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University of California GASB 35 Financial Statement Presentation

Issues Resolution Memo No. 176

Definition and Presentation of Cash Flow from Investing Activities and Activities of External Trusts

Define Issues

Paragraph 105 of GASB Statement No. 34 requires the University to prepare a Statement of Cash Flows presented using the direct method. The University must define the activities that generate cash flow. This Issues Resolution Memo defines the investing and external trust activities that generate cash flows for the University's consolidated Statement of Cash Flows.

Background

- **Cash Management and Investment Activity Associated with the Short Term Investment Pool (STIP)**

Investments authorized by The Regents include fixed income securities with a maximum maturity of five years, with the exception of Mortgage Origination Program (MOP) loans for up to 30 years. STIP investments are insured, registered or held in the University's name by State Street Bank and Trust Company (State Street), the University's custodial bank as an agent for the University.

All of the University's fund groups participate in the STIP. Funds to provide for payroll, operating expenses and construction expenditures of all campuses and medical centers are invested in STIP until expended. In addition, component units and agency funds deposit cash balances with the University and are included in the STIP.

Arrangements with University departments, component units or agency funds are that of a demand deposit or Money Market Fund. One deposits a dollar, earns interest on it, plus realized appreciation on infrequent sales of investments, and withdraws a dollar.

The Treasurer initiates transactions to purchase or sell securities in the pool. While such activity occurs at a "trade date," cash does not flow until the "settlement date" of the trade.

- **Purchases and Sales of Investment Securities**

Other than the STIP, the University's investments are associated with the University of California Retirement System (UCRS), the General Endowment Pool (GEP), the High Income Pool (HIP), or are separately invested. Investments authorized by the Regents for UCRS, GEP, HIP or separately invested funds include equity and fixed income securities. The GEP and HIP are portfolios in which a large number of individual endowment funds participate. UCRS, GEP and HIP may also invest in the STIP. All investments are insured, registered or held in the University's name by State Street, the University's custodial bank as an agent for the University.

The Treasurer initiates transactions to purchase or sell securities in the UCRS, GEP or HIP. While such activity occurs at a "trade date," cash does not flow until the "settlement date" of the trade.

- **Activity With External Trusts for Self-Insurance Programs**

The University has entered into agreements with trustees (Trust Company of the West) to maintain trust funds for the University's self-insurance programs. The University makes deposits into the trusts based upon an annual evaluation by an independent actuary of the cost for these self-insurance programs. University deposits into the trust are invested and managed by the trustee under trust agreements that allow for investments in fixed income securities. All investments are insured, registered or held by the University's custodial bank, State Street, as agent for the University.

Claims are administered by a third party administrator (TPA). The TPA requests funds from the trustees as claim payments and administrative expenses are incurred.

The trustee initiates transactions to purchase or sell securities in these trusts. However, cash does not flow to the University based upon those transactions. The only cash that flows between the University and the trust is in conjunction with the initial deposit.

- **Activity with External Trusts for Bond Trustee Programs**

The University has entered into agreements with trustees (BNY or US Bank) to maintain trust funds under the terms of the Indentures for the University's revenue bond and certificates of participation (COP) financing programs. The University makes deposits into these trusts based upon an evaluation by the trustee of the amount of funds required to be maintained under the terms of the Indenture and for principal and interest payments to bondholders. University deposits into the trusts are invested and managed by the trustee under trust agreements that allow for investments in fixed income securities.

Debt service payments are administered by the trustee.

The trustee initiates transactions to purchase or sell securities in these trusts. However, cash does not flow to the University based upon these transactions. The only cash that flows between the University and the trust is in conjunction with the deposits.

- **Activity with State Public Works Board (SPWB) Projects**

The University enters into lease-purchase agreements with the SPWB recorded as capital leases. The SPWB sells lease revenue bonds to finance construction of certain state owned buildings to be used by the University. During construction, the University acts as agent for the SPWB. Proceeds from the SPWB bond sale are remitted directly to the contractor to pay for the construction costs. Upon completion, the buildings are leased to the University under terms and amounts that are sufficient to satisfy the SPWB lease revenue bond requirements with the understanding that the state will provide general fund appropriations to satisfy the annual lease requirements.

The state provides general fund appropriations either to UC or directly to the SPWB on behalf of the University. No cash is directly received by the University if the state interacts directly with the SPWB.

The SPWB then makes the appropriate payments to the bondholders.

- **Securities Lending Activity**

The University participates in a securities-lending program through the Global Securities Lending (GSL) program of State Street as a means to augment income. Securities are lent by GSL to select brokerage firms for which collateral is received in excess of the fair value of such investments during the period of the loan. Collateral may be cash or securities issued by the U.S. Government or its agencies, or the sovereign or provincial debt of foreign countries. Collateral securities cannot be pledged or sold by the University unless the borrower defaults.

