GASB 28 — Securities Lending Transactions
In the accounting for its securities lending transactions, the State applies the requirements of Governmental Accounting Standards Board Statement No. 28 (GASB 28), *Accounting and Financial Reporting for Securities Lending Transactions.*

A. Cash Equity with Treasurer
On its balance sheet, the State of Ohio reports cash balances accounted for under balance sheet account number "101000" on the Ohio Administrative Knowledge System (OAKS) as "Cash Equity with Treasurer." This asset account represents each state-appropriated fund's equity in the Treasurer of State's cash and investment pool, which is also referred to as the State's Regular Account at the Treasurer's Office. The Treasurer of State (Treasurer) routinely lends securities from the State's investment portfolio under securities lending agreements.

For the State's securities out on loan, the Treasurer receives cash collateral from the borrower. The State is obligated to return the cash to the borrower when the security lending agreement terminates. The Treasurer reinvests the cash collateral in various investment types, including U.S. government and agency obligations, repurchase agreements, commercial paper, corporate bonds, asset-backed securities, master notes, variable rate notes and money market funds. Also, cash collateral may be placed with financial institutions. The market value of the investments the Treasurer purchases with the cash collateral is equal to at least 102 percent of the market value of the underlying securities, which are defined as the State's original investments out on loan.

Borrowers receive rebates and the agents receive fees equal to an agreed-upon percentage of the investment income realized on the collateral the Treasurer invests. These costs are netted against securities lending income before the Treasurer deposits the income in OAKS Fund 4E90: Securities Lending Income, a fund classified in the State's General Fund for financial reporting purposes.

As of the balance sheet date, the Treasurer reports the following for the State's Regular Account on schedules contained in the year-end deposits and investments reporting package, which the Office of Budget and Management (OBM) annually prepares and the Treasurer completes:

- Carrying amount of the underlying investments out on loan
- Market value of the underlying investments out on loan
- The amount of cash collateral received in exchange for the underlying investments out on loan
- Carrying amount and fair value (including any accrued interest) of investments purchased with cash collateral
- Period costs of securities lending, including borrower rebates and agent fees
- Disclosure of any period losses on securities lending transactions
- Disclosures, as required under GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*
- Disclosures, as required under GASB Statement No. 40, *Deposit and Investment Risk Disclosures*
- Other pertinent disclosure information, as required by paragraphs 11 through 16 of GASB 28.

For the cash collateral the Treasurer receives in return for the State's securities out on loan, as of June 30, the State reports assets and liabilities arising from the securities lending transactions on the balance sheets of the funds that have the risk of loss on the collateral assets, in conformity with paragraph 6 of GASB 28. The State reports the assets under the account, "Collateral on Lent Securities," and the related liability for the cash collateral received under the account, "Obligations under Securities Lending."

After discussion with representatives from the Treasurer of State's Office, OBM has determined that state funds with reported balances under the balance sheet account, "Cash Equity with Treasurer," bear the risk of loss on the collateral assets. Consequently, the recording of assets and liabilities for securities lending transactions involves a pro-rata allocation to the various funds on the basis of their equity in the pool, as of the balance sheet date, in conformity with paragraph 9 of GASB 28. OBM performs the allocation by calculating each OAKS fund's ending cash equity balance, as of June 30, as a percentage of the total cash equity balance reported on the OAKS for all appropriated state funds (after certain adjustments for cash balances redistributed from agency fund clearing accounts and unrecorded receipts on deposit in the state treasury at year-end), then multiplying the resulting percentage by the balance of cash collateral on lent securities received in the state treasury under the securities lending agreement, as of June 30, as reported on a schedule contained in the Treasurer's year-end deposits and investments reporting package.

For balance sheet reporting purposes only, the following journal entry applies to each OAKS fund.

