



Exposure Draft

May 5, 2014

Comments Due: August 15, 2014

Proposed Statement
of the Governmental Accounting Standards Board

Fair Value Measurement and Application

This Exposure Draft of a proposed Statement of Governmental Accounting Standards is issued by the Board for public comment. Written comments should be addressed to:

Director of Research and Technical Activities
Project No. 26-5E

Governmental Accounting Standards Board

FAIR VALUE MEASUREMENT AND APPLICATION

WRITTEN COMMENTS

Deadline for submitting written comments: August 15, 2014

Requirements for written comments. Comments should be addressed to the Director of Research and Technical Activities, Project No. 26-5E, and emailed to director@gasb.org or mailed to the address below.

OTHER INFORMATION

Public hearing. The Board has not scheduled a public hearing on the issues addressed in this Exposure Draft.

Public files. Written comments will become part of the Board's public file and are posted on the GASB's website.

Orders. This Exposure Draft may be downloaded from the GASB's website at www.gasb.org. For information on prices for printed copies, please contact the Order Department at the following address:

Governmental Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Telephone Orders: 1-800-748-0659

Please ask for our Product Code No. GE91.

GASB publications also may be ordered at www.gasb.org.

Copyright © 2014 by Financial Accounting Foundation. All rights reserved. Permission is granted to make copies of this work provided that such copies are for personal or intraorganizational use only and are not sold or disseminated and provided further that each copy bears the following credit line: "Copyright © 2014 by Financial Accounting Foundation. All rights reserved. Used by permission."

Notice to Recipients of This Exposure Draft

The Governmental Accounting Standards Board (GASB) is responsible for developing standards of state and local governmental accounting and financial reporting and other accounting and financial reporting communications that will (1) result in useful information for users of financial reports and (2) guide and educate the public, including issuers, auditors, and users of those financial reports.

The due process procedures that we follow before issuing our standards and other communications are designed to encourage broad public participation in the standards-setting process. As part of that due process, we are issuing this Exposure Draft setting forth a proposed Statement that would address accounting and financial reporting issues related to fair value measurement and application.

We invite your comments on all matters in this proposed Statement. Because this proposed Statement may be modified before it is issued as a final Statement, it is important that you comment on any aspects with which you agree as well as any with which you disagree. To facilitate our analysis of comment letters, it would be helpful if you explain the reasons for your views, including alternatives that you believe the GASB should consider.

All responses are distributed to the Board and to staff members assigned to this project, and all comments are considered during the Board's deliberations leading to a final Statement. When the Board is satisfied that all alternatives have been adequately considered and modifications, if any, have been made, a vote is taken on the Statement. A majority vote is required for adoption.

Summary

This proposed Statement addresses accounting and financial reporting issues related to fair value measurements. The definition of *fair value* is 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. This proposed Statement would provide guidance for determining a fair value measurement for financial reporting purposes. This proposed Statement also would provide application guidance for certain investments and related disclosures.

To determine a fair value measurement, a government would consider the *unit of account* of the asset or liability. The unit of account refers to the level at which an asset or a liability is aggregated or disaggregated for measurement purposes as provided by the accounting standards. Fair value measurements would assume a transaction takes place in the government's principal market, or most advantageous market in the absence of a principal market. The fair value also would be measured assuming that general market participants would act in their economic best interest. Fair value would be described as an *exit price* and would not be adjusted for *transaction costs*.

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. The techniques should be consistent with one or more of the following widely used approaches: *the market approach*, *the cost approach*, or *the income approach*. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets, liabilities, or a group of assets and liabilities. The cost approach reflects the amount that would be required currently to replace the service capacity of an asset. The income approach converts future amounts (such as cash flows or income and expenses) to a single current (discounted) amount. Valuation techniques should be applied consistently, though a change may be appropriate in certain circumstances. Valuation techniques would maximize the use of relevant observable inputs and minimize the use of unobservable inputs.

This proposed Statement would establish a hierarchy of inputs to valuation techniques used to measure fair value. That hierarchy would have three levels, with *Level 1* being quoted prices (unadjusted) in active markets for identical assets or liabilities, *Level 2* being inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly, and *Level 3* being unobservable inputs.

