

EXAMPLE DISCLOSURES FOR CALIFORNIA LOCAL  
GOVERNMENTS IMPLEMENTING GASB STATEMENT NO. 40  
(DEPOSIT AND INVESTMENT RISK DISCLOSURES)

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# EXAMPLE DISCLOSURES FOR CALIFORNIA LOCAL GOVERNMENTS IMPLEMENTING GASB STATEMENT NO. 40 (DEPOSIT AND INVESTMENT RISK DISCLOSURES)

## I. INTRODUCTION

### Purpose of this Paper

In March 2003, GASB issued GASB Statement No. 40, Deposit and Investment Risk Disclosures. GASB No. 40 is effective for periods beginning after June 15, 2004 (i.e., years ending June 30, 2005 or later). GASB No. 40 adds to and changes certain of the financial statement disclosure requirements for cash and investments of local governments. The purpose of this white paper is assist local governments in California by offering offer several California-specific examples of a cash and investment footnote that incorporate the application of GASB No. 40.

### Materiality

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

### Authoritative Status

The opinions expressed in this white paper are the opinions of the members of CCMA and do not have authoritative status. Rather, the guidance in this white paper is suggestive to assist California cities in the application of generally accepted accounting principles. Other positions on these matters may be defended as appropriate applications of generally accepted accounting principles.

The information provided below is a generalized summary of the requirements of GASB Statement No. 40. This document should not be relied upon to provide all aspects associated with GASB No. 40. The practitioner should refer to GASB No. 40 and the GASB 40 Implementation Guide for full details regarding the requirements of GASB No. 40.

## II. GASB STATEMENT NO. 40

### Risk Oriented Pronouncement

GASB Statement No. 40 adds to existing disclosure requirements for cash and investments by adding information regarding certain *risks* associated with cash and investments. GASB No. 40 does not replace or eliminate in their entirety the disclosure requirements of existing pronouncements dealing with cash and investments, such as GASB No. 3 and GASB No. 31. Accordingly, GASB No. 40 should not be viewed to contain all of the information now required to be disclosed for cash and investments and the requirements of GASB No. 31, GASB No. 3 (except where superceded), and related technical bulletins should still be considered when preparing the cash and investment footnote for local governments. The accompanying examples reflect the requirements of GASB No. 40 as well as the requirements of GASB No. 31 and GASB No. 3 that were not superceded by GASB No. 40.

### Relationship to GASB No. 3

GASB No. 40 eliminated certain provisions of GASB No. 3. The eliminated requirements include the classification of deposits and investments into three risk categories relating to

custodial credit risk. Information regarding custodial credit risk is still required under GASB 40. However, deposits and investments are no longer required to be classified into three categories of risk.

GASB No. 3 required entities to disclose certain conditions that existed during the year that may not have existed at the end of the year. GASB 40 eliminates that requirement. All risk related disclosures of GASB 40 pertain only as of the end of the year.

However, known material violations of the entity's investment policy or state investment laws that occurred during the year (but corrected as of year end) should still be disclosed in the year end financial statements, as required by GASB 3's paragraph 66 (which was not superceded by GASB No. 40).

#### Effective Date

GASB Statement No. 40 is first required for years ending **June 30, 2005** (i.e., periods beginning after June 15, 2004).

#### Example Cash and Investment Footnotes

Accompanying this paper are six cash and investment footnote examples. Each example illustrates one of the five interest rate risk options available to the financial statement preparer. The sixth example provides an illustration of a smaller local government that has all of its money in LAIF (except for debt reserves held by bond trustee). All of the notes are similarly structured, with the main difference being the section relating to interest rate risks. An effort was made in developing this white paper to provide California specific information wherever possible in these examples. Where appropriate, tables were designed to make it easier for the reader to access the information presented, as well as to make it easier for the preparer to update the information annually. Limited explanatory information has been included in the example notes to describe the risks being disclosed so that the reader is in a position to understand the required disclosures. The notes also contain other (non-GASB 40) disclosure information appropriate for cash and investment footnotes.

**These examples have been provided to illustrate how the disclosures required by GASB No. 40 might be presented for a typical California local government. These examples are not meant to represent a preferred structure or form for the cash and investment note. Other footnote wording and formats are equally acceptable. Local governments should consider other presentation styles that might better reflect the style of their CAFR, their personal preferences, and the input of their auditors.**

These examples are as follows:

Example 1—Segmented Time Distribution

Example 2—Weighted Average Maturity

Example 3—Specific Identification

Example 4—Simulation

Example 5—Duration

Example 6—LAIF and Bond Trustee Investments Only

## Reconciliation to the Statement of Net Assets

The accompanying note examples include a reconciliation to the Statement of Net Assets. Although not required by the authoritative literature, this is typically presented in cash and investment notes as a helpful “tie in” to the numbers in the financial statements. There is also a recap table in this part of the note that corresponds to the breakdown of cash and investments in the other sections of the cash note.

### III. SUMMARY OF CERTAIN PROVISIONS OF GASB NO. 40

To assist California local governments in implementing GASB No. 40, we have summarized certain provisions of GASB No. 40 and the related GASB Implementation Guide below. Numbers in parentheses refer either to paragraphs of **GASB Statement No. 40** or questions contained in the GASB 40 **implementation guide** (Q&A):

#### LAIF Reporting

When it comes to the disclosure requirements of GASB 40, an entity’s investment in LAIF is considered to be a single investment. For GASB 40 purposes, the investment in LAIF is not considered to be an indirect holding of the various investment types in the LAIF pool to which the disclosure requirements of GASB 40 must be applied individually. There is no “look through” requirement in GASB 40 when it comes to an investment in a pool (question 3).

#### Legal and Policy Disclosures

The second section of the example note summarizes or briefly describes any entity policies that relate to the five risks addressed by GASB 40. This is required by GASB 40. This information is required to be provided separately for each investment type. The accompanying examples use a tabular format for summarizing this information. A separate table has been provided to summarize debt agreement requirements.

For purposes of this disclosure, “policy” includes any requirement adopted by an entity’s governing board that relates to one of the risks covered by GASB No. 40. “Policy” also includes any requirement in the state government code that relates to one of the GASB No. 40 risks. If the entity has an exposure to one of the GASB No. 40 risks but no “policy” (as defined above) pertaining to that risk, the notes should state that fact.

#### Interest Rate Risk

The next section of the example note deals with interest rate risk. Interest rate risk is the risk that changes in interest rates demanded by the market will adversely affect the fair value of an investment. Disclosures must be by investment type and amount (paragraph 15). For this reason, a tabular format has been used in the accompanying examples.

Assumptions regarding timings of cash flows (such as whether an investment is or is not assumed to be called at the next call date, interest rate information, etc.) that impact how an investment is reported with respect to interest rate risk must be disclosed (question 15). Investments in mutual funds, LAIF, and other pools, are subject to these disclosures (paragraph 15) as a single investment. The sensitivity of the fair values in the portfolio to market interest rate fluctuations must be disclosed using one of five methods. Entities are encouraged to use the method that is most consistent with how they manage the sensitivity of their portfolio fair values to changes in market interest rates (paragraph 15). In some cases, an entity uses more than one of the five methods. In that case, the entity can choose any one of the methods for disclosure purposes. If an entity changes its method of measuring interest rate risk, the note must disclose the change and why it was changed (question 33). It is

acceptable to use a different interest rate risk disclosure method for different investments if that is consistent with how the entity manages interest rate risk (question 35).

