

## Chapter 5

### DEPOSITS AND INVESTMENTS

Depository and investment regulations for political subdivisions from Ohio Rev. Code Chapter 135 generally apply to all public offices other than to charter municipalities which have exempted themselves by charter or ordinance.<sup>1</sup> (See the OCS Legal Matrices Appendix for more specific guidance regarding the applicability of the requirements in this chapter to particular entity types.) Auditors should design audit procedures based on charter municipalities' own investment and deposit provisions. Provisions of Chapter 135 relating to counties are separate from those pertaining to other subdivisions.

<b>Compliance Requirements</b>	<b>Page</b>
<b>Chapter 5 - Deposits and Investments</b>	

#### Section A: Subdivisions other than counties

5-1	ORC 135.13, 135.14, 135.45, 133.03: Eligible investments for interim monies .....	2
5-2	ORC 135.14: Other requirements .....	8
5-3	ORC 135.142, 135.14(B)(7): Other eligible investments .....	11
5-4	ORC 135.18, 135.181: Security for repayment of public deposits .....	13
5-5	Article XII, Section 5a, Ohio Constitution; ORC 135.21 and 5705.10; 1982 Op. Atty. Gen. No. 82-031 and 7 CFR Part 210.02, 210.2, 210.5 and 210.14(a): Allocating interest among funds .....	16

#### Section B: County (and County Hospital) Requirements

5-6	ORC 135.34, 135.341: Investment advisory committee .....	18
5-7(a)	<u>ORC 135.35: Eligible investments</u> .....	20
5-7(b)	ORC 135.35: Other requirements .....	27
5-8	ORC 135.37: Security for repaying public deposits .....	30
5-9	Article XII, Section 5a, Ohio Constitution; ORC 135.21, 135.351 and 5705.10 & .131; 1982 Op. Atty. Gen. No. 82-031: Allocating interest among funds .....	31

#### Section C: Community Schools

5-10	Contractually imposed deposit and investment requirements .....	33
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#### Appendices:

##### A Federal agency guarantees

##### B Governmental Accounting Standards Board Statement No. 40: Disclosing policies the ORC mandates related to investment and deposit risks

<sup>1</sup> While charter governments can exempt themselves from RC 135, they cannot exempt themselves from Ohio constitutional requirements. Therefore charter governments cannot purchase equity securities, because Article VIII, Sections 4 and 6 of the Ohio Constitution prohibit public bodies from becoming a "stockholder in any joint stock company, corporation or association."

## Section A: Subdivisions Other Than Counties

**5-1 Compliance Requirement:** Ohio Rev. Code Section 135.14 and 133.03(A)(1) – Eligible investments for **interim** monies; section 135.13: **inactive** deposits and maturities.

**Summary of Requirements:**

- Investments must mature within 5 years from the settlement date, unless the investment is matched to a specific obligation or debt of the subdivision, or unless other provisions apply. [RC 135.14(D)]
- The following classifications of obligations are eligible for such investment or deposit:
  - United States obligations or any other obligation guaranteed as to principal and interest by the United States.<sup>2</sup> This law prohibits investing in stripped principal or interest obligations. [135.14(B)(1)]
  - Bonds, notes, debentures, or any other obligations or securities issued by any federal government agency or instrumentality. All federal agency securities must be direct<sup>3</sup> issuances of federal government agencies or instrumentalities. [135.14(B)(2)]
  - Interim deposits in the eligible institutions applying for interim monies as provided in Ohio Rev. Code § 135.08. [135.14(B)(3)]
    - Per 135.13, *Interim deposits* are certificates of deposit<sup>4</sup> maturing not more than one year from the deposit date, or savings or deposit accounts, including passbook accounts.
  - Bonds or other obligations of the State of Ohio. [135.14(B)(4)]
  - No-load money market mutual funds consisting exclusively of obligations described in (B)(1) or (2) of Ohio Rev. Code § 135.14 (i.e. the investments listed in the first two bullets above), and repurchase agreements secured by such obligations, provided the government purchases the money market mutual fund **only** through eligible institutions mentioned in Ohio Rev. Code § 135.03 (which are, generally, Ohio banks and national banks authorized to do business in Ohio). [135.14(B)(5)] Also, per RC 135.01(O)(2), these funds must have the highest letter or numerical rating provided by at least one nationally recognized standard rating service.

<sup>2</sup> See Appendix A for a list of agencies the Federal government guarantees.

<sup>3</sup> An example of an *indirect* issuance would be a FNMA CMO (collateralized mortgage obligation), where FNMA pools mortgages it guarantees. However, the mortgages are not a direct issuance of FNMA

<sup>4</sup> It is the position of the Auditor of State that RC Sections 135.03 & 135.32 prohibit purchasing certificates of deposit (negotiable or otherwise) from a bank unless the CD is subject to inspection by the Ohio Superintendent of Financial Institutions. Because the Superintendent inspects only banks domiciled in Ohio, purchasing CD's from out-of-state banks is illegal, unless the bank has an office in Ohio. Also, a government cannot purchase negotiable or nonnegotiable CDs unless the governing body has designated the bank as eligible to hold interim or inactive deposits. See ADAM 2002-05.

- The Ohio Subdivisions Fund (STAR Ohio) as provided in Ohio Rev. Code § 135.45. [135.14(B)(6)]
  - Chapter 133 securities (generally debt instruments Ohio State & local governments have issued) [RC 133.03].
- Per RC 135.14(E), the treasurer or governing board may also enter into a repurchase agreement with any **eligible institution** mentioned in Ohio Rev. Code § 135.03 or any **eligible dealer** pursuant to Ohio Rev. Code § 135.14(M). (Eligible institutions per RC 135.03 include national banks, or Ohio savings banks, but do not include credit unions, non Ohio savings banks or savings association. Eligible dealers per RC 135.14(M) are national association of securities dealers members (NASD), banks, savings bank, or savings and loan associations regulated by the superintendent of financial institutions, or institutions regulated by the comptroller of the currency, federal deposit insurance corporation, or board of governors of the federal reserve system.) In these agreements, the treasurer or governing board purchases, and such institution or dealer agrees unconditionally to repurchase any of the securities listed in division (B)(1) to (5) of § 135.18,<sup>5</sup> except letters of credit described in division (B)(2) are not permitted for repurchase agreements.
- The market value of securities subject to an overnight repurchase agreement must exceed the cash invested subject to the repurchase agreement by 2%. A term repurchase agreement may not exceed 30 days and must be marked to market daily.<sup>6</sup>
  - All securities purchased pursuant to a repurchase agreement are to be delivered into the custody of the treasurer or governing board or an agent designated by the treasurer or governing board.<sup>7</sup>
  - Repurchase agreements must be in writing. They must require that, for each transaction, the participating institution provide:
    - (a) the par value of the securities;
    - (b) the type, rate, and maturity date of the securities;
    - (c) a numerical identifier (e.g., a CUSIP number) generally accepted in the industry that designates the securities.

<sup>5</sup> Ohio Rev. Code § 135.18(B) (1) - (10) are summarized in Ohio Compliance Supplement Section 5-4.

<sup>6</sup> The dealer would be responsible for marking the securities, not the government.

<sup>7</sup> Counterparties (e.g. banks) accomplish this by maintaining a separate “customer” account at the Federal Reserve designated as a customer account. (For purposes of GASB 40, we currently believe securities held in a customer account would not be exposed to custodial risk.)

<sup>8</sup> Note: The ORC still uses the definition of a derivative taken from GASB Technical Bulletin 94-1. GASB Technical Bulletin 2003-1 now uses the FASB No. 133 definition of a derivative. So, for legal compliance purposes, governments must follow the ORC definition. For financial reporting, governments must follow the GASB definition. For example, an interest rate swap would be subject to GASBTB 2003-01 derivative disclosure requirements, but is **not** illegal.