A fair value measurement would take into account the *highest and best use* for a nonfinancial asset. A fair value measurement of a liability would assume that the liability would be transferred to the market participant and not settled with the counterparty. In the absence of a quoted price for the transfer of an identical or similar liability and when another party holds an identical item as an asset, the government would be able to use the fair value of that asset to measure the fair value of the liability.

This proposed Statement would require additional analysis of fair value when the volume or level of activity for an asset or liability has significantly decreased. It also would require identification of transactions that are not orderly. Quoted prices provided by third parties would be permitted, as long as the government determines that those quoted prices were developed in accordance with the provisions of this proposed Statement.

This proposed Statement would generally require investments to be measured at fair value. An *investment* would be defined as 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. Investments not measured at fair value would continue to include, for example, money market investments, 2a7-like external investment pools, investments in life insurance contracts, common stock meeting the criteria for applying the equity method, unallocated insurance contracts, and synthetic guaranteed investment contracts.

This proposed Statement would require measurement at acquisition value for donated capital assets, donated works of art, historical treasures, and similar assets and capital assets received in a service concession arrangement. A government is permitted in certain circumstances to determine the fair value of an investment that does not have a readily determinable fair value by using the net asset value per share (or its equivalent) of the investment.

This proposed Statement would require disclosures to be made about fair value measurements, valuation techniques, and inputs. It also would require additional disclosure information regarding investments in certain entities that calculate net asset value per share (or its equivalent).

The requirements of this proposed Statement would be effective for financial statements for periods beginning after June 15, 2015. Earlier application would be encouraged.

How the Changes in This Proposed Statement Would Improve Financial Reporting

The requirements of this proposed Statement would enhance comparability of financial statements among governments by requiring measurement of certain assets and liabilities at fair value using a consistent definition and accepted valuation techniques. This proposed Statement also would enhance fair value application guidance and related disclosures in order to provide information to financial statement users about the impact of fair value measurements on a government's financial position.

Unless otherwise specified, pronouncements of the GASB apply to financial reports of all state and local governmental entities, including general purpose governments; public benefit corporations and authorities; public employee retirement systems; and public utilities, hospitals and other healthcare providers, and colleges and universities. Paragraph 2 discusses the applicability of this Statement.

Proposed Statement of the Governmental Accounting Standards Board

Fair Value Measurement and Application

May 5, 2014

CONTENTS

	Paragraph Numbers
Introduction.....	1
Standards of Governmental Accounting and Financial Reporting	2–79
Scope and Applicability of This Statement	2–4
General Principles.....	5–17
The Asset or Liability	6
Unit of Account.....	7–8
Markets	9–14
Market Participants	15
The Price and Transaction Costs.....	16–17
Valuation Techniques and Approaches	18–54
Valuation Techniques	18–22
Valuation Approaches	23–26
Market Approach	23–24
Cost Approach	25
Income Approach.....	26
Inputs to Valuation Techniques	27–30
Basic Principles.....	27–29
Inputs Based on Bid and Ask Prices	30
Fair Value Hierarchy.....	31–44
Level 1 Inputs	35–38
Blockage factor	38
Level 2 Inputs	39–41
Level 3 Inputs	42–43
Categorizing Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent) within the Fair Value Hierarchy	44
Measuring Fair Value When the Volume or Level of Market Activity for an Asset or a Liability Has Significantly Decreased	45–48
Identifying Transactions That Are Not Orderly.....	49–51
Using Quoted Prices Provided by Third Parties	52–54
Measurement Principles.....	55–63
Nonfinancial Assets	55–58
Highest and Best Use of Nonfinancial Assets	55–58
Liabilities	59–63
Basic Principles.....	59

	Paragraph Numbers
Liabilities Held by Other Parties as Assets.....	60–61
Nonperformance Risk.....	62
Restrictions Preventing the Transfer of a Liability.....	63
Application of Fair Value to Certain Assets and Liabilities.....	64–76
Present Service Capacity.....	65
Held Primarily for Income or Profit.....	66
Present Service Capacity Based Solely on an Asset’s Ability to Generate Cash or to Be Sold to Generate Cash.....	67
Purpose Determined by a Government’s Usage.....	68
Investment Measurements and Other Statements.....	69
Life Settlement Contracts.....	70
Recognition and Reporting.....	71
Acquisition Value.....	72
Applying Fair Value to Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent).....	73–76
Disclosures.....	77–79
Fair Value Measurements of Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent).....	79
Effective Date and Transition.....	80–82
Glossary.....	83
Appendix A: Background.....	A1–A6
Appendix B: Basis for Conclusions.....	B1–B93
Appendix C: Illustrations.....	C1
Appendix D: Codification Instructions.....	D1