The five methods specified in GASB No. 40 to provide information about interest rate risk are as follows:

- Segmented Time Distribution
- Weighted Average Maturity
- Specific Identification
- Simulation
- Duration

#### Segmented time distribution

This is one of the five optional methods that can be used for the disclosure requirements for interest rate disclosures. Under the segmented time distribution method, the dollar amount of investments are grouped together in tabular form with a separate columns for various ranges of maturities.

The weighted average maturity of the investments contained in an external investment pool (such as LAIF) or a mutual fund determine the maturity that should be used for the segmented time distribution method (question 36 and 37).

#### Specific identification

This is another one of the five optional methods that can be used for the disclosure requirements for interest rate disclosures. Under the specific identification method, each investment is listed individually in the note in order to display amount, maturity date, and any call options.

An entity may consider an investment with a reset date to have a maturity equal to the time until its next reset date (question 39). Such assumptions must be disclosed (question 39).

#### Weighted average maturity

Weighted average maturity calculates in years or months the time to elapse for a group of investments to become due and payable (weighted for the amount of individual investments in that investment type).

#### Duration

Duration calculates in years or months the time to elapse for a group of investments to become due and payable (weighted for the present value of investment cash flows).

#### Simulation model

Simulation model calculates the affect on investment fair values for hypothetical changes in interest rates.

## Highly sensitive investments

Additional information must be provided in the notes for investments whose fair values are highly sensitive to market interest rate changes. The dollar amount (at fair value) or percentage of the portfolio held in highly sensitive investments must be disclosed. Highly sensitive investments are investments whose sensitivity to market interest rate fluctuations are not fully addressed by use of one of the five methods for reporting interest rate risk. Besides the dollar amount (or percentage) held in these investments, the notes to the financial statements must summarize the *characteristics* of these investments that make their fair value highly sensitive to interest rate fluctuations.

Investment characteristics that make the fair value of investments particularly sensitive to interest rate fluctuations include the following:

- Coupon multipliers—small changes in interest rates are amplified by the underlying multiplier.
- Floors, caps, and Collars—these features can increase the sensitivity of an investment's fair value to market interest rate changes because, when the underlying benchmark index reaches certain levels, the investment essentially functions at that point like a fixed rate instrument which increases its sensitivity to interest rate changes (question 58).
- Mortgage-backed interest only tranches—the risk of prepayment in a falling interest rate environment has such an impact on the future cash flows that were expected by the investor for this investment that the fair value of the investment changes dramatically as a result of market interest rate fluctuations (question 50).
- Mortgage-backed principal only tranches—when interest rates are falling and mortgage prepayments accelerate, the value of a principal only tranche will increase. When interest rates are rising and prepayments slow down, the value of the principal only tranches will drop (question 51).
- Range notes—e.g., a security pays two different interest rates depending on whether or not a benchmark index (such as the rate for the thirty year Treasury bond) falls within a pre-determined range (for example, between 4.75 percent and 5.25%).
- Step-up features—On certain specified dates, the issuer can call the security. If the security is not called, the interest rate increases by a specified amount (question 48).
- Mortgage-backed securities—When interest rates fall, mortgages are refinanced and paid off early. The reduced stream of future interest payments diminishes the fair value of the investment (question 47).

## Credit Risk

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. The financial statement preparer must disclose any entity requirements or policies associated with this risk. The notes also must disclose the credit quality ratings investments as determined by nationally recognized statistical rating organizations as of year end. The rating should be as of the date of the financial statements. Only the direct investment in U.S. Treasury securities or GNMA securities (question 21) are exempt from this disclosure requirement because these securities are guaranteed by the federal government. Mutual funds composed only of U.S. Treasury securities are not guaranteed by the federal government and must be rated. Securities issued by other federal agencies (FNMA, etc.) are not guaranteed by the federal government and must be rated. If different rating agencies offer different ratings, the notes must present either both ratings or at a minimum the rating that is the most negative. The magnitude of credit risk must be communicated to the reader by disclosing the dollar value or percentage associated with each of these ratings.

Investments in mutual funds and external investment pools are not exempted and either their rating must be shown or a statement made that investment has not been rated (paragraph 7). *Investments* such as a guaranteed investment contracts are often unrated and should be disclosed as such even if the *issuer* has a rating for other instruments (question 17).

#### Concentration of credit risk

Concentration of credit risk is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. The preparer must disclose by issuer and amount investments in any one issuer that represent 5% or more of total investments for that reporting unit (primary government, major fund, nonmajor funds in the aggregate, etc.).

U.S. Treasury securities, mutual funds, and external investment pools are exempted from this particular requirement (paragraph 11).

If the table used for interest rate risk has investments broken down by issuer (federal agency, etc.), this requirement can be met by incorporating that detail into the table used for interest rate disclosures. This can be practical for local governments investing in a limited number of issuers.

#### Custodial credit risk

Custodial credit risk for *deposits* is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for *investments* is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party.

GASB No. 40 only requires the identification of those deposits and investments that previously were classified as category three by GASB No. 3. The dollar amount involved and the circumstances associated with their heightened custodial credit risk must be disclosed. No reference should be made to "category three."

#### Foreign currency risk

Foreign currency risk is the risk that changes in foreign exchange rates will adversely affect the fair values of an investment or deposit.

## Example 1—Cash and Investments Note (GASB 40—Segmented Time Distribution)

### (2) Cash and Investments

Cash and investments as of June 30, 2004 are classified in the accompanying financial statements as follows:

Statement of net assets:	
Cash and investments	\$74,405,000
Cash and investments held by bond trustee	1,500,000
Fiduciary funds:	
Cash and investments	<u>600,000</u>
Total cash and investments	<u>\$76,505,000</u>

Cash and investments as of June 30, 2004 consist of the following:

Cash on hand	\$ 5,000
Deposits with financial institutions	1,000,000
Investments	<u>75,500,000</u>
Total cash and investments	<u>\$76,505,000</u>

### **Investments Authorized by the California Government Code and the Entity's Investment Policy**

The table below identifies the **investment types** that are authorized for the Entity by the California Government Code (or the Entity's investment policy, where more restrictive). The table also identifies certain provisions of the California Government Code (or the Entity's investment policy, where more restrictive) that address **interest rate risk**, **credit risk**, and **concentration of credit risk**. This table does not address investments of debt proceeds held by bond trustee that are governed by the provisions of debt agreements of the Entity, rather than the general provisions of the California Government Code or the Entity's investment policy. *[The format of this disclosure should be modified as necessary to reflect the requirements of the Entity's investment policy.]*:

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>	<u>Maximum Percentage Of *Portfolio</u>	<u>Maximum Investment in One Issuer</u>
Local Agency Bonds	5 years	None	None
U.S. Treasury Obligations	5 years	None	None
U.S. Agency Securities	5 years	None	None
Banker's Acceptances	180 days	40%	30%
Commercial Paper	270 days	25%	10%
Negotiable Certificates of Deposit	5 years	30%	None
Repurchase Agreements	1 year	None	None
Reverse Repurchase Agreements	92 days	20% of base value	None
Medium-Term Notes	5 years	30%	None
Mutual Funds	N/A	20%	10%
Money Market Mutual Funds	N/A	20%	10%
Mortgage Pass-Through Securities	5 years	20%	None
County Pooled Investment Funds	N/A	None	None
Local Agency Investment Fund (LAIF)	N/A	None	None
JPA Pools (other investment pools)	N/A	None	None

\* Excluding amounts held by bond trustee that are not subject to California Government Code restrictions.



