

Attachment HE-10 - TAB 7 Part 18 & Supplemental Item 7b: GASBS No. 53, Accounting and Financial Reporting for Derivative Instruments

Purpose

The purpose of GASBS No. 53 is to provide financial reporting standards for derivative instruments. GASBS No. 59, *Financial Instruments Omnibus*, GASBS No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions*, and GASBS No. 72, *Fair Value Measurement and Application*, include amendments to GASBS No. 53. Any reference to GASBS No. 53 in this document is referring to GASBS No. 53 as amended by GASBS No. 59, GASBS No. 64, and GASBS No. 72. Per GASBS No. 53 paragraph 19 the classification of derivative instruments depends on whether they represent an asset or liability and should be reported on the statement of net position.

Per GASBS No. 53 paragraph 20, derivative instruments should be measured at fair value*, except for fully benefit-responsive synthetic guaranteed investment contracts (SGICs). Changes in the fair value of investment derivative instruments, including derivative instruments that are determined to be an ineffective hedge, should be reported on the investment revenue line item. Changes in fair value of hedging derivative instruments (effective hedge) should be reported on either the deferred inflows of resources or deferred outflows of resources line items on the statement of net position. GASBS No. 53 paragraphs 67 and 79 provides guidance on the reporting and disclosures for SGICs.

Note*: GASBS No. 72 amended GASBS No. 53 and requires fair value to be determined consistent with the requirements of GASBS No. 72.

This document is provided for informational purposes and is not authoritative. HEIs must refer to GASBS No. 53 for reporting requirements. In addition, the Implementation Guide No. 2015-1 includes information on this statement.

Applicability

Higher Education Institutions (HEIs) are required to properly report any activity/balances related to this statement in their individually published financial statements as well as the financial statement template.

Attachment HE-10, Financial Statement Template, TAB 7 Part 18 is for HEIs to answer certain questions regarding this GASB statement.

Supplemental Item 7b is for HEIs that have derivative instruments as of June 30, 2016, to provide additional information/disclosures. This Supplemental Item 7b is an Excel file available on DOA's website after the Attachment HE-10.

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Definitions

Per GASBS No. 53 paragraph 7, a derivative instrument is defined as a financial instrument or other contract that has the following characteristics:

- Settlement factors
- Leverage
- Net settlement

GASBS No. 53 paragraphs 9 through 13* provide additional information on these characteristics. GASBS No. 53 paragraphs 63 to 66* provide additional information regarding a derivative instrument that is embedded in a financial instrument or contract.

Note*: GASBS No. 59 includes amendments to paragraphs 13 and 64.

Not applicable

Per GASBS No. 53 paragraphs 14 through 18** this statement **does not apply to the following**:

- 1) Normal purchases and normal sales contracts
- 2) Insurance contracts
- 3) Certain financial guarantee contracts
- 4) Certain contracts that are not exchange-traded

Refer to GASBS No. 53 for information regarding the scope and applicability of this statement.

Note **: GASBS No. 59 includes amendments to paragraphs 16 & 17.

**Overall
derivative
instrument
categories**

The following are overall categories of derivative instruments referred to in Attachment HE-10 – TAB 7 Part 18:

- Hedging derivative instrument – effective hedge
- Investment derivative instrument – ineffective hedge
- Investment derivative instrument*** – a) held primarily for the purpose of income or profit, and b) has a present service capacity based solely on its ability to generate cash or to be sold to generate cash
- Fully benefit-responsive SGICs

Note***: GASBS No. 72 amended the definition of investment derivative instrument.

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**Hedging
derivative
instrument –
effective hedge**

Per GASBS No. 53, a hedging derivative instrument is a derivative instrument that is associated with a hedgeable item and significantly reduces an identified financial risk by substantially offsetting changes in cash flows or fair values of the hedgeable item (see GASBS No. 53 paragraphs 28 to 30 for additional information on hedgeable items). Per GASBS No. 53 paragraph 27, a hedging derivative instrument exists if both of the following criteria are met:

- The derivative instrument is associated with a hedgeable item.
- The potential hedging derivative instrument is effective in significantly reducing the identified financial risk.