Proposed Statement of the Governmental Accounting Standards Board

Fair Value Measurement and Application

May 5, 2014

INTRODUCTION

1. The objective of this Statement is to improve financial reporting by clarifying the definition of **fair value**¹ for financial reporting purposes, establishing general principles for measuring fair value, enhancing the fair value application guidance, and enhancing disclosures about fair value measurements. These improvements are based in part on the concepts and definitions established in Concepts Statement No. 6, *Measurement of Elements of Financial Statements*, and other relevant literature.

STANDARDS OF GOVERNMENTAL ACCOUNTING AND FINANCIAL REPORTING

Scope and Applicability of This Statement

2. This Statement establishes general principles for measuring fair value and standards of accounting and financial reporting for assets and liabilities measured at fair value. The provisions of this Statement should be applied to financial statements of all state and local governments.

3. This Statement supersedes Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, paragraph 44 and Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, paragraph 21 and footnote 9. It also amends Statement 10, paragraphs 42, 43, and 46; Statement No. 14, *The Financial Reporting Entity*, paragraph 55; Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, paragraphs 24 and 44; Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, paragraphs 2, 7, 15, and 22; Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, paragraphs 18 and 27; Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, paragraphs 22 and 46 and footnote 4; Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, paragraph 3; Statement 53, paragraph 82; Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, paragraph 9; Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, paragraphs 137, 203, 373, 409, 424, and 425; and Statement No. 67, *Financial Reporting for Pension Plans*, paragraph 18.

¹Terms defined in the glossary are printed in **boldface type** the first time they are used in this Statement.

4. Paragraphs 5–17 of this Statement address the general principles of fair value measurements, paragraphs 18–54 describe **valuation techniques** and approaches, paragraphs 55–63 prescribe measurement principles, paragraphs 64–76 address the application of fair value to certain assets and liabilities, and paragraphs 77–79 address disclosures.

General Principles

5. Fair value is 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. Fair value is a market-based measurement, not an entity-specific measurement. For some assets and liabilities, observable market transactions or market information might be available; for others, it might not be available. However, the objective of a fair value measurement in both cases is the same—that is, to determine the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions. Fair value is an **exit price** at the measurement date from the perspective of a market participant that controls the resource or is obligated for the liability.

The Asset or Liability

6. The focus of a fair value measurement is on a particular asset or liability. Therefore, when measuring fair value, a government should take into account the characteristics of the asset or liability that market participants would consider when pricing the asset or liability at the measurement date. Such characteristics include, for example, the condition and location of the asset and restrictions, if any, on the sale or use of the asset that are characteristics of the asset and not characteristics of a specific government’s ownership. The effect on the measurement arising from a particular characteristic will differ depending on how that characteristic would be taken into account by market participants.

Unit of Account

7. The particular asset or liability measured at fair value might be either (a) a stand-alone asset or liability (for example, a **financial instrument**) or (b) a group of assets, a group of liabilities, or a group of related assets and liabilities.

8. Recognition or disclosure of an asset or liability—whether a single asset or liability, a group of assets, a group of liabilities, or a group of related assets and liabilities—depends on the **unit of account** of the asset or liability. The unit of account refers to the level at which an asset or a liability is aggregated or disaggregated for recognition purposes as provided by the accounting standards. Amounts reported vary depending on the measurement attribute applied. The measurement attributes are historical cost, fair value, replacement cost, and settlement value. Once accounting standards establish the unit of account—whether at an individual item level or an aggregated level—relevant measurement attributes and disclosures can be applied.

Markets

9. A fair value measurement assumes that a transaction to sell an asset or transfer a liability takes place in either (a) the government’s **principal market** or (b) the government’s **most**

advantageous market, in the absence of a principal market. The most advantageous market is determined after taking into account **transaction costs** and **transportation costs**.

10. A government need not undertake an exhaustive search of all possible markets to identify the principal market or, in the absence of a principal market, the most advantageous market; however, it should take into account all information that is reasonably available. In the absence of evidence to the contrary, the market in which the government normally would enter into a transaction to sell an asset or to transfer a liability is presumed to be the principal market or, in the absence of a principal market, the most advantageous market.

