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University of California
GASB 35 Financial Statement Presentation

Issues Resolution Memo No. 129

Classification of Investments and Investment of Cash Collateral

Define Issues

GASB Statement No. 34 requires that the University prepare a classified balance sheet (Statement of Net Assets) that segregates current and non-current assets and liabilities. The approach to the classification of investments and investment of cash collateral is presented below.

Background

During 1999, the Government Accounting Standards Board (GASB) introduced GASB Statements 34 and 35. These Statements substantially revised the standards for external financial reporting by public institutions. The new reporting standards are required for the fiscal year beginning July 1, 2001, with comparative information for the prior year.

According to the new standards, the separately issued financial statements of public colleges and universities must include:

- Management's Discussion and Analysis (MD&A)
- Statement of Net Assets
- Statement of Revenues, Expenditures and Changes in Net Assets
- Statement of Cash Flows
- Notes to the Financial Statements

Financial statements must be prepared in accordance with GAAP (generally accepted accounting principles) and are subject to audit under GAAS (generally accepted auditing standards).

The University Treasurer invests assets from a number of sources. These include:

- Retirement plan assets, which will be disclosed in accordance with GASB Statements No. 25, 26 and 27;

- Endowment fund assets;

- Current operating deposits (STIP);
- Unexpended Plant Funds and bond reserves (STIP);
- Agency fund deposits*; and
- Investments associated with securities lending transactions.

* Agency funds include monies placed on deposit by the Campus foundations, by various affiliates ("friends of…") and other monies, such as those held on behalf of UCSF/Stanford Health Care.

Currently, the University discloses the components of investments in compliance with the *Industry Audit Guide for Colleges and Universities.*

Cash and cash equivalents include not only currency on hand, but also demand deposits with banks and other financial institutions. Cash also includes deposits in other kinds of accounts or cash management pools that have the general characteristics of demand deposit accounts in that the University may deposit additional cash or withdraw cash at any time without prior notice or penalty. Cash equivalents are defined as short term, highly liquid investments that are readily convertible to known amounts of cash or are so near their maturity that they present insignificant risk of changes in value because of changes in interest rates.

Generally, only investments with original maturities of three months or less, when purchased, meet this definition. Such investments may include Treasury bills, commercial paper, certificates of deposit, money market funds and cash management pools. Institutions are permitted, however, to adopt a policy (which must be disclosed) to exclude from cash and cash equivalents items that fall under the above definition.

Within the University, the population of "assets" that needs a determination as to whether it is classified as "cash" or, alternatively, as "investments," includes demand deposits, the UCRP money market fund and the STIP.

When the University lends securities, the Treasurer (State Street) receives collateral. If the University receives cash as collateral, the University records a liability to the security borrower who gave us the cash collateral and records the cash as an asset. The borrower can cancel the contract on short notice, return the University's securities to the Treasurer (State Street) and the cash collateral is returned to the borrower. The University invests the cash received in a pool of funds, managed by State Street (not a UC pool) under guidelines issued by the Treasurer. In fiscal year 2000, this pool had a weighted average maturity of 189 days. Even though the investment pool has a weighted average maturity of 189 days, the underlying securities in the pool may have some fixed income securities with a maturity in excess of one year.

Authoritative Guidance

In discussing the classification of the Statement of Net Assets, Paragraph 97 of GASB Statement No. 34 refers to the standards set forth in ARB 43:

> *Paragraph 97*—Assets and liabilities of proprietary funds should be presented in a classified format to distinguish between current and long-term assets and liabilities

> as discussed in Chapter 3 of ARB 43, *Restatement and Revision of Accounting Research Bulletins*.

Paragraph 7 of Chapter 3 of ARB 43 suggests a classification that is related to what is "reasonably likely" to be used or liquidated in "the current operating cycle."

> A one-year time period is to be used as a basis for segregating current assets in cases where there are several operating cycles occurring within a year.

In classifying investments, Paragraph 99 of GASB Statement No. 34 recommends that entities take into account any restrictions on the use of these investments:

> *Paragraph 99*—Restricted assets should be reported when restrictions (as defined in GASB 34, Paragraph 34) on asset use change the nature or normal understanding of the availability of the asset. For example, cash and investments normally are classified as current assets, and a normal understanding of these assets presumes that restrictions do not limit the government's ability to use the resources to pay current liabilities. But cash and investments held in a separate account that can be used to pay debt principal and interest only (as required by the debt convenant) and that that cannot be used to pay other current liabilities should be reported as restricted assets. Because restricted assets may include temporarily invested debt proceeds or other resources that are not generated through options (such as customer deposits), the amount reported as restricted assets will not necessarily equal restricted net assets.

The GASB 35 Implementation Guide provides further guidance as to the treatment of commercial paper and Treasury notes. The guide indicates that both commercial paper and Treasury notes may be classified as cash equivalents if the remaining time to maturity at the date of acquisition is less than 90 days. However, an institution can also elect to report all such purchases as investments even if purchased with a remaining time to maturity of less than 90 days.

