Government Finance Officers Association

August 21, 2014

Mr. David R. Bean  
Director of Research and Technical Activities  
Project No. 26-5E  
Governmental Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

Dear Mr. Bean:

We are writing to you on behalf of the Government Finance Officers Association (GFOA) in response to the Governmental Accounting Standards Board’s (GASB) exposure draft (ED) on Fair Value Measurement and Application. This response was prepared jointly by the GFOA’s standing Committees on: 1) Accounting, Auditing, and Financial Reporting (CAAFR); 2) Retirement and Benefits Administration (CORBA); and 3) Treasury and Investment Management (TIM).

Overview

The GFOA generally supports the GASB’s proposals on fair value measurement and its application for financial statements prepared using the economic resources measurement focus and the accrual basis of accounting. We also support the proposed application of fair value to certain investments reported in governmental funds, but not to the extent proposed in the ED. While we generally support fair value measurement regardless of the measurement focus we believe that there is an opportunity to reduce the scope of investments that are subject to the fair value reporting requirement. The GFOA supports the proposed exceptions to fair value reporting, but encourages additional exceptions for certain investments that are not likely to change in value as a result of market fluctuations.

In addition, the GFOA believes the GASB should lessen the proposed volume of required note disclosure and that some of the clarifications offered in the “basis for conclusions” section of the ED should be incorporated into the text of the final standard to avoid potential misunderstandings and misapplications.

Specific Recommendations

Application of “fair value.” In our response to the preliminary views (PV) document, we asked the board to specify which liabilities would need to be reported at fair value. The board addressed those concerns by providing a clarification in the “basis for conclusions” section of ED. We believe that nothing short of incorporating this clarification into the text of the final standard will be adequate to avoid misunderstandings and misapplications. Accordingly, we urge the GASB to include language similar to that found in paragraph B43 of the “basis for conclusions”:

…The scope of this project related to the application of fair value is limited to assets and liabilities that are currently measured at fair value (emphasis added) and investments that are not measured at fair value…..

into paragraph 1 and/or paragraph 2 of the final standard.
Furthermore, we believe that including a derivative instrument in a liability position in Illustration 5, **Disclosures** (example 2, **Defined Benefit Pension Plan**) would greatly enhance the value of that illustration by offering a clear example of the type of liability a government should report at fair value.

**Transaction costs.** We very much appreciate the discussion included in the “basis for conclusions” about transaction costs. That discussion essentially alleviates the concern we expressed in our response to the PV regarding the potential inappropriate treatment of transaction costs.

During our reconsideration of this issue we took a second look at the definition of **transaction costs**. The ED defines the term in the context of the sale of an asset or the transfer of a liability (exit-price focus), but does not clearly address transaction costs associated with the **acquisition** of an investment (entry price focus). Accordingly, we believe that the final standard should clarify that transaction costs related to the acquisition of investments should be reported in the period in which they are incurred, rather than included as part of the cost of the investment. We take this position because it is not likely that a buyer will include in what they are willing to pay to acquire an investment (i.e., fair value) an amount relating to the transaction costs that the seller incurred upon their acquisition of the investment.

**Definition of “investment”**. In our response to the PV, we indicated that we agreed with the proposed definition of an **investment**. Based on comments received from other respondents, the board ultimately chose to delete the last words of that definition (“or to procure services for the citizenry”). We believe that nothing is lost by deleting those words and support the change.

We also suggested in our response to the PV that the definition of an investment could benefit from additional clarification/guidance on how to distinguish assets held as investments from assets held to provide service, especially in the case of real estate. We appreciate the clarification that the board provided in the “basis for conclusions” of the ED. However, we believe that the clarification needs to be incorporated into the text of the standard itself. We also suggest the final standard clearly indicate that a mixed-use/multi-use asset must be reported either as a capital asset or as an investment, rather than reporting a portion of its value in each category.

**Investment measurement.** We agree that investments generally should be measured at fair value and that the current exceptions to fair value reporting should be retained. However, we remain persuaded that the board needs to create an additional exception for certain investments held in “matched positions” (matching maturities), meaning that investment maturity dates are structured to provide resources, as needed, to liquidate specific liabilities (examples include lawsuits with a structured settlement and prize payouts for lottery winners). In our view, it is essentially meaningless to report investments at fair value if constraints, legal or otherwise, prevent their liquidation for any purpose other than to generate the resources needed to pay off the associated liability. Indeed, the GASB applied essentially the same logic to justify the exception made for nonparticipating investment contracts. Accordingly, we believe the statement that all debt securities reported as assets should be reported at fair value should be removed from the text of the final standard. We also believe the discussion in the “basis for conclusions” should elaborate on the types of assets in matched positions that would not meet the definition of an investment (and thus would not need to be fair valued) including an indication whether the type of assets held (e.g., annuity contracts vs. debt securities) affects that determination.