11. If there is a principal market for the asset or liability, the fair value measurement should represent the price in that market (whether that price is quoted in an active market for an identical asset or whether it is determined using another valuation technique), even if the price in a different market is potentially more advantageous at the measurement date.

12. The government should have access to the principal (or most advantageous) market at the measurement date. The government's principal (or most advantageous) market (and, thus, market participants) should be considered from the perspective of the government, thereby allowing for differences between and among entities with different activities.

13. Though a government should be able to access the market, the government does not need to be able to sell the particular asset or transfer the particular liability on the measurement date to be able to measure fair value on the basis of the price in that market.

14. Even if there is no observable market to provide pricing information about the sale of an asset or the transfer of a liability at the measurement date, a fair value measurement should assume that a transaction takes place at that date, considered from the perspective of a market participant that controls the resource or is obligated for the liability. That assumed transaction establishes a basis for determining the price to sell the asset or to transfer the liability.

Market Participants

15. A government should measure the fair value of an asset or a liability using the assumptions that market participants would use in pricing the asset or liability, assuming that market participants act in their economic best interest. In developing those assumptions, a government need not identify specific market participants. Rather, the government should identify characteristics that distinguish market participants generally, considering factors specific to all of the following:

- a. The asset or liability
- b. The principal or most advantageous market, as appropriate, for the asset or liability
- c. Market participants with whom the government would enter into a transaction in that market.

The Price and Transaction Costs

16. The price in the principal (or most advantageous) market used to measure the fair value of an asset or a liability should not be adjusted for transaction costs. Transaction costs are not a

characteristic of an asset or a liability; rather, they are specific to a transaction and will differ depending on how a government enters into a transaction for the asset or liability.

17. Transaction costs do not include transportation costs. If location is a characteristic of the asset (as might be the case for a commodity), the price in the principal (or most advantageous) market should be adjusted for the costs, if any, that would be incurred to transport the asset from its current location to that market.

Valuation Techniques and Approaches

Valuation Techniques

18. Valuation techniques are used to determine fair value. A government should use valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant **observable inputs** and minimizing the use of **unobservable inputs**. A government should use valuation techniques consistent with one or more of three approaches to measuring fair value: the **market, cost, and income approaches**.

19. In some cases, a single valuation technique is appropriate (for example, when valuing an asset or a liability using quoted prices in an **active market** for identical assets or liabilities). In other cases, multiple valuation techniques are appropriate (for example, when valuing an **investment** that represents a combination of financial and nonfinancial assets). If multiple valuation techniques are used to measure fair value, the results (that is, respective measurements of fair value) should be evaluated considering the reasonableness of the range of values indicated by those results. A fair value measurement is the point within that range that is most representative of fair value in the circumstances.

20. Valuation techniques used to measure fair value should be applied consistently from period to period. However, a change in a valuation technique or its application (for example, a change in the weighting of individual valuation techniques when multiple valuation techniques are used, or a change in an adjustment applied to a valuation technique) is appropriate if the change results in a measurement that is equally or more representative of fair value in the circumstances. That might be the case if, for example, any of the following events occur:

- a. New markets develop
- b. New information becomes available
- c. Information previously used is no longer available
- d. Valuation techniques improve
- e. Market conditions change.

21. If the transaction price is fair value at initial recognition and a valuation technique that uses unobservable inputs will be used to measure fair value in subsequent periods, the valuation technique should be calibrated so that, at initial recognition, the result of the valuation technique equals the transaction price. After initial recognition, when measuring fair value using a valuation technique or techniques that use unobservable inputs, a government should ensure that those valuation techniques reflect observable market data (for example, the price for a similar asset or liability) at the measurement date.

22. Revisions resulting from a change in the valuation technique or its application should be accounted for as a change in accounting estimate.

Valuation Approaches

Market Approach

23. The market approach to measuring fair value uses prices and other relevant information generated by market transactions involving identical or similar assets, liabilities, or a group of assets and liabilities. Using quoted market prices is a technique that is consistent with the market approach. Valuation techniques consistent with the market approach often use market multiples derived from a set of identical or similar assets, liabilities, or a group of assets and liabilities. Market multiples might be in ranges with a different multiple for similar assets, liabilities, or groups of assets and liabilities. For example, the fair value of an investment in a company could be determined based on the price/earnings ratios of similar companies. Similar companies may trade at different ratios; therefore, the selection of the appropriate ratio within the range of price/earnings ratios requires professional judgment, considering qualitative and quantitative factors specific to the measurement.

