

LSL



"Back to Basics" **WEBINAR**

Investments

1 CPE Credit

Wed, Oct 1
10:00 am PST

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Your Presenter



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Objectives

- Best Practices - Investments
- Reconciling investment balances to general ledger
- Discuss year-end closing entries such as GASB 31 and Interest Allocations
- Reporting disclosures for Investments on financial statements
- Avoid common errors related to pooled cash and fair value adjustments

POLLING QUESTION #1

Which investment constitutes the largest portion of your entity's funds?

- A. LAIF
- B. CAMP
- C. Equity Securities
- D. Mutual Fund

Investments

Best Practices

- Investment Policy
- Collateralizing Public Deposits
- Diversifying the Investment Portfolio
- Present Investment Reports to Governing Body at least quarterly
- Safekeeping and Third-Party Custodian Services



Reconciling Investments to General Ledger

GASB31 Applicable

- Transactions that are applicable to GASB 31– investments in interest-earning investment contracts; external investment pools; open-end mutual funds; debt securities; equity securities; option contracts; stock warrants; and stock rights that have readily determinable fair values
- GASB 31 does not apply to investments held by the following: governmental external investment pools, defined benefit pension plans, or Internal Revenue Code (IRC) Section 457 deferred compensation
- Typical types of investments – CD, LAIF, CAMP

Investment Valuation

- Money market investments and participating interest-earning investment contracts that have a remaining maturity at time of purchase of one year or less, provided that the fair value of those investments is not significantly affected by the impairment of credit standing of the issuer or by other factors, allowed to be reported at amortized cost.
- Fair value of investments in open-end mutual funds should be determined by the fund's current share price.
- Investment positions in 2a7-like pools should be determined by the pool's share price.
- How often should investments be recorded at fair value? At a minimum, investments should be marked-to-market as of the date of the statement of financial position.

GASB 31 Journal Entries

- Example: A local government invests \$100,000 in an external investment pool on January 15, receiving 100,000 shares or units in the pool. The pool is not a 2a7-like pool and does not have a legally binding guarantee for its share price. However, the pool seeks to maintain a stable \$1.00 net asset value as a matter of day-to-day operations; participants enter and exit the pool using the \$1.00 net asset value. On June 30, the end of the local government's fiscal year, the pool sponsor reports that pool participants should fair-value their pool position at \$1.05 per share. On October 15, the local government withdraw its investments in the pool, using the \$1.00 net asset value. How does the participant report its investment in the pool at June 30?
- Answer: On January 15, the investment should be valued at \$100,000, its fair value on the date acquired. As of June 30, the investment should be valued at \$105,000 in the financial statements. The \$5,000 increase should be included on the participant's statement of operations in investment income as an increase in the fair value of investments. On October 15 when the investment is withdrawn, investments are reduced by \$105,000. The change in the fair value of investments is charged \$5,000 because the fair value change is reversed.

GASB 31 Journal Entries (Continued)

Journal entries, in addition to any interest paid to the participant, would be as follows:

		<u>Debit</u>	<u>Credit</u>
January 15	Investments	\$100,000	
	Cash		\$100,000
	(To record initial investment in external investment pool)		
June 30	Investments	\$5,000	
	Change in the fair value of investments		\$5,000
	(To report fair value increase)		
October 15	Cash	\$100,000	
	Change in the fair value of investments	5,000	
	Investments		\$105,000
	(To record withdrawal from external investment pool)		

Interest Allocation

- Government reports the entire position of its internal investment pool as cash and cash equivalents in the general fund, with an amount due to other funds for those other funds' positions in the pool. Each fund with a position in the internal investment pool should report its position as equity in cash management pool, cash and cash equivalents, or investments with corresponding interfund receivables and payables for the other funds' equity positions.
- Typically, each fund would be allocated interest by a weighted average of the investment balance in the fund multiplied by the monthly interest rate. It is important to note the interest should not be allocated to negative investment balance. Government should report negative investment income as negative revenue.
- If a proprietary fund distinguishes between operating and nonoperating income, the change in the fair value of investments should be reported in the same manner as other investment income is reported, which may be as nonoperating revenue.

