u> | <u>5,369,000</u> | Capital projects |
| | <u>6,865,000</u> | <u>7,158,000</u> | |

Assumptions (continued)

| | <u>Carrying Amount</u> | <u>Market Value</u> | <u>Fund</u> |
|--|-----------------------------|-----------------------------|-------------|
| FHLMC-Participating Certificates: | | | |
| Held by broker-dealer under reverse repurchase agreements | 31,619,000 | 28,929,000 | Pension |
| Commercial Paper: | | | |
| Uninsured, unregistered, and held by City's agent in City's name | 14,470,000 | 14,550,000 | Pool |
| Bankers' Acceptances: | | | |
| Uninsured, unregistered, and held by dealer bank | 14,880,000 | 14,906,000 | Pool |
| Uninsured, unregistered, and held by dealer bank's trust department in City's name | 41,574,000 | 41,800,000 | Pension |
| Corporate Bonds: | | | |
| Registered and held by City's agent | 54,048,000 | 46,128,000 | Pension |
| Investment in State Treasurer's Investment Pool | <u>1,019,000</u> | <u>1,019,000</u> | Pool |
| Total Other Investments | <u>\$206,124,000</u> | <u>\$196,393,000</u> | |
| Total Investments | <u><u>\$239,332,000</u></u> | <u><u>\$229,601,000</u></u> | |

Assumptions (continued)

Reverse Repurchase Agreements:

| <u>Agreements</u> | <u>Underlying Securities</u> |
|--|---|
| \$41,399,000 received, to be repaid with interest of 7.49% on 1/20/X6 | \$43,000,000 USTB maturing 2/20/X6; \$41,649,000 carrying amount, \$41,903,000 market value |
| \$18,591,000 received, to be repaid with interest of 8.45% on 12/18/X5 | \$10,000,000 FHLMC-PC 10 1/2% maturing 5/1/Z9; \$19,000,000 FHLMC-PC 9 1/4% maturing 10/1/Z8; \$7,653,000 and \$13,505,000 carrying amount, respectively, \$7,313,000 and \$12,160,000 market value, respectively |
| \$9,102,000 received, to be repaid with interest of 8.50% on 12/31/X5 | \$15,000,000 FHLMC-PC 9 1/4% maturing 7/1/Z8; \$10,461,000 carrying amount, \$9,456,000 market value |
| <u>Total Agreements</u> | <u>Total Underlying Securities</u> |
| Proceeds \$69,092,000 | Market Value \$70,832,000 |
| Accrued Interest <u>453,000</u> | Accrued Interest <u>252,000</u> |
| Obligation <u>\$69,545,000</u> | Market Value plus Accrued Interest <u>\$71,084,000</u> |

Note X: Equity in Pooled Cash and Investments, Cash, Investments, and Obligations under Reverse Repurchase Agreements*

The City maintains a cash and investment pool that is available for use by all funds, except the pension trust fund. Each fund type’s portion of this pool is displayed on the combined balance sheet as “Equity in pooled cash and investments.” In addition, investments are separately held by several of the City’s funds. The deposits and investments of the pension trust fund are held separately from those of other City funds.

*Explanation of the valuation of the carrying amounts of deposits and investments would be in the Summary of Significant Accounting Policies.

Deposits. At year-end, the carrying amount of the City's deposits was \$9,054,000 and the bank balance was \$9,278,000. Of the bank balance, \$3,215,000 was covered by federal depository insurance or by collateral held by the City's agent in the City's name, \$4,380,000 was covered by collateral held in the pledging bank's trust department in the City's name, and \$1,683,000 was uninsured and uncollateralized. The uninsured and uncollateralized deposits are held by the pension trust fund.

Statutes require collateral pledged for pool deposits to be held in the City's name by the trust department of a bank other than the pledging bank; however, during the year the City often permitted collateral on the pool's deposits to be held in the City's name by the pledging bank's trust department.

Investments. Statutes authorize the City to invest in obligations of the U.S. Treasury, agencies, and instrumentalities, commercial paper rated A-1 by Standard & Poor's Corporation or P-1 by Moody's Commercial Paper Record, bankers' acceptances, repurchase agreements, and the state treasurer's investment pool. The City is also authorized to enter into reverse repurchase agreements. The pension trust fund is also authorized to invest in corporate bonds rated AA or better by Standard & Poor's Corporation or Aa or better by Moody's Bond Ratings.