This overall category of derivative instruments will be referred in the Attachment HE-10 – TAB 7 Part 18 as a hedging derivative instrument – effective hedge.

**Potential
hedging
derivative
instrument**

A potential hedging derivative instrument represents a derivative instrument that is associated with a hedgeable item prior to the determination of whether the derivative instrument is effective in significantly reducing the identified financial risk.

**Effectiveness
evaluation
method**

A potential hedging derivative instrument must be evaluated to determine if it is a hedging derivative instrument – effective hedge **or** an investment derivative instrument – ineffective hedge at the end of a reporting period. GASBS No. 53 paragraphs 31 to 62 provide guidance on evaluating the effectiveness of a potential hedging derivative instrument. Some effectiveness evaluation methods are as follows:

- Consistent critical terms method
- Synthetic instrument method*
- Dollar offset method*
- Regression analysis method*

Note*: These represent quantitative methods. Per GASBS No. 53 paragraph 48 other quantitative methods may be used if they meet certain criteria.

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**Effectiveness
evaluation
method,
*continued***

First reporting period: GASBS No. 53 paragraph 31a states that if an institution uses the consistent critical terms method in the first reporting period and the potential hedging derivative instrument does not meet the effectiveness criteria, it must be evaluated using at least one quantitative method before concluding that it is ineffective. If a potential hedging derivative instrument is first evaluated using a quantitative method and does not meet the criteria for effectiveness, it may be evaluated using another quantitative method(s) before concluding that it is ineffective. If the potential hedging derivative instrument is determined to be effective, it is considered a hedging derivative instrument – effective hedge and in future years it must be re-evaluated to determine effectiveness. If the potential hedging derivative instrument is determined to be an ineffective hedge, it is considered an investment derivative instrument – ineffective hedge and will not have to be reevaluated for effectiveness in future years.

Second reporting period: Per GASBS No. 53 paragraph 31b, a hedging derivative instrument – effective hedge as of the end of the prior reporting period must be re-evaluated at the end of the current reporting period using the same method that was applied in the prior reporting period. If it is determined that the prior year’s hedging derivative instrument – effective hedge is no longer effective as of the end of the current reporting period, the institution may apply another method(s) before concluding that the hedging derivative instrument is no longer effective.

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**Financial
statement
template line
items**

Below is some general guidance on the reporting of derivative instruments on the financial statement template (FST) for the HEI:

Derivative Instrument – If the FST does not have a line item that properly classifies the derivative instrument, report the derivative instrument on the “Other Assets” or “Other Liabilities” FST line item and provide a description of the derivative instrument on the applicable Attachment HE-10 TAB 7 Parts 11a or 12a.

Changes in fair values: Hedging derivative instrument – effective hedge: The “Deferred Outflows of Resources” or “Deferred Inflows of Resources” FST line items are to report the change in fair values for derivative instruments that are an effective hedge.

Changes in fair values: Investment derivative instrument – ineffective hedge & investment derivative instrument – a) held primarily for the purpose of income or profit, and b) has a present service capacity based solely on its ability to generate cash or to be sold to generate cash: These changes in fair values should be reported on the “Investment Earnings” FST line item.

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**TAB 7
Part 18a**

Derivative instruments as of June 30, 2016: Attachment HE-10 – TAB 7 Part 18 is to provide information regarding derivative instruments. Part 18a is to indicate whether the HEI has a derivative instrument as of June 30, 2016. If yes, the overall category must be indicated as follows:

- Hedging derivative instrument – effective hedge
- Investment derivative instrument – ineffective hedge
- Investment derivative instrument – a) held primarily for the purpose of income or profit, and b) has a present service capacity based solely on its ability to generate cash or to be sold to generate cash
- Fully benefit-responsive synthetic guaranteed investment contracts (SGICs)

In addition, the notional amount and type (i.e., interest rate swaps, interest rate locks, commodity swaps, forward contracts, futures contracts, etc.) must be provided.