	DR.	CR.
Collateral on Lent Securities (Asset)	$XXX	
Obligations under Securities Lending (Liability)		$XXX

In the event the fair value[1] of securities purchased with the cash collateral at year-end differs significantly from the value of the cash collateral received, the collateral on lent securities account would be adjusted to reflect the fair value of the securities purchased, including accrued interest. A gain or loss, as the case may be, would be recorded for the difference as follows:

	DR.	CR.
Collateral on Lent Securities (Asset)	$XXX	
Investment Income (from Gain on Securities Purchased with Cash Collateral)		$XXX

	DR.	CR.
Investment Income (from Loss on Securities Purchased with Cash Collateral)	$XXX	
Collateral on Lent Securities (Asset)		$XXX

The above entries would result in a difference in the carrying amount of the "collateral on lent securities" asset account and the carrying amount of the "obligations under securities" liability account. Essentially, when cash collateral is received, the liability account is limited to the

[1] Fair value is defined in footnotes 10 and 11 of paragraph 14 of GASB 28 as "the market value of the underlying securities (including accrued interest). "

amount of cash that needs to be returned to the borrower while the securities purchased with the collateral that are recorded as assets should theoretically be reported at fair value, including any accrued interest. Using professional judgment, OBM staff will determine when the difference is considered to be significant enough to make the appropriate adjustments to the collateral on lent securities account and the investment income account.

The State reports the investment income from the securities lending activities in the General Fund, since this is where Fund 4E90, which is legally entitled to the income, is classified. Since costs of the securities lending transactions are netted against earnings prior to the deposit of investment income proceeds in Fund 4E90, OBM adjusts Fund 4E90's investment income upward by the amount of the securities lending costs and reports expenditures in the fund for the amount of the costs, in conformity with paragraph 8 of GASB 28.

B. Lottery Commission's Structured Investment Portfolio

The Treasurer of State also participates in securities lending transactions for the Lottery Commission's investment portfolio that is dedicated to the payment of lottery prizes in the future. While these securities lending activities for the Lottery Commission affect assets considered being part of the cash and investment pool that comprise the State's treasury, the Treasurer of State accounts for them apart from other securities lending transactions just discussed for the rest of the Regular Account. All earnings and expenses resulting from the securities lending transactions for the dedicated investment portfolio legally accrue to Fund 8710: Deferred Prizes, the OAKS fund from which lottery prizes are paid.

The Lottery Commission is an independently audited organization. Consequently, OBM obtains the necessary information for reporting the Commission's securities lending activities in the State's Comprehensive Annual Financial Report (CAFR) from the Lottery Commission's separately issued financial report. The Commission also obtains the disclosure information it needs for its securities lending transactions from a separate schedule contained in the year-end deposits and investments reporting package that OBM prepares and the Treasurer completes.

C. Internal Portion of the STAR Ohio Investment Pool

For the internal portion of the STAR Ohio investment pool, OBM allocates the securities lending collateral and the associated obligation on a pro-rata basis to properly reflect the asset and liability balances on the respective balance sheets of the participating funds of the State's primary government and blended component units.

For the State's discretely presented component unit funds (i.e., colleges and universities), however, OBM reports the securities lending collateral and the associated obligation in the Other Agency Fund. This approach is supported in a March 29, 2001 letter from the GASB to the State of North Carolina, a copy of which can be obtained from OBM's Financial Reporting Section. In the letter, the GASB points out that the securities lending activities need not be reported in the component unit presentation if the component unit's position in the pool is reported in the primary government's agency funds.

Furthermore, OBM does not require the State's component units to report their respective shares of the investment pool's securities lending collateral or the related obligation in their respective separately issued financial statements. The GASB states in its letter that the securities lending activities need to be reported by the component unit funds in the "reporting entity report." This means the State's financial report only. This conclusion is also supported with paragraph 46 of GASB 28, which states, "...this Statement's requirements do not extend to legally separate entities participating in the pool." Component units are by definition legally separate from the State's primary government.