The City's investments are categorized on page XX to give an indication of the level of risk assumed by the entity at year-end. Category 1 includes investments that are insured or registered or for which the securities are held by the City or its agent in the City's name. Category 2 includes uninsured and unregistered investments for which the securities are held by the broker's or dealer's trust department or agent in the City's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the broker or dealer, or by its trust department or agent but not in the City's name.

| | Category | | | Carrying Amount | Market Value |
|--|---------------------|---------------------|---------------------|----------------------------|-------------------------|
| | 1 | 2 | 3 | | |
| Repurchase agreements | \$23,207,000 | \$5,004,000 | \$4,997,000 | \$ 33,208,000 | \$ 33,208,000 |
| U.S. Government securities | 6,865,000 | -- | -- | 6,865,000 | 7,158,000 |
| Bankers' acceptances | -- | 41,574,000 | 14,880,000 | 56,454,000 | 56,706,000 |
| Commercial paper | 14,470,000 | -- | -- | 14,470,000 | 14,550,000 |
| Corporate bonds | <u>54,048,000</u> | <u>--</u> | <u>--</u> | <u>54,048,000</u> | <u>46,128,000</u> |
| | <u>\$98,590,000</u> | <u>\$46,578,000</u> | <u>\$19,877,000</u> | 165,045,000 | 157,750,000 |
| Investments held by broker-dealers under reverse repurchase agreements: | | | | | |
| U.S. Government securities | | | | 41,649,000 | 41,903,000 |
| U.S. Instrumentality securities | | | | 31,619,000 | 28,929,000 |
| Investment in state treasurer's investment pool | | | | <u>1,019,000</u> | <u>1,019,000</u> |
| Total Investments | | | | <u>\$239,332,00</u> | <u>\$229,601,000</u> |

The pension trust fund owns approximately 89 percent of the investments that are in category 2 and approximately 20 percent of the investments that are in category 3.

Statutes require that securities underlying repurchase agreements must have a market value of at least 102 percent of the cost of the repurchase agreement. The market value of securities underlying repurchase agreements fell significantly below this required level on a few occasions during the year, but no losses were incurred.

Due to significantly higher cash flows at certain times during the year, the City's investment in overnight repurchase agreements for which the underlying securities were held by the dealer increased significantly. As a result, the amounts that were in category 3 at those times were substantially higher than at year-end.

Reverse Repurchase Agreements. State statutes permit the City to enter into reverse repurchase agreements, that is, a sale of securities with a simultaneous agreement to repurchase them in the future at the same price plus a contract rate of interest. The market value of the securities underlying reverse repurchase agreements normally exceeds the cash received, providing the dealers a margin against a decline in market value of the securities. If the dealers default on their obligations to resell these securities to the City or provide securities or cash of equal value, the City would suffer an economic loss equal to the difference between the market value plus accrued interest of the underlying securities and the agreement obligation, including accrued interest. This credit exposure at year-end was \$1,539,000.

Appendix C

ILLUSTRATION OF NOTE DISCLOSURE FOR DEPOSITS AND INVESTMENTS

115. This appendix illustrates disclosures required by this Statement. The facts assumed in this example are illustrative only and are not intended to modify or limit the requirements of this Statement or to indicate the Board's endorsement of the policies or practices shown. Application of the provisions of this Statement may require disclosures and formats other than those illustrated here.

Assumptions

Deposits. Deposits are carried at cost plus accrued interest. The carrying amount of deposits is separately displayed on the balance sheet as "Cash."

| | <u>Carrying Amount</u> | <u>Bank Balance</u> |
|--|-----------------------------------|--------------------------------|
| Insured (FDIC) | \$100,000 | \$100,000 |
| Uninsured, collateral held by Town's agent in Town's name | <u>245,000</u> | <u>271,000</u> |
| Total Deposits | <u>\$345,000</u> | <u>\$371,000</u> |

Investments. The Town's investment in the state treasurer's investment pool is stated at cost plus accrued interest. Commercial paper is stated at amortized cost.

| | <u>Carrying Amount</u> | <u>Bank Balance</u> |
|---|-----------------------------------|--------------------------------|
| Commercial paper Uninsured, unregistered, and held by Town's agent in Town's name | \$ 256,000 | \$ 258,000 |
| Investment in state treasurer's investment pool | <u>810,000</u> | <u>810,000</u> |
| Total Investments | <u>\$1,066,000</u> | <u>\$1,068,000</u> |

Note Y: Cash and Investments*

The Town's deposits at year-end were entirely covered by federal depository insurance or by collateral held by the Town's custodial bank in the Town's name.