POLLING QUESTION #2

How often do you reconcile investments?

- A. Daily
- B. Monthly
- C. Yearly
- D. I don't touch any reconciliations

Financial Statement Disclosures

Disclosures

- Governmental entities should make the following disclosures in the notes to the financial statements:
 - The methods and significant assumptions used to estimate the fair value of investments, if that fair value is based on other than quoted market prices
 - The policy for determining which investment, if any, are reported at amortized cost
 - For any investments in external investment pools that are not SEC-registered, a brief description of any regulatory oversight for the pool and whether the fair value of the position of the pool is the same as the value of the pool shares will need to be disclosed in the footnotes.
- Other disclosures include the following: Interest Rate Risk, Custodial Credit Risk, Concentration of Credit Risk, Credit Risk, and Fair Value Measurement and Application

Disclosures Example

Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. The Treasurer mitigates this risk by ensuring sufficient liquidity to meet cash flow needs and only then investing in longer-term securities. The Treasurer uses the weighted average maturity method to identify and manage interest rate risk. The weighted average to maturity of the Pool as of June 30, 2024 was 582 days.

Custodial Credit Risk

The custodial credit risk for deposits is the risk that in the event of the failure of a depository institution, the County will not be able to recover deposits or will not be able to recover collateral securities that are in possession of an outside party. The custodial credit risk for investments is the risk that, in the event of failure of the counterparty (i.e. fiscal agent) to a transaction, the County 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 County'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 and local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law. The fair 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 deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits. As of June 30, 2024, the carrying amount of the County's deposits and investments held by financial institutions was \$98,483 and the bank balance was \$107,354, and total uncollateralized deposits was \$44,658. Of the County's deposits and investments with financial institutions, the carrying amount and bank balance of \$53,180 and \$62,097, respectively, were restricted cash and investments held by fiscal agents. As of June 30, 2024, all of the County's

Disclosures Example

investments were held by the County itself or by a fiscal agent (counterparty) other than the broker-dealer used by the County to purchase the securities.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the amount of investment in a single issuer. U.S. treasury and agency securities are considered to be of the best quality grade, as such there is no limitation on amounts invested in U.S. treasury or agency securities per California Government Code. Investments in any one issuer (other than investments issued or explicitly guaranteed by the U.S. government and investments in mutual funds, external investment pools, and other pooled investments) that represent 5% or more of the total County investments are as follows:

Issuer Name	Investment Type	Amount
Federal Home Loan Bank	U.S. government agencies	\$ 1,292,626

Credit Risk

Credit risk is the risk of loss due to an issuer of an investment not fulfilling its obligation to the holder of the investment. The County Treasurer mitigates these risks by holding a diversified portfolio of high quality investments. The County Treasurer's policy permits investment in the debt of issuers with a short-term rating of superior capacity and a minimum long-term rating of upper medium grade by two of the three largest nationally recognized rating agencies. For short-term ratings, the issuers' rating must be at least A-1 and P-1, and long-term ratings must be at least A- and A3 by two of the three largest nationally recognized rating agencies. In addition, the County Treasurer is permitted to invest in the debt of the State of California Local Agency Investment Fund (LAIF), collateralized certificates of deposits, bonds and notes issued by other California local agencies and the local government investment pools. The County's pool and LAIF are not rated.