24. Valuation techniques consistent with the market approach include **matrix pricing**. Matrix pricing is a mathematical technique used principally to value some types of financial instruments, such as debt securities, without relying exclusively on quoted prices for the specific securities. Instead, matrix pricing relies on the securities' relationship to other benchmark quoted securities.

Cost Approach

25. The cost approach to measuring fair value reflects the amount that would be required currently to replace the present service capacity of an asset. From the perspective of a market participant seller, the price that would be received for the asset is based on the cost to a market participant buyer to acquire or construct a substitute asset of comparable utility, adjusted for obsolescence. Obsolescence encompasses physical deterioration, functional (technological) obsolescence, and economic (external) obsolescence.

Income Approach

26. The income approach to measuring fair value converts future amounts (for example, cash flows or income and expenses) to a single current amount (such as discounted **present value**). When the income approach is used, the fair value measurement reflects current market expectations about those future amounts. Valuation techniques consistent with the income approach include (a) present value, (b) **option pricing models**, such as the Black–Scholes–Merton formula, and (c) the **multi-period excess earnings method**.

Inputs to Valuation Techniques

Basic Principles

27. Valuation techniques should maximize the use of relevant observable inputs and minimize the use of unobservable inputs. If there is a quoted price in an active market for an identical asset or an identical liability, a government should use that quoted price without adjustment when measuring fair value, except as specified in paragraph 37.

28. A government should select **inputs** that are consistent with the characteristics of the asset or liability that market participants would take into account in a transaction for the asset or liability. In some cases, those characteristics result in the application of an adjustment, such as a premium or discount (for example, a control premium or noncontrolling interest discount). However, a fair value measurement should not incorporate a premium or discount that is inconsistent with the unit of account provision in paragraphs 7 and 8.

29. Premiums or discounts that reflect size as a characteristic of a government's holding are not permitted in the measurement of fair value. An example is a blockage factor that adjusts the quoted price of an asset or a liability because the market's normal daily trading volume is not sufficient to absorb the quantity held by the government, as described in paragraph 38. On the other hand, a control premium when measuring the fair value of a controlling interest is a characteristic of the asset or liability.

Inputs Based on Bid and Ask Prices

30. If an asset or a liability measured at fair value has a bid price and an ask price (for example, an input from a **dealer market**), the price within the bid-ask spread that is most representative of fair value in the circumstances should be used to measure fair value regardless of where the input is categorized within the fair value hierarchy (as discussed in paragraphs 31–43). When no price is more representative than another, the use of a bid price (for an asset position) and an ask price (for a liability position) is permitted. Mid-market pricing or other pricing conventions that are used by market participants for measuring fair value within a bid-ask spread also are permitted.

Fair Value Hierarchy

31. The fair value hierarchy categorizes the inputs to valuation techniques used to measure fair value into three levels. **Level 1 inputs** are quoted prices (unadjusted) in active markets for identical assets or liabilities that a government can access at the measurement date. **Level 2 inputs** are inputs—other than quoted prices included within Level 1—that are observable for the asset or liability, either directly or indirectly. **Level 3 inputs** are unobservable inputs for the asset or liability. The fair value hierarchy gives the highest priority to Level 1 inputs and the lowest priority to Level 3 inputs. When a price for an identical asset or liability is not observable, a government should measure fair value using another valuation technique that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs.

32. 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. For example, if there are three inputs significant to a certain fair value measurement and two of them are Level 2 inputs, and one is a Level 3 input, the fair value measurement would be categorized in Level 3 of the fair value hierarchy. Assessing the significance of a particular input to the entire measurement requires professional judgment, taking into account factors specific to the asset or liability.

33. The availability of relevant inputs and their relative subjectivity might affect the selection of appropriate valuation techniques. However, the fair value hierarchy prioritizes the inputs to valuation techniques, not the valuation techniques used to measure fair value. For example, a measurement of fair value that uses a present value technique might be categorized within either Level 2 or Level 3, depending on the inputs that are significant to the entire measurement and the level of the fair value hierarchy within which those inputs are categorized.

