August 15, 2014

Mr. David R. Bean  
Director of Research and Technical Activities  
Governmental Accounting Standards Board (GASB)  
401 Merritt 7  
Norwalk, CT 06856-5116

Re: Project No. 26-5E

Dear Mr. Bean:

On behalf of the Association of Government Accountants (AGA), the Financial Management Standards Board (FMSB) appreciates the opportunity to provide comments to the Governmental Accounting Standards Board (GASB or the Board) on the exposure draft entitled Fair Value Measurement and Application (ED) issued on May 5, 2014. Please note that this is a revised submission to our August 5, 2014 letter to the Board due to additional discussions among the members of the FMSB. Please replace that letter with this one.

The FMSB is comprised of 24 members (list attached) with accounting and auditing backgrounds in federal, state and local government, as well as academia and public accounting. The FMSB reviews and responds to proposed standards and regulations of interest to AGA members. Local AGA chapters and individual members are also encouraged to comment separately.

If adopted, this proposed Statement would address accounting and financial reporting issues related to fair value measurements and would generally require investments to be measured at fair value. As stated in the summary to the ED, this proposed Statement would require a government to use valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value. Further, this proposed Statement would require disclosures to be made about fair value measurements, valuation techniques, and inputs.

The FMSB has reviewed this ED and agrees with the positions adopted by the Board relative to fair value measurement and its application. However, based on our review of the ED, we have several suggestions and recommendations that we believe would greatly improve the guidance. Our comments and recommendations are discussed in the following paragraphs.

FMSB Comments to Preliminary View Document

In our September 28, 2013 letter of comments submitted in response to GASB’s Preliminary Views (PV) document, the FMSB commented on one matter regarding the application of fair value measurement that we would like to
reiterate. A major concern of the members of the FMSB was that the resulting benefits from the concepts discussed in the PV may disproportionately increase the burden upon preparers and auditors relative to the significance of the items affected by the pronouncement. We wish to raise these concerns again with the Board. It was unclear from the Basis for Conclusion section of the ED the extent to which this matter was considered. We still have concerns as to the relative cost and benefits of this proposed change in accounting standards and ask GASB to reconsider this matter in its deliberations.

Illustration 5—Disclosures

The FMSB is pleased to see that the GASB has chosen to include Illustrations of the various concepts and disclosures in Appendix C of the ED. We believe that such illustrations provide invaluable assistance to the practitioners who will be implementing this new standard. With this thought in mind, we believe that the GASB should expand the illustrations in Appendix C to provide a more comprehensive set of illustrations.

In particular, GASB needs to add an additional illustration for a Special Purpose Government so that a comprehensive set of disclosures are presented. We also believe that GASB should use these illustrations to present how the new disclosures will modify and affect the current disclosures required by Statement 3 and Statement 40. For example, a public transportation authority would appear to have the following disclosures upon implementation of the provisions of the ED as proposed:

- Custodial risk in cash deposits
- Fair value measurement of investments using level 1, level 2 and level 3
- Notes on the valuation methods by classification.
- Disclosure of investments that calculate net asset value per share (or its equivalent).

Missing is any disclosure that is contained in Statement 40 including, but not limited to, interest rate risk, credit risk, custodial credit risk and foreign currency risk. We believe that additional illustrations will greatly improve the ED and we strongly recommend that these be added to the illustration.

We also continue to be concerned with the guidance currently contained in Statement 40, paragraphs 11 through 13 with regard to risks associated with investments explicitly guaranteed by the United States government (or any sovereign debt). I'm sure we can agree that the only risk free investment is one that is in cash in a non-inflationary environment. Even United States government explicitly guaranteed “paper” has some risk involved. That said, the level of disclosure is unclear balancing what is proposed in the Exposure Draft and what is contained within GASB Statements No. 3 and 40.

Disclosures

Our recommendation regarding Statement 40 is that the Board utilize the issuance of its proposed standard on “Fair Value Measurement and Application,” to amend Statement 40 to eliminate the above “carve out” for investments issued or explicitly guaranteed by the U.S. government so that requirements of Statement 40, paragraphs 11, 12, and 13, will equally apply to such investments. We believe that the downgrade of U.S. Treasury securities in August 2011, by Standard & Poor’s and the concerns with the fiscal sustainability of the federal government as reported in the 2013 Financial Report of the United States Government provides more than ample justification for the Board to update Statement 40 in this regard.
**Fair Value Hierarchy**

The FMSB agrees with the approach outlined in the ED and the concept of a Fair Value Hierarchy for classifying the types of inputs that are used in the valuation techniques. Paragraph 31 of the ED states that the inputs to valuation techniques should be categorized into three levels. Level 1 inputs are quoted prices (unadjusted) in active markets that a government can access at the measurement date for assets or liabilities. Level 2 are those inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. Level 3 are unobservable inputs. Paragraph 31 states that this hierarchy gives highest priority to Level 1 inputs and lowest priority to Level 3.