Disclosures Example

As of June 30, 2024, the County's investments and credit ratings are as follows:

Investment Type	Credit Rating		Weighted Average Maturity (Days)	Amount
	Moody's	Standard & Poor's		
Investment in County Pool:				
U.S. Treasury	Exempt	Exempt	625	\$ 650,059
U.S. government agencies	Aaa	AA+	608	1,439,412
Negotiable certificates of deposit	P-1	A-1	219	69,939
Collateralized certificates of deposits	Not rated	Not rated	215	23,000
Commercial paper	P-1	A-1	1	80,000
Public investment money market	Not rated	Not rated	1	20,000
Local agency bonds	Not rated	Not rated	4,780	(1) 9,506
Local agency bonds (mPOWER Folsom)	Not rated	Not rated	4,560	(2) 379
Local agency bonds (mPOWER Placer)	Not rated	Not rated	4,649	(3) 5,443
Local agency bonds (Pioneer)	Not rated	Not rated	5,787	(4) 4,159
Local government investment pool - CAMP	Not rated	AAAm	38	90,000
Local government investment pool - CalTRUST	Not rated	AAAm	25	35,000
Total investments in County Pool				<u>2,426,897</u>
Restricted investments with fiscal agents: ⁽⁵⁾				
Money markets	Not rated	Not rated	n/a	1,218
Mutual funds - equity	Not rated	Not rated	n/a	43,424
Mutual funds - fixed income	Not rated	Not rated	n/a	13,347
Total restricted investments				<u>57,989</u>
Total investments				<u>\$ 2,484,886</u>

Disclosures Example

Fair Value Measurements

The Pool categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. These principles recognize a three level fair value hierarchy as follows:

- Level 1 – Investments reflect quoted prices in active markets for identical assets;
- Level 2 – Investments reflect prices that are based on observable inputs, either directly or indirectly, of similar assets, which may include inputs in markets that are not considered to be active; and,
- Level 3 – Investments reflect prices based upon unobservable inputs.

This framework prioritizes and ranks the level of market price observability used in measuring investments at fair value. U.S. GAAP also allows investments to be valued at amortized cost or net asset value (NAV). The following table presents the County's investments at their fair value level but also includes certain investments at amortized cost or NAV as of June 30, 2024:

Disclosure Example

Investments by Fair Value Level	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Debt securities:				
U.S. treasury	\$ 650,059	\$ 650,059	\$ -	\$ -
U.S. government agencies	1,439,412	-	1,439,412	-
Negotiable certificates of deposit	69,939	-	69,939	-
Commercial paper	80,000	-	80,000	-
Local agency bonds	9,506	-	-	9,506
Local agency bonds (mPOWER Folsom)	379	-	-	379
Local agency bonds (mPOWER Placer)	5,443	-	-	5,443
Local agency bonds (Pioneer)	4,159	-	-	4,159
Mutual funds - equity	43,424	43,424	-	-
Mutual funds - fixed income	13,347	13,347	-	-
Total investments measured at fair value	<u>2,315,668</u>	<u>\$ 706,830</u>	<u>\$ 1,589,351</u>	<u>\$ 19,487</u>
Investments measured at amortized cost:				
Public investment money market	20,000			
Collateralized certificates of deposit	23,000			
Money Market	1,218			
Investments measured at net asset value:				
Local government investment pool - CAMP	90,000			
Local government investment pool - CalTRUST	35,000			
Total investments	<u>\$ 2,484,886</u>			

Disclosures Example

The City categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs. Debt securities classified in Level 2 of the fair value hierarchy use a market approach to measure fair value. The City's pricing vendor, through rules based logic, utilizes valuation techniques that reflect market participants' assumptions and vary by asset class and per methodology, and maximizes the use of relevant observable data including quoted prices for similar assets, benchmark yield curves and market corroborated inputs.

The City has the following recurring fair value measurements as of June 30, 2024:

Investment Type	Total	Uncategorized	Fair Value Level	
			1	2
Local Agency Investment Fund (LAIF)	\$ 36,029,344	\$ 36,029,344	\$ -	\$ -
US Treasury and Agency Notes	42,769,190	-	42,769,190	-
US Agencies	30,470,210	-	-	30,470,210
Medium-Term Corporate Notes	21,853,390	-	-	21,853,390
Total Investments	<u>\$ 131,122,134</u>	<u>\$ 36,029,344</u>	<u>\$ 42,769,190</u>	<u>\$ 52,323,600</u>

POLLING QUESTION #3

Which area of financial disclosure poses the most significant risk or challenge for your organization?