State Street maintains specific collateral in an account in the name of the University. Cash collateral is invested by State Street, as an agent for the University, in a pool in the University's name, with guidelines approved by the Treasurer.

State Street initiates lending transactions, daily collateral "true up" transactions, and transactions to purchase or sell securities in the cash collateral pool. However, cash does not flow to the University based upon these transactions. The University receives cash only with respect to the distribution of the income from this lending program, net of fees.

- **Commercial Paper Activity**

The University has entered into agreements with an Issuing and Paying Agent (Bankers Trust) to issue, settle and administer the commercial paper activity on a daily basis. The University specifies the level of commercial paper outstanding and Bankers Trust works with the dealers who initiate the sale of the University's commercial paper with various buyers in the financial markets. The University maintains a constant outstanding balance of \$550 million. Cash is sent to Bankers Trust to redeem outstanding commercial paper as interim financing is converted to long term in conjunction with a bond issuance. Bankers Trust then send the same amount back to the University in order to maintain the full \$550 million outstanding.

The only cash flow between the University and Bankers Trust are in conjunction with:

1. Payments to Bankers Trust for discounts
2. Payments to Bankers Trust for interest expense
3. Payments to Bankers Trust to redeem commercial paper as a result of projects financed through a bond issuance
4. Payments received from Bankers Trust to restore the outstanding commercial paper balance to \$550 million.

A determination must be made about whether any or all of this activity, or whether an allocation of the STIP investment purchases and sales, should be shown on the University's Statement of Cash Flows and the separately-issued cash flow statements of the individual UC enterprises with separately audited financial statements.

Authoritative Guidance

Paragraph 105 of GASB Statement No. 34 specifies that the Statement of Cash Flows must be prepared based upon the provisions of GASB Statement No. 9.

Paragraph 78 of GASB Concept Statement No. 1, *Objectives of Financial Reporting*, also focuses on the need for, and importance of, cash flow information. It states that an objective of financial reporting is to "provide information about how the governmental entity financed its activities and met its cash requirements."

Paragraph 7 of GASB Statement No. 9 indicates, "The primary purpose of a statement of cash flows is to provide relevant information about the cash receipts and cash payments of an entity during a period."

Paragraph 50 of GASB Statement No. 9 states, "The GASB concluded that cash management pools that are used essentially as demand deposit accounts should be treated in the same way as any other demand deposit account." That is, cash flows are recognized for transactions between the depositor and the pool, rather than transactions of the pool itself.

Under GASB Statements No. 28 and 31, the investment collateral and the obligation would both be reported on the University's balance sheet at market, as they are now.

Paragraph 12 of GASB Statement No. 38 is applicable to disclosure of commercial paper activity.

Approach

The University will record cash flow on the Statement of Cash Flows based upon two principles:

- The settlement date, not trade date, will determine the date when the cash flows, and
- Transactions **between** UC and the fund manager, foundation or trustee, not transactions **of** the fund manager, foundation or trustee will be recorded as cash flow.

In practice, this means that for:

Cash Management and Investment Activity Associated with the STIP

- Investment purchases or sales initiated by the Treasurer in the overall management of the funds in the STIP will be shown in the University's Statement of Cash Flows as an investing activity.
- Specific deposit and redemption cash management activity between the STIP and UC funds, or pools, are within the UC financial reporting entity and will not be included on the University's Statement of Cash Flows. However, since their STIP deposits are incorporated into the University's financial statements, their activity will be included in the University's Statement of Cash Flows to the extent their cash activities result in the Treasurer initiating a purchase or sale of securities in conjunction with the overall management of the STIP.
- Specific deposit and redemption cash management activity between the STIP and UCRS, which will treat their investment in STIP as a Money Market Fund investment at \$1 will not be included on the University's Statement of Cash Flows. UCRS is not required to prepare a Statement of Cash Flows. However, since UCRS STIP deposits are incorporated into the University's financial statements, UCRS activity will be included in the University's Statement of Cash Flows to the extent their cash requirements result in the Treasurer initiating a purchase or sale of securities in conjunction with the overall management of the STIP.
- Specific deposit and redemption cash management activity between the STIP and the Foundations, who may have money invested in the STIP through the Agency funds, will not be shown on the University's statements, nor will any transactions with other Agency funds. Agency fund transactions are to be excluded from the University's Statement of Cash Flows. However, since their STIP deposits are incorporated into the University's financial statements, their activity will be included in the University's Statement of Cash Flows to the extent their cash requirements result in the Treasurer initiating a purchase or sale of securities in conjunction with the overall management of STIP.
- Specific deposit and redemption cash management activity between the STIP and other UC enterprises with separately audited financial statements, such as the medical centers and CEB, will not be shown on the University's Statement of Cash Flows. However, since their STIP deposits are incorporated into the University's financial statements, the activity will be included in the University's Statement of Cash Flows to the extent their cash requirements result in the Treasurer initiating a purchase or sale of securities in conjunction with the overall management of STIP.