Statutes authorize the Town to invest in obligations of the U.S. Treasury and U.S. agencies, bankers' acceptances, repurchase agreements, commercial paper rated A-1 by Standard & Poor's Corporation or P-1 by Moody's Commercial Paper Record, and the state treasurer's investment pool.

The Town's investments at year-end are shown below. All of the commercial paper was held by the Town's custodial bank in the Town's name. The Town also invested in bankers' acceptances and U.S. Treasury securities during the year.

| | <u>Carrying Amount</u> | <u>Bank Balance</u> |
|--|-----------------------------------|--------------------------------|
| Commercial paper 258,000 | \$ 256,000 | \$ |
| Investment in state treasurer's investment pool | <u>810,000</u> | <u>810,000</u> |
| Total Investments | <u>\$1,066,000</u> | <u>\$1,068,000</u> |

*Explanation of the valuation of the carrying amounts of deposits and investments would be in the Summary of Significant Accounting Policies.

Appendix D

GLOSSARY

116. This appendix defines certain terms used in this Statement.

Bankers' acceptances

Bankers' acceptances generally are created based on a letter of credit issued in a foreign trade transaction. Bankers' acceptances are short-term, non-interest-bearing notes sold at a discount and redeemed by the accepting banks at maturity for face value.

Book entry

A system that eliminates the need for physically transferring bearer-form paper or registering securities by using a central depository facility.

Carrying amount

The amount at which assets and liabilities are reported in the financial statements. Carrying amount is also known as book value.

Collateral

Security pledged by a financial institution to a governmental entity for its deposit.

Collateral pool

- a. Single financial institution collateral pool. A group of securities pledged by a single financial institution against all the public deposits it holds.
- b. Multiple financial institution collateral pool. A group of securities pledged by various financial institutions to provide common collateral for their deposits of public funds. In such a collateral pool, the assets of the pool and the power to make additional assessments against the members of the pool, if necessary, insure there will be no loss of public funds because of the default of a member.

Commercial paper

An unsecured promissory note issued primarily by corporations for a specific amount and maturing on a specific day. The maximum maturity for commercial paper is 270 days, but most is sold with maturities of up to 30 days. Almost all commercial paper is rated as to credit risk by rating services.

Counterparty

Another party to a transaction. In the case of deposits and investments made by governmental entities, a counterparty could be the issuer of a security, a financial institution holding a deposit, a broker-dealer selling securities, or a third party holding securities or collateral.

Credit risk

The risk that a counterparty to an investment transaction will not fulfill its obligations. Credit risk can be associated with the issuer of a security, with a financial institution holding deposits, or with a party holding securities or collateral. Credit risk exposure can be affected by a concentration of deposits or investments in any one investment type or with any one counterparty.

Custodial agreement

A written contract establishing the responsibilities of a custodian holding collateral for deposits with financial institutions, investment securities, or securities underlying repurchase agreements.

Depository insurance

Insurance on deposits with financial institutions. For purposes of this Statement, depository insurance includes:

- a. Federal depository insurance funds, such as those maintained by the Federal Deposit Insurance Corporation (FDIC) and Federal Savings and Loan Insurance Corporation (FSLIC)
- b. State depository insurance funds
- c. Multiple financial institution collateral pools that insure public deposits.

Dollar repurchase-reverse repurchase agreement

A repurchase-reverse repurchase agreement that involves the transfer of securities in which the parties agree that the securities returned usually will be of the same issuer but will not be the same certificates. Fixed coupon and yield maintenance agreements are the most common types of dollar agreements.

Federal Deposit Insurance Corporation (FDIC)

A federal institution that insures bank deposits, currently up to \$100,000 per deposit.

Federal Savings and Loan Insurance Corporation (FSLIC)

A federal institution that insures savings and loan deposits, currently up to \$100,000 per deposit.

Fixed coupon repurchase-reverse repurchase agreement

A dollar repurchase-reverse repurchase agreement in which the parties agree that the securities returned will have the same stated interest rate as, and maturities similar to, the securities transferred.

Margin

The excess of the market value including accrued interest of the securities underlying a repurchase-reverse repurchase or a fixed coupon repurchase-reverse repurchase agreement over the agreement amount including accrued interest. It is common practice for a margin to be built into an agreement to protect against declines in the market value of the underlying securities.