In addition, one existing exception is not included in paragraph 69 as investments that do not need to be reported at fair value. Specifically, the exception from GASB Statement No. 31, **Certain Investments and External Investment Pools**, which allows external investment pools to report short-term debt investments (remaining maturity of 90 days or less at fiscal year end) at amortized cost, is absent. We believe that existing exception should be included in the final statement.
Finally, we do appreciate the increased discussion about inputs, even though the board did not adopt our suggestion to eliminate the hierarchy of inputs. We believe the additional guidance on inputs will be of real assistance to financial statement preparers in using the three levels of inputs to determine fair value.

**Note disclosure.** We appreciate the changes made to the required disclosures from what was proposed in the PV. The elimination of the quantitative information about unobservable inputs and information about the sensitivity of the fair value of investments will undoubtedly reduce the volume of disclosure, although we are still concerned about the volume of the disclosure that remains. In particular, we are concerned about the disclosure requirements of paragraph 78a3, 4, and 5.

Entities with large investment portfolios (employee benefit plans, endowment funds, investment pools) normally will hold hundreds, if not thousands, of different investments. Moreover, such entities often rely on an expert (a third-party pricing vendor) to determine the fair value of their investments. The unique nature of many of the investments held by these entities requires complex valuation techniques. Sometimes only general information is available about the techniques applied to determine the investment’s fair value. Models developed by the experts to determine those values are often derivatives of commonly known valuation techniques, but do not have their own industry accepted names or descriptions. Attempting to obtain this information will be difficult, and if disclosed could be misleading. Accordingly, we suggest that the disclosures about valuation techniques and changes in valuation techniques be amended to allow for general disclosures of this information for these types of investments at an aggregated level. When the investment held is in an investment fund company, the financial statements of that company will provide additional detail, so it is not necessary to duplicate those disclosures in the investing government’s financial statements. We believe a disclosure similar to the following would be sufficient for this purpose: The government has obtained the services of multiple companies (if only one or a few companies are used they could be identified by name) to calculate the fair value of investments. The model used for this purpose, while likely to normally be complex, is nevertheless derived from commonly known industry valuation techniques.

Also, it is unclear if the disclosure of the effect of investments categorized in Level 3 (other than those with a net asset value {NAV} or its equivalent) on investment income is essential. We agree with the board’s statement in the “basis for conclusions” (when discussing why a disclosure reconciling Level 3 investments was not required) that “…Financial statement readers nonetheless will be presented with the ending balance of Level 3 measurements, providing information that will indicate the relative significance of those measurements.” Consequently, we believe the disclosure to indicate the significance of Level 3 investments on income is not essential and should therefore be eliminated.

Finally, we are not convinced that the costs necessary to obtain the information on an ongoing basis to meet the proposed disclosures is worth the benefits that these disclosures provide. We are especially concerned about the costs that smaller entities (smaller employee benefit plans) will incur to meet all of the requirements of the final statement.

**Effective date.** The ED proposes that the final statement first take effect for financial statements of periods that end June 30, 2016. We do not believe that this effective date allows sufficient time for governments to plan for and implement the final statement. In addition to the concerns expressed earlier about the volume of required disclosure and the difficulty inherent in obtaining all of the information needed, we also are concerned that the information will not be readily available as of the reporting date for many governments. We expect this will be especially problematic when governments have investments in entities that calculate NAV or its equivalent. Such entities may only provide information to governments (their investors) as of the entity’s reporting date, which in many cases will not be the same as the reporting date of the government (many governments have a June 30 fiscal year end, while many entities that calculate a NAV have December 31 year ends). An additional problem will be the need
for these entities to implement the money market fund reform regulations issued by the Securities and Exchange Commission, which have effective dates from October 14, 2014-October 14, 2016.

This specific issue could be especially troublesome for employee benefit plans, which often have hundreds of investments that have a NAV. Furthermore, we do not believe that the additional information that employee benefit plans will have to provide participating employer governments on an ongoing basis for pension plans beginning with June 30, 2015 year ends has been appropriately considered. The burden for employee benefit funds will also increase when the requirements for other postemployment benefit (OPEB) plans and governments that provide OPEB benefits are implemented (implementation proposed for years beginning after December 15, 2015 and December 15, 2016, respectively).

To allow for appropriate planning to occur, including the development of processes, where necessary, to obtain information as of the government’s reporting date, we suggest a delay of at least one year of the effective date of this standard. In addition, we suggest a corresponding delay in the effective date proposed in the two ED’s on OPEB (for both plans and employers).

If you have any questions regarding our position, please contact the GFOA’s Director of Technical Services, Stephen J. Gauthier (312/917-6101; FAX 312/977-4806; e-mail: sgauthier@gfoa.org).

Sincerely yours,

William Hall, chair
Committee on Accounting, Auditing, and Financial Reporting

John Tuohy, chair
Committee on Retirement and Benefits Administration

Marion Gee, Chair
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