October 16, 2013

David R. Bean, CPA
Director of Research and Technical Activities
GASB
401 Merritt 7
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Re: June 3, 2013 Preliminary Views (PV) of the Governmental Accounting Standards Board (GASB), on major issues related to Fair Value Measurement and Application [Project No. 26-5P]

Dear Mr. Bean:

One of the objectives that the Council of the American Institute of Certified Public Accountants (AICPA) established for the PCPS Executive Committee is to represent the views of local and regional firms on professional issues in keeping with the public interest, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective. These comments, however, do not necessarily reflect the positions of the AICPA.

TIC appreciated the opportunity to discuss its comments on this PV with the GASB Chair and staff at the GASB/TIC Liaison Meeting on September 26, 2013. TIC has re-examined the ED and is providing the following comments for your consideration.

GENERAL COMMENTS

TIC believes this is an important project and supports most of the guidance in the PV. However, TIC believes the scope of the proposed standard should be devoted exclusively to the definition, methodology, and disclosures relating to fair value measurements. Requirements to apply fair value to specific financial statement elements (such as investments) should not be part of the fair value standard. TIC is therefore recommending that the definition of an investment and the various measurement attributes that would apply to accounting for investments be moved to a different standard. TIC has, however, provided specific comments below on the investments guidance for the Board’s consideration under the assumption that the guidance is retained in the proposal.

TIC is otherwise supportive of the proposed definition of fair value and the related framework but disagrees with the proposed requirement for sensitivity disclosures for
Level 3 recurring fair value measurements. This and other comments and requests for clarification are included below for the Board’s consideration.

**SPECIFIC COMMENTS**

**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?

TIC supports the proposed definition. TIC believes it is important for GASB and FASB to have consistent definitions of fair value.

**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?

TIC agrees that transaction costs should be accounted for as period costs. TIC believes transaction costs represent the cost of completing a transaction and should not be a component of the fair value measurement of an investment. TIC also supports the Board’s conclusion that such costs should be characterized as entity-specific in nature, rather than market-based, and that entity-specific costs are not consistent with the definition of fair value.

**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?

**Investments Guidance in the Fair Value Measurement Standard**

TIC believes the definition of an investment and the measurement attributes that apply to investments do not belong in a standard on fair value measurement. TIC prefers the approach used by FASB in developing FASB Statement No. 157 (FAS 157), *Fair Value Measurements*. The purpose of FAS 157 was to provide a consistent methodology for applying fair value measurements that were required by other standards. FAS 157 did not require any new fair value measurements. TIC recommends that the Board narrow the scope of this standard in the same manner. Other, subject-specific standards that address financial statement elements should dictate when fair value measurements would be required.
The stated scope of the PV is “...assets and liabilities already measured at fair value and investments that previously have not been measured at fair value.” However, the investments section seems to dominate the document to the point that it’s easy to forget that the PV has broader application. TIC believes the potential confusion that could result is another good reason to segregate the investments guidance into a separate standard. However, if the Board decides to retain the investments section in the PV, TIC recommends that Chapter 3 be expanded to address other assets and liabilities.

Definition of an Investment

As to the definition itself (if retained in this standard), TIC believes the scope of the definition would not be understandable without the detailed examples provided on pages 17-18 of the PV.

One major source of confusion surrounding the definition is the phrase “to procure services for the citizenry.” It’s unclear how any security or other asset would be held primarily for the purpose of income or profit and used to procure services for the citizenry. They seem to be two contradictory objectives. The last line of Chapter 3, paragraph 4, is also somewhat ambiguous. If an investment asset is surrendered in an exchange transaction to procure services, would the services acquired have to be for the benefit of the government? If the government enters into a noncash transaction that involves the surrender of an asset in exchange for the acquisition of services for the citizenry, that transaction would seem to be outside of the definition of an investment.

The phrase is also very similar to the notion in GASB Concepts Statement No. 4, paragraph 6, which states that “…a resource is an item that can be drawn on to provide services to the citizenry.” It’s unclear whether procuring services for the citizenry is meant to be a significantly different notion than providing services to the citizenry.

TIC therefore recommends that the definition of an investment be revised to clarify the new proposed criterion relating to “present service capacity.” TIC questions whether the criterion relating to a present service capacity to procure services for the citizenry should be retained. If so, an example should be added to illustrate how the asset could be held to procure services for the citizenry and still qualify as an investment. Otherwise, this criterion will cause confusion or misapplication of the definition.

The examples illustrating the application of the definition of an investment (paragraphs 6 – 13) imply that management intent plays a key role in whether a particular asset would be classified as an investment. If that is the case, the definition should be revised to include this point.

In addition, TIC recommends that guidance be provided on the appropriate accounting if management’s intent changes causing classification of the asset to change to/from an investment. For example, if an asset becomes an investment, would the asset need to be accounted for as an investment for a set (minimum) period of time?
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?

Level 3 Investments

TIC noted that the PV did not provide much guidance on calculating fair value for Level 3 investments. Unobservable inputs are the most difficult for governments to develop and are least likely to be understood by financial statement users. TIC recommends expanding the discussion of Level 3 investments to include an explanation of how this information may be used, identification of the various valuation techniques and application examples.

Use of the Equity and Cost Methods (Chapter 3, paragraphs 20-22)

TIC found this section to be somewhat confusing, such that it was difficult to determine when the cost and equity methods would be required/permissioned. TIC requests that this section be revised to provide more explicit guidance as to when the cost method will be prohibited and when fair value v. the equity method is appropriate. Illustrative examples should be provided, where relevant. This section should also explicitly state that the criteria for applying the equity method described in GASB Statement No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements, paragraphs 205-208, will remain unchanged.