Market risk

The risk that the market value of an investment, collateral protecting a deposit, or securities underlying a repurchase agreement will decline. Market risk is affected by the length to maturity of a security, the need to liquidate a security before maturity, the extent that collateral exceeds the amount invested, and the frequency at which the amount of collateral is adjusted for changing market values.

Master agreement

A written contract covering all future transactions between the parties to repurchase-reverse repurchase agreements that establishes each party's rights in the transactions. A master agreement will often specify, among other things, the right of the buyer-lender to liquidate the underlying securities in the event of default by the seller-borrower.

Matched position

A condition existing when reverse repurchase agreement proceeds are invested in securities that mature at or almost at the same time as the reverse repurchase

agreement and the proceeds from those securities will be used to liquidate the agreement.

Perfected security interest

An interest in property, including securities, that is superior to the interests of the general creditors. Possession of the security by the secured party or its agent is generally needed to create a perfected security interest. In addition, a perfected security interest can be created without taking possession of the security if the transferor of the security interest has signed a security agreement that contains a description of the collateral and the secured party pays for the investment. Such a security interest is perfected for a period of 21 days. However, the secured party risks loss or impairment of its security interest during the 21-day period, because the Uniform Commercial Code provides that a holder in due course of a negotiable instrument or a bona fide purchaser of the instrument will take priority over the secured party. After 21 days, the security interest becomes unperfected unless the secured party takes possession of the security.

Primary dealers

A group of government securities dealers included in the “List of Government Securities Dealers Reporting to the Market Reports Division of the Federal Reserve Bank of New York [NY Fed]” that submit daily reports of market activity and positions and monthly financial statements to the NY Fed and are subject to its informal oversight. Primary dealers include SEC-registered securities broker-dealers, banks, and a few unregulated firms.

Registered security

A security that has the name of the owner written on its face. A registered security cannot be negotiated except by the endorsement of the owner.

Repurchase agreement

- a. An agreement in which a governmental entity (buyer-lender) transfers cash to a broker-dealer or financial institution (seller-borrower); the broker-dealer or financial institution transfers securities to the entity and promises to repay the cash plus interest in exchange for the *same* securities.
- b. A generic term for an agreement in which a governmental entity (buyer-lender) transfers cash to a broker-dealer or financial institution (seller-borrower); the broker-dealer or financial institution transfers securities to the entity and promises to repay the cash plus interest in exchange for the same securities (as

in definition (a) above) or for different securities. (See also **Dollar repurchase-reverse repurchase agreement.**)

Reverse repurchase agreement

- a. An agreement in which a broker-dealer or financial institution (buyer-lender) transfers cash to a governmental entity (seller-borrower); the entity transfers securities to the broker-dealer or financial institution and promises to repay the cash plus interest in exchange for the same securities.
- b. A generic term for an agreement in which a broker-dealer or financial institution (buyer-lender) transfers cash to a governmental entity (seller-borrower); the entity transfers securities to the broker-dealer or financial institution and promises to repay the cash plus interest in exchange for the same securities (as in definition (a) above) or for different securities. (See also **Dollar repurchase-reverse repurchase agreement.**)

SEC-registered broker-dealer

A securities broker-dealer regulated by the Securities and Exchange Commission under the Securities Exchange Act of 1934.

Securities Investor Protection Corporation (SIPC)

A nonprofit corporation funded by its member SEC-registered broker-dealers that protects customer accounts in the event of the financial failure of a member. SIPC distributes customer assets and then provides funds for all remaining claims of each customer up to a maximum of \$500,000, including up to \$100,000 on claims for cash. SIPC does not consider repurchase agreement participants to be customers of its member broker-dealers and does not extend its insurance to repurchase agreements.

Underlying securities

Securities transferred in accordance with a repurchase-reverse repurchase agreement.

Yield maintenance repurchase-reverse repurchase agreement

A dollar repurchase-reverse repurchase agreement in which the parties agree that the securities returned will provide the seller-borrower with a yield as specified in the agreement.

Appendix E

CODIFICATION INSTRUCTIONS

117. The section that follow update the November 1, 1984 *Codification of Governmental Accounting and Financial Reporting Standards* for the effects of this Statement. Only the paragraph number is listed if the paragraph will be cited in full in the codification.

* * *

NOTES TO FINANCIAL STATEMENTS

SECTION 2300

Sources: [Add the following:] GASB Statement 3

[Add the following:]

- .104 o. Cash deposits with financial institutions. (See Section C20, “Cash Deposits with Financial Institutions.”)
- p. Investments. (See Section I50, “Investments, including Repurchase Agreements.”)