In summary, if commercial paper and Treasury notes have a remaining time to maturity at the date of acquisition of less than 90 days, they can be classified as cash equivalents or short-term investments. If these securities have a remaining time to maturity at the date of acquisition of more than 90 days, they must be classified and disclosed as investments.

Approach

With regard to segregating cash from investments, the University will consider all securities, except for demand deposits, as investments. This avoids the need to split activity within an investment pool and is in line with GASB and NACUBO guidance.

In classifying investments, this guidance suggests that the University take into account both:

- the nature of the underlying security (e.g., fixed income due within a year and beyond a year); and

- the characteristics of the fund to which the investment belongs (e.g., an Endowment Fund that cannot be "converted to cash in the current operating cycle").

Under these rules, the University would be precluded from selecting a method of classification that presented the following as current investments:

- securities that were maturing in more than a year; or
- securities that could not be converted to cash because of restrictions placed by the donor or depositor.

In defining a policy for accounting for and reporting investments, the University will classify as "cash" only demand deposit accounts, not including any short-term investments that have maturity dates within 90 days. The University will classify all fixed income investments with a maturity between 1 and 365 days as short-term investments. All STIP will be classified as investments, in spite of the fact that some have maturities under 90 days. All equity investments will be classified as long-term. However, there will be exceptions to this general principle for the classifications related to agency funds and investment of cash collateral.

This approach is based on the foundation that the maturity of the underlying security has priority over the restricted or unrestricted nature of the asset (except for the agency funds) as long as the amount of noncurrent investments on the Statement of Net Assets exceeds the restricted net assets (e.g., restricted endowments and indentured reserves).

In practice, the University's approach results in:

- All fixed income securities with a maturity of less than one year will be classified as a <u>current</u> investment at fair market value (FMV).
- All fixed income securities with a maturity of more than one year will be classified as a <u>noncurrent</u> investment at FMV.
- All equity securities will be classified as a <u>noncurrent</u> investment at FMV.

In the case of *agency funds*, this principle will be modified such that:

- All securities will be classified as a <u>current</u> investment at FMV.
- The agency fund liability, shown as "Funds Held for Others" will be classified as a <u>current</u> liability on the Statement of Net Assets. This treatment of the assets supporting this liability will provide for a presentation of current assets to support the current liability.

However, if the application of the above principles result in the FMV of noncurrent investments being less than the restricted net assets on the Statement of Net Assets, then the University will consider the reclassification of an appropriate amount of current investments to noncurrent investments on the Statement of Net Assets. The University believes that such an occurrence is highly unlikely.

For *investment of cash collateral*:

- All fixed income securities with a maturity of less than one year will be classified as a current investment at FMV titled, “Investment of cash collateral;”
- All fixed income securities with a maturity of more than one year will be classified as a noncurrent investment at FMV titled, “ Investment of cash collateral;” and
- If the University has any equity securities in this pool, they will be classified as a noncurrent investment at FMV, though the current investment guidelines authorized by the Treasurer does not allow this form of investment.

For purposes of establishing an accounting and closing process related to investments, allocations to individual fund groups that were previously made as part of the closing process will now be modified as follows:

- STIP will be allocated to the UCRS and Agency funds early in the closing process to facilitate the preparation of financial statements. At the conclusion of the closing process STIP will be allocated to the remaining fund groups.
- The unrealized gains and losses associated with the STIP will no longer be allocated to fund groups or investment pools. All unrealized gains or losses will be maintained in the Current Fund group.
- The “gross up” of STIP and investment transactions resulting from maturities, sales and purchases will not be allocated to any fund groups or to any financial statements of related activities.

The following table summarizes the classification of investments and investment as cash collateral on the University’s Statement of Net Assets:

Statement of Net Assets

Liability	Cash	Investment	Investment in Cash Collateral
Current	▪ Demand Deposit	▪ Fixed income securities with maturity < 1 year (including investment in STIP) ▪ All Agency Funds, including equity and fixed income securities with maturity > 1 year	▪ Fixed income securities with maturity < 1 year
Noncurrent		▪ Fixed income securities with maturity > 1 year (including investment in STIP) ▪ All equity securities ▪ *Note:* An adjustment will be considered if noncurrent investments are less than restricted net assets	▪ Fixed income securities with maturity > 1 year ▪ All equity securities

Next Steps—Required Actions

- The University will incorporate these principles in establishing the Account Group Codes and General Ledger accounts to be used to close at June 30, 2001. However, FY 2001 published financial statements will be prepared by UCOP using the current reporting structure and disclosure requirements for the components of investments.
- The University will restate the June 30, 2001 final balance sheet using the new reporting structure and investments classification in order to prepare comparative statements for the FY 2001-2002 Annual Report.