

# **INVESTMENT MANAGEMENT & OVERSIGHT WORKSHOP**



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**TEXAS MUNICIPAL LEAGUE INTERGOVERNMENTAL  
RISK POOL**

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# GASB Statement No. 31

## (Accounting and Reporting for Investments)



- ❑ Report investments at fair value in the balance sheet.
- ❑ Cost basis information can be presented parenthetically on the balance sheet.
- ❑ Report all investment income, including changes in fair value, as revenue in the income statement.
- ❑ Can separate components of investment income into (1) interest income and (2) change in fair value.
- ❑ Cost-based records are acceptable, provided that fair value adjustments are made for financial statements.

# Texas Pool Makes Decisions Excluding Unrealized Gains (Losses)



- ❑ Unrealized gains/losses distort financial statements
- ❑ Volatility of market flows through the income statement
- ❑ Exclude unrealized gains (losses) in rate making
- ❑ Consider Members' equity without unrealized gains (losses):
  - For adequacy of members' equity
  - For equity returns to members

# Components of Investment Income



- Interest income
- Amortization (Accretion) of Premium (Discount)
- Realized gains (losses)
- Change in fair value

Options:

Report all together as “investment income”

Separate and report “interest income” and everything else as “Change in fair value”

(See Handouts – Page 1)

# How Texas Pool Reports Investments on Interim (Monthly) Statements



**On interim reports and for all financial decisions:**

- Report investments at market value on the balance sheet**
- Separate Members' Equity into two components**
  - **Members' Equity excluding unrealized gains (losses)**
  - **Members' Equity including unrealized gains (losses)**
- Report "Revenues over Expenses" without unrealized gains / losses**
  - **Revenues over (under) expenses before unrealized gains (losses)**
  - **Change in unrealized gains (losses)**
  - **Revenues over (under) expenses after unrealized gains (losses)**

# How Texas Pool Reports Investments on Annual (Audited) Statements



## On Annual (audited) Financial Statements:

- ❑ Separate investment income into (1) Interest Income, and (2) Change in Market Value
- ❑ Report investment income as operating income
- ❑ Report investment at ***market value*** on balance sheet
- ❑ Include amortized cost amounts parenthetically

(See Handouts – Page 3-4)

## Certificate of Achievement for Excellence in Financial Reporting (CAFR)



- ❑ The Pool received the award 14 consecutive years.
- ❑ The Pool did not apply for the award after 2007.
- ❑ The issue was whether investment income was operating revenue or non-operating revenue.

# Pool Reports Investment Income as Operating Revenue



GASB 34 defines operating revenues and expenses:

- ❑ If investing is the entity's principal ongoing operation, investment earnings could be reported as operating.

In the GASB implementation guide:

- ❑ Question: For a risk pool, can interest be considered operating revenue because those earnings are needed to pay claims?
- ❑ Answer: **No**, for pools the principal ongoing activity is not likely investing, but rather risk financing.

# Reporting Investment Income as Operating



From GASB 34

- ❑ “For example, interest revenue and expense transactions should be reported as operating revenue and expense by a proprietary fund **established to provide loans to first-time homeowners.**”

By substituting this, “**established to provide risk financing to government entities,**” what’s the difference between the two?

Investing is an integral and essential function of risk financing.

Investment income is revenue in setting rates

Investments are 98% of total assets.

# GASB STATEMENT NO. 40

## (Deposit and Investment Risk Disclosures)



Establishes disclosure requirements related to investment risks:

- Credit risks
  - Custodial credit risk
  - Concentrations of credit risk
- Interest rate risk
- Foreign currency risk

Establishes disclosure requirements for deposit risks:

- Custodial credit risk
- Foreign current risk

Need to describe deposit and investment policies that relate to these risks.

# Foreign Currency Risk Disclosure



Disclose U.S. dollar balances of deposits or investments exposed to foreign currency risk

Investment	Currency	Maturity	Fair Value
Investment 1	British Pound	5/31/2015	\$1,000,000
Investment 2	Canadian Dollar	1/31/2020	<u>2,000,000</u>
Total			<u>\$3,000,000</u>

# Credit Risk Disclosure



- ❑ Disclose credit ratings
- ❑ U. S. government obligations are not considered to have credit risk (Yeah, right!)
- ❑ Concentration of Credit Risk
  - Disclose amount and issuer, if 5% or more of total investments.
- ❑ Disclose credit ratings of external pools and money market funds

# CUSTODIAL CREDIT RISK



## ❑ Deposits

- Disclose **only if** exposed to custodial credit risk:
  - Uninsured and uncollateralized
  - Collateralized with securities held by pledging bank
  - Collateralized with securities held by bank's trust department

## ❑ Disclose actual cash balance at the bank

- Reported balance on balance sheet includes outstanding checks

## ❑ Investments

- Disclose **only if** exposed to custodial credit risk:
  - Uninsured and;
  - Not registered in the name of government entity, and;
  - Held by either:
    - The counterparty or its trust department/agent

# Interest Rate Risk Disclosure



**Disclose interest rate risk by using one of the following:**

- Segmented time distribution
- Specific identification
- Weight average maturity
- Duration
- Simulation model

# INTEREST RATE RISK



- ❑ Use method used in managing interest rate risk
  - Disclose assumptions about timing of cash flows and interest rate changes
  
- ❑ Disclose terms of investments that may cause the value to be highly sensitive to interest rate changes
  - If not considered in the method used
  - Examples
    - Variable-rate investments
    - Asset-backed securities

(See Handouts – Page 5-7)

# OTHER TOPICS



- ❑ The Pool calculates book value return on investments (handout-page 8).
- ❑ The Pool reports 8 major funds on the financial statements (handout - pages 9-10).
- ❑ The Pool has “restricted” Members’ Equity for its unfunded actuarial liability at Texas Municipal Retirement System (TMRS) (handout – page 10).
- ❑ Why does the Pool file a corporate tax return (Form 1120)? (pages 11-14)
- ❑ How much members’ equity is adequate? (page 15)
- ❑ How does the Pool return members’ equity? (pages 16-17)