## Investments Authorized by Debt Agreements

Investment of debt proceeds held by bond trustee are governed by provisions of the debt agreements, rather than the general provisions of the California Government Code or the Entity's investment policy. The table below identifies the **investment types** that are authorized for investments held by bond trustee. The table also identifies certain provisions of these debt agreements that address **interest rate risk, credit risk, and concentration of credit risk**.

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>	<u>Maximum Percentage Allowed</u>	<u>Maximum Investment in One Issuer</u>
U.S. Treasury Obligations	None	None	None
U.S. Agency Securities	None	None	None
Banker's Acceptances	180 days	None	None
Commercial Paper	270 days	None	None
Money Market Mutual Funds	N/A	None	None
Investment Contracts	30 years	None	None

## Disclosures Relating to Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the Entity manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations.

Information about the sensitivity of the fair values of the Entity's investments (including investments held by bond trustee) to market interest rate fluctuations is provided by the following table that shows the distribution of the Entity's investments by maturity:

<u>Investment Type</u>		<u>Remaining Maturity (in Months)</u>			
		<u>12 Months Or Less</u>	<u>13 to 24 Months</u>	<u>25-60 Months</u>	<u>More Than 60 Months</u>
U.S. Treasury notes	\$ 6,000,000	6,000,000	-	-	-
U.S. Treasury bonds	3,000,000	-	-	3,000,000	-
U.S. Treasury strips	2,000,000	-	-	2,000,000	-
Federal agency securities	35,000,000	5,000,000	22,000,000	8,000,000	-
Corporate medium term notes	5,000,000	-	5,000,000	-	-
Commercial paper	3,000,000	3,000,000	-	-	-
Banker's acceptances	2,000,000	2,000,000	-	-	-
Mortgage-backed securities	3,000,000	-	-	3,000,000	-
State investment pool	15,000,000	15,000,000	-	-	-
Held by bond trustee:					
Money market funds	500,000	500,000	-	-	-
Investment contracts	<u>1,000,000</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,000,000</u>
Total	<u>\$75,500,000</u>	<u>31,500,000</u>	<u>27,000,000</u>	<u>16,000,000</u>	<u>1,000,000</u>

## Investments with Fair Values Highly Sensitive to Interest Rate Fluctuations

The Entity's investments (including investments held by bond trustees) include the following investments that are highly sensitive to interest rate fluctuations (to a greater degree than already indicated in the information provided above):

<u>Highly Sensitive Investments</u>	<u>Fair Value at Year End</u>
Federal agency securities with coupon multipliers ranging from 1.25 to 2.5 times the three-month LIBOR reset on a basis ranging from monthly to semiannually. These multipliers amplify the effect of interest rate changes by greater than a one-to-one basis.	\$3,000,000
Mortgage backed securities. These securities are subject to early payment in a period of declining interest rates. The resultant reduction in expected total cash flows affects the fair value of these securities and makes the fair values of these securities highly sensitive to changes in interest rates.	3,000,000
Federal agency securities with interest rates that vary inversely to a benchmark index set quarterly that ranges from 2 percent to 4.5 percent minus the three-month LIBOR and with floors ranging from zero to one percent. These were purchased at a time when the California Government Code permitted the purchase of such investments.	1,000,000

## Disclosures Relating to Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Presented below is the minimum rating required by (where applicable) the California Government Code, the Entity's investment policy, or debt agreements, and the actual rating as of year end for each investment type.

<u>Investment Type</u>		<u>Minimum Legal Rating</u>	<u>Exempt From Disclosure</u>	<u>Rating as of Year End</u>		
				<u>AAA</u>	<u>Aa</u>	<u>Not Rated</u>
U.S. Treasury notes	\$ 6,000,000	N/A	6,000,000	-	-	-
U.S. Treasury bonds	3,000,000	N/A	3,000,000	-	-	-
U.S. Treasury strips	2,000,000	N/A	2,000,000	-	-	-
Federal agency securities	35,000,000	N/A		35,000,00	-	-
Corporate medium term notes	5,000,000	A	-	2,000,00	3,000,00	-
Commercial paper	3,000,000	A		-	3,000,00	-
Banker's acceptances	2,000,000	N/A		1,000,00	1,000,00	-
Mortgage-backed securities	3,000,000	AA	-	-	3,000,00	-
State investment pool	15,000,000	N/A		-		15,000,00
Held by bond trustee:						
Money market funds	500,000	A			500,00	
Investment contracts	<u>1,000,000</u>	N/A				<u>1,000,00</u>
<b>Total</b>	<b><u>\$75,500,000</u></b>		<b><u>11,000,000</u></b>	<b><u>38,000,00</u></b>	<b><u>10,500,00</u></b>	<b><u>16,000,00</u></b>

## Concentration of Credit Risk

The investment policy of the Entity contains no limitations on the amount that can be invested in any one issuer beyond that stipulated by the California Government Code. Investments in any one issuer (other than U.S. Treasury securities, mutual funds, and external investment pools) that represent 5% or more of **total Entity investments** are as follows:

<u>Issuer</u>	<u>Investment Type</u>	<u>Reported Amount</u>
FNMA	Federal agency securities	\$5,000,000
Federal Farm Credit Agency	Federal agency securities	7,000,000

Investments in any one issuer that represent 5% or more of total investments **by reporting unit** (primary government, discretely presented component unit, governmental activities, major fund, nonmajor funds in the aggregate, etc.) are as follows:

\$1,000,000 of the cash and investments (including amounts held by bond trustee) reported in the Water Fund (a major fund of the Entity) are held in the form of a nonnegotiable unrated investment contract issued by the Example Insurance Company that matures on October 1, 2017.

### **Custodial Credit Risk**

Custodial credit risk for *deposits* is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for *investments* is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and the Entity's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits: The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure City deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.

As of June 30, 2004, \$576,332 of the Entity's deposits with financial institutions in excess of federal depository insurance limits were held in uncollateralized accounts. As of June 30, 2004, Entity investments in the following investment types were held by the same broker-dealer (counterparty) that was used by the Entity to buy the securities:

<u>Investment Type</u>	<u>Reported Amount</u>
Federal agency securities	\$35,000,000
Corporate medium term notes	5,000,000
Commercial paper	3,000,000
Banker's acceptances	2,000,000

### **Investment in State Investment Pool**

The Entity is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by the California Government Code under the oversight of the Treasurer of the State of California. The fair value of the Entity's investment in this pool is reported in the accompanying financial statements at amounts based upon the Entity's pro-rata share of the fair value provided by LAIF for the entire LAIF portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by LAIF, which are recorded on an amortized cost basis.

