

County Administered External Investment Pools

Required Risk to Assess: Risk that the County may improperly report an external investment pool on the financial statements as an agency fund.

As county governments have fiduciary responsibilities for an external investment pool, the county should report such pools as separate funds on the fiduciary statements ("investment trust fund") and include the required note disclosures to ensure fair presentation of the financials. This investment trust fund would include only the external portion of an investment pool, while the internal portion (that belonging to the primary government and its component units), generally is allocated as assets to those funds and component units.

During FY16 financial statement audits, deficiencies were identified related to the proper reporting of county administered external investment pools. The primary issues identified were:

- Investment pools were improperly reported within the fiduciary funds as an agency fund, thus not reported in accordance with GAAP in an "investment trust fund" with the required notes and disclosures,
- Reported as an "investment trust fund," but missing the required disclosures, and
- Not properly reported at fair value when the pool did not meet the criteria of GASB 79 par. 4 to report at amortized cost.

Background

GASB defines an external investment pool as "An arrangement that commingles (pools) the moneys of more than one legally separate entity and invests, on the participants' behalf, in an investment portfolio; one or more of the participants is not part of the sponsor's reporting entity. An external investment pool can be sponsored by an individual government, jointly by more than one government, or by a nongovernmental entity. An investment pool that is sponsored by an individual state or local government is an external investment pool if it includes participation by a legally separate entity that is not part of the same reporting entity as the sponsoring government. If a government-sponsored pool includes only the primary government and its component units, it is an internal investment pool and not an external investment pool. (GASB No. 31, p. 22).

Step 1: Review fiduciary statements to identify types of funds reported by the county.

| | Yes/No | Auditor Notes |
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| 1. Does the county report an "Investment Trust Fund"? If yes, continue to Step 3 for GAAP Counties. For Cash Counties, see BARS manual for required presentation and disclosures. If no, continue to question 2. | No | |
| 2. Does the county report an "Agency Fund"? If yes, continue to Step 2. If no, auditor to conclude the county has no external investment pool which they sponsor. | Yes | |

Step 2: Evaluate the nature of the funds reported as an agency fund to determine whether the fund is properly reported.

| | Yes/No | Auditor Notes |
|---|--------|---------------|
| Does the county commingle (pools) the moneys of more than one legally separate entity and invests, on the participants' behalf, the moneys of one | Yes | |

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| <p>or more of the participants who are not part of the counties reporting entity.</p> <p>[If yes, the county sponsors an external investment and should report an investment trust fund on the fiduciary statements. For GAAP counties proceed to step 3. For Cash counties, see BARS manual for required disclosures. If no, auditor to conclude entity has no external investment pool to report.]</p> | | |
| <p>[County Treasurers, per RCW, can act as the official treasurer for special-purpose districts within the county. Moneys may be pooled and invested by the treasurer. In this scenario, the districts may or may not be considered participants in an external investment pool. As an external investment pool investments for the benefit of participants, if the districts participate in the investment income of the pooled investments, they are considered participants in an external investment pool. If the districts do not participate in the investment income (or the possibility of loss) of the pooled investments, the districts are not considered participants in an external investment pool and the funds should be reported as an agency fund. This could be the case if, for example, the districts' moneys are invested for the benefit of the county's general fund in an assignment of income and the districts are protected from loss.]</p> | | |

Step 3: Complete checklist below to ensure county has properly reported the external investment pool and included all required disclosures.

Required Presentation and Disclosure

GASB 31, p. 19c, requires that if an external investment pool does not issue a separate report, the annual financial report of the sponsoring government should include the following in the notes to the financial statements for each pool:

- The additional disclosures required in paragraph .103 of Section In5, and, if applicable, those required in paragraph .141 of that section.
- The disclosures required by this section and Sections C20, "Cash Deposits with Financial Institutions," I55, and I60, and other cash and investment standards.
- Condensed statements of fiduciary net position and changes in fiduciary net position. If a pool includes both internal and external investors, those condensed financial statements should include, in total, the net position held in trust for all pool participants, and the equity of participants should distinguish between internal and external portions.

If separate GAAP financial reports have been issued, the notes should include information about how to obtain those separate reports. If a separate report is not issued, the sponsor's financial statements should include the disclosures required by paragraph .103 of Section In5 for such a separate report.