- Agreements by which the treasurer or governing board agrees to sell securities owned by the subdivision to a purchaser and agrees with that purchaser to unconditionally repurchase those securities (i.e., *Reverse Repos*) are prohibited. [RC 135.14(E)]
- Derivative Investments are prohibited. *Derivative*<sup>8</sup> means a financial instrument or contract or obligation whose value or return is based upon or linked to another asset or index, or both, separate from the financial instrument, contract, or obligation itself. Any security, obligation, trust account, or other instrument that is created from an issue of the United States Treasury or is created from an obligation of a federal agency or instrumentality or is created from both is considered a derivative.
  - An eligible investment described in Ohio Rev. Code § 135.14 with a variable interest rate payment or single interest payment, based upon a single index comprised of other eligible investments provided for in division (B)(1) or (2) of § 135.14 (see above), is **not** a derivative, if the variable rate investment has a maximum maturity of 2 years. [RC 135.14(C)] (Therefore, an investment with a variable interest rate indexed to Federal securities would be legal. However, an investment indexed to the London Interbank Offered Rate (LIBOR) or to a bank's prime rate would not be legal.)
    - OAG Opinion 99-26 deemed collateralized mortgage obligations to be illegal derivatives.
    - A treasury inflation-protected security (TIPS) is permissible for counties only, per ORC 135.35 (B).
- Article VIII, Sections 4 and 6 of the Ohio Constitution prohibit public bodies from becoming a "stockholder in any joint stock company, corporation or association."
  - However, Article VIII, Section 6 of the Constitution provides an exemption which allows public bodies to purchase insurance from mutual insurance companies (Note that insured parties of mutual insurance companies become stockholders.).
  - The AOS also does not believe ORC 135 prohibits a government from **holding stock donated** to it. (However, considering the volatility of many equity securities, our management letter should recommend liquidating stock, if liquidation does not violate a trust or other agreement.)
- Per RC 135.14(F), a government cannot purchase an investment unless it reasonably expects to hold it until maturity. **NOTE:** We believe the intention of this section is to reduce the likelihood a government would suffer losses on early redemptions required due to inadequate cash flow planning. See the description of audit procedures for more information.
- Per RC 135.14(G), subdivisions may not pay interim moneys into an investment pool except:
  - The Ohio Subdivision's Fund (STAR Ohio) pursuant to § 135.14(B)(6).
  - A fund created solely to acquire, construct, own, lease, or operate municipal utilities pursuant to Ohio Rev. Code § 715.02 or Ohio Const. Art XVIII, §4.
- Leveraging (a government using its current investment assets as collateral for purchasing other investments) is prohibited. [RC 135.14(H)]
- Issuing taxable notes for arbitrage is prohibited. [RC 135.14(H)]

<p>➤ Governments cannot contract to sell securities not yet acquired (short sales), for the purpose of purchasing such securities on the speculation that their price will decline. [RC 135.14(H)]</p> <p>➤ Payment for securities may be made only upon delivery of the securities to the treasurer, governing board, or qualified trustees, or, if not represented by a certificate, only upon receipt of confirmation of transfer from the custodian. [RC 135.14(M)(2)]</p> <p>➤ Proceeds from refunding securities must be held in the debt service fund or in escrow, and shall be invested in direct obligations of or obligations guaranteed as to payment by the United States that mature or are subject to redemption by and at the option of the holder not later than the date or dates when the moneys, together with interest or other investment income accrued on those moneys, will be required to refund the debt. [RC 133.34(D)].</p> <p>➤ <u>Ohio Rev. Code § 135.13 requires depositing <i>inactive</i> funds in certificates of deposit maturing not later than the end of the depository designation period or by savings or deposit accounts, including, but not limited to, passbook accounts. (Chapter 7 includes a test of depository designations.)</u></p>		
In determining how the government ensures compliance, consider the following:	What control procedures address the compliance requirement?	W/P Ref.
<ul style="list-style-type: none"> <li>• Policies and Procedures Manuals</li> <li>• Knowledge and Training of personnel</li> <li>• Tickler Files/Checklists</li> <li>• Presence of an Effective Accounting System</li> <li>• Legislative and Management Monitoring</li> <li>• Management's identification of changes in laws and regulations</li> <li>• Management's communication of changes in laws and regulations to employees</li> </ul>		
<b>Suggested Audit Procedures – Compliance (Substantive) Tests</b>		
<p>Select a representative number of investments and:</p> <p>1. Read investment dealer confirmations* to determine if the investment is of a type authorized.</p> <p>* Note: Dealer confirmations are suitable evidence supporting the details (e.g. valuation, occurrence) of an investment at the time of purchase. However, it provides no evidence the government still owned the investment as of its fiscal year end. We require other evidence to support existence at year end. The audit program should include suitable existence steps.</p> <p>2. Determine that the investments mature within the prescribed limits (generally no later than 5 years, but 1 year for interim deposits in a certificate of deposit, or <i>other</i></p>		

<sup>9</sup> "Emergency" premature sales can result in losses. If inadequate cash flow planning contributed to the need to sell early, we should cite them. In other circumstances, a government may choose to redeem a security early at a loss in order to re-invest at a greater overall rate of return. We would not deem this latter circumstance to violate the intent of RC 135.14(F).

<p>periods for repurchase agreements, bankers' acceptances and commercial paper.)</p> <ol style="list-style-type: none"> <li>3. Inspect documentation supporting repurchase agreements and determine that: <ol style="list-style-type: none"> <li>a. The market values of securities exceed the principal values of securities subject to the overnight repurchase agreement by 2%.</li> <li>b. A term repurchase agreement did not exceed 30 days and the values of the securities were marked to market daily.</li> <li>c. Repurchase agreements were in writing, including the par value of the securities; the type, rate, and maturity date of the securities; and a numerical identifier.</li> </ol> </li> <li>4. <u>Read the prospectus for money market mutual funds with which the government has significant investment. Determine whether the prospectus limits investments to those authorized under RC 135.14(B)(1) &amp; (B)(2). (B)(1) &amp; (B)(2) describe Federally issued or insured securities. (B)(1) &amp; (B)(2) would not include, for example, reverse repos consisting of Federal securities or securities other states issue.</u></li> <li>5. <u>Determine whether money market mutual funds have the highest credit rating issued by one national ratings agency (such as that S&amp;P, Moody's or Fitch issues).</u></li> <li>6. <u>Regarding RC 135.14(F), scan investment records to determine whether the government is selling securities prior to maturity. If a significant number or amount of premature sales occurred because the government had an emergency need for cash, review the CFO's cash flow forecasts supporting that the government had reasonable support, at the time of purchase, that it could hold the security to maturity. <i>If there is inadequate cash flow planning,</i><sup>9</sup> cite this section. The noncompliance finding should also recommend the government improve its cash flow forecasting. The finding should also describe any losses the government suffered from these sales.</u></li> <li>7. <u>If the government hires an investment manager for all or a portion of its investments, obtain copies of investment summary reports the manager prepares.</u> <ol style="list-style-type: none"> <li>a. <u>Read the agreement between the manager and the government. Determine if the agreement (or the investment policy Step 5-2 describes) requires the manager to comply with all applicable RC 135 requirements. Maintain a copy or summary of the agreement in the permanent file.</u></li> <li>b. <u>Test selected investments from the reports for compliance with steps 1 – 5 above.</u></li> <li>c. <u>Scan purchases and sales to determine whether the manager sells securities prior to their maturity for other than an urgent need for cash.</u></li> <li>d. <u>(Note that for financial audit purposes, an investment manager may constitute a service organization under SAS 70 &amp; 92.)</u></li> </ol> </li> </ol>	
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Note: The steps above should normally be sufficient for most governments. Because we believe the risk of governments engaging in certain prohibited activities such as leveraging, short sales or arbitrage violations is low, there are no steps included to test these requirements. You should scan the other requirements in this step, and based on your knowledge of the government's investing activities, investigate them if evidence suggests the government may have materially violated these requirements.	
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<b>Audit implications (adequacy of the system and controls, and the direct and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, reportable conditions/material weaknesses, and management letter comments):</b>
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**5-2 Compliance Requirement:** Ohio Rev. Code Sections 135.14 – Other Requirements.**Summary of Requirements:**

- Per 135.14(O)(1), Investments or deposits under Section 135.14 cannot be made unless a written investment policy approved by the treasurer or governing board is on file with the Auditor of State, with the following two exceptions:
  - Per 135.14(O)(2), If a written investment policy is not filed with the Auditor of State, the treasurer or governing board can invest only in interim deposits, STAR Ohio, or no-load money market mutual funds.
  - Per 135.14(O)(3), A subdivision whose average annual portfolio of investments is \$100,000 or less need not file an investment policy, provided that the treasurer or governing board certifies to the Auditor of State that the treasurer or governing board will comply and is in compliance with the provisions of Section 135.01 to 135.21.
- Per 135.14(O)(1), The investment policy must be signed by:
  - All entities conducting investment business with the treasurer or governing board (except the Treasurer of State);
  - All brokers, dealers, and financial institutions, described in Section 135.14(M)(1), initiating transactions with the treasurer or governing board by giving advice or making investment recommendations;
  - All brokers, dealers, and financial institutions, described in Section 135.14(M)(1), executing transactions initiated by the treasurer or governing board.
- If any securities or certificates of deposit purchased are issuable to a designated payee or to the order of designated payee, the designated party is to be the treasurer and the treasurer's office.
- If the securities are registerable either as to principal and/or interest, then the securities are to be registered in the treasurer's name.
- The treasurer is responsible for safekeeping all the documents evidencing a deposit or investment. Any securities may be deposited for safekeeping with a qualified trustee as provided in Section 135.18 of the Revised Code.
- Except for investments in securities described in Section 135.14(B)(5) and (6) (no-load money funds, certain repos and STAR Ohio) and for investments by a municipal corporation in the issues of that municipal corporation, all investments must be made through:
  - members of the National Association of Securities Dealers, Inc. (NASD); or
  - institutions regulated by the Superintendent of Banks, Superintendent of Savings and Loan Associations, Comptroller of Currency, Federal Deposit Insurance Corporation, or Board of Governors of the Federal Reserve System.