Other Investments That Should Be Excluded from Measurement at Fair Value

TIC believes that certain investments that are held-to-maturity by a government should not be measured at fair value. TIC members identified the following examples:

- A state lottery system buys treasury strips in the lottery’s name to cover lottery winnings by its citizens. When measured at fair value, unrealized gains may result. Fair value measurements create confusion in this case because legislators will attempt to “take” the gains for other purposes. Marking-to-market is therefore not relevant for this purpose. TIC understands that such annuities (or any investment within the scope of GASB Statement No. 31, Accounting and Financial Reporting for Certain Investments and for External Investment Pools) would be required to be measured at fair value under the proposal.
- In recent years, governments have recognized huge losses on the investments purchased with the proceeds of advance refundings that do not meet the definition of a defeasance, even though the government has no intention of selling the securities prior to maturity. Measuring such investments at fair value will create
unrealized gains and losses that will cause periodic fluctuations from year-to-year in the statement of activities. The unrealized amounts are unlikely to be realized if the investments are held to maturity.

**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?

TIC believes the “sensitivity” disclosures described in Chapter 4, paragraph 11, for recurring fair value measurements categorized as Level 3 could be misleading to financial statement users. Changing one assumption would likely have cascading effects on other assumptions. As the analysis increases in complexity, the disclosures become very subjective and lose reliability, especially given the fact that Level 3 measurements are highly subjective in the first place. TIC questions whether users should be making decisions based on such information, especially since they may not fully understand the data presented in the sensitivity disclosures. The illustration on page 35 of the PV includes, in some cases, wide-ranging probabilities and weighted averages that are difficult to interpret given the variability that could occur when assumptions change.

TIC also believes the disclosures would not be relevant to financial statement users of smaller governments who do not look at the government’s financial statements from an analyst’s perspective. It should be noted that FASB amended Accounting Standards Codification™ (ASC) Topic 820 in 2011 to exempt nonpublic entities from the sensitivity disclosures due to the unique characteristics of those entities. (See ASC 820-10-50-2F and FASB Accounting Standards Update 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*, paragraph BC106-BC107.) Similar cost/benefit decisions should be made for governmental entities so that smaller governments are not burdened with disclosure requirements that will not be relevant to financial statement users.

Before the Board finalizes its decision about sensitivity disclosures, it should perform user outreach with those that use smaller government financial statements and determine whether this disclosure represents “essential information” in all cases. TIC believes it is enough for the government to disclose that these estimates are highly subjective and the general factors that would cause directional changes.

If the Board decides to retain the requirement for sensitivity disclosures, TIC offers recommendations on the following issues:

- The extent of the sensitivity disclosures that would be required for recurring, Level 3 fair value measurements is unclear. Paragraph 12 of the PV states that the proposed disclosures are very similar to those already required by GASB Statement 40, *Deposit and Investment Risk Disclosures*. Paragraph 16 of that standard just seems to require factual disclosure about the terms of the investments that could create variability. Statement 40 does not include a
requirement for either forward-looking information or extensive quantitative data. However, the illustration on page 35 of the PV includes detailed quantitative information for multiple unobservable inputs for each investment. TIC therefore recommends that the Board provide guidance as to when a simple narrative will suffice and under what circumstances, if any, that detailed, quantitative data would be appropriate.

- The PV is unclear as to the effect on disclosure when the valuation of level 3 investments is obtained from a third party. TIC suggests that the disclosure exemption for certain third-party pricing models discussed in paragraph 10 be repeated in paragraph 11.

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

TIC believes no additional disclosures are needed.

OTHER COMMENTS

Nonrecurring Measurements

TIC requests that more examples of nonrecurring measurements be included in the future exposure draft. Paragraph 8 of Chapter 4 includes one example of a capital asset that is subsequently measured at the lower of its carrying value or fair value when an impairment loss has been identified. In FASB standards, there is confusion about the definition of nonrecurring measurements and whether the definition could refer to initial measurements as well as subsequent measurements.

As TIC deliberated this issue, some confusion arose surrounding initial and subsequent measurement of unconditional promises to give that are expected to be collected by a not-for-profit organization in one year or more. Most NPOs initially recognize these pledges using a discounted cash flow technique, which is suggested by Example 21a (Multiyear Promise without Eligibility Requirement) of GASB Statement No. 33, Accounting and Financial Reporting for Nonexchange Transactions. However, GASB Q&A Z.33.19 discusses this example and states that discounting is not required. Since the GASB standards do not include any explicit measurement requirements for such transactions, TIC is uncertain which measurement attribute from the proposed GASB Concepts Statement, Measurement of Elements of Financial Statements, would apply since, theoretically speaking, either fair value or the settlement amount could be used as the initial measurement or remeasurement approaches.

TIC recommends that GASB address the appropriate measurement approaches for long-term pledges receivable, especially since the PV already specifies measurement requirements for donated capital assets. TIC suggests that the settlement approach would be the best approach for both initial and subsequent measurement.
However, if the Board decides that pledges receivable should be initially measured at fair value but not subsequently measured at fair value, the Board should provide guidance on the appropriateness of fair value disclosures in subsequent periods. Such guidance would be needed whenever an asset is initially measured at fair value but subsequently remeasured at other than fair value, since that would seem to represent a nonrecurring fair value measurement.

TIC appreciates the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

Karen Kerber, Chair
PCPS Technical Issues Committee

cc: PCPS Executive and Technical Issues Committees