Perform review presentation and disclosure checklist below to ensure the county has properly reported the external investment pool in the fiduciary fund statements and presented the required notes and disclosures (which includes condensed statements for the entire pool) to the financial statements for each pool.

| | Yes/No/NA | Auditor Notes |
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| 1. If the external investment pool issues separate financial statements, do the notes to the sponsoring government's financial statements: | | |
| Describe how to obtain the separate financial statements? | | |
| Also included the pool's GASB No. 3, as amended, disclosures in an aggregated or disaggregated presentation? | | |
| [Note: If the external investment pool issues a separate report, the sponsoring government's financial statements could aggregate all deposits and investments, including those of the pool, into a single disclosure about custodial credit risk. In certain situations disaggregation is required by GASB No. 3, p. 65, and GASB No. 40, p. 5. (Q&A 6.43.4)] If the sponsoring government issues a separate report for its external investment pool, the custodial credit risk disclosure in the sponsoring government's | | |

report could aggregate all deposits and investments into a single disclosure, including those of the pool. (Such aggregation is subject to the provisions of this section and Section C20 for disaggregation in certain situations—see paragraphs .147 and .149 of this section and paragraph .104 of Section C20.) However, disaggregation is acceptable.

2. If the external investment pool does not issue separate financial statements, are the following disclosures made for each pool in the notes to the sponsoring government's financial reports: (GASB Cod. I50.137, I50.141, In5.103; GASB 72 p. 81 and GASB 79 p. 42).

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| | A brief description of any regulatory oversight (including whether the pool is registered with the SEC as an investment company)? | | |
| | The frequency of determining the fair value of investments? | | |
| | The method used to determine participants' shares sold and redeemed and whether that method differs from the method used to report investments? | | |
| | Whether the pool sponsor has provided or obtained any legally binding guarantees during the period to support the value of shares? | | |
| | The extent of involuntary participation in the pool, if any? | | |
| | The summary of the fair value, the carrying amount (if different from fair value, the numbers of shares or the principal amount, ranges of interest rates, and maturity dates of each major investment classification? | | |
| | For recurring and nonrecurring fair value measurements, the fair value measurement at the end of the period; the level of the fair value hierarchy within which the measurements are categorized in their entirety (Level 1, Level 2, or Level 3); a description of the valuation techniques used in the measurement; and, if applicable, any changes in the valuation techniques used that have a significant impact on the results and the reasons for such changes? | | |
| | For nonrecurring fair value measurements, the reason(s) for the measurement? | | |
| | If the financial report distinguishes between different components of investment income (such as interest, dividends, or other income), has the accounting policy for defining each component been disclosed? | | |
| | The disclosures required by GASB No. 3, as amended, and 28 and other cash and investment statements? (GASB Cod. Sec I50.137b). | | |
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| | If the sponsoring government does not issue a separate report for its external investment pool, GASB requires a separate custodial credit risk disclosure in the sponsoring government's report for the deposits and investments of the pool as a whole. This is the same disclosure as would have been presented if the pool had issued a separate report. Standards do not specify whether the sponsoring government's "general" custodial credit risk disclosure should include all, some, or none of the pool's deposits and investments. Sponsoring governments should select the presentation that they believe best presents the required information and should disclose what is included in the presentation. Any presentation should consider the provisions a through c below: | | |
| | A. Risk disclosures should also be made for governmental and business-type activities, individual major funds, nonmajor funds in the aggregate, or fiduciary fund types when the risk exposures are significantly greater than the deposit and investment risks of the primary government. For example, a primary government's total investments may not be exposed to concentration risk. However, if the government's capital projects fund has all of its investments in one issuer of corporate bonds, disclosure should be made for | | |