- .105 w. Reverse repurchase and dollar reverse repurchase agreements. (See Section R10, “Reverse Repurchase Agreements.”)

- .601 III.A.1. [Add the following:] (See Section C20, “Cash Deposits with Financial Institutions,” and Section I50, “Investments, including Repurchase Agreements.”)
- III.A.2. [Add the following:] (See Section I50, “Investments, including Repurchase Agreements.”)

[Add the following:]

- III.B.8. Obligations under reverse repurchase agreements. (See Section R10, “Reverse Repurchase Agreements.”)

* * *

Sources: GASB Statement 3

Scope of This Section

.101 This section provides guidance for disclosures by governmental entities about deposits with financial institutions. Disclosures required by this section may be combined with disclosures required by Section I50, “Investments, including Repurchase Agreements.” [GASBS 3, ¶1]

Introduction and Background

.102 Section I50, paragraphs .102-120, provides a discussion of the nature and types of deposits with financial institutions and the risks associated with them. In addition, Section I50, paragraph .501, provides definitions of terms used in this section.

Required Note Disclosures for Deposits with Financial Institutions

.103 Disclosures about deposits with financial institutions help users of state and local governmental financial statements assess the risks an entity takes in investing public funds. As explained more fully below, entities should make certain disclosures about:

- a. Legal or contractual provisions for deposits
- b. Deposits as of the balance sheet date and during the period. [GASBS 3, ¶63]

.104 The disclosures required by this section should generally be made for the entity as a whole. Additional or separate disclosures for component units, pension trust funds, or other funds or fund types should be made in certain circumstances as discussed in paragraph .107. However, additional or separate presentation by fund or fund type is not precluded for any other disclosures required by this section. [GASB 3, ¶64]

Legal on Contractual Provisions for Depositions

.105 Significant violations during the period of legal or contractual provisions¹ for deposits should be disclosed. For example, if state statutes require collateral on deposits

to be held by the entity's independent third-party agent but the collateral was usually held by the pledging financial institution's trust department, that should be disclosed. [FASBS 3, ¶66] [Includes fn9 as fn1]

Deposits as of the Balance Sheet Date and during the Period

.106 [GASBS 3, ¶67, including fn10 as fn2] [Change paragraph reference and "Statement" to "section."]

.107 If the credit risk to the oversight unit is not apparent because (a) the deposit balances of component units, pension trust funds, or other funds are significant and (b) the mix of credit risk categories for those units or funds is significantly different from that of the oversight unit, additional or separate disclosures concerning credit risk categories should be made for those units or funds. [GASBS 3, ¶70]

.108 If the amount of an entity's "Uncollateralized" deposits (paragraph .106b(3)) during the period significantly exceeded the amount in that category as of the balance sheet date, that fact and the causes should be briefly stated. The amount in that category during the period could have exceeded that as of the balance sheet date because of increased amounts of deposits, changes in practices, or for other reasons. For example, disclosure is required if it is an entity's practice not to have deposits collateralized and the entity had significant deposits at midyear due to peak cash flows but few deposits involving similar risks at year-end³ [GASBS 3, ¶73] [Change fn13 to fn3 as follows:] In this situation, the entity would disclose that, due to significantly higher cash flows at certain times during the year, the entity's uncollateralized deposits increase significantly; as a result, the amounts of uncollateralized deposits at those times were substantially higher.

.109 The entity should disclose losses recognized during the period due to default by counterparties to deposit transactions and amounts recovered from prior-period losses if not separately displayed on the operating statement. [GASBS 3, ¶75]

Nonauthoritative Discussion

.601 Illustrations of the disclosures required by this section are presented in Section I50, paragraphs .601 and .602.

* * *

INVESTMENTS, INCLUDING REPURCHASE AGREEMENTS SECTION I50

Sources: GASB Statement 3

Scope of This Section

.101 This section provide guidance for disclosures by governmental entities about deposits with financial institutions and investments. It also provides accounting and financial reporting guidance for repurchase agreements. [GASBS 3, ¶1]

Introduction and Background

.102-158 [GASBS 3, ¶3-¶59] [Change paragraph references and “Statement” to “section” as appropriate.]