## Example 2—Cash and Investments Note (GASB 40—Weighted Average Maturity)

### (2) Cash and Investments

Cash and investments as of June 30, 2004 are classified in the accompanying financial statements as follows:

Statement of net assets:	
Cash and investments	\$74,405,000
Cash and investments held by bond trustee	1,500,000
Fiduciary funds:	
Cash and investments	<u>600,000</u>
Total cash and investments	<u>\$76,505,000</u>

Cash and investments as of June 30, 2004 consist of the following:

Cash on hand	\$ 5,000
Deposits with financial institutions	1,000,000
Investments	<u>75,500,000</u>
Total cash and investments	<u>\$76,505,000</u>

### **Investments Authorized by the California Government Code and the Entity's Investment Policy**

The table below identifies the **investment types** that are authorized for the Entity by the California Government Code (or the Entity's investment policy, where more restrictive). The table also identifies certain provisions of the California Government Code (or the Entity's investment policy, where more restrictive) that address **interest rate risk**, **credit risk**, and **concentration of credit risk**. This table does not address investments of debt proceeds held by bond trustee that are governed by the provisions of debt agreements of the Entity, rather than the general provisions of the California Government Code or the Entity's investment policy. *[The format of this disclosure should be modified as necessary to reflect the requirements of the Entity's investment policy.]*:

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>	<u>Maximum Percentage Of *Portfolio</u>	<u>Maximum Investment in One Issuer</u>
Local Agency Bonds	5 years	None	None
U.S. Treasury Obligations	5 years	None	None
U.S. Agency Securities	5 years	None	None
Banker's Acceptances	180 days	40%	30%
Commercial Paper	270 days	25%	10%
Negotiable Certificates of Deposit	5 years	30%	None
Repurchase Agreements	1 year	None	None
Reverse Repurchase Agreements	92 days	20% of base value	None
Medium-Term Notes	5 years	30%	None
Mutual Funds	N/A	20%	10%
Money Market Mutual Funds	N/A	20%	10%
Mortgage Pass-Through Securities	5 years	20%	None
County Pooled Investment Funds	N/A	None	None
Local Agency Investment Fund (LAIF)	N/A	None	None
JPA Pools (other investment pools)	N/A	None	None

\* Excluding amounts held by bond trustee that are not subject to California Government Code restrictions.

## Investments Authorized by Debt Agreements

Investment of debt proceeds held by bond trustee are governed by provisions of the debt agreements, rather than the general provisions of the California Government Code or the Entity's investment policy. The table below identifies the **investment types** that are authorized for investments held by bond trustee. The table also identifies certain provisions of these debt agreements that address **interest rate risk, credit risk, and concentration of credit risk**.

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>	<u>Maximum Percentage Allowed</u>	<u>Maximum Investment in One Issuer</u>
U.S. Treasury Obligations	None	None	None
U.S. Agency Securities	None	None	None
Banker's Acceptances	180 days	None	None
Commercial Paper	270 days	None	None
Money Market Mutual Funds	N/A	None	None
Investment Contracts	30 years	None	None

## Disclosures Relating to Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the Entity manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations. The Entity monitors the interest rate risk inherent in its portfolio by measuring the weighted average maturity of its portfolio. The Entity has no specific limitations with respect to this metric.

<u>Investment Type</u>	<u>Weighted Average Maturity (in years)</u>
U.S. Treasury notes	\$ 6,000,000
U.S. Treasury bonds	3,000,000
U.S. Treasury strips	2,000,000
Federal agency securities	35,000,000
Corporate medium term notes	5,000,000
Commercial paper	3,000,000
Banker's acceptances	2,000,000
Mortgage-backed securities	3,000,000
State investment pool	15,000,000
Held by bond trustee:	
Money market funds	500,000
Investment contracts	<u>1,000,000</u>
 Total	 <u>\$75,500,000</u>

## Investments with Fair Values Highly Sensitive to Interest Rate Fluctuations

The Entity's investments (including investments held by bond trustees) include the following investments that are highly sensitive to interest rate fluctuations (to a greater degree than already indicated in the information provided above):

<u>Highly Sensitive Investments</u>	<u>Fair Value at Year End</u>
Federal agency securities with coupon multipliers ranging from 1.25 to 2.5 times the three-month LIBOR reset on a basis ranging from monthly to semiannually. These multipliers amplify the effect of interest rate changes by greater than a one-to-one basis.	\$3,000,000
Mortgage backed securities. These securities are subject to early payment in a period of declining interest rates. The resultant reduction in expected total cash flows affects the fair value of these securities and makes the fair values of these securities highly sensitive to changes in interest rates.	3,000,000
Federal agency securities with interest rates that vary inversely to a benchmark index set quarterly that ranges from 2 percent to 4.5 percent minus the three-month LIBOR and with floors ranging from zero to one percent. These were purchased at a time when the California Government Code permitted the purchase of such investments.	1,000,000

## Disclosures Relating to Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Presented below is the minimum rating required by (where applicable) the California Government Code, the Entity's investment policy, or debt agreements, and the actual rating as of year end for each investment type.

<u>Investment Type</u>		<u>Minimum Legal Rating</u>	<u>Exempt From Disclosure</u>	<u>Rating as of Year End</u>		
				<u>AAA</u>	<u>Aa</u>	<u>Not Rated</u>
U.S. Treasury notes	\$ 6,000,000	N/A	6,000,000	-	-	-
U.S. Treasury bonds	3,000,000	N/A	3,000,000	-	-	-
U.S. Treasury strips	2,000,000	N/A	2,000,000	-	-	-
Federal agency securities	35,000,000	N/A		35,000,00	-	-
Corporate medium term notes	5,000,000	A	-	2,000,00	3,000,00	-
Commercial paper	3,000,000	A		-	3,000,00	-
Banker's acceptances	2,000,000	N/A		1,000,00	1,000,00	-
Mortgage-backed securities	3,000,000	AA	-	-	3,000,00	-
State investment pool	15,000,000	N/A		-	-	15,000,00
Held by bond trustee:						
Money market funds	500,000	A			500,00	
Investment contracts	<u>1,000,000</u>	N/A				<u>1,000,00</u>
<b>Total</b>	<b><u>\$75,500,000</u></b>		<b><u>11,000,000</u></b>	<b><u>38,000,00</u></b>	<b><u>10,500,00</u></b>	<b><u>16,000,00</u></b>

## Concentration of Credit Risk

The investment policy of the Entity contains no limitations on the amount that can be invested in any one issuer beyond that stipulated by the California Government Code. Investments in any one issuer

(other than U.S. Treasury securities, mutual funds, and external investment pools) that represent 5% or more of **total Entity investments** are as follows:

<u>Issuer</u>	<u>Investment Type</u>	<u>Reported Amount</u>
FNMA	Federal agency securities	\$5,000,000
Federal Farm Credit Agency	Federal agency securities	7,000,000

Investments in any one issuer that represent 5% or more of total investments **by reporting unit** (primary government, discretely presented component unit, governmental activities, major fund, nonmajor funds in the aggregate, etc.) are as follows:

\$1,000,000 of the cash and investments (including amounts held by bond trustee) reported in the Water Fund (a major fund of the Entity) are held in the form of a nonnegotiable unrated investment contract issued by the Example Insurance Company that matures on October 1, 2017.

### **Custodial Credit Risk**

Custodial credit risk for *deposits* is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for *investments* is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and the Entity's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits: The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure City deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.

As of June 30, 2004, \$576,332 of the Entity's deposits with financial institutions in excess of federal depository insurance limits were held in uncollateralized accounts. As of June 30, 2004, Entity investments in the following investment types were held by the same broker-dealer (counterparty) that was used by the Entity to buy the securities:

<u>Investment Type</u>	<u>Reported Amount</u>
Federal agency securities	\$35,000,000
Corporate medium term notes	5,000,000
Commercial paper	3,000,000
Banker's acceptances	2,000,000

### **Investment in State Investment Pool**

The Entity is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by the California Government Code under the oversight of the Treasurer of the State of California. The fair value of the Entity's investment in this pool is reported in the accompanying financial statements at amounts based upon the Entity's pro-rata share of the fair value provided by LAIF for the entire LAIF portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by LAIF, which are recorded on an amortized cost basis.