<b>In determining how the government</b>	<b>What control procedures address the</b>	<b>W/P</b>
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ensures compliance, consider the following:	compliance requirement?	Ref.
<ul style="list-style-type: none"> <li>• Policies and Procedures Manuals</li> <li>• Knowledge and Training of personnel</li> <li>• Tickler Files/Checklists</li> <li>• Presence of an Effective Accounting System</li> <li>• Legislative and Management Monitoring</li> <li>• Management's identification of changes in laws and regulations</li> <li>• Management's communication of changes in laws and regulations to employees</li> </ul>		
<b>Suggested Audit Procedures – Compliance (Substantive) Tests</b>		
<p>Read the government's investment policy for the period.</p> <p>Inspect documentation that the policy was approved by the treasurer or governing board and is on file with the Auditor of State. <u>(We need not repeat this step every audit. Keep a copy in the permanent file, and inquire whether the government has amended the policy since the prior audit.)</u></p> <p>Inspect the policy for the requisite signatures:</p> <ul style="list-style-type: none"> <li>• All entities conducting investment business with the treasurer or governing board (except the Treasurer of State);</li> <li>• All brokers, dealers, and financial institutions initiating transactions with the treasurer or governing board by giving advice or making investment recommendations;</li> <li>• All brokers, dealers, and financial institutions executing transactions initiated by the treasurer or governing board.</li> <li>• Select a representative number of investments made by the entity and determine whether the investments are in accordance with the entity's investment policy as adopted by the entity's legislative body.</li> </ul> <p>Determine if the policy requires financial institutions, brokers and dealers to comply with RC 135. (There is no legal requirement to include this, but if the policy does not include this requirement, we should recommend the government amend their policy to require compliance.)</p> <p>If there is no written investment policy filed with the Auditor of State, scan the government's investment portfolio for the period to determine that it is composed solely of interim deposits, STAR Ohio, or no-load money market mutual funds, or that its average annual size is \$100,000 or less. Inspect documentation certifying that the treasurer or governing board will comply and is in compliance with the provisions of Sections 135.01 to 135.21. Inspect documentation that the certification was filed with the Auditor of State</p> <p>Select a representative number or amount of investments:</p> <ul style="list-style-type: none"> <li>• Inspect purchase documents and determine that investments were made only through members of NASD, or institutions regulated by the Superintendent of Banks, Superintendent of Savings and Loan Associations, Comptroller of Currency, Federal Deposit Insurance Corporation, or Board of Governors of the Federal Reserve System.</li> </ul>		

<ul style="list-style-type: none"><li>• For certificates of deposit, inspect documentation that any designated payee is the treasurer or treasurer's office; and that the CDs are in the treasurer's name.</li></ul>	
<b>Audit implications (adequacy of the system and controls, and the direct and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, reportable conditions/material weaknesses, and management letter comments):</b>	

**5-3 Compliance Requirements:** Ohio Rev. Code Section 135.142 (school districts), 135.14(B)(7) (other subdivisions) – Additional investments allowable for subdivisions other than counties.

**Summary of Requirements:** Ohio Compliance Supplement Section 5-1 identifies certain investments that are eligible for **interim** monies. In addition to those investments, subdivisions can invest interim monies as follows:

- Up to twenty-five per cent of interim moneys available for investment in either of the following [135.142(A) for school districts; 135.14(B)(7) for other subdivisions]:

**Commercial paper** notes issued by an entity defined in section 1705.01(D), Revised Code (see definition below) and that has assets exceeding five hundred million dollars, to which all the following apply

- A. The notes are rated at the time of purchase in the highest classification established by at least two nationally recognized standard rating services.
- B. The aggregate value of the notes does not exceed ten per cent of the aggregate value of the outstanding commercial paper of the issuing corporation.
- C. The notes mature not later than one hundred eighty days after purchase.

**Bankers acceptances** of banks insured by the FDIC and to which both of the following apply:

- A. The obligations are eligible for purchase by the Federal Reserve System.
  - B. The obligations mature not later than one hundred eighty days after purchase.
- Boards of education must authorize the treasurer to invest in commercial paper or bankers acceptances by a 2/3 majority vote. [135.142(A)] (Once authorized, the authorization remains effective unless the policy changes. Therefore, we need not test this every audit. We should maintain documentation of the approval in the permanent file.)
  - “Entity” means any of the following [1705.01(D)]:
    - A. A for profit corporation existing under the laws of this state or any other state;
    - B. Any of the following organizations existing under the laws of this state, the United States, or any other state:
      - i. A business trust or association;
      - ii. A real estate investment trust;
      - iii. A common law trust;
      - iv. An unincorporated business or for profit organization, including a general or limited partnership;
      - v. A limited liability company.

In determining how the government ensures compliance, consider the following:	What control procedures address the compliance requirement?	W/P Ref.
<ul style="list-style-type: none"> <li>• Policies and Procedures Manuals</li> </ul>		

<ul style="list-style-type: none"> <li>• Knowledge and Training of personnel</li> <li>• Presence of an Effective Accounting System</li> <li>• Legislative and Management Monitoring</li> <li>• Management's identification of changes in laws and regulations</li> <li>• Management's communication of changes in laws and regulations to employees</li> </ul>		
<b>Suggested Audit Procedures – Compliance (Substantive) Tests</b>		
<ol style="list-style-type: none"> <li>1. Inspect dealer confirmations of the commercial paper notes purchased and determine that the entity has maintained related documentation that the:               <ol style="list-style-type: none"> <li>a. Commercial paper was rated in the highest classification by two standard rating services.</li> <li>b. The paper mature not later than 180 days after purchase.</li> </ol> </li> <li>2. Inspect dealer confirmations of the bankers acceptances purchased and determine that the entity has maintained related documentation that the:               <ol style="list-style-type: none"> <li>a. Banks are insured by the Federal Deposit Insurance Corporation</li> <li>b. Dealer confirmations should indicate if banker's acceptances were <b>NOT</b> eligible for purchase by the Federal Reserve System. Read the confirmation to determine whether the banker's acceptance was <b>ineligible</b>. (A statement of ineligibility would indicate an <b>ineligible</b> investment, per RC 135.142(A) for school districts or 135.14(B)(7) for other non-county entities.</li> <li>c. The acceptances mature not later than 180 days after purchase</li> </ol> </li> <li>3. For school districts, assure the permanent file documents the resolution authorizing the treasurer to invest in commercial paper and / or bankers acceptances.</li> </ol>		
<b>Audit implications (adequacy of the system and controls, and the direct and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, reportable conditions/material weaknesses, and management letter comments):</b>		

<b>Minor revision per HB 524, effective June 28, 2002</b>
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**5-4 Compliance Requirements:** Ohio Rev. Code Sections 135.18 (specific collateral) and 135.181 (pooled collateral) – Security for repaying public deposits.

**Summary of Requirements:** The treasurer of a political subdivision must require the depository to provide security equal to the funds on deposit at all times. Security may consist of federal deposit insurance, surety company bonds, or pledged securities. [Section 135.18].

*Depositories may pledge the following securities under the subsections of Section 135.18(B) listed below:*

- (1) Bonds, notes, or other obligations of the United States; or bonds, notes, or other obligations guaranteed as to principal and interest by the United States or those for which the faith of the United States is pledged for the payment of principal and interest thereon, by language appearing in the instrument specifically providing such guarantee or pledge and not merely by interpretation or otherwise;
- (2) Bonds, notes, debentures, letters of credit, or other obligations or securities issued by any federal government agency, or instrumentality, or the export-import bank of Washington; bonds, notes, or other obligations guaranteed as to principal and interest by the United States or those for which the full faith of the United States is pledged for the payment of principal and interest thereon, by interpretation or otherwise and not by language appearing in the instrument specifically providing such guarantee or pledge;
- (3) Obligations of or fully insured or fully guaranteed by the United States or any federal government agency or instrumentality;
- (4) Obligations partially insured or partially guaranteed by any federal agency or instrumentality;
- (5) Obligations of or fully guaranteed by the Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, Federal Farm Credit Bank, or Student Loan Marketing Association;
- (6) Bonds and other obligations of this state;
- (7) Bonds and other obligations of any county, township, school district, municipal corporation, or other legally constituted taxing subdivision of this state, which is not at the time of such deposit, in default in the payment of principal or interest on any of its bonds or other obligations, for which the full faith and credit of the issuing subdivision is pledged.
- (8) Bonds of other states of the United States which have not during the ten years immediately preceding the time of such deposit defaulted in payments of either interest or principal on any of their bonds;
- (9) Shares of no-load money market mutual funds consisting exclusively of obligations described in division (B)(1) or (2) of Section 135.18 [these sections are (1) & (2), above] and repurchase agreements secured by such obligations.

- (10) A surety bond issued by a corporate surety licensed by the state and authorized to issue surety bonds in this state pursuant to Chapter 3929 of the Revised Code, and qualified to provide surety bonds to the federal government pursuant to 96 Stat. 1047 (1982), 31 U.S.C.A. 9304.