Finally, since the securities lending income and expense amounts have been determined to have an immaterial impact on the State's operating statements, OBM does not report the securities lending income separately from the securities lending expense for each affected fund, as required in paragraph 46 of GASB 28. Rather, the State reports the securities lending expenses as a component of "net" investment income in the respective fund's operating statement.

D. Independently Audited Organizations

Independently audited organizations that report securities lending activities for investment portfolios that are considered outside of the State treasury (not part of the Regular Account) and for which OBM obtains the necessary information for reporting the securities lending activities in the State's CAFR from separately issued financial reports include the Bureau of Workers' Compensation Enterprise Fund, the State Highway Patrol Retirement System Pension Trust Fund, and the STAR Ohio Investment Trust Fund (external portion).

E. Agency Funds

Although the investments of the four retirement systems (i.e., Ohio Public Employees Retirement System, State Teachers Retirement System of Ohio, School Employees Retirement System of Ohio, and Ohio Police and Firemen's Pension Fund) that are accounted for in the Retirement Systems Agency Fund are lent out through securities lending programs, the State does not report the related collateral balances in the Agency Fund. While the Treasurer of State is legal custodian of the assets of the four retirement systems, the Treasurer's Office does not manage the systems' investment portfolios nor is a party to the securities lending agreements executed by each respective retirement system.

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GOVERNMENTAL ACCOUNTING STANDARDS BOARD
401 Merritt 7, P.O. Box 5116, Norwalk, Connecticut 06856-5116 / 203-847-0700 ext. 244
Fax: 203-849-9714

GASB

DAVID R. BEAN
Director of Research

March 29, 2001

Mr. Clayton Murphy
Office of the State Controller
State of North Carolina
1410 Mail Service Center
Raleigh, NC 27699-1410

Dear Mr. Murphy:

You inquired regarding the applicability of paragraph 46 of Statement No. 28, *Securities Lending Transactions*. Specifically, the presentation of securities lending assets and liabilities arising from securities lending activities the state treasurer as reported by the state's colleges and universities. Those organizations are displayed as discretely presented component units and also issue their own separate financial statements.

When securities lending is conducted with pooled funds, Statement 28 indicates securities lending assets and liabilities should be reported *by the funds* which have the risk of loss.

> 9. If a government pools money from several funds for investment purposes and the pool, rather than the individual funds, has securities lending transactions, the government should report the assets and liabilities arising from the securities lending transactions in the balance sheets of the funds that have the risk of loss on the collateral assets. In many cases, this will involve a pro rata allocation to the various funds based on their equity in the pool.

On the other hand, in the basis for conclusions, *legally separate* entities do not report securities lending assets and liabilities. Paragraph 46 indicates:

> 46. One respondent questioned whether this Statement requires participating entities that are legally separate from a government that sponsors an investment pool with securities lending transactions to report their share of securities lending assets, liabilities, income, and costs. The respondent questioned how those entities could obtain the information needed for such reporting. The paragraph 9 and 10 provisions for reporting securities lending in investment pools apply to the financial statements of the governmental reporting entity sponsoring the pool; this Statement's requirements do not extend to legally separate entities participating in the pool.

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The answer to your question turns on the presentation of the pooled investments—and related securities lending assets and liabilities—on the state's financial statements. If the colleges' and universities' position in the pool is reported in the state's agency funds, the securities lending activities need not be reported in the colleges' and universities' component unit presentation. By extension, the separately issued statements of the component units would not report securities lending assets and liabilities. However, if the colleges' and universities' portion of the pool is eliminated from the primary government's reporting, the securities lending activities should be reported by the component units in the reporting entity report.

I hope this analysis answers your questions. If you have any questions, please contact Randy Finden.

Sincerely,

David R. Bean

cc: John Barfield, North Carolina Office of the State Controller
Cliff Flood, North Carolina Office of State Auditor
Randal Finden, Project Manager

Drb/letters/murphy.doc.