34. If an observable input requires an adjustment using an unobservable input and that adjustment results in a significantly higher or lower fair value measurement, the resultant measurement would be categorized within Level 3 of the fair value hierarchy. For example, if a market participant takes into account the effect of a restriction on the sale of an asset when determining the price for the asset, a government would adjust the quoted price to reflect the effect of that restriction. If that quoted price is a Level 2 input and the adjustment is an unobservable input that is significant to the entire measurement, the measurement would be categorized within Level 3 of the fair value hierarchy.

Level 1 Inputs

35. A quoted price for identical assets or liabilities in an active market provides the most reliable evidence of a Level 1 input of fair value and should be used to measure fair value without adjustment whenever available, except as specified in paragraph 37. Examples of markets in which inputs might be observable include **exchange markets**, dealer markets, **brokered markets**, and **principal-to-principal markets**.

36. A Level 1 input will be available for many **financial assets** and **financial liabilities**, some of which might be exchanged in multiple active markets (for example, on different exchanges). Therefore, the emphasis within Level 1 is on determining both of the following:

- a. The principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability
- b. Whether the government can enter into a transaction for the asset or liability at the price in that market at the measurement date.

37. A government should not adjust a Level 1 input except in the following circumstances:

- a. *Large number of similar assets or liabilities.* An adjustment to a Level 1 input should be made if (1) a government holds a large number of similar (but not identical) assets or liabilities (for example, debt securities) that are measured at fair value and (2) a quoted price in an active market is available but not readily accessible for each of those assets or liabilities individually, except as noted in paragraph 38. That is, given the large number of

similar assets or liabilities held by the government, it would be difficult to obtain pricing information for each individual asset or liability at the measurement date. In this case, a government may measure fair value using an alternative pricing method that does not rely exclusively on quoted prices (for example, matrix pricing). However, the use of an alternative pricing method results in a fair value measurement categorized within either Level 2 or 3 of the fair value hierarchy.

- b. *Quoted price not representative of fair value.* An adjustment to a Level 1 input should be made when a quoted price in an active market does not represent fair value at the measurement date. That might be the case if, for example, significant events (such as transactions in a principal-to-principal market, trades in a brokered market, or announcements) take place after the close of a market but before the measurement date. A government should establish and consistently apply a policy for identifying those events that might affect fair value measurements. However, if the quoted price is adjusted for new information, the adjustment results in a fair value measurement categorized within either Level 2 or 3 of the fair value hierarchy.
- c. *Fair value of an asset not representative of fair value of a liability.* An adjustment to a Level 1 input should be made if (1) the fair value of a liability is measured using the quoted price for the identical item traded as an asset in an active market and (2) that price needs to be adjusted for factors specific to the asset that are not applicable to the liability (see paragraph 61). If no adjustment to the quoted price of the asset is required, the result is a fair value measurement categorized within Level 1 of the fair value hierarchy. However, any adjustment to the quoted price of the asset results in a fair value measurement categorized within either Level 2 or 3 of the fair value hierarchy.

Blockage factor

38. If a position in a single asset or liability (including a position comprising a large number of identical assets or liabilities, such as a holding of financial instruments) is held and the asset or liability is traded in an active market, the fair value of the asset or liability should be measured within Level 1 as the product of the quoted price for the individual asset or liability and the quantity held by the reporting entity. That is the case even if a market's normal daily trading volume is not sufficient to absorb the quantity held, and placing orders to sell the position in a single transaction might affect the quoted price.

Level 2 Inputs

39. Level 2 inputs include:

- a. Quoted prices for similar assets or liabilities in active markets
- b. Quoted prices for identical or similar assets or liabilities in markets that are not active
- c. Inputs other than quoted prices that are observable for the asset or liability, such as:
 - (1) Interest rates and yield curves observable at commonly quoted intervals
 - (2) Implied volatilities
 - (3) Credit spreads.
- d. **Market-corroborated inputs.**

40. For financial reporting purposes, if the asset or liability has a specified (contractual) term, a Level 2 input is required to be observable for substantially the full term of the asset or liability.

41. Adjustments to Level 2 inputs will vary depending on factors specific to the asset or liability, including:

- a. The condition or location of the asset
- b. The extent to which inputs relate to items that are comparable to the asset or liability (including those factors described in paragraph 61)
- c. The volume or level of activity in the markets within which the inputs are observed.