### Example 3—Cash and Investments Note (GASB 40—Specific Identification)

#### (2) Cash and Investments

Cash and investments as of June 30, 2004 are classified in the accompanying financial statements as follows:

Statement of net assets:	
Cash and investments	\$74,405,000
Cash and investments held by bond trustee	1,500,000
Fiduciary funds:	
Cash and investments	<u>600,000</u>
Total cash and investments	<u>\$76,505,000</u>

Cash and investments as of June 30, 2004 consist of the following:

Cash on hand	\$ 5,000
Deposits with financial institutions	1,000,000
Investments	<u>75,500,000</u>
Total cash and investments	<u>\$76,505,000</u>

#### Investments Authorized by the California Government Code and the Entity's Investment Policy

The table below identifies the **investment types** that are authorized for the Entity by the California Government Code (or the Entity's investment policy, where more restrictive). The table also identifies certain provisions of the California Government Code (or the Entity's investment policy, where more restrictive) that address **interest rate risk**, **credit risk**, and **concentration of credit risk**. This table does not address investments of debt proceeds held by bond trustee that are governed by the provisions of debt agreements of the Entity, rather than the general provisions of the California Government Code or the Entity's investment policy. *[The format of this disclosure should be modified as necessary to reflect the requirements of the Entity's investment policy.]*:

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>	<u>Maximum Percentage Of *Portfolio</u>	<u>Maximum Investment in One Issuer</u>
Local Agency Bonds	5 years	None	None
U.S. Treasury Obligations	5 years	None	None
U.S. Agency Securities	5 years	None	None
Banker's Acceptances	180 days	40%	30%
Commercial Paper	270 days	25%	10%
Negotiable Certificates of Deposit	5 years	30%	None
Repurchase Agreements	1 year	None	None
Reverse Repurchase Agreements	92 days	20% of base value	None
Medium-Term Notes	5 years	30%	None
Mutual Funds	N/A	20%	10%
Money Market Mutual Funds	N/A	20%	10%
Mortgage Pass-Through Securities	5 years	20%	None
County Pooled Investment Funds	N/A	None	None
Local Agency Investment Fund (LAIF)	N/A	None	None
JPA Pools (other investment pools)	N/A	None	None

\* Excluding amounts held by bond trustee that are not subject to California Government Code restrictions.



## Investments Authorized by Debt Agreements

Investment of debt proceeds held by bond trustee are governed by provisions of the debt agreements, rather than the general provisions of the California Government Code or the Entity's investment policy. The table below identifies the **investment types** that are authorized for investments held by bond trustee. The table also identifies certain provisions of these debt agreements that address **interest rate risk, credit risk, and concentration of credit risk**.

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>	<u>Maximum Percentage Allowed</u>	<u>Maximum Investment in One Issuer</u>
U.S. Treasury Obligations	None	None	None
U.S. Agency Securities	None	None	None
Banker's Acceptances	180 days	None	None
Commercial Paper	270 days	None	None
Money Market Mutual Funds	N/A	None	None
Investment Contracts	30 years	None	None

## Disclosures Relating to Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the Entity manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations.

As of June 30, 2004, the Entity had the following investments. Except for the investment in money market funds and the Example Insurance Company investment contract, all investments are in the Entity's internal investment pool.

		<u>Maturity Date</u>
U.S. Treasury note	\$ 6,000,000	November 6, 2005
U.S. Treasury bond	3,000,000	October 4, 2007
U.S. Treasury strip	2,000,000	March 7, 2005
Federal Farm Credit Note	35,000,000	December 31, 2008
ABC corporate note	5,000,000	February 18, 2008
LEF commercial paper	3,000,000	September 15, 2004
Banker's acceptances	2,000,000	September 6, 2004
GNMA	3,000,000	May 17, 2008
State investment pool	15,000,000	1.47 year
Held by bond trustee:		
Money market funds	500,000	.13 year
Investment contracts	<u>1,000,000</u>	October 1, 2017
Total	<u>\$75,500,000</u>	

## Investments with Fair Values Highly Sensitive to Interest Rate Fluctuations

The Entity's investments (including investments held by bond trustees) include the following investments that are highly sensitive to interest rate fluctuations (to a greater degree than already indicated in the information provided above):

<u>Highly Sensitive Investments</u>	<u>Fair Value at Year End</u>
Federal agency securities with coupon multipliers ranging from 1.25 to 2.5 times the three-month LIBOR reset on a basis ranging from monthly to semiannually. These multipliers amplify the effect of interest rate changes by greater than a one-to-one basis.	\$3,000,000
Mortgage backed securities. These securities are subject to early payment in a period of declining interest rates. The resultant reduction in expected total cash flows affects the fair value of these securities and makes the fair values of these securities highly sensitive to changes in interest rates.	3,000,000
Federal agency securities with interest rates that vary inversely to a benchmark index set quarterly that ranges from 2 percent to 4.5 percent minus the three-month LIBOR and with floors ranging from zero to one percent. These were purchased at a time when the California Government Code permitted the purchase of such investments.	1,000,000

### Disclosures Relating to Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Presented below is the minimum rating required by (where applicable) the California Government Code, the Entity's investment policy, or debt agreements, and the actual rating as of year end for each investment type.

<u>Investment Type</u>		<u>Minimum Legal Rating</u>	<u>Exempt From Disclosure</u>	<u>Rating as of Year End</u>		
				<u>AAA</u>	<u>Aa</u>	<u>Not Rated</u>
U.S. Treasury notes	\$ 6,000,000	N/A	6,000,000	-	-	-
U.S. Treasury bonds	3,000,000	N/A	3,000,000	-	-	-
U.S. Treasury strips	2,000,000	N/A	2,000,000	-	-	-
Federal agency securities	35,000,000	N/A		35,000,00	-	-
Corporate medium term notes	5,000,000	A	-	2,000,00	3,000,00	-
Commercial paper	3,000,000	A		-	3,000,00	-
Banker's acceptances	2,000,000	N/A		1,000,00	1,000,00	-
Mortgage-backed securities	3,000,000	AA	-	-	3,000,00	-
State investment pool	15,000,000	N/A		-	-	15,000,00
Held by bond trustee:						
Money market funds	500,000	A			500,00	
Investment contracts	<u>1,000,000</u>	N/A				<u>1,000,00</u>
<b>Total</b>	<b><u>\$75,500,000</u></b>		<b><u>11,000,000</u></b>	<b><u>38,000,00</u></b>	<b><u>10,500,00</u></b>	<b><u>16,000,00</u></b>

### Concentration of Credit Risk

The investment policy of the Entity contains no limitations on the amount that can be invested in any one issuer beyond that stipulated by the California Government Code. Investments in any one issuer (other than U.S. Treasury securities, mutual funds, and external investment pools) that represent 5% or more of **total Entity investments** are as follows:

<u>Issuer</u>	<u>Investment Type</u>	<u>Reported Amount</u>
FNMA	Federal agency securities	\$5,000,000
Federal Farm Credit Agency	Federal agency securities	7,000,000

Investments in any one issuer that represent 5% or more of total investments **by reporting unit** (primary government, discretely presented component unit, governmental activities, major fund, nonmajor funds in the aggregate, etc.) are as follows:

\$1,000,000 of the cash and investments (including amounts held by bond trustee) reported in the Water Fund (a major fund of the Entity) are held in the form of a nonnegotiable unrated investment contract issued by the Example Insurance Company that matures on October 1, 2017.