- A. Interest Rate Risk
- B. Credit Risk
- C. Fair Value Measurement and Application
- D. Concentration of Credit Risk



How Your Auditors Audit Your Investments

Audit Steps to Audit Your Investments

1. Obtain a list and statements for all accounts held by the organization
2. Review GASB 31 fair value adjustment entry and reconcile the cash to your GL. This includes your footnotes as well
3. Confirm investment balances directly with the financial institution. Possibly through confirmation.com or sending confirmation directly to financial institution via mail or email.
4. Review your investment reconciliations including reconciling items, timing and documentation

Institution Name	A/C #	Bank Balance 6/30/2023		Outstanding Checks/DIT	Adj Bank Balance 6/30/2023	Fair Value @ 6/30/2023	
DEMAND DEPOSITS							
General Checking (Wells Fargo)		1,262,859.04	<u>D. 8</u>	C	(80,942.17)	1,181,916.87	1,181,916.87 <u>D.10</u>
Imprest Cash		750.00		GL	-	750.00	750.00
INVESTMENTS							
LAIF		24,932,372.59	<u>D. 6</u>	C	-	24,932,372.59	24,554,111.07 <u>D. 7</u>
US Bank		4,441,399.46	<u>D. 9</u>	C	-	4,441,399.46	4,441,238.16
CAMP Pool		17,580,799.27	<u>D. 9</u>	D		17,580,799.27	17,580,799.27
Total cash and investment per bank					48,137,238.19	47,758,815.37	
Total cash and investments per fund					47,758,977.00	47,758,977.00	
Difference					378,261.19	(161.63)	B
RESTRICTED INVESTMENTS							
Depository Account (US Bank)		550,110.73	<u>D. 8</u>	C	-	550,110.73	550,110.73
PARS Post-Employment Benefits Trust		1,217,584.23	<u>D. 9</u>	C, D	-	1,217,584.23	1,217,584.23 <u>D.11</u>
US Bank- Cash Equiv Rev Bond 2022A		2,073,362.20	<u>D. 9</u>	D		2,073,362.20	2,073,362.20
US Treasury Notes - Rev Bond 2022A Short Term		8,382,636.54	<u>D. 9</u>	D		8,382,636.54	8,394,731.54 E
US Treasury Notes - Rev Bond 2022A Long Term		7,899,603.90	<u>D. 9</u>	D		7,899,603.90	7,873,911.90 E
US Bank - Rev Bond 2017A		270.59	<u>D. 9</u>	D		270.59	270.59
Total fiscal agent cash per bank					20,123,568.19	20,109,971.19	
Total fiscal agent cash per fund					20,110,170.00	20,110,170.00	
Difference					13,398.19	(198.81)	A
TOTAL CASH & INVESTMENTS PER BANK:					68,260,806.38	67,868,786.56	
TOTAL CASH & INVERSTMENTS PER FUND:					67,869,147.00	67,869,147.00	
DIFFERENCE:					(391,659.38)	360.44	B

Agency Confirmation as of 06/30/23

<u>FISCAL QUARTER</u>	<u>QUARTER DATE</u>	<u>BALANCE</u>	<u>INTEREST</u>
1st	9/30/2022	\$33,375,055.68	\$115,133.71
2nd	12/31/2022	\$39,390,189.39	\$188,982.41
3rd	3/31/2023	\$36,679,171.80	\$253,200.79
4th	6/30/2023	\$24,932,372.59	\$229,839.16 <u>E. 4</u>

Balance as of 06/30/23 is : \$24,932,372.59 D. 2

Total Interest is: \$787,156.07 E. 18

INVESTMENTS

LAIF	24,932,372.59 <u>D. 6</u>	C	-	24,932,372.59	24,554,111.07 <u>D. 7</u>
US Bank	4,441,399.46 <u>D. 9</u>	C	-	4,441,399.46	4,441,238.16
CAMP Pool	17,580,799.27 <u>D. 9</u>	D		17,580,799.27	17,580,799.27
Total cash and investment per bank				48,137,238.19	47,758,815.37
Total cash and investments per fund				47,758,977.00	47,758,977.00
Difference				378,261.19	(161.63) <u>B</u>