Level 3 Inputs

42. A government should develop Level 3 inputs using the best information available in the circumstances, which might include the government's own data. In developing unobservable inputs, a government may begin with its own data, but it should adjust those data if (a) reasonably available information indicates that other market participants would use different data or (b) there is something particular to the government that is not available to other market participants (for example, an entity-specific synergy). A government need not undertake exhaustive efforts to obtain information about market participant assumptions. However, a government should take into account all information about market participant assumptions that is reasonably available. Unobservable inputs developed in the manner described above are considered market participant assumptions and meet the objective of a fair value measurement.

43. Assumptions about risk include the risk inherent in a particular valuation technique used to measure fair value (such as a pricing model) and the risk inherent in the inputs to the valuation technique. A measurement that does not include an adjustment for risk would not represent a fair value measurement if market participants would include one when pricing the asset or liability. For example, it might be necessary to include a risk adjustment when there is significant measurement uncertainty. That could be the case if (a) there has been a significant decrease in the volume or level of activity compared with normal market activity for the asset or liability, or similar assets or liabilities, and (b) the government has determined that the transaction price or quoted price does not represent fair value, as described in paragraphs 45–51.

Categorizing Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent) within the Fair Value Hierarchy

44. Categorization within the fair value hierarchy of a fair value measurement of an investment within the scope of paragraphs 73–76 that is measured at **net asset value (NAV) per share** (or its equivalent, for example, member units or an ownership interest in partners' capital to which a proportionate share of net assets is attributed) requires professional judgment, considering the following:

- a. If a government has the ability to redeem its investment with the **investee** at NAV per share (or its equivalent) at the measurement date, the fair value measurement of the investment should be categorized within Level 2 of the fair value hierarchy.
- b. If a government will never have the ability to redeem its investment with the investee at NAV per share (or its equivalent), the fair value measurement of the investment should be categorized within Level 3 of the fair value hierarchy.
- c. If a government cannot redeem its investment with the investee at NAV per share (or its equivalent) at the measurement date, but the investment may be redeemable with the

investee at a future date (for example, an investment is subject to a redemption restriction, such as a lockup or gate, or an investment has a redemption period that does not coincide with the measurement date), the government should take into account the length of time until the investment will become redeemable in determining whether the fair value measurement of the investment should be categorized within Level 2 or Level 3 of the fair value hierarchy. For example, if the government does not know when it will have the ability to redeem the investment or it does not have the ability to redeem the investment in the near term at NAV per share (or its equivalent), the fair value measurement of the investment should be categorized within Level 3 of the fair value hierarchy.

Measuring Fair Value When the Volume or Level of Market Activity for an Asset or a Liability Has Significantly Decreased

45. The fair value of an asset or a liability might be affected when there has been a significant decrease in the volume or level of activity for that asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities). Determining the price at which market participants would be willing to enter into a transaction at the measurement date under current market conditions if there has been a significant decrease in the volume or level of activity for the asset or liability depends on the facts and circumstances at the measurement date and requires professional judgment. To determine whether, on the basis of the available evidence, there has been a significant decrease in the volume or level of activity for the asset or liability, a government should evaluate the significance and relevance of factors such as the following:

- a. There are few recent transactions.
- b. Price quotations are not developed using current information.
- c. Price quotations vary substantially either over time or among **market makers** (for example, some brokered markets).
- d. Indices that previously were highly correlated with the fair values of the asset or liability are demonstrably uncorrelated with recent indications of fair value for that asset or liability.
- e. There is a significant increase in implied liquidity **risk premiums**, yields, or performance indicators (such as delinquency rates or loss severities) for observed transactions or quoted prices when compared with the government's estimate of expected cash flows, taking into account all available market data about credit and other **nonperformance risk** for the asset or liability.
- f. There is a wide bid-ask spread or significant increase in the bid-ask spread.
- g. There is a significant decline in the activity of a market for new issues (that is, a primary market) for the asset or liability or similar assets or liabilities, or there is an absence of such a market.
- h. Little information is publicly available (for example, for transactions that take place in a principal-to-principal market).