### **Custodial Credit Risk**

Custodial credit risk for *deposits* is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for *investments* is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and the Entity's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits: The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure City deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.

As of June 30, 2004, \$576,332 of the Entity's deposits with financial institutions in excess of federal depository insurance limits were held in uncollateralized accounts. As of June 30, 2004, Entity investments in the following investment types were held by the same broker-dealer (counterparty) that was used by the Entity to buy the securities:

<u>Investment Type</u>	<u>Reported Amount</u>
Federal agency securities	\$35,000,000
Corporate medium term notes	5,000,000
Commercial paper	3,000,000
Banker's acceptances	2,000,000

### **Investment in State Investment Pool**

The Entity is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by the California Government Code under the oversight of the Treasurer of the State of California. The fair value of the Entity's investment in this pool is reported in the accompanying financial statements at amounts based upon the Entity's pro-rata share of the fair value provided by LAIF for the entire LAIF portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by LAIF, which are recorded on an amortized cost basis.

## Example 4—Cash and Investments Note (GASB 40—Simulation)

### (2) Cash and Investments

Cash and investments as of June 30, 2004 are classified in the accompanying financial statements as follows:

Statement of net assets:	
Cash and investments	\$74,405,000
Cash and investments held by bond trustee	1,500,000
Fiduciary funds:	
Cash and investments	<u>600,000</u>
Total cash and investments	<u>\$76,505,000</u>

Cash and investments as of June 30, 2004 consist of the following:

Cash on hand	\$ 5,000
Deposits with financial institutions	1,000,000
Investments	<u>75,500,000</u>
Total cash and investments	<u>\$76,505,000</u>

### **Investments Authorized by the California Government Code and the Entity's Investment Policy**

The table below identifies the **investment types** that are authorized for the Entity by the California Government Code (or the Entity's investment policy, where more restrictive). The table also identifies certain provisions of the California Government Code (or the Entity's investment policy, where more restrictive) that address **interest rate risk**, **credit risk**, and **concentration of credit risk**. This table does not address investments of debt proceeds held by bond trustee that are governed by the provisions of debt agreements of the Entity, rather than the general provisions of the California Government Code or the Entity's investment policy. *[The format of this disclosure should be modified as necessary to reflect the requirements of the Entity's investment policy.]*:

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>	<u>Maximum Percentage Of *Portfolio</u>	<u>Maximum Investment in One Issuer</u>
Local Agency Bonds	5 years	None	None
U.S. Treasury Obligations	5 years	None	None
U.S. Agency Securities	5 years	None	None
Banker's Acceptances	180 days	40%	30%
Commercial Paper	270 days	25%	10%
Negotiable Certificates of Deposit	5 years	30%	None
Repurchase Agreements	1 year	None	None
Reverse Repurchase Agreements	92 days	20% of base value	None
Medium-Term Notes	5 years	30%	None
Mutual Funds	N/A	20%	10%
Money Market Mutual Funds	N/A	20%	10%
Mortgage Pass-Through Securities	5 years	20%	None
County Pooled Investment Funds	N/A	None	None
Local Agency Investment Fund (LAIF)	N/A	None	None
JPA Pools (other investment pools)	N/A	None	None

\* Excluding amounts held by bond trustee that are not subject to California Government Code restrictions.

## Investments Authorized by Debt Agreements

Investment of debt proceeds held by bond trustee are governed by provisions of the debt agreements, rather than the general provisions of the California Government Code or the Entity's investment policy. The table below identifies the **investment types** that are authorized for investments held by bond trustee. The table also identifies certain provisions of these debt agreements that address **interest rate risk, credit risk, and concentration of credit risk**.

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>	<u>Maximum Percentage Allowed</u>	<u>Maximum Investment in One Issuer</u>
U.S. Treasury Obligations	None	None	None
U.S. Agency Securities	None	None	None
Banker's Acceptances	180 days	None	None
Commercial Paper	270 days	None	None
Money Market Mutual Funds	N/A	None	None
Investment Contracts	30 years	None	None

## Disclosures Relating to Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the Entity manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations.

The following table summarizes the estimated effects of hypothetical increases in interest rates on investment fair values. It assumes that the increases occur immediately and uniformly to each type of investment. The hypothetical changes in market interest rates do not reflect what could be deemed best- or worst-case scenarios. Variations in market interest rates could produce significant changes in the timing of repayments due to any prepayment options. For these reasons, actual results might differ from those reflected in the table.

<u>Investment Type</u>	<u>Carrying Amount</u>	<u>Fair value after basis point increase of:</u>		
		<u>100 Points</u>	<u>200 Points</u>	<u>300 Points</u>
U.S. Treasury notes	\$6,000,000	5,831,958	5,669,512	5,512,452
U.S. Treasury bonds	3,000,000	2,915,979	2,834,756	2,756,226
U.S. Treasury strips	2,000,000	1,943,986	1,889,837	1,837,484
Federal agency securities	35,000,000	32,853,088	31,905,487	30,989,303
Corporate medium term notes	5,000,000	4,859,965	4,724,593	4,593,710
Commercial paper	3,000,000	2,915,979	2,834,756	2,756,226
Banker's acceptances	2,000,000	1,943,986	1,889,837	1,837,484
Mortgage-backed securities	3,000,000	2,915,979	2,834,756	2,756,226
State investment pool	15,000,000	14,079,895	13,673,780	13,281,130
Held by bond trustee:				
Money market funds	500,000	485,997	472,459	459,371
Investment contracts	<u>1,000,000</u>	<u>838,660</u>	<u>811,585</u>	<u>785,409</u>
Total	<u>\$75,500,000</u>	<u>71,585,472</u>	<u>69,541,359</u>	<u>67,565,021</u>

## Investments with Fair Values Highly Sensitive to Interest Rate Fluctuations

The Entity's investments (including investments held by bond trustees) include the following investments that are highly sensitive to interest rate fluctuations (to a greater degree than already indicated in the information provided above):

<u>Highly Sensitive Investments</u>	<u>Fair Value at Year End</u>
Federal agency securities with coupon multipliers ranging from 1.25 to 2.5 times the three-month LIBOR reset on a basis ranging from monthly to semiannually. These multipliers amplify the effect of interest rate changes by greater than a one-to-one basis.	\$3,000,000
Mortgage backed securities. These securities are subject to early payment in a period of declining interest rates. The resultant reduction in expected total cash flows affects the fair value of these securities and makes the fair values of these securities highly sensitive to changes in interest rates.	3,000,000
Federal agency securities with interest rates that vary inversely to a benchmark index set quarterly that ranges from 2 percent to 4.5 percent minus the three-month LIBOR and with floors ranging from zero to one percent. These were purchased at a time when the California Government Code permitted the purchase of such investments.	1,000,000

## Disclosures Relating to Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Presented below is the minimum rating required by (where applicable) the California Government Code, the Entity's investment policy, or debt agreements, and the actual rating as of year end for each investment type.