By written notice to the treasurer, an institution designated as a public depository may designate a qualified trustee<sup>10</sup> and deposit the eligible securities required by this section with the trustee for safekeeping for the account of the treasurer (and the institution). In this case, the treasurer accepts the trustee's written receipt describing the securities which have been deposited with the trustee by the public depository. All such securities so deposited with the trustee are deemed to be pledged and deposited with the treasurer. [Section 135.18(D)].

Any federal reserve bank<sup>11</sup> or branch located in this state or Federal Home Loan Bank is qualified to act as trustee for the safekeeping of securities.

Any institution mentioned in Section 135.03 is qualified to act as trustee for the safekeeping of securities, other than those belonging to itself, under this section.

### **135.181**

In lieu of the specific pledging requirements of Section 135.18, a public depository at its option may pledge a single pool of eligible securities to secure the repayment of all its public deposits not otherwise secured, provided that at all times the total market value of the securities so pledged is at least equal to one hundred five per cent of its total public deposits to be secured by the pooled securities, including the portion of these deposits covered by any federal deposit insurance.

The securities described in division (B) of section 135.18 (described above), shall be eligible as collateral, provided no such securities pledged as collateral are at any time in default as to either principal or interest.

A public depository must designate a qualified trustee (i.e., the Federal Reserve) and deposit the eligible pledged securities with that trustee for safekeeping. The depository must give written notice of the qualified trustee to any treasurer depositing public monies for which such securities are pledged. The treasurer shall accept the written receipt of the trustee describing the pool of securities so deposited by the depository. [Section 135.181(E)].

Upon request of a treasurer up to 4 times per year, a *public depository* must report: the amount of public monies deposited by the treasurer and secured and the total value based on the valuations described above, of the pool of securities pledged to secure public monies held by the depository, including those deposited by the treasurer [section 135.181(L)].

Upon request of a treasurer up to 4 times per year, a *qualified trustee* must report the total value of the securities pool deposited with it by the depository and provide an itemized list of pooled securities. The trustee must make these reports as of the date the treasurer specifies.

<sup>10</sup> All securities eligible as collateral are book-entry only and held at the Federal Reserve. Therefore, by holding the securities at the Federal Reserve, the financial institution is complying with RC 135.18(D).

<sup>11</sup> The Federal Reserve Bank of Cleveland sometimes uses the Boston Federal Reserve Bank for safekeeping. We do not deem this arrangement to violate this provision.

In determining how the government ensures compliance, consider the following:	What control procedures address the compliance requirement?	W/P Ref.
<ul style="list-style-type: none"> <li>• Policies and Procedures Manuals</li> <li>• Knowledge and Training of personnel</li> <li>• Presence of an Effective Accounting System</li> <li>• Legislative and Management Monitoring</li> <li>• Management's identification of changes in laws and regulations</li> <li>• Management's communication of changes in laws and regulations to employees</li> </ul>		
<b>Suggested Audit Procedures – Compliance (Substantive) Tests</b>		
<ul style="list-style-type: none"> <li>• Compare depository balances to the amount of pledged securities and other depository collateral during the audit period, noting maximum amounts on deposit at any time. Calculate (or inspect, if available, the government's calculations) if legal security equaled or exceeded depository balances.</li> <li>• Inspect the financial institution's listing of pledged securities. Select a few securities and determine if the institution pledged only eligible securities. (When determining the extent of testing, auditors should consider that we do not require a high level of assurance, so a "few" items should be sufficient. Auditors can reduce or eliminate this testing based on the assessed level of control risk* and past experience with the financial institution. Therefore, if the government documents its review of collateral eligibility, or we have not noted eligibility problems in prior audits, we can reduce or eliminate this test.)</li> </ul> <p>* "Control risk" in this context refers to the <i>government's</i> controls, if any, over reviewing their financial institutions' collateral lists. The AOS has no basis for assessing a financial institution's control risk.</p>		
<b>Audit implications (adequacy of the system and controls, and the direct and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, reportable conditions/material weaknesses, and management letter comments):</b>		

**5-5 Compliance Requirements:** Article XII, Section 5a, Ohio Constitution; Ohio Rev. Code Sections 135.21, 5705.10 and 5705.131; 1982 Op. Atty Gen. No. 82-031, and 7 CFR Part 210.2, 210.5, and 210.14(a) – Allocating interest among funds.

**Summary of Requirements:** The distribution of interest earned on monies held for the treasuries of other subdivisions (i.e. as fiscal agent or custodian) is generally subject to Ohio Rev. Code Sections 135.21 and 5705.10, although specific exceptions may exist. As a general rule:

- Interest earned on monies deposited by a treasurer which do not belong in the treasury of the subdivision, due to their status as custodial funds,<sup>12</sup> because he is acting as ex officio treasurer, or otherwise, generally must be apportioned to the funds to which the principal belongs. [RC 135.21]

All other interest earned must be credited to the general fund of the subdivision [RC 135.21], with the **following exceptions:**

- Interest earned on money derived from a motor vehicle license or fuel tax must follow the principal. [Article XII, Section 5a, Ohio Const. and 1982 Op. Atty Gen. No. 82-031.
- Federal regulations may require local governments to credit interest earned on federal money to the fund to which the principal belongs. 7 CFR Part 210.2, 210.5, and 210.14(a)
- Interest earned on principal of a non-expendable trust fund<sup>13</sup> established to receive donations or contributions that the donor or contributor requires to be maintained intact must be credited to the non-expendable trust fund to which the principal belongs. [Section 5705.131].

**School District Exceptions:**

- The board of education of any school district may adopt a resolution requiring the treasurer of the district to credit the earnings made on the investment of the principal of the moneys specified in the resolution to the fund from which the earnings arose, or any other fund of the district as the board specifies in its resolution. [Section 3315.01(A)].

This procedure does not apply to the earnings made on the investment of a school district's bond retirement fund, the sinking fund, a project construction fund established pursuant to Sections 3318.01 to 3318.20 of the Revised Code (see school Classroom Facilities Assistance Program requirements in OCS Chapter 2), or the payments districts receive from the school foundation program. [Section 3315.01(B)].

- All investment earnings of a school district project construction fund shall be credited to the fund. After the project has been completed:  
 (A) Any investment earnings remaining in the project construction fund attributable to the school district's contribution to the fund shall be transferred to the district's maintenance fund required by division (B) of Section 3318.05 of the Revised Code, and the money shall be used

<sup>12</sup> Custodial funds include all fiduciary funds.

<sup>13</sup> For accounting purposes, funds this RC section describes would now be permanent funds or private-purpose trust funds under GASB 34.



solely for maintaining the classroom facilities included in the project. [RC 3318.12(C)(1)]

(B) Any investment earnings remaining in the project construction fund that are attributable to the state's contribution to the fund shall be transferred to the state commission for expenditure pursuant to RC 3318.01 to 3318.20. [RC 3318.12(C)(2)]

- All revenue, as defined in 7 CFR 201.2, received by or accruing to the food service fund of any school district including but not limited to, children's payments, earnings on investments, and other local revenues should be credited to and used by those funds. (7 CFR 210.2, 210.5 and 210.14 (a)).

**Cemetery Exception:**

- Interest earned on a cemetery bequest fund is credited to that fund. [RC 5705.10]

**Library Exception:**

- The board of library trustees of any free public library district may adopt a resolution requiring the treasurer of the district to credit the earnings made on the investment of the principal of the moneys specified in the resolution to the fund from which the earnings arose or any other fund of the district as the board specifies in its resolution. [RC 3375.391]
- This does not apply to the earnings made on the investment of any library bond retirement fund or any sinking fund. [RC 3375.391]

In determining how the government ensures compliance, consider the following:	What control procedures address the compliance requirement?	W/P Ref.
<ul style="list-style-type: none"> <li>• Policies and Procedures Manuals</li> <li>• Knowledge and Training of personnel</li> <li>• Tickler Files/Checklists</li> <li>• Presence of an Effective Accounting System</li> <li>• Legislative and Management Monitoring</li> <li>• Management's identification of changes in laws and regulations</li> <li>• Management's communication of changes in laws and regulations to employees</li> </ul>		
<b>Suggested Audit Procedures – Compliance (Substantive) Tests</b>		
Trace a representative selection of interest earned during the fiscal year and determine that it was paid into the proper funds.		
<b>Audit implications (adequacy of the system and controls, and the direct and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, reportable conditions/material weaknesses, and management letter comments):</b>		

## Section B: County and County Hospital Requirements

The provisions of Chapter 135, Ohio Rev. Code, relating to counties (~~and county hospitals~~) are in separate sections from the provisions relating to all other subdivisions. However, in most cases the requirements are very similar.

**5-6 Compliance Requirement:** Ohio Rev. Code Sections 135.34, 135.341 – Investment advisory committee; county commissioners’ review of investment policies.