Required Note Disclosures for Deposits with Financial Institutions and Investments (including Repurchase Agreements)

.159 Disclosures about deposits with financial institutions and investments (including repurchase agreements) help users of state and local governmental financial statements assess the risks an entity takes in investing public funds. As explained more fully below, entities should make certain disclosures about:

- a. Legal or contractual provisions for deposits and investments, including repurchase agreements
- b. Deposits and investments, including repurchase agreements, as of the balance sheet date and during the period. [GASBS 3, ¶63]

.160-.171 [GASBS 3, ¶64-¶75] [Change paragraph references and “Statement” to “section” as appropriate.]

Accounting and Reporting Guidance for Repurchase Agreements

.172 Income from repurchase and fixed coupon repurchase agreements should be shown as interest income. [GASBS 3, ¶82]

.173 Yield maintenance repurchase agreements should be accounted for as purchases and sales of securities, and gains or losses should be recognized. [GASBS 3, ¶83]

Definitions

.501 [GASBS 3, ¶116] [Change “Statement” to section.]

Nonauthoritative Discussion

.601 This paragraph illustrates disclosures required by this section as well as by Section C20, “Cash Deposits with Financial Institutions,” and Section R10, “Reverse Repurchase Agreements.” The facts assumed in this example are illustrative only and are not intended to modify or limit the requirements of this section, Section C20, or Section R10, or to indicate the GASB’s endorsement of the policies or practices shown. Application of the provisions of this section, Section C20, or Section R10 may require disclosures and formats other than those illustrated here. . . . [GASB 3, ¶114]

.602 This paragraph illustrates disclosures required by this section as well as by Section C20. The facts assumed in this example are illustrative only and are not intended to modify or limit the requirements of this section or Section C20 or to indicate the GASB’s endorsement of the policies or practices shown. Application of the provisions of this section or Section C20 may require disclosures and formats other than those illustrated here. . . . [GASBS 3, ¶115]

* * *

Source: GASB Statement 3

Scope of This Section

.101 This section provides accounting and financial reporting guidance for reverse repurchase agreements. Section I50, “Investments, including Repurchase Agreements,” provides accounting and financial reporting guidance for repurchase agreements. The disclosures required by this section may be combined with those required by Section I50. [GASBS 3, ¶1]

Introduction and Background

.102 Section I50, paragraphs .131-.138, provides a discussion of the nature and types of reverse repurchase agreements. In addition, Section I50, paragraph .501, provides definitions of terms used in this section.

.103-.105 [GASBS 3, ¶60-¶62, including fn8 as fn1]

Required Note Disclosures for Reverse Repurchase Agreements

.106 Disclosures about reverse repurchase agreements help users of state and local governmental financial statements assess the risks an entity takes in investing public funds. As explained more fully below, entities should make certain disclosures about:

- a. Legal or contractual provisions for reverse repurchase agreements
- b. Reverse repurchase agreements as of the balance sheet date. [GASBS 3, ¶63]

.107 The disclosures required by this section should generally be made for the entity as a whole. However, additional or separate presentation by fund or fund type is not precluded for any disclosures required by this section. [GASBS 3, ¶64]

.108-.112 [GASBS 3, ¶76-¶80]

Accounting and Reporting Guidance for Reverse Repurchase Agreements

.113 [GASBS 3, ¶81]

.114 The interest cost of reverse repurchase and fixed coupon reverse repurchase agreements should be reported as interest expenditure/expense. The interest cost associated with reverse repurchase or fixed coupon reverse repurchase agreements should not be netted against interest earned on any related investments. [GASBS 3, ¶82]

.115 Yield maintenance reverse repurchase agreements should be accounted for as sales and purchases of securities, and gains or losses should be recognized. [GASBS 3, ¶83]

Nonauthoritative Discussion

.601 An illustration of disclosures required by this section is presented in Section I50, paragraph .601.

* * *

PENSION FUNDS

SECTION Pe5

Sources: [Add the following:] GASB Statement 13

Cash Deposits with Financial Institutions and Investments (replaces **Equity Securities** and **Fixed-Income Securities**)

.116 [As is.]

.117 [As is.]

.117A Section C20, “Cash Deposits with Financial Institutions,” require certain disclosures about cash deposits with financial institutions. Section I50, “Investments, including Repurchase Agreements,” provides guidance for disclosures required for all investments and accounting for repurchase agreements. Section R10, “Reverse Repurchase Agreements,” provides guidance on accounting and reporting on securities underlying reverse repurchase agreements.

.121 [Add the following:] They may also include obligations arising from reverse repurchase agreement transactions, which should be accounted for and disclosed in accordance with Section R10.