<u>Investment Type</u>		<u>Minimum Legal Rating</u>	<u>Exempt From Disclosure</u>	<u>Rating as of Year End</u>		
				<u>AAA</u>	<u>Aa</u>	<u>Not Rated</u>
U.S. Treasury notes	\$ 6,000,000	N/A	6,000,000	-	-	-
U.S. Treasury bonds	3,000,000	N/A	3,000,000	-	-	-
U.S. Treasury strips	2,000,000	N/A	2,000,000	-	-	-
Federal agency securities	35,000,000	N/A		35,000,00	-	-
Corporate medium term notes	5,000,000	A	-	2,000,00	3,000,00	-
Commercial paper	3,000,000	A		-	3,000,00	-
Banker's acceptances	2,000,000	N/A		1,000,00	1,000,00	-
Mortgage-backed securities	3,000,000	AA	-	-	3,000,00	-
State investment pool	15,000,000	N/A		-	-	15,000,00
Held by bond trustee:						
Money market funds	500,000	A			500,00	
Investment contracts	<u>1,000,000</u>	N/A				<u>1,000,00</u>
<b>Total</b>	<b><u>\$75,500,000</u></b>		<b><u>11,000,000</u></b>	<b><u>38,000,00</u></b>	<b><u>10,500,00</u></b>	<b><u>16,000,00</u></b>

## Concentration of Credit Risk

The investment policy of the Entity contains no limitations on the amount that can be invested in any one issuer beyond that stipulated by the California Government Code. Investments in any one issuer (other than U.S. Treasury securities, mutual funds, and external investment pools) that represent 5% or more of **total Entity investments** are as follows:

<u>Issuer</u>	<u>Investment Type</u>	<u>Reported Amount</u>
FNMA	Federal agency securities	\$5,000,000
Federal Farm Credit Agency	Federal agency securities	7,000,000

Investments in any one issuer that represent 5% or more of total investments **by reporting unit** (primary government, discretely presented component unit, governmental activities, major fund, nonmajor funds in the aggregate, etc.) are as follows:

\$1,000,000 of the cash and investments (including amounts held by bond trustee) reported in the Water Fund (a major fund of the Entity) are held in the form of a nonnegotiable unrated investment contract issued by the Example Insurance Company that matures on October 1, 2017.

### **Custodial Credit Risk**

Custodial credit risk for *deposits* is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for *investments* is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and the Entity's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits: The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure City deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.

As of June 30, 2004, \$576,332 of the Entity's deposits with financial institutions in excess of federal depository insurance limits were held in uncollateralized accounts. As of June 30, 2004, Entity investments in the following investment types were held by the same broker-dealer (counterparty) that was used by the Entity to buy the securities:

<u>Investment Type</u>	<u>Reported Amount</u>
Federal agency securities	\$35,000,000
Corporate medium term notes	5,000,000
Commercial paper	3,000,000
Banker's acceptances	2,000,000

### **Investment in State Investment Pool**

The Entity is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by the California Government Code under the oversight of the Treasurer of the State of California. The fair value of the Entity's investment in this pool is reported in the accompanying financial statements at amounts based upon the Entity's pro-rata share of the fair value provided by LAIF for the entire LAIF portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by LAIF, which are recorded on an amortized cost basis.

## Example 5—Cash and Investments Note (GASB 40—Duration)

### (2) Cash and Investments

Cash and investments as of June 30, 2004 are classified in the accompanying financial statements as follows:

Statement of net assets:	
Cash and investments	\$74,405,000
Cash and investments held by bond trustee	1,500,000
Fiduciary funds:	
Cash and investments	<u>600,000</u>
Total cash and investments	<u>\$76,505,000</u>

Cash and investments as of June 30, 2004 consist of the following:

Cash on hand	\$ 5,000
Deposits with financial institutions	1,000,000
Investments	<u>75,500,000</u>
Total cash and investments	<u>\$76,505,000</u>

### **Investments Authorized by the California Government Code and the Entity's Investment Policy**

The table below identifies the **investment types** that are authorized for the Entity by the California Government Code (or the Entity's investment policy, where more restrictive). The table also identifies certain provisions of the California Government Code (or the Entity's investment policy, where more restrictive) that address **interest rate risk**, **credit risk**, and **concentration of credit risk**. This table does not address investments of debt proceeds held by bond trustee that are governed by the provisions of debt agreements of the Entity, rather than the general provisions of the California Government Code or the Entity's investment policy. *[The format of this disclosure should be modified as necessary to reflect the requirements of the Entity's investment policy.]*:

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>	<u>Maximum Percentage Of *Portfolio</u>	<u>Maximum Investment in One Issuer</u>
Local Agency Bonds	5 years	None	None
U.S. Treasury Obligations	5 years	None	None
U.S. Agency Securities	5 years	None	None
Banker's Acceptances	180 days	40%	30%
Commercial Paper	270 days	25%	10%
Negotiable Certificates of Deposit	5 years	30%	None
Repurchase Agreements	1 year	None	None
Reverse Repurchase Agreements	92 days	20% of base value	None
Medium-Term Notes	5 years	30%	None
Mutual Funds	N/A	20%	10%
Money Market Mutual Funds	N/A	20%	10%
Mortgage Pass-Through Securities	5 years	20%	None
County Pooled Investment Funds	N/A	None	None
Local Agency Investment Fund (LAIF)	N/A	None	None
JPA Pools (other investment pools)	N/A	None	None

\* Excluding amounts held by bond trustee that are not subject to California Government Code restrictions.



## Investments Authorized by Debt Agreements

Investment of debt proceeds held by bond trustee are governed by provisions of the debt agreements, rather than the general provisions of the California Government Code or the Entity's investment policy. The table below identifies the **investment types** that are authorized for investments held by bond trustee. The table also identifies certain provisions of these debt agreements that address **interest rate risk, credit risk, and concentration of credit risk**.

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>	<u>Maximum Percentage Allowed</u>	<u>Maximum Investment in One Issuer</u>
U.S. Treasury Obligations	None	None	None
U.S. Agency Securities	None	None	None
Banker's Acceptances	180 days	None	None
Commercial Paper	270 days	None	None
Money Market Mutual Funds	N/A	None	None
Investment Contracts	30 years	None	None

## Disclosures Relating to Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the Entity manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations. The Entity monitors the interest rate risk inherent in its portfolio by measuring the modified duration of its portfolio. The Entity has no specific limitations with respect to this metric.

<u>Investment Type</u>	<u>Modified Duration (in years)</u>
U.S. Treasury notes	\$ 6,000,000
U.S. Treasury bonds	3,000,000
U.S. Treasury strips	2,000,000
Federal agency securities	35,000,000
Corporate medium term notes	5,000,000
Commercial paper	3,000,000
Banker's acceptances	2,000,000
Mortgage-backed securities	3,000,000
State investment pool	15,000,000
Held by bond trustee:	
Money market funds	500,000
Investment contracts	<u>1,000,000</u>
 Total	 <u>\$75,500,000</u>

## Investments with Fair Values Highly Sensitive to Interest Rate Fluctuations

The Entity's investments (including investments held by bond trustees) include the following investments that are highly sensitive to interest rate fluctuations (to a greater degree than already indicated in the information provided above):

<u>Highly Sensitive Investments</u>	<u>Fair Value at Year End</u>
Federal agency securities with coupon multipliers ranging from 1.25 to 2.5 times the three-month LIBOR reset on a basis ranging from monthly to semiannually. These multipliers amplify the effect of interest rate changes by greater than a one-to-one basis.	\$3,000,000
Mortgage backed securities. These securities are subject to early payment in a period of declining interest rates. The resultant reduction in expected total cash flows affects the fair value of these securities and makes the fair values of these securities highly sensitive to changes in interest rates.	3,000,000
Federal agency securities with interest rates that vary inversely to a benchmark index set quarterly that ranges from 2 percent to 4.5 percent minus the three-month LIBOR and with floors ranging from zero to one percent. These were purchased at a time when the California Government Code permitted the purchase of such investments.	1,000,000

### Disclosures Relating to Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Presented below is the minimum rating required by (where applicable) the California Government Code, the Entity's investment policy, or debt agreements, and the actual rating as of year end for each investment type.

