



State of North Carolina

Department of State Treasurer

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Memorandum No. 1056

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To: Local Government Officials, School Board Officials and
Certified Public Accountants

From: Sharon Edmundson, Director
Fiscal Management Section

Subject: Investment Policy Guidelines for GASB Statement No. 40
"Deposit and Investment Risk Disclosures"

Effective with the implementation of GASB Statement No. 40 (typically at June 30, 2005), local units of government had to disclose all risks related to their deposits and investments held as of the statement date. These risks could include interest rate risk, credit risk, custodial credit risk, and concentration risk. Foreign currency risk, although discussed in the Statement, is not an issue for local governments in North Carolina, since investments exposed to foreign currency risk are not allowable under G.S. 159-30. In addition to the risk disclosures, the local government also must disclose any "formally adopted" policy in place to mitigate each specific risk or include a statement specifying that there is no policy. If there is no risk then the policy disclosure is not required. For further information, Memo #1000, issued July 30, 2004, discusses the Statement in more detail.

For local governments in North Carolina, GASB Statement No. 40 and its respective implementation guide indicate that for a policy to be considered "formally adopted" it must be board approved. If the investment or deposit risk is addressed by a board approved policy, units of government that adopted policies patterned after guidance in the Department of State Treasurer's Policies Manual may have already addressed the risks on which Statement 40 required reporting. Alternatively, some units may have board approved policies which do not address all the risks; or local governments may operate with an internal policy that provides guidelines for the investment function but is not formally board approved. In these situations, where there is not a formal policy or the specific risk is not addressed, the GASB staff has confirmed that the unit can disclose that they have "no formal policy" but then include a brief statement regarding policy and/or management practices that are used to help manage cash and/or investments.

From our review of financial statements, there are three risks that consistently occur but have no policies: custodial credit risk for deposits, custodial credit risk for investments, and credit risk for investments. A comprehensive cash management policy will be issued with the updated Cash Management Section of the Policies Manual due out later this year. It will provide the opportunity for local governments to revisit this subject in its entirety. For now, we would like to suggest some revised language that could be considered for the three most frequent risk disclosures. These three areas: custodial credit risk for deposits, custodial credit risk for investments, and credit risk for

investments were the areas we found to most frequently have no policy in the risk disclosures. These are also the areas most often not addressed by traditional policies.

Whether a unit of local government chooses to have a board adopted cash and investment policy versus an internal policy is up to the unit's management and governing board. The language presented in the examples below can be used for either formally adopted policies or internal policies but the resulting note disclosure will vary based on the decision.

Change in Policy and Note Disclosure

Deposits – custodial credit risk

The State Treasurer enforces standards of minimum capitalization for all pooling method financial institutions. The City relies on the State Treasurer to monitor those financial institutions. The City analyzes the financial soundness of any other financial institution used by the City. The City complies with the provisions of G.S. 159-31 when designating official depositories and verifying that deposits are properly secured.

Investments – custodial credit risk

The City shall utilize a third party custodial agent for book entry transactions, all of which shall be held in the City's name. The custodial agent shall be a trust department authorized to do trust work in North Carolina who has an account with the Federal Reserve. Certificated securities shall be in the custody of the finance officer.

Investments – credit risk

The City limits investments to the provisions of G.S. 159-30 and restricts the purchase of securities to the highest possible ratings whenever particular types of securities are rated.

If these changes are included in formal policies (board adopted), then the note disclosure would indicate the policy. If they are implemented but are not board adopted, then the note disclosure would read that the city has no policy regarding *custodial credit risk* but that management practice or internal policies are ... *(include a summary of the statement above.)*

These examples can be tailored for your specific needs or the language can be extracted to supplement your existing policies. It is not presented as a comprehensive solution. A more comprehensive cash management policy will be issued with the revised chapter of the Policies Manual later this year. Whatever changes you make must be approved through board action by June 30, 2006 to allow the note disclosures for cash and investments to present "formally adopted" policy statements. Otherwise, a statement to the effect that the unit has "no policy" must be made for each risk having no "formally adopted" policy. As previously discussed, the unit may also state that they have "no formal policy" and then briefly discuss their internal management practices.

If there are questions or comments regarding this memo, please contact Sara Shippee at (919) 807-2356 or sara.shippee@nctreasurer.com.