A majority of the FMSB members are concerned about the guidance provided in Paragraph 32 when the fair value of an asset or liability is measured using inputs from more than one level in the hierarchy. The first sentence in Paragraph 32 states, “If the fair value of an asset or a liability is measured using inputs from more than one level of the fair value hierarchy, the measurement is considered to be based on the lowest priority level input that is significant to the entire measurement.” This statement appears to remove any aspect of professional judgment from the classification of inputs within the Hierarchy by requiring that the lowest level be assigned automatically. This statement also seems to be in conflict with Paragraph 31 which gives a higher priority to a Level 1 versus Level 3. We believe that what should be required is an assessment as to the relative significance of the various inputs and then a decision made as to the appropriate level. This view is not shared by some members of the FMSB.

A minority of the FMSB’s members do support the approach outlined in the ED for situations when inputs from more than one level of the Hierarchy are used to establish the fair value of an asset or liability. Where significant elements from the lower level of the hierarchy are used in the valuation, the minority do support the ED’s approach to handling the disclosure.

**Application of Fair Value to Certain Assets and Liabilities**

Paragraph 64 provides guidance as to what investments should be measured at fair value. It states that, “Except as provided in paragraph 69, investments should be measured at fair value. An investment is a security or other asset (a) that a government holds primarily for the purpose of income or profit and (b) with a present service capacity that is based solely on its ability to generate cash or to be sold to generate cash.” The third sentence in this paragraph states that a capital asset held for sale is not an investment asset. We believe this sentence creates confusion and should be removed from this paragraph and included in paragraph 65, which explains the difference between a capital asset and an investment.

**Glossary**

Throughout the ED, reference is made to determining the present value of cash flows to make certain valuations. However, we do not believe the ED adequately defines what discount rate should be applied in the circumstances. Is the entity expected to use their internal discount rate related to the cost of capital or a discount rate relative to the yields on its investments? We believe that this term should be defined in the Glossary. By defining a discount rate, as done in GASB 67, this allows better comparability among governments and consistency in valuation of investments. In addition, we would suggest the GASB undertake a master glossary project to be included in the Codification of governmental accounting standards as an appendix, rather than including definitions in each standard. (Note that we will be suggesting this as an improvement to the Proposed Implementation Guide.)
The Price and Transaction Costs

Paragraph 16 states that the price in the principal market used to measure the fair value should not be adjusted for transaction costs, as such costs are specific to a transaction. We agree with this concept, however in certain instances transaction costs may not be separately accounted for in the price but rather is included in the price. Separating transaction costs may not be feasible. We believe that GASB should consider adding clarification to this paragraph for this contingency.

Applying Fair Value to Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)

Paragraph 73 states that, “A government is permitted to determine the fair value of an investment in a non-governmental entity that does not have a readily determinable fair value by using the Net Asset Value (NAV) per share (or its equivalent, such as member units or an ownership interest in partners’ capital to which a proportionate share of net assets is attributed) of the investment. This method of determining fair value is permitted if the NAV per share of the investment is calculated as of the government’s measurement date in a manner consistent with the Financial Accounting Standards Board’s measurement principles for investment companies.” We believe that the last sentence in the ED should be modified to remove the reference to the Financial Accounting Standards Board (FASB) since it was the intent of GASB 62 to no longer reference FASB standards as GASB standards. We believe that if the FASB standard is to be used that the actual wording from FASB be included in the ED.

We appreciate the opportunity to comment on this document and would be pleased to discuss this letter with you at your convenience. A majority of the FMSB members approved of the issuance of this letter of comments. If there are any questions regarding the comments in this letter, please contact Steven E. Sossei, CPA, and AGA’s staff liaison for the FMSB, at ssossei@agacgfm.org or at 518-522-9968.

Sincerely,

Lealan Miller, CPA,
Chair- AGA Financial Management Standards Board

cc: William Miller, CGFM
AGA National President
Association of Government Accountants
Financial Management Standards Board

July 2014 – June 2015

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