RESTRICTED INVESTMENTS



PMIA/LAIF Performance Report as of 07/26/23



Quarterly Performance Quarter Ended 06/30/23

LAIF Apportionment Rate ⁽²⁾ :	3.15
LAIF Earnings Ratio ⁽²⁾ :	0.00008636172883763
LAIF Administrative Cost ^{(1)*} :	0.06
LAIF Fair Value Factor ⁽¹⁾ :	0.984828499 <u>D. 2</u>
PMIA Daily ⁽¹⁾ :	3.26
PMIA Quarter to Date ⁽¹⁾ :	3.01
PMIA Average Life ⁽¹⁾ :	260

PMIA Average Monthly Effective Yields⁽¹⁾

June	3.167
May	2.993
April	2.870
March	2.831
February	2.624
January	2.425

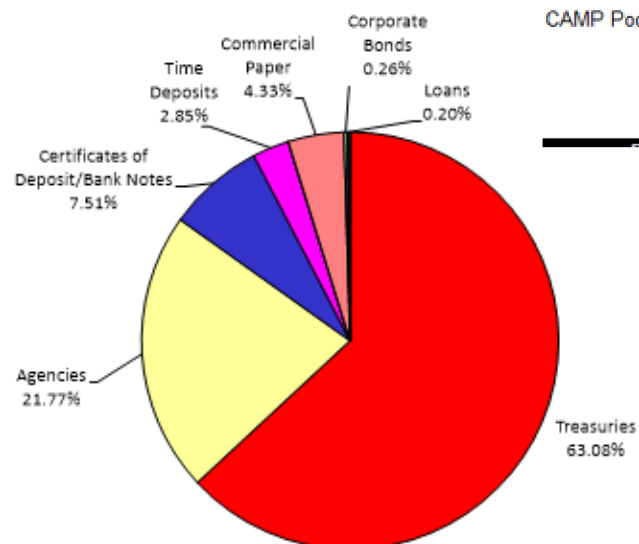
LAIF Bal

Fair Value
Adjustment
factorFair Value
Adjustment
LAIF

$$\$24,932,372.59 \times 0.984828499 = \$24,544,111.07$$

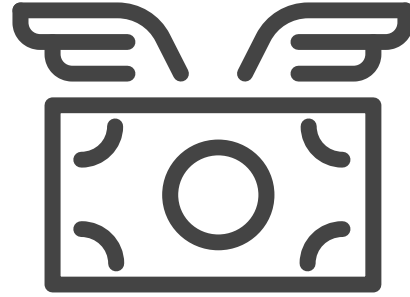
Pooled Money Investment Account Monthly Portfolio Composition ⁽¹⁾

06/30/23
\$178.4 billion



INVESTMENTS

LAIF	24,932,372.59	<u>D. 6</u>	C	-	24,932,372.59	24,544,111.07 <u>D. 7</u>
US Bank	4,441,399.46	<u>D. 9</u>	C	-	4,441,399.46	4,441,238.16
CAMP Pool	17,580,799.27	<u>D. 9</u>	D	-	17,580,799.27	17,580,799.27
Total cash and investment per bank					48,137,238.19	47,758,815.37
Total cash and investments per fund					47,758,977.00	47,758,977.00
Difference					378,261.19	(161.63) B



Common Mistakes and Questions

Common Mistakes & Questions

- Interest allocation is off; e.g., negative cash
- Do fair value adjustment entries always need to be recorded?
- Impairment valuation reported using cost-based measures
- External circumstances that negatively affect markets

POLLING QUESTION #4

**Do you feel more confident
in what you need to prepare for your auditors?**

- A. Absolutely
- B. I feel the same
- C. No, I am still confused

Questions?

Contact Heather



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