**Summary of Requirements:**

Ohio Rev. Code Section 135.341(A) establishes in each county a county investment advisory committee of 3 members:

- 2 county commissioners; and
- the county treasurer

The board of county commissioners *may* declare that all 3 county commissioners shall serve on the county investment advisory committee. If the board so declares, the county investment advisory committee consists of 5 members:

- the 3 county commissioners;
- the county treasurer; and
- the clerk of court of common pleas of the county

The committee elects its own chair, and committee members receive no additional compensation. [135.341(B)]

The committee must meet at least once every 3 months to review or revise its policies and to advise the investing authority (generally the county treasurer) on county investments, with the objective of ensuring the best and safest return of funds to the county. Any member of the committee, upon giving 5 days’ notice, may call a committee meeting. The committee’s policies may establish a limit on the period of time that moneys may be invested in any particular type of investment. [135.341(C)]

The committee is authorized to retain the services of an investment advisor, provided that the advisor is registered with the Securities and Exchange Commission and possesses public funds investment management experience, specifically in the area of state and local government investment portfolios, or the advisor is an eligible institution mentioned in Section 135.03. [135.341(D)]

The committee shall act as the investing authority in place of the treasurer for purposes of investing county funds and managing the county portfolio when this authority is transferred to it pursuant to divisions (E)(1) and (F)(2) of section 321.46 of the Revised Code or when ordered to do so by a court pursuant to section 321.47 of the Revised Code. For these purposes, the committee shall retain the services of an investment advisor described in division (D) of this section. [135.341(E)]

The board of county commissioners may semiannually review investment procedures of the investing authority. Whenever such reviews indicate that the investing authority has failed to invest inactive monies of the county as provided by law or in “documented substantial, material, and continuing” disregard of the advice or policies of the investment advisory committee, the board notifies the investing authority of its findings. If at the next review it determines that such procedures have not been corrected, the board may designate, by resolution, a different investing authority. This may include the board of county commissioners, one of its members, or one of its employees. Thereafter,

until rescinded by resolution of the board, the investing authority is as designated by the board.  
[Section 135.34]

All or part of the moneys determined not to be necessary to meet current county hospital demands may be invested by the hospital trustees in any classifications of securities eligible for deposit or investment of county moneys pursuant to RC 135.35, subject to the approval of the board's written investment policy by the county investment advisory committee established pursuant to RC 135.341.  
[RC 339.06]

In determining how the government ensures compliance, consider the following:	What control procedures address the compliance requirement?	W/P Ref.
<ul style="list-style-type: none"> <li>• Policies and Procedures Manuals</li> <li>• Knowledge and Training of personnel</li> <li>• Tickler Files/Checklists</li> <li>• Presence of an Effective Accounting System</li> <li>• Legislative and Management Monitoring</li> <li>• Management's identification of changes in laws and regulations</li> <li>• Management's communication of changes in laws and regulations to employees</li> </ul>		
<b>Suggested Audit Procedures – Compliance (Substantive) Tests</b>		
<p>Read minutes and records of the county investment advisory committee and determine that the committee is meeting at least quarterly and has established written county investment policies.</p> <p>Obtain a copy of the written investment policies established by the committee. Examine a representative selection of investment transactions to determine whether the investing authority is complying with the committee's policies.</p> <p>Inquire (or read minutes) as to the results of any quarterly reviews of the county investment procedures by the board of county commissioners and determine whether appropriate action was taken by the board.</p>		
<b>Audit implications (adequacy of the system and controls, and the direct and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, reportable conditions/material weaknesses, and management letter comments):</b>		

**Revisions per OAG Opinion 99-026, SB 82 (effective 6/12/04); and per HB 168 (effective 6/15/04).**

**5-7 (a) Compliance Requirements:** Ohio Rev. Code Section 135.35- Eligible Investments for inactive county money (county hospitals may invest in these same securities, per RC 339.06).

**Summary of Requirements:**

- Investments must mature within 5 years from the date of settlement unless the investment matches a specific obligation or debt, and the investment advisory committee specifically approves it.
- The following classifications of securities and obligations are eligible for deposit or investment:
  - United States obligations or any other obligation guaranteed as to principal or interest by the United States, or any book entry, zero-coupon United States treasury security that is a direct obligation of the United States. [RC 135.35(A)(1)]
  - Stripped principal or interest obligations are not permitted. Except, Federally-issued or Federally-guaranteed stripped principal or interest obligations are permitted. [RC 135.35(A)(1)]
  - Bonds, notes, debentures, or any other obligations or securities issued by any federal government agency or instrumentality. All federal agency securities must be direct issuances of federal government agencies or instrumentalities. [RC 135.35(A)(2)]
  - Time certificates of deposit<sup>14</sup> or savings or deposit accounts, including passbook accounts, in any eligible institution mentioned in Section 135.32. [RC 135.35(A)(3)]
  - Bonds and other obligations of this state or the political subdivisions of this state provided that such political subdivisions are located wholly or partly within the same county as the investing authority. [RC 135.35(A)(4)]
  - No-load money market mutual funds consisting exclusively of obligations described in Section 135.35(A)(1) or (2) (see above), or repurchase agreements secured by such obligations, if purchased from eligible institutions mentioned in Section 135.32 (generally, **Ohio** banks and national banks authorized to do business in Ohio. [RC 135.35(A)(5)]\*
  - No-load money market mutual funds if rated in the highest category at the time of purchase by at least one nationally recognized standard rating service and invested exclusively in:

<sup>14</sup> It is the position of the Auditor of State that RC Sections 135.03 & 135.32 prohibit purchasing certificates of deposit (negotiable or otherwise) from a bank unless the CD is subject to inspection by the Ohio Superintendent of Financial Institutions. Because the Superintendent inspects only banks domiciled in Ohio, purchasing CD's from out-of-state banks is illegal, unless the bank has an office in Ohio.

- United States treasury bills, notes, bonds, or any other obligations or securities issued by the United States treasury or any other obligation guaranteed as to principal and interest by the United States, Bonds, notes, debentures, or any other obligations or securities issued by any federal government agency or instrumentality or corporate commercial paper rated in the highest category by two ratings agencies (i.e. securities RC 135.143(A)(1), (2) or (6) permits);
- Bonds, notes, debentures, or any other obligations or securities issued by any federal government agency or instrumentality; Commercial paper issued by any corporation incorporated under the laws of the United States or a state, which notes are rated at the time of purchase in the two highest categories by two nationally recognized rating agencies [RC 135.35(A)(10)]\*

**\* Note:** RC 135.35(A)(5) and (A)(10) are similar. (A)(5) permits buying money market mutual funds which invest in repurchase agreements, but does not authorize commercial paper, and requires purchasing the fund through a bank. (A)(10) permits buying money market mutual funds which invest in commercial paper but does not authorize repurchase agreements. (A)(10) also permits purchasing a mutual fund through a bank or through a broker dealer. A county can follow either or both sections.

- The Ohio Subdivision's Fund (STAR Ohio) as provided in Section 135.45. [RC 135.35(A)(6)]
- Securities lending agreements with any eligible institution mentioned in Section 135.32 that is a member of the Federal Reserve System or Federal Home Loan Bank, or with any recognized U.S. government securities dealer,<sup>15</sup> under the terms of which agreements in the investing authority lends securities and the eligible institution agrees to simultaneously exchange either similar securities described in Section 135.35(A)(1) or (2) or cash or both securities and cash, equal value for equal value. [RC 135.35(A)(7)]
- Up to twenty-five per cent of the county's total portfolio in either of the following [RC 135.35(A)(8)]:

<sup>15</sup> ORC 135.35(J)(1) defines these security dealers as being "members of the national association of securities dealers, through a bank, savings bank, or savings and loan association regulated by the superintendent of financial institutions, or through an institution regulated by the comptroller of the currency, federal deposit insurance corporation, or board of governors of the federal reserve system."

<sup>16</sup> As of the date this OCS was issued, we are aware the United States does not recognize the following nations: Cuba, Bhutan, Iran, North Korea, Sudan, Somalia, and the Republic of China (Taiwan).

<sup>17</sup> Ohio Compliance Supplement Step 5-4 summarizes Ohio Rev. Code § 135.18(B)(1) to (10).

<sup>18</sup> Counterparties (e.g. banks) accomplish this by maintaining a separate "customer" account at the Federal Reserve designated as a customer account. (For purposes of GASB 40, we currently believe securities held in a customer account would not be exposed to custodial risk.)

<sup>19</sup> Note: The ORC still uses the definition of a derivative taken from GASB Technical Bulletin 94-1. GASB Technical Bulletin 2003-1 now uses the FASB No. 133 definition of a derivative. So, for legal compliance purposes, governments must follow the ORC definition. For financial reporting, governments must follow the GASB definition.

**Commercial paper** issued by an “entity” that is defined in division (D) of section 1705.01 of the Revised Code (see definition below) and that has assets exceeding five hundred million dollars, to which notes all of the following apply:

- The aggregate value of the notes does not exceed ten per cent of the aggregate value of the outstanding commercial paper of the issuing corporation.
- The notes are rated at the time of purchase in the highest classification established by at least two nationally recognized standard rating services.
- The notes mature not later than ~~180~~ 270 days after purchase.