<u>Investment Type</u>		<u>Minimum Legal Rating</u>	<u>Exempt From Disclosure</u>	<u>Rating as of Year End</u>		
				<u>AAA</u>	<u>Aa</u>	<u>Not Rated</u>
U.S. Treasury notes	\$ 6,000,000	N/A	6,000,000	-	-	-
U.S. Treasury bonds	3,000,000	N/A	3,000,000	-	-	-
U.S. Treasury strips	2,000,000	N/A	2,000,000	-	-	-
Federal agency securities	35,000,000	N/A		35,000,00	-	-
Corporate medium term notes	5,000,000	A	-	2,000,00	3,000,00	-
Commercial paper	3,000,000	A		-	3,000,00	-
Banker's acceptances	2,000,000	N/A		1,000,00	1,000,00	-
Mortgage-backed securities	3,000,000	AA	-	-	3,000,00	-
State investment pool	15,000,000	N/A		-	-	15,000,00
Held by bond trustee:						
Money market funds	500,000	A			500,00	
Investment contracts	<u>1,000,000</u>	N/A				<u>1,000,00</u>
<b>Total</b>	<b><u>\$75,500,000</u></b>		<b><u>11,000,000</u></b>	<b><u>38,000,00</u></b>	<b><u>10,500,00</u></b>	<b><u>16,000,00</u></b>

### Concentration of Credit Risk

The investment policy of the Entity contains no limitations on the amount that can be invested in any one issuer beyond that stipulated by the California Government Code. Investments in any one issuer (other than U.S. Treasury securities, mutual funds, and external investment pools) that represent 5% or more of **total Entity investments** are as follows:

<u>Issuer</u>	<u>Investment Type</u>	<u>Reported Amount</u>
FNMA	Federal agency securities	\$5,000,000
Federal Farm Credit Agency	Federal agency securities	7,000,000

Investments in any one issuer that represent 5% or more of total investments **by reporting unit** (primary government, discretely presented component unit, governmental activities, major fund, nonmajor funds in the aggregate, etc.) are as follows:

\$1,000,000 of the cash and investments (including amounts held by bond trustee) reported in the Water Fund (a major fund of the Entity) are held in the form of a nonnegotiable unrated investment contract issued by the Example Insurance Company that matures on October 1, 2017.

### **Custodial Credit Risk**

Custodial credit risk for *deposits* is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for *investments* is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and the Entity's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits: The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure City deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.

As of June 30, 2004, \$576,332 of the Entity's deposits with financial institutions in excess of federal depository insurance limits were held in uncollateralized accounts. As of June 30, 2004, Entity investments in the following investment types were held by the same broker-dealer (counterparty) that was used by the Entity to buy the securities:

<u>Investment Type</u>	<u>Reported Amount</u>
Federal agency securities	\$35,000,000
Corporate medium term notes	5,000,000
Commercial paper	3,000,000
Banker's acceptances	2,000,000

### **Investment in State Investment Pool**

The Entity is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by the California Government Code under the oversight of the Treasurer of the State of California. The fair value of the Entity's investment in this pool is reported in the accompanying financial statements at amounts based upon the Entity's pro-rata share of the fair value provided by LAIF for the entire LAIF portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by LAIF, which are recorded on an amortized cost basis.

## Example 6—Cash and Investments Note (GASB 40—LAIF and Trustee Investments Only)

### (2) Cash and Investments

Cash and investments as of June 30, 2004 are classified in the accompanying financial statements as follows:

Statement of net assets:	
Cash and investments	\$36,005,000
Cash and investments held by bond trustee	1,000,000
Fiduciary funds:	
Cash and investments	<u>500,000</u>
Total cash and investments	<u>\$37,505,000</u>

Cash and investments as of June 30, 2004 consist of the following:

Cash on hand	\$ 5,000
Deposits with financial institutions	1,000,000
Investments	<u>36,500,000</u>
Total cash and investments	<u>\$37,505,000</u>

### **Investments Authorized by the Entity’s Investment Policy**

The Entity’s investment policy only authorizes investment in the local government investment pool administered by the State of California (LAIF). The Entity’s investment policy does not contain any specific provisions intended to limit the Entity’s exposure to **interest rate risk**, **credit risk**, and **concentration of credit risk**.

### **Investments Authorized by Debt Agreements**

Investment of debt proceeds held by bond trustee are governed by provisions of the debt agreements, rather than the general provisions of the California Government Code or the Entity’s investment policy. The table below identifies the **investment types** that are authorized for investments held by bond trustee. The table also identifies certain provisions of these debt agreements that address **interest rate risk**, **credit risk**, and **concentration of credit risk**.

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>
U.S. Treasury Obligations	None
U.S. Agency Securities	None
Banker’s Acceptances	180 days
Commercial Paper	270 days
Money Market Mutual Funds	N/A
Investment Contracts	30 years

### **Disclosures Relating to Interest Rate Risk**

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair

value to changes in market interest rates. As of year end, the weighted average maturity of the investments contained in the LAIF investment pool is approximately 10.5 months.

Information about the sensitivity of the fair values of the Entity’s investments to market interest rate fluctuations is provided by the following table that shows the maturity date of each investment:

		<u>Maturity Date</u>
State investment pool	35,500,000	10.5 months average
Investment contracts	<u>1,000,000</u>	October 1, 2017
Total	<u>\$36,500,000</u>	

### **Disclosures Relating to Credit Risk**

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. LAIF does not have a rating provided by a nationally recognized statistical rating organization.

### **Concentration of Credit Risk**

The investment policy of the Entity contains no limitations on the amount that can be invested in any one issuer beyond that stipulated by the California Government Code. There are no investments in any one issuer that represent 5% or more of **total Entity investments**.

Investments in any one issuer that represent 5% or more of total investments **by reporting unit** (primary government, discretely presented component unit, governmental activities, major fund, nonmajor funds in the aggregate, etc.) are as follows:

\$1,000,000 of the cash and investments (including amounts held by bond trustee) reported in the Water Fund (a major fund of the Entity) are held in the form of a nonnegotiable unrated investment contract issued by the Example Insurance Company that matures on October 1, 2017.

### **Custodial Credit Risk**

Custodial credit risk for *deposits* is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The California Government Code and the Entity’s investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits, other than the following provision for deposits: The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure City deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.

\$576,332 of the Entity’s deposits with financial institutions in excess of federal depository insurance limits were held in uncollateralized accounts.

The custodial credit risk for *investments* is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and the Entity’s investment policy do not contain legal or policy requirements that would limit the exposure

to custodial credit risk for investments. With respect to investments, custodial credit risk generally applies only to direct investments in marketable securities. Custodial credit risk does not apply to a local government's indirect investment in securities through the use of mutual funds or government investment pools (such as LAIF).

### **Investment in State Investment Pool**

The Entity is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by the California Government Code under the oversight of the Treasurer of the State of California. The fair value of the Entity's investment in this pool is reported in the accompanying financial statements at amounts based upon the Entity's pro-rata share of the fair value provided by LAIF for the entire LAIF portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by LAIF, which are recorded on an amortized cost basis.