

<b>OREGON ACCOUNTING MANUAL</b>		Number 15.20.00.PO
Oregon Department of Administrative Services State Controller's Division	<b>Policy</b>	Effective Date August 28, 2003
Chapter	<b>Accounting and Financial Reporting</b>	.1 OF .3
Part	<b>Derivative Securities</b>	
Section		Approval  Signature on file at SCD

Authority [ORS 291.015](#)  
[ORS 293.590](#)  
Governmental Accounting Standards Board (GASB) Technical Bulletin No. 2003-1

### Purpose

- .101 This policy defines derivative instruments and financial statement disclosure requirements for derivatives. It applies to all state agencies that have derivative securities and are thereby required to report derivative securities for both agency and statewide financial reporting purposes.

### Description of Derivative Instruments

- .102 A derivative instrument is a financial instrument or other contract with all three of the following characteristics:
- a. It has (1) one or more underlyings and (2) one or more notional amounts or payment provisions or both. Those terms determine the amount of the settlement and in some cases whether or not settlement is required.
  - b. It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.
  - c. Its terms require or permit net settlement, it can readily be settled net by a means outside the contract, or it provides for delivery of an asset that puts the recipient in a position not substantially different from net settlement.
- .103 An underlying is a specified interest rate, security price, foreign exchange rate, index of prices or rates, or other variable (including the occurrence or nonoccurrence of a specified event such as a scheduled payment under a contract). An underlying may be a price or rate of an asset or liability but is not the asset or liability itself.

A notional amount is a number of currency units, shares, bushels, pounds, or other units specified in the contract. The settlement of a derivative instrument with a notional amount is determined by interaction of the notional amount and the underlying. The interaction may be simple multiplication or it may involve a formula with leverage factors or other constants.

- .104 Net settlement – a contract fits the description of paragraph .102c if its settlement provisions meet one of the following criteria:
- a. Neither party is required to deliver an asset that is associated with the underlying and that has a principal amount, stated amount, face value, number of shares, or other denomination that is equal to the notional amount (or the notional amount plus a premium or minus a discount). For example, most interest rate swaps do not require that either party deliver interest-bearing assets with a principal amount equal to the notional amount of the contract.
  - b. One of the parties is required to deliver an asset of the type described in paragraph .104a, but there is a market mechanism that facilitates net settlement; for example, an exchange that offers a ready opportunity to sell the contract or to enter into an offsetting contract.
  - c. One of the parties is required to deliver an asset of the type described in paragraph .104a, but that asset is readily convertible to cash or is itself a derivative instrument. An example of that type of contract is a forward contract that requires delivery of an exchange-traded equity security. Even though the number of shares to be delivered is the same as the notional amount of the contract and the price of the shares is the underlying, an exchange-traded security is readily convertible to cash.
- .105 Examples of financial instruments that are derivative instruments are:
- Futures contracts
  - Forward contracts that contain net settlement provisions
  - Option contracts
  - Interest rate and currency swaps
  - Other financial instruments with similar characteristics

## Reporting Requirements

- .106 Disclosures are required if an agency has violated legal, regulatory, or contractual provisions by using, holding, or writing (selling) certain derivatives.
- .107 The following disclosures are required for derivatives that are not reported at fair value on the statement of net assets:
- a. The objective of the derivative.
  - b. Significant terms of the transaction, including:
    - Notional, face, or contract amount;
    - Underlying indexes or interest rates, including terms such as caps, floors, or collars;
    - Options embedded in the derivatives;
    - The date when the derivative became effective and when it is scheduled to terminate or mature; and
    - The amount of cash paid or received when the derivative was initiated.
  - c. Fair value of the derivative at the reporting date and the method and significant assumptions used to estimate fair value, if based on other than quoted market prices.
  - d. Associated debt.
  - e. Exposure to the following risks:
    - Credit risk – the risk that another party to a transaction will not fulfill its obligations.

- Interest rate risk – the risk that changes in interest rates will adversely affect the fair values of a government's financial instruments or a government's cash flows.
- Basis risk – the risk that arises when variable interest rates on a derivative and an associated bond or other interest paying financial instrument are based on different indexes.
- Termination risk – the risk that a derivative's unscheduled end will affect a government's asset/liability strategy or will present the government with potentially significant unscheduled termination payments to the counterparty.
- Rollover risk – the risk that a derivative associated with a government's debt does not extend to the maturity of that debt. When the derivative terminates, the associated debt will no longer have the benefit of the derivative.
- Market-access risk – the risk that a government will not be able to enter credit markets or that credit will become more costly.

.108 The Oregon State Treasury will report derivative instruments at fair value on year end investment information provided to agencies with designated investments. Treasury will work with affected agencies and Statewide Accounting and Reporting Services if the additional disclosures in paragraph .107 are necessary.