**Bankers acceptances** of banks that are insured by the federal deposit insurance corporation and to which both of the following apply:

- The obligations are eligible for purchase by the Federal Reserve System.
- The obligations mature not later than one hundred eighty days after purchase.

No investment shall be made in commercial paper or bankers acceptances unless the treasurer or governing board has completed additional training for making those investments. The type and amount of additional training shall be approved by the auditor of state and may be conducted by or provided under the supervision of the auditor of state.

“Entity” means any of the following [RC 1705.01(D)]:

1. A for profit corporation existing under the laws of this state or any other state;
  2. Any of the following organizations existing under the laws of this state, the United States, or any other state:
    - i. A business trust or association;
    - ii. A real estate investment trust;
    - iii. A common law trust;
    - iv. An unincorporated business or for profit organization, including a general or limited partnership;
    - v. A limited liability company.
- Per ORC 135.35(A)(9), up to fifteen per cent of the county’s total average portfolio in notes issued by corporations incorporated under U.S. law and that operate within the United States, or by depository institutions doing business under U.S. authority or any state’s authority, and that operate within the United States, provided both of the following apply:
    - The notes are rated in one of the two highest categories by at least two nationally recognized standard rating services at the time of purchase;
    - The notes mature not later than two years after purchase.
  - Per ORC 135.35(A)(11) up to 1% of its portfolio in the debt of foreign nations, if:
    - Rated at the time of purchase in the three highest categories by two nationally recognized standard rating services
    - The U.S. government recognizes it diplomatically.<sup>16</sup>

- All interest and principal shall be denominated and payable in United States funds.
- The foreign government guarantees the debt.
- The debt matures within five years of purchase.
- The investing authority may also enter into a written repurchase agreement with any eligible institution mentioned in Ohio Rev. Code Section 135.32 or any eligible dealer pursuant to Ohio Rev. Code Section 135.35(J), under the terms of which agreement the investing authority purchases, and the eligible institution or dealer agrees unconditionally to repurchase any of the securities listed in divisions (B)(1) to (5) of § 135.18, except letters of credit described in division (B)(2) are not permitted for repurchase agreements <sup>17</sup>. The market value of securities subject to an overnight repurchase agreement must exceed the principal value of securities subject to a repurchase agreement by 2%. A term repurchase agreement may not exceed 30 days and the value of the securities must be marked to market daily. [RC 135.35(D)]
  - All securities purchased pursuant to a repurchase agreement are to be delivered into the custody of the investing authority or the qualified custodian of the investing authority or an agent designated by the investing authority. <sup>18</sup> [RC 135.35(D)]
  - Repurchase agreements with an eligible securities dealer must be transacted on a delivery versus payment basis.
  - Repurchase agreements must be in writing. For each transaction, the participating institution must provide:
    1. the par value of the securities;
    2. the type, rate, and maturity date of the securities;
    3. a numerical identifier (e.g., a CUSIP number), generally accepted in the industry, designating the securities.
  - Securities which are the subject of a repurchase agreement may be delivered to the treasurer or held in trust by the participating institution if it is a designated depository of the subdivision for the current period of designation. [135.35(I)].
- Agreements by which the investing authority agrees to sell securities owned by the county to a purchaser and agrees with that purchaser to unconditionally repurchase those securities (*Reverse Repos*) are prohibited.
- Investment in derivatives is prohibited. A *derivative*<sup>19</sup> is a financial instrument or contract or obligation whose value or return is based upon or linked to another asset or index, or both, separate from the financial instrument, contract, or obligation itself. Any security, obligation, trust account, or other instrument that is created from an issue of the United States Treasury or is created from an obligation of a federal agency or instrumentality or is created from both is considered a derivative.
  - \* An eligible investment described in Ohio Rev. Code Section 135.14 with a variable interest rate payment or single interest payment, based upon a single index comprised of other eligible investments provided for in division (A)(1) or (2) of Section 135.35, is **not** a derivative, if the variable rate investment has a maximum maturity of 2 years.
  - \* OAG Opinion 99-26 deemed collateralized mortgage obligations to be derivatives.

<p>* <u>A treasury inflation-protected security (TIPS) shall not be considered a derivative for counties, provided the security matures not later than five years after purchase (RC 135.35(B)).</u></p> <p>➤ Per 135.35(E): No investing authority can invest under Section 135.35, unless the investment authority reasonably expects that the investment can be held until its maturity. The investing authority's written investment policy should specify the conditions under which an investment may be redeemed or sold prior to maturity.</p> <p>➤ Per 135.35(F), no investing authority may pay a county's inactive moneys, or moneys of a county library and local government support fund, into an investment pool <i>other than</i>:</p> <ul style="list-style-type: none"> <li>the Ohio Subdivision's Fund (STAR Ohio) pursuant to Section 135.35(A)(6)</li> <li>a fund created solely for the purpose of acquiring, constructing, owning, leasing, or operating municipal utilities pursuant to Ohio Rev. Code Section 715.02 or Ohio Const. Art XVIII, Section 4.</li> </ul> <p>➤ A county may not leverage its investments. (That is, a county cannot use its current investments as collateral to purchase other investments.) [RC 135.35(G)]</p> <p>➤ A county cannot issue taxable notes for arbitrage purposes. [RC 135.35(G)] (That is, a county cannot invest the proceeds of taxable notes hoping to earn a higher return on the proceeds than the interest rate on the TAN.)</p> <p>➤ A county cannot contract to sell securities it does not own. (These are called <i>short sales</i>, where a county purchases the rights to a security solely on the speculation that its price will decline.) [RC 135.35(G)]</p> <p>➤ Payment for investments shall be made only upon the delivery of securities representing such investments to the treasurer, investing authority, or qualified trustee. If the securities transferred are not represented by a certificate, payment shall be made only upon receipt of confirmation of transfer from the custodian by the treasurer, governing board, or qualified trustee. [135.35(J)(2)]</p>		
<b>In determining how the government ensures compliance, consider the following:</b>	<b>What control procedures address the compliance requirement?</b>	<b>W/P Ref.</b>
<ul style="list-style-type: none"> <li>Policies and Procedures Manuals</li> <li>Knowledge and Training of personnel</li> <li>Tickler Files/Checklists</li> <li>Presence of an Effective Accounting System</li> <li>Legislative and Management Monitoring</li> <li>Management's identification of changes in laws and regulations</li> <li>Management's communication of changes in laws and regulations to employees</li> </ul>		
<b>Suggested Audit Procedures – Compliance (Substantive) Tests</b>		
<p>Select a representative number of investments and:</p> <ol style="list-style-type: none"> <li>1. Read investment dealer confirmations* to determine if the investment is of a type authorized.</li> </ol>		



\* Note: Dealer confirmations are suitable evidence supporting the details (e.g. part of the valuation [cost] and occurrence assertions) of an investment at the time of purchase. However, it provides no evidence the county still owned the investment as of its fiscal year end. We require other evidence to support existence at year end. The audit program should include suitable existence steps.

2. Determine that the investments mature within the prescribed limits (generally no later than 5 years, or **other** periods for repurchase agreements [30 days], bankers acceptances and commercial paper [180 or 270 days, respectively, from the purchase date], or securities matched to debt maturities, etc.)
3. Inspect documentation supporting repurchase agreements and determine that:
  - a. The market values of securities exceed the principal values of securities subject to the overnight repurchase agreement by 2%.
  - b. A term repurchase agreement did not exceed 30 days and the values of the securities were marked to market daily.
  - c. Repurchase agreements were in writing, including the par value of the securities; the type, rate, and maturity date of the securities; and a numerical identifier.
4. For investments in Bankers Acceptances and Commercial Paper Notes, inspect documentation and determine whether the additional training was received.
5. Read the prospectus for money market mutual funds with which the government has significant investments. Determine whether the prospectus limits investments to those authorized under RC 135.35(A)(1) & (A)(2) or 135.143(A)(1), (2) or (6).
6. Determine whether mutual funds, commercial paper, and any notes of U.S. corporations have the necessary credit rating issued by national ratings agencies (such as that S&P, Moody's or Fitch issues).
7. Inspect dealer confirmations of the bankers acceptances purchased and determine that the county has maintained related documentation that the:
  - a. Banks are insured by the Federal Deposit Insurance Corporation
  - b. Dealer confirmations should indicate if banker's acceptances were **NOT** eligible for purchase by the Federal Reserve System. Read the confirmation to determine whether the banker's acceptance was **ineligible**. (A statement of ineligibility would indicate an **ineligible** investment, per RC 135.35(A)(8)(b)(i).
8. Scan the county's computation of the composition of its investments. Determine if the portfolio contains ≤:
  - a. 1% foreign national securities
  - b. 15% debt of U.S. corporations
  - c. 25% commercial paper + bankers acceptances
9. Scan investment records to determine whether the county is selling securities prior to maturity. If a significant number or amount of premature sales occurred:
  - a. Determine whether the premature sales complied with the county's policy regarding early redemption. (We believe the policy should generally require sufficient cash flow planning to support that the county had sufficient cash at the time of purchase so that a premature sale would not

<p>be needed to meet emergency cash flow needs. Forced premature sales often result in losses.)</p> <p>b. Review the county's cash flow forecasts supporting that the county had reasonable support at the time of purchase that it could hold the security to maturity. If there is inadequate cash flow planning necessitating premature sales, cite this section and recommend the government improve its cash flow forecasting. The finding should also describe any losses the government suffered from these sales.</p> <p>Note: The steps above should normally be sufficient for most counties. Because we believe the risk of counties engaging in certain prohibited activities such as leveraging, short sales or arbitrage violations is low, there are no steps included to test these requirements. You should scan the other requirements in this step, and based on your knowledge of the county's investing activities, investigate them if evidence suggests the county may have materially violated these requirements.</p>	
<p><b>Audit implications (adequacy of the system and controls, and the direct and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, reportable conditions/material weaknesses, and management letter comments):</b></p>	

**5-7 (b) Compliance Requirements:** Ohio Rev. Code Section 135.35 – Other County and County Hospital [RC 339.06] Requirements.

