September 30, 2013

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

Dear Mr. Bean:

We are pleased to have the opportunity to provide our comments on the Governmental Accounting Standards Board (GASB) Preliminary Views, *Fair Value Measurement and Application* (the PV). Our responses to the questions posed in the PV are in the section that follows.

**Issue 1—Definition of Fair Value**

1. It is the Board’s preliminary view that the definition of fair value should be the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (See Chapter 2, paragraphs 3–6.) Do you agree with this view? Why or why not?

We agree with the definition of fair value. We also support the alignment of the Board’s definition to the definition in the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 820 as we believe fair value should be a market-based measurement, not an entity- or government-specific measurement.

**Issue 2—Transaction Costs**

2. It is the Board’s preliminary view that transaction costs to sell an investment should be treated as period costs. That is, transaction costs would not be a reduction of an investment’s fair value in the statement of financial position. Transaction costs would be reported as expenses or expenditures in the period an investment is sold. (See Chapter 2, paragraphs 21 and 22.) Do you agree with this view? Why or why not?

We agree that transaction costs to sell an investment should be recognized as expenditures when an investment is sold. Transaction costs are not a characteristic of the asset or liability, but rather a characteristic of the transaction. We also agree that transaction costs would be considered in determining the most advantageous market, as described in paragraph 17 of the PV.
Issue 3—Definition of an Investment

3. It is the Board’s preliminary view that the definition of an investment should be a security or other asset that a government holds primarily for the purpose of income or profit, and its present service capacity is based solely on its ability to generate cash, to be sold to generate cash, or to procure services for the citizenry. (See Chapter 3, paragraphs 2–4.) Do you agree with this view? Why or why not?

We believe the definition of an investment in the PV is overly broad and may result in inconsistent application of the proposed standard. There could be different interpretations of what types of instruments are held “primarily for the purpose of income or profit, and the present service capacity of which is based solely on its ability to generate cash, to be sold to generate cash, or to procure services for the citizenry.” We are also concerned that the latter portion of the definition covering present service capacity based “solely on the ability to procure services for the citizenry” is not clear and will be misunderstood in terms of the types of transactions that the GASB is attempting to scope in. Although the examples provided in paragraphs 5–13 of Chapter 3 of the PV provide some guidance, they are not sufficient and should not be used as a substitute for clear criteria (definition) in the standard.

We encourage the Board to refine the definition of an investment and the corresponding circumstances where fair value would be applied. In addition, it is unclear how the board intends for non-financial assets to be included within the definition of an investment that should be accounted for at fair value. The potential for different interpretations of which types of non-financial assets fall within the definition of an investment may lead to inconsistent application of fair value to non-financial assets.

Finally, we recommend the Board consider separating the measurement and application aspects of the fair value project going forward. Doing so would more clearly emphasize the Board’s decision-making process for applying fair value measurement to particular transactions, as well as the research supporting users’ needs for such fair value measurements. Further, it would more effectively facilitate applying fair value to transactions other than investments in the future.

Issue 4—Measurement of Investments

4. It is the Board’s preliminary view that investments generally should be measured at fair value on a recurring basis. (See Chapter 3, paragraphs 14–16.) Unless specifically excluded from a fair value measurement, investments would no longer be valued using amortized cost or other measures. (See Chapter 3, paragraph 19.) Do you agree with this view? Why or why not?

We are supportive of measuring investments at fair value on a recurring basis. However, we recommend the board consider whether it would be appropriate to recognize the offset of changes in fair value as deferred outflows of resources or deferred inflows of resources, as applicable, for fixed income investments for which a government has both the ability and intent to hold to maturity.

We have concerns with the application of the NAV practical expedient. In addition to the criterion that the investment “does not have a readily determinable fair value”, ASC 820 Fair Value Measurement, also requires the investment to be in an entity that has all of the attributes of an investment company (as described in ASC 946 Financial Services—Investment Companies). It
is unclear if this second criterion will also apply to the proposed GASB guidance for fair value measurement. If an additional criterion similar to ASC 946 is not required to make use of the practical expedient, then we believe the GASB will have to provide additional guidance on when the use of the practical expedient is appropriate. Diversity in practice currently exists for the use of NAV in place of fair value, and we are concerned that ambiguity in the proposed guidance may cause further diversity.

In addition, paragraph 44 of the PV document states: “If a government may never be able to redeem the investment at its net asset value, a Level 3 classification would be used.” We do not believe that the NAV would be an appropriate measure if an entity does not believe it is reflective of the redemption value of the investment. There may also be circumstances where a NAV measurement is based on observable inputs, although the entity may not be able to redeem the investment at its NAV. In those circumstances, we believe it would be inappropriate to require a level 3 classification with other assets that are based on unobservable inputs.

Finally, Chapter 3 of the PV document, “Application of Fair Value to Assets and Liabilities,” is unclear as to when financial liabilities should be measured at fair value. We believe this may cause confusion and give rise to inconsistent application of fair value to financial liabilities.

**Issue 5—Disclosures**

5a. *It is the Board’s preliminary view that the disclosures discussed in Chapter 4 should be required. Are any of the proposed disclosures not essential to a financial statement user’s understanding of financial position or inflows and outflows of resources? Why or why not?*

5b. *What other disclosures related to fair value should the Board consider? Why?*

We agree with the proposed disclosures and agree that disclosures should include information relating to how fair value measurements were determined.

Consistent with the Board’s preliminary views for non-financial assets, we agree that the fair value should be determined based on the highest and best use of those assets. However, we believe that disclosures should be required when an entity uses a non financial asset in a way that differs from its highest and best use.

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If you have any questions or need additional information regarding our comments, please contact Jeff Markert at 212-909-5306 or jmarkert@kpmg.com.

Very truly yours,

**KPMG LLP**