Purchases and Sales of Investment Securities

- The University will use the settlement date, not the trade date, for measuring “cash flow.”
- Investment purchases or sales initiated by the Treasurer in the overall management of the funds in the GEP, HIP or separate investments will be shown in the University’s Statement of Cash Flows as an investing activity.
- Investment purchases or sales initiated by the Treasurer in the overall management of the funds in the UCRS will not be shown in the University’s Statement of Cash Flows.
- Investment purchases or sales initiated by the Treasurer in the overall management of the funds in the UCRS will not be shown in the UCRS financial statements since a statement of cash flows is not required for fiduciary funds.

Activity with External Trusts for Self Insurance Programs

- Deposits made by the University into the self-insurance trusts will be shown in the University’s Statement of Cash Flows as an operating activity. Cash payments from the trust to the third party administrator (TPA) for payments of claims are not cash flows for purposes of the University’s Statement of Cash Flows.
- Any receipts by the University from the self-insurance trusts will be shown in the University’s Statement of Cash Flows as an operating activity.
- All investment transaction initiated by the trustee in conjunction with the overall management of the trust funds will not be shown in the University’s Statement of Cash Flows.
- All activity between the trust and the TPA will not be included in the University’s Statement of Cash Flows.

Activity with External Trusts for Bond Trustee Programs

- Deposits made by the University into the trusts will be shown in the University’s Statement of Cash Flows as a Capital and Related Financing Activity. Cash payments from the trust to bondholders for principal and interest payments are not cash flows for purposes of the University’s Statement of Cash Flows.
- Deposits made by the University will be split between principal and interest. Adjustments to the required deposits resulting from investment income earned on trust investments will be net against the interest portion of the required University deposit.
- Receipts by the University from the trusts, if any, will be shown in the University’s Statement of Cash Flows as a Capital and Related Financing Activity.
- All investment transactions initiated by the trustee in conjunction with the overall management of the trust funds will not be shown in the University’s Statement of Cash Flows.
- All activity between the trust and the bondholders will not be included in the University’s Statement of Cash Flows.

Activity with State Public Works Board (SPWB) Projects

- Nothing is recorded in the University's Statement of Cash Flows for the University's capital lease payments to the SPWB made directly to the SPWB by the State of California.
- If there should be cash flow directly between the State of California and the University, and the University and the SPWB, it will be shown on the University's Statement of Cash Flows as a Capital and Related Financing Activity.
- Any investment transactions initiated by the SPWB in conjunction with the overall management of their funds will not be shown in the University's Statement of Cash Flows.
- All activity between the SPWB and the contractor or bondholders will not be included in the University's Statement of Cash Flows.
- Buildings or equipment financed through capital leases, regardless of with the SPWB or another entity, will be shown as Supplemental Noncash Investing, Capital and Related Financing Activities in the University's Statement of Cash Flows.

Securities Lending Activity

- Investment income, net of investment expense, received by the University from State Street will be included (grossed up) in the University's Statement of Cash Flows as an investing activity.
- Any other receipts or disbursements directly between State Street and the University will be included in the University's Statement of Cash Flows as an investing activity.
- Lending and cash collateral transactions initiated by State Street with borrowers of securities will not be included in the University's Statement of Cash Flows.

Commercial Paper Activity

- Nothing is reported in the University's Statement of Cash Flows for the transactions between Bankers Trust and commercial paper buyers and sellers.
- The University's Statement of Cash Flows will show as a Capital and Related Financing Activity:
 1. Payments for discounts
 2. Payments for interest
 3. Payments for redemption associated with proceeds received from issuance of bonds
 4. Receipts from proceeds to restore outstanding commercial paper to \$550 million
- The University's short-term debt footnote activity will reflect payments and receipts associated only with items 3 and 4, above.

Exhibit 1 outlines the approach described above. See also positions taken in IRM 130, *Definition and Presentation of Cash and Cash Equivalents of Entities such as Medical Centers, CEB and UC Press*.

Next Steps—Required Actions

Responsibility (C, OP, MC)	Required Completion Date	Action Item/Task
OP	31-May-01	Incorporate the Approach to Cash Flow into the Financial Statement Presentation Template —Incorporate the approach outlined in the IRM into the Statement of Cash Flows (IRM No. 175).

University of California

- Separate Financial Statements
- Separate Trusts for UCRS and Foundations
- Common Fiduciary, The Regents, for UC, Medical Centers and UCRS