**Summary of Requirements:**

- Investment or deposit under Section 135.35 cannot be made unless a written investment policy approved by the investing authority (for hospitals, the authority is the county hospital board, per RC 339.06) is on file with the Auditor of State. If a written investment policy is not filed with the Auditor of State, the investing authority may invest only in certificates of deposit, savings or deposit accounts, STAR Ohio, or no-load money market mutual funds.
- The investment policy must be signed by:
  - All entities conducting investment business with the investing authority (except the Treasurer of State);
  - All brokers, dealers, and financial institutions, described in Section 135.35(J)(1), initiating transactions with the investment authority by giving advice or making investment recommendations;
  - All brokers, dealers, and financial institutions, described in Section 135.35(J)(1), executing transactions initiated by the investing authority.
- An investment made by the investing authority pursuant to Section 135.35 prior to September 27, 1996 that was a legal investment under the law before September 27, 1996 may be held until maturity. If the investment does not have a maturity date, it may be held until September 27, 2001, regardless of whether the investment would qualify as a legal investment under the terms of Section 135.35 as amended.
- The investing authority is required to inventory all obligations and securities. The inventory includes a description of each obligation or security, including type, cost, par value, maturity date, settlement, date, and any coupon rate.
- The investing authority is required to keep a complete record of all purchases and sales of the obligations and securities.
- The investing authority is required to keep a monthly portfolio report and issue a copy of the monthly report describing its investments to the county investment advisory committee. This report indicates:
  - the current inventory of all obligations and securities,
  - all transactions during the month that affected the inventory,
  - any income received from the obligations and securities, and
  - any investment expenses paid.
  - The names of any persons executing transactions on behalf of the investing authority.
- The inventory and the monthly portfolio report are public records and must be filed with the board of county commissioners.

- Any securities, certificates of deposit, deposit accounts, or any other documents evidencing deposits or investments must be issued in the name of the county with the county treasurer as the designated payee. [Section 135.35(H)].
- If any such deposits or investments are registerable as to principal and/or interest, they must be registered in the name of the treasurer. [Section 135.35(H)].
- The investing authority is responsible for safekeeping documents evidencing a deposit or investment. Securities and documents confirming the purchase of securities under any repurchase agreement may be deposited with a qualified trustee. [135.35(I)].
- Where securities, including securities which are the subject of a repurchase agreement, have been delivered to a qualified trustee for safekeeping, the qualified trustee must report on request to the treasurer, governing board, Auditor of State, or authorized IPA as to the identity, market value, and location of the document evidencing each security.
- All investments in securities except investments described in division (A) (5) and (6) [no load money market mutual funds and certain repos] are required to be made through
  - members of the National Association of Securities Dealers, Inc., or
  - institutions regulated by the Superintendent of Banks, Superintendent of Savings and Loan Associations, Comptroller of the Currency, Federal Deposit Insurance Corporation, or Board of Governors of the Federal Reserve System. [135.35(J)(1)].
- Payment for securities may be made only upon delivery of the securities to the treasurer, investing authority, or qualified trustee, or, if in book-entry form, only upon confirmation of delivery to such parties. [135.35 (J)(2)]

In determining how the government ensures compliance, consider the following:	What control procedures address the compliance requirement?	W/P Ref.
<ul style="list-style-type: none"> <li>• Policies and Procedures Manuals</li> <li>• Knowledge and Training of personnel</li> <li>• Tickler Files/Checklists</li> <li>• Presence of an Effective Accounting System</li> <li>• Legislative and Management Monitoring</li> <li>• Management's identification of changes in laws and regulations</li> <li>• Management's communication of changes in laws and regulations to employees</li> </ul>		
<b>Suggested Audit Procedures – Compliance (Substantive) Tests</b>		
<p>Read the county's investment policy for the period.</p> <p>Inspect documentation that it was filed with the Auditor of State. Inspect the policy for the requisite signatures:</p> <ul style="list-style-type: none"> <li>• All entities conducting investment business with the county (except the Treasurer of State);</li> <li>• All brokers, dealers, and financial institutions initiating transactions with the county by giving advice or making investment recommendations;</li> </ul>		

<ul style="list-style-type: none"> <li>• All brokers, dealers, and financial institutions executing transactions initiated by the county.</li> <li>• Select a representative number of investments made by the entity and determine whether the investments are in accordance with the county's investment policy as adopted by the county's legislative body.</li> </ul> <p>Determine if the policy requires financial institutions, brokers and dealers to comply with RC 135. (There is no legal requirement to include this, but if the policy does not include this requirement, we should recommend the government amend their policy to require compliance.)</p> <p>If there is no written investment policy filed with the Auditor of State, scan the county's investment portfolio for the period to determine that it is composed solely of certificates of deposit, savings or deposit accounts, STAR Ohio, or no-load money market mutual funds.</p> <p>Select a representative number or amount of investments and:</p> <ul style="list-style-type: none"> <li>• Inspect documentation that any designated payee is the treasurer or treasurer's office; and that registerable securities are registered in the treasurer's name.</li> <li>• Inspect purchase documents and determine that investments were made through appropriate parties: members of the National Association of Securities Dealers, Inc., or institutions regulated by the Superintendent of Banks, Superintendent of Savings and Loan Associations, Comptroller of the Currency, Federal Deposit Insurance Corporation, or Board of Governors of the Federal Reserve System. Compare purchase dates and payments and determine that payment for securities was made upon delivery of the securities or upon receipt of confirmation of transfer from the custodian.</li> <li>• Inspect copies of the investing authority's (i.e. treasurer's) inventory documents: scan the documents and determine if it appears the inventory includes a description of each obligation or security, including type, cost, par value, maturity date, settlement, date, and any coupon rate; the inventory reflects a complete record of all purchases and sales of the obligations and securities; and that the county is keeping a monthly portfolio report and is issuing a quarterly investment report describing its investments to the county investment advisory committee.</li> </ul>	
<p><b>Audit implications (adequacy of the system and controls, and the direct and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, reportable conditions/material weaknesses, and management letter comments):</b></p>	

**5-8 Compliance Requirement:** Ohio Rev. Code Section 135.37 – Security for repaying county (and county hospital) public deposits.

**Summary of Requirement:** Depository security requirements for county (and county hospital) monies parallel the requirements of other governmental entities pursuant to RC 135.18. RC 135.37(F) expressly permits counties to follow the pool collateral requirements of RC 135.181. See Ohio Compliance Supplement Section **5-4** for more information.

In determining how the government ensures compliance, consider the following:	What control procedures address the compliance requirement?	W/P Ref.
<ul style="list-style-type: none"> <li>• Policies and Procedures Manuals</li> <li>• Knowledge and Training of personnel</li> <li>• Tickler Files/Checklists</li> <li>• Presence of an Effective Accounting System</li> <li>• Legislative and Management Monitoring</li> <li>• Management's identification of changes in laws and regulations</li> <li>• Management's communication of changes in laws and regulations to employees</li> </ul>		
<b>Suggested Audit Procedures – Compliance (Substantive) Tests</b>		
See Ohio Compliance Supplement Section 5-4.		
<b>Audit implications (adequacy of the system and controls, and the direct and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, reportable conditions/material weaknesses, and management letter comments):</b>		

**5-9 Compliance Requirements:** Article XII, Section 5a, Ohio Constitution; Ohio Rev. Code Sections 135.351 and 5705.10 & .131; and 1982 Op. Atty Gen. No. 82-031, – Allocating interest among county funds.