Note: If “yes” to Part 18a, Supplemental Information Item 7b must also be completed and submitted along with the Attachment HE-10 submission.

**TAB 7
Part 18b –
Parts 1, 2, 3**

Derivative instruments as of June 30, 2016 & existed as of June 30, 2015: **Part 18b Part 1** is to indicate whether a derivative instrument that existed as of June 30, 2016, and is listed in Part 18a existed as of June 30, 2015, also. If yes, provide a description of the derivative instrument. If no, skip to 18c.

Part 18b Part 2 is to indicate if the derivative instrument that existed as of June 30, 2016, and as of June 30, 2015, was an investment derivative instrument – ineffective hedge as of June 30, 2016, and was considered to be a hedging derivative instrument – effective hedge as of June 30, 2015. If no, skip to 18c.

If **Part 18b Part 2** is “yes”, **Part 18b Part 3** is to indicate whether the deferral amount (deferred inflows of resources or deferred outflows of resources) was reported within the Investment Earnings FST line item upon reclassification for FY 2016 (ineffective hedge as of June 30, 2016, and effective hedge as of June 30, 2015). If yes, the deferral amount that was reported within the Investment Earnings FST line item must be provided. If no, an explanation must be provided.

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**TAB 7
Part 18c**

Derivative instruments as of June 30, 2015, that ended or terminated during FY 2016:

Part 18c Part 1 is to indicate if a derivative instrument existed as of June 30, 2015, and did not exist as of June 30, 2016 (i.e., ended or terminated during FY 2016). If yes, provide the overall derivative instrument category and also provide the type and notional amount. If no, skip to Part 18d.

Part 18c Part 2* is to provide the following information if the hedging derivative instrument – effective hedge that existed as of June 30, 2015, ended or was terminated during FY 2016: type, notional amount, description of the hedged item, and termination event and/or reason the hedging derivative instrument – effective hedge was terminated or ended during FY 2016.

Part 18c Part 3* is to indicate if the termination of the hedging derivative instrument – effective hedge was properly reported on the financial statement template. If no, explain.

Note*: Part 18c Parts 2 & 3 would be left blank if Part 18c Part 1 was “no” or if Part 18c Part 1 was “yes” and the overall derivative instrument category was not a hedging derivative instrument – effective hedge.

**TAB 7
Part 18d**

Derivative instruments – activity only during FY 2016 – Part 18d is to indicate if the HEI had any other derivative instrument activity during fiscal year 2016 not already described in the previous parts. If yes, provide a description.

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**TAB 7
Part 18e**

Evaluation of Effectiveness – potential hedging derivative instruments as of June 30, 2016 – Part 18e is to indicate whether potential hedging derivative instruments as of June 30, 2016, were properly evaluated to determine effectiveness. If yes, provide a description of the method used to determine effectiveness. If no, explain.

Note: A “n/a” response would be reasonable under either of the following conditions:

- 1) The answer to Part 18a is “no.”
- 2) The answer to Part 18a is “yes” and the overall derivative instrument category is an investment derivative instrument – a) held primarily for the purpose of income or profit and b) has a present service capacity based solely on its ability to generate cash or to be sold to generate cash, or fully benefit-responsive SGICs.

**TAB 7
Part 18f**

Reporting: Part 18f is to confirm that the HEI’s derivative instrument activity/balances during FY 2016 and as of June 30, 2016, were properly reported on the financial statement template in accordance with GASBS No. 53. If no, an explanation must be provided.