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| | the capital projects fund's exposure to a concentration of credit risk. [GASBS 40, ¶5] | | |
| | B. The entity should briefly describe in the notes to financial statements the types of investments authorized by legal or contractual provisions. If the types of investments authorized for different funds, fund types, blended component units, or discretely presented component units differ significantly from those authorized for the primary government, and those funds, fund types, or component units have material investment activity compared with the reporting entity's investment activity, the differences in authorized investment types should be disclosed. [GASBS 3, ¶65, as amended by GASBS 14 and GASBS 34, ¶6] | | |
| | C. The disclosures required by this section generally should be made for the primary government, including its blended component units. Risk disclosures should also be made for governmental and business-type activities, individual major funds, nonmajor funds in the aggregate, or fiduciary fund types when the risk exposures are significantly greater than the deposit and investment risks of the primary government. For example, a primary government's total investments may not be exposed to concentration risk. However, if the government's capital projects fund has all of its investments in one issuer of corporate bonds, disclosure should be made for the capital projects fund's exposure to a concentration of credit risk. [GASBS 40, ¶5] | | |
| | Are the following disclosures made concerning legal or contractual provisions for deposits and investments (including repurchase agreements): | | |
| | a. Brief description of the types of investments authorized by legal or contractual provisions? | | |
| | b. Any significant differences in authorized investment types between the primary government and different funds, fund types, or component units whose investment activity is significant in relation to the reporting entity's investment activity? | | |
| | c. For deposits and investments, significant violations during the period of legal or contractual provisions? | | |
| | d. If the governing body has not formally adopted deposit and investment policies that limit the government's allowable deposit or investments and address the specific types of risk to which the government is exposed, is that fact disclosed? | | |
| | If the pool has elected to measure all of its investments at amortized cost, 1) did the pool operate in accordance with paragraph .104 of section In5 (see GASB 79 testing strategy – Pool must meet the criteria of; a) transacts with its participants at a stable net asset value per share, b) Meets certain portfolio maturity requirements c) Meets certain portfolio quality requirements, d) Meets certain portfolio diversification requirements, e) Meets certain portfolio liquidity requirements, f) Meets certain shadow pricing requirements), and 2) were the following disclosures made: | | |
| | The disclosures required for fair value measurements in GASB No. 72, p. 80-82, as they relate to the disclosures of the fair value of investments required by GASB No. 31, p 17f. | | |
| | The presence of any limitation or restrictions on participant withdrawals (for example, redemption notice period, maximum transactions amounts, and the pools authority to impose liquidity or redemption gates)? | | |
| | Condensed statements of fiduciary net position and changes in fiduciary net position? (For pools with both external and internal investors, the condensed financial statements should | | |

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| | include the total net position held in trust for all pool participants and separate disclosure of the internal and external portions of the equity of participants.) See Appendix A for additional information and example. | | |
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| | 3. If a governmental external investment pool distributes investment income on an amortized cost basis, do the notes indicate that distributions are made on an amortized cost basis, which differs from a fair value basis, and that the difference between the two methods is reported in the net position section on the statement of fiduciary net position as undistributed and unrealized gains and (loses)? (Q&A 6.44.4). See Appendix B. | | |

Appendix A

The sponsor's financial statements should disclose condensed statements of fiduciary net position and changes in fiduciary net position for the pool. If the pool includes both internal and external investors (a "mixed pool"), those condensed financial statements should include, in total, the net position held in trust for all pool participants, and the equity of participants should distinguish between internal and external portions. If the government sponsors more than one external investment pool, the disclosures are required for each pool. The difference between the external pool assets and liabilities should be captioned net assets held in trust for pool participants. See components of condensed statements below:

Condensed statement of net position:

- (1) Total assets—distinguishing between current assets, capital assets, and other assets. Amounts receivable from other funds or component units should be reported separately.
- (2) Total deferred outflows of resources.
- (3) Total liabilities—distinguishing between current liabilities and long-term liabilities. Amounts payable to other funds or component units should be reported separately.
- (4) Total deferred inflows of resources.
- (5) Total net position—distinguishing among net investment in capital assets, restricted (separately reporting expendable and nonexpendable components), and unrestricted.

Condensed statement of activities:

- (1) Expenses (by major functions and for depreciation expense, if separately reported).
- (2) Program revenues (by type).
- (3) Net program (expense) revenue.
- (4) Tax revenues.
- (5) Other nontax general revenues.
- (6) Contributions to endowments and permanent fund principal.
- (7) Special and extraordinary items.
- (8) Change in net position.
- (9) Beginning net position.
- (10) Ending net position

Appendix B

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

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

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| Net position | <u>\$ 10,500,000</u> |
| Net position consists of: | |
| Participant units outstanding (\$1.00 par) | \$ 10,000,000 |
| Undistributed and unrealized gains | <u>500,000</u> |
| Net position | <u>\$ 10,500,000</u> |
| Participant net asset value at fair value price per share (\$10,500,000 ÷ 10,000,000 units) | <u>\$ 1.05</u> |

Disclosure

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

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