**Summary of Requirements:** Ohio Rev. Code Sections 135.351(A) and 5705.10 govern the distribution of interest earned on money in the county treasury. Generally, all interest must be credited to the county general fund. The following are exceptions to this general rule:

- Ohio Rev. Code Section 135.351(B) establishes requirements for distributing monies belonging to other subdivisions which are invested or deposited by the county. If such monies are not distributed as required in divisions (B) (1), (2), or (3), Section 135.351(C) requires that all interest accruing after the required distribution date be paid to the subdivisions.
- Interest earned on money derived from a motor vehicle license or fuel tax must be paid into the fund to which the principal belongs, not to the general fund. Article XII, Section 5a, Ohio Constitution; 1982 Op. Atty Gen. No. 82-031.
- Federal statutory or regulatory requirements may require that interest earned on monies received from the federal government be paid into the fund to which the principal belongs. This must be determined on an individual basis with each federal program.
- Interest earned on money in the county treasury belonging to a metropolitan park district established under Chapter 1545, Ohio Rev. Code, must be paid into the fund to which the principal belongs. [RC 1545.22(B)(1), as referenced from 135.351(A)].
- Interest earned on the investment of monies in the county library and local government support fund must be credited to that fund [Section 135.352].
- Interest earned on principal of a non-expendable trust fund<sup>20</sup> established to receive donations or contributions that the donor or contributor requires to be maintained intact must be credited to the non-expendable trust fund to which the principal belongs. [Section 5705.131].

In determining how the government ensures compliance, consider the following:	What control procedures address the compliance requirement?	W/P Ref.
<ul style="list-style-type: none"> <li>• Policies and Procedures Manuals</li> <li>• Knowledge and Training of personnel</li> <li>• Tickler Files/Checklists</li> <li>• Presence of an Effective Accounting System</li> <li>• Legislative and Management Monitoring</li> <li>• Management's identification of changes in laws and regulations</li> <li>• Management's communication of changes in laws and regulations to employees</li> </ul>		
<b>Suggested Audit Procedures – Compliance (Substantive) Tests</b>		

<sup>20</sup> For accounting purposes, funds the RC describes in this section would now be *permanent funds* or *private-purpose trust funds* under GASB 34.

Trace a representative selection of interest earned during the fiscal year and determine that it was paid into the proper funds.	
<b>Audit implications (adequacy of the system and controls, and the direct and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, reportable conditions/material weaknesses, and management letter comments):</b>	



## Section C: Community Schools

**5-10 Compliance Requirements:** Pursuant to RC 3314.04, ORC 135 does not apply to community schools. However, other entities may impose restrictions on investments, collateral, etc. Such entities could be grantors, creditors, the sponsor, board policy, etc. Auditors should identify and list any applicable requirements below:

*[Insert applicable depository and investment requirements.]*

In determining how the government ensures compliance, consider the following:	What control procedures address the compliance requirement?	W/P Ref.
<ul style="list-style-type: none"> <li>• Policies and Procedures Manuals</li> <li>• Knowledge and Training of personnel</li> <li>• Tickler Files/Checklists</li> <li>• Presence of an Effective Accounting System</li> <li>• Legislative and Management Monitoring</li> <li>• Management's identification of changes in laws and regulations</li> <li>• Management's communication of changes in laws and regulations to employees</li> </ul>		
<b>Suggested Audit Procedures – Compliance (Substantive) Tests</b>		
<i>[Insert applicable audit procedures. See other OC S Sections for example audit procedures.]</i>		
<b>Audit Implications (adequacy of the system and controls, and the direct and material effects of non-compliance, effects on the audit opinions and/or footnote disclosures, reportable conditions/material weaknesses, and management letter comments):</b>		

## Appendix A Federal Agencies

<b>Discount notes</b>	<b>US Govt. Guaranteed?</b>
Fed Farm Credit Banks ..... (Instrumentality)	No
FNMA (Fannie Mae) ..... (Instrumentality)	No
Fed Home Loan Bank ..... (Instrumentality)	No
<b>Variable Rate Notes</b>	
Student Loan Marketing Assn (Sally Mae) ..... (Instrumentality)	Not directly
Small Business Administration ..... (Agency)	Face value + int.
Agency for International Development ..... (Agency)	Face value + int.
<b>Coupon Securities</b>	
FNMA (Fannie Mae) ..... (Instrumentality)	No
Fed Home Loan Bank ..... Instrumentality)	No
Bank for Co-ops ..... (Instrumentality)	No
Federal Land Banks ..... (Instrumentality)	No
World Bank ..... (International Agency)	No
Private Export Funding Corp ..... (Instrumentality)	No
<b>Mortgage pass-through securities</b>	
GNMA (Ginny Mae) ..... (Agency)	Principal + int.
FHLMC (Freddie Mac) ..... (Instrumentality)	No

This information is from GFOA's *Investing Public Funds*, Page 115. It describes many of the agencies with which governments invest. If a government invests with an agency not on this list, the financial statement preparer and the auditor need another source to determine whether the Federal government insures the agency's securities.

## Appendix B

### Governmental Accounting Standards Board Statement No. 40

Policies the ORC mandates related to investment and deposit risks

GASB 40 is effective for financial statement periods beginning after June 15, 2004. The GASB encourages early adoption. Paragraph 6 requires governments to *briefly* describe policies related to the following risks for deposits and investments, *if* the government has instruments exposed to those risks:

<u>Risk</u>	<u>Deposits</u>	<u>Investments</u>
Credit		✓
Custodial credit	✓	✓
Concentration of credit		✓
Interest rate		✓
Foreign currency	✓	✓

The 2004 GASB *Comprehensive Implementation Guide* (the CIG) question 1.20 implies the Ohio Revised Code is a source of policies requiring GASB 40 disclosure. A summary of ORC requirements related to GASB 40 follows.

The ORC is not the only source of potential policies requiring disclosure. For example, locally adopted policies and charter provisions may also contain policies requiring disclosure. Financial statement preparers must read GASB 40 and should refer to the CIG for more information when preparing GASB 40 disclosures.

<b>ORC section</b>	<b>OCS Step</b>	<b>Requirement</b>	<b>Related GASB 40 Risk</b>
135.14 135.35(A)(10)	5-1 5-7(a)	Per RC 135.01(O)(2), no load money market funds must have the highest credit rating issued by national raters. (Note: Per Imp. Guide Q. 1.40, governments should disclose the rating for mutual funds even if the fund limits investments to obligations the U.S. government guarantees, since it is the fund's rating that is of concern, not its underlying investments.)	Credit risk
135.14 135.35(C)	5-1 5-7a	Investments generally must mature within 5 years of purchase.	Interest rate
135.14& 135.35	5-1 5-7(a)	Repurchase agreements cannot exceed 30 days.	Interest rate
135.35(C) 135.13	5-7a 5-1	<ul style="list-style-type: none"> <li>CDs counties purchase must mature within 5 years.</li> <li>CDs other subdivisions purchase must mature as follows: <ul style="list-style-type: none"> <li>Interim CDs: within one year.</li> <li>Inactive CDs: No later than the expiration of the depository agreement.</li> </ul> </li> </ul> <p>Note: Only negotiable CDs are <i>investments</i> subject to disclosing policies related to interest rate risk. (Nonnegotiable CDs are deposits.)</p>	Interest rate
135.14 & 135.35	5-1 5-7(a)	The market value of securities for repurchase agreements must exceed the principal value by $\geq 2\%$ .	Interest rate
135.14& 135.35	5-1 5-7(a)	Repurchase agreement securities must be delivered into the custody of the treasurer or governing board or an	Custodial credit

		agent.	
135.45(B)(1)	(Tested by the State Region)	STAR Ohio must maintain the highest letter or numerical rating provided by at least one nationally recognized standard service.	Credit
135.14 & 135.142	5-3	Commercial paper + bankers acceptances cannot exceed 25% of a government's investment portfolio	Concentrations of credit
135.14 & 135.35	5-3 5-7(a)	Commercial paper must be rated in the highest classification by at least two nationally-recognized rating services	Credit
135.14 & 135.35	5-3 5-7(a)	Commercial paper and bankers' acceptances must mature within 180 days. (270 days for a county's commercial paper.)	Interest rate
135.18 & 135.181	5-4, 5-8	Depositories must collateralize deposits.	Custodial credit
135.35	5-7(a)	A county's corporate debt investments must mature within 2 years of purchase.	Interest rate
135.35	5-7(a)	A county's corporate debt investments cannot exceed 15% of its investment portfolio	Concentrations of credit
135.35	5-7(a)	A county's corporate debt investments must be rated in 1 of the 2 highest categories by 2 ratings organizations.	Credit
135.35	5-7(a)	A county's foreign debt investments must mature within 5 years of purchase.	Interest rate
135.35	5-7(a)	A county's foreign debt investments cannot exceed 1% of its investment portfolio	Concentrations of credit
135.35	5-7(a)	A county's foreign debt investments must be rated in 1 of the 3 highest categories by 2 ratings organizations.	Credit
135.13, 135.14 & 135.35	5-1, 5-3, 5-7a	Authorized investments	*

\* Note: In additions to the risk-related policies above, GASB Codification I 50.124 still requires disclosing investments the ORC (or other legal or contractual provisions) authorize. The asterisked ORC Sections / OCS steps list authorized investments.