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Supplemental information 7b- derivative instruments as of June 30, 2016

If the HEI answered “yes” to Attachment HE-10 – TAB 7 Part 18a, the supplemental information item 7b must be submitted along with the financial statement template. **Supplemental Information Item 7b is to provide more detailed information/disclosures on the derivative instruments that existed as of June 30, 2016.**

Part 1a) Below is some information to be provided for the following categories of derivative instruments: **hedging derivative instrument – effective hedge, investment derivative instrument – ineffective hedge, and/or investment derivative instrument – a) held primarily for the purpose of income or profit, and b) has a present service capacity based solely on its ability to generate cash or to be sold to generate cash:**

- Overall Category
- Type
- Notional \$
- \$ Change in fair value during FY 2016
- Financial Statement Template (FST) line item the change in fair value is reported*
- \$ fair value of derivative instrument as of June 30, 2016
- FST line item the fair value of the derivative instrument is reported on as of June 30, 2016
- Did implementation of GASBS No. 72 result in a change in the fair value of the derivative instrument reported as of June 30, 2015?
- Fair value disclosures required by GASBS No. 72 paragraphs 80 & 81

Note*: The FST line item for the FY 2016 change in fair value for the following categories should be “**Investment Earnings**”:

- Investment derivative instrument – ineffective hedge and/or
- Investment derivative instrument – a) held primarily for the purpose of income or profit, and b) has a present service capacity based solely on its ability to generate cash or to be sold to generate cash.

The FST line item for the FY 2016 change in fair value for the following category should be the applicable “**Deferred Inflows of Resources**” or “**Deferred Outflows of Resources**” FST line items:

- Hedging derivative instruments – effective hedges.
-

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**Supplemental
information 7b-
derivative
instruments as
of June 30,
2016
(continued)**

Parts 1b and 1c are to indicate if the HEI has a **fully benefit-responsive synthetic guaranteed investment contract (SGIC)** as of June 30, 2016, and to confirm that the SGIC was reported in accordance with GASBS No. 53 which states the combination of the underlying investments and the wrap contract should be reported at contract value. Also, footnote disclosures must be provided.

Part 1d is to indicate if there are any **contingent features** included in any derivative instrument as of June 30, 2016, and to provide disclosures of the contingent features.

Part 1e is to indicate if any derivative instrument as of June 30, 2016, is part of a **hybrid instrument (embedded derivative instrument and a companion instrument)** and to provide a description of the companion instrument.

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**Supplemental
information 7b-
hedging
derivative
instruments –
effective hedge**

Parts 1f, 1g, 1h, 1i are to provide the following information on **hedging derivative instruments – effective hedge** that existed as of June 30, 2016:

Part 1f:

- Objectives for entering into instrument
- Fair value hedge or cash flow hedge
- Reference rates
- Embedded options
- Date the hedging derivative instrument – effective hedge was entered into and when it is scheduled to terminate or mature
- Cash paid or received, if any, when a forward contract or swap (including swaptions) was entered into

Part 1g: Indicate if the hedged item is a bonds payable (institutional debt issued by the institution) that is reported on the Attachment HE-10 – TAB 5 – Part 4. Complete the **Hedged debt tab** for disclosure of future net cash flows required by GASBS No. 53.

Part 1h: Indicate if effectiveness was evaluated by a quantitative method not identified in GASBS No. 53 and provide disclosures required by GASBS No. 53 paragraph 75.

Part 1i: Identify what types of risks* as of June 30, 2016, the HEI is exposed to that could give rise to financial loss and provide disclosures as required by GASBS No. 53:

Note*: Below are the types of risks that are defined in GASBS No. 53:

- Credit risk
 - Interest rate risk
 - Basis risk
 - Termination risk
 - Rollover risk
 - Market access risk
 - Foreign currency risk
-

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**Supplemental
information 7b-
investment
derivative
instruments**

Part 1j: For investment derivative instruments (ineffective hedge or a) held primarily for the purpose of income or profit, and b) has a present service capacity based solely on its ability to generate cash or to be sold to generate cash) identify what types of the following risks as of June 30, 2016, the HEI is exposed to that could give rise to financial loss and provide disclosures as required by GASBS No. 53:

- Credit risk
 - Interest rate risk
 - Foreign currency risk
-

**Supplemental
information 7b-
Hedged debt
tab**

The **Hedged debt** tab is to provide the future principal and interest payments on the hedged debt as well as the hedging derivative instrument's net cash flows as required by GASBS No. 53 paragraph 74. This tab is also to provide a description and principal amount of the hedged debt.