46. If a government concludes that there has been a significant decrease in the volume or level of activity for the asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities), further analysis of the transactions or quoted prices is needed. A decrease in the volume or level of activity on its own may not indicate that a transaction price or quoted price does not represent fair value or that a transaction in that market is not orderly (see

paragraphs 49–51). However, if a government determines that a transaction or quoted price does not represent fair value (for example, there may be transactions that are not orderly), an adjustment to the transactions or quoted prices will be necessary if (a) the government uses those prices as a basis for measuring fair value and (b) that adjustment is significant to the fair value measurement in its entirety. Adjustments also may be necessary in other circumstances (for example, when a price for a similar asset requires significant adjustment to make it comparable to the asset being measured or when the price is stale).

47. Regardless of the valuation technique used, a government should include appropriate risk adjustments, including a risk premium reflecting the amount that market participants would demand as compensation for the uncertainty inherent in the cash flows of an asset or a liability. In some cases, determining the appropriate risk adjustment might be difficult. However, the degree of difficulty alone is not a sufficient basis on which to exclude a risk adjustment. The risk adjustment should be reflective of an orderly transaction between market participants at the measurement date under current market conditions.

48. If there has been a significant decrease in the volume or level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate (for example, changing from a market multiple technique to a **relief from royalty technique**). When weighing indications of fair value resulting from the use of multiple valuation techniques, a government should consider the reasonableness of the range of fair value measurements. The objective is to determine the point within the range that is most representative of fair value under current market conditions. A wide range of fair value measurements may be an indication that further analysis is needed.

Identifying Transactions That Are Not Orderly

49. The determination of whether a transaction is orderly can be difficult if there has been a significant decrease in the volume or level of activity for an asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities). In such circumstances, it is not appropriate to conclude that all transactions in that market are not orderly (for example, forced liquidations or distress sales). A government should evaluate the circumstances of the transaction to determine whether, based on the available evidence, the transaction is orderly. Circumstances that may indicate that a transaction is not orderly include the following:

- a. There was not an adequate period of exposure to the market before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities under current market conditions.
- b. There was a usual and customary marketing period, but the seller marketed the asset or liability to a single market participant.
- c. The seller is in or near bankruptcy (that is, the seller is distressed).
- d. The seller was required to sell to meet regulatory or legal requirements (that is, the seller was forced).
- e. The transaction price is an outlier when compared with other recent transactions for the same or a similar asset or liability.

50. A government should consider all of the following when measuring fair value, including the determination of **market risk** premiums or discounts:

- a. If the evidence indicates the transaction is not orderly, a government should place little, if any, weight (compared with other indications of fair value) on that transaction price.
- b. If the evidence indicates that a transaction is orderly, a government should take into account that transaction price. The reliance on that transaction price compared with other indications of fair value will depend on the facts and circumstances, such as:
 - (1) The volume of the transaction
 - (2) The comparability of the transaction to the asset or liability being measured
 - (3) The proximity of the transaction to the measurement date.
- c. If a government does not have sufficient information to conclude that a transaction is orderly, it should take into account the transaction price. However, that transaction price may not represent fair value (that is, the transaction price is not necessarily the sole or primary basis for measuring fair value or determining market risk premiums or discounts). When a government does not have sufficient information to conclude that particular transactions are orderly, the government should place less weight on those transactions when compared with other transactions that are known to be orderly.

51. To determine whether a transaction is orderly, a government should consider information that is reasonably available. When a government is a party to a transaction, it is presumed to have sufficient information to determine whether the transaction is orderly.

Using Quoted Prices Provided by Third Parties

52. Quoted prices provided by third parties, such as pricing services or brokers, may be used if a government has determined that the quoted prices provided by those parties are developed in accordance with the provisions of this Statement.

53. If there has been a significant decrease in the volume or level of activity for the asset or liability, a government should evaluate whether the quoted prices provided by third parties are developed using current information that reflects orderly transactions or a valuation technique that reflects market participant assumptions (including assumptions about risk). In weighting a quoted price as an input to a fair value measurement, a government should rely less on quoted prices that do not reflect the result of transactions (when compared with other indications of fair value that reflect the results of transactions).

54. Furthermore, the nature of a quoted price (for example, whether the quoted price is an indicative price or a binding offer) should be taken into account when considering the available evidence, with more consideration given to quoted prices provided by third parties that represent binding offers.

Measurement Principles

Nonfinancial Assets

Highest and Best Use of Nonfinancial Assets

55. A fair value measurement of a nonfinancial asset takes into account a market participant's ability to generate resources by using the asset according to its **highest and best use** or by

selling it to another market participant that would use the asset according to its highest and best use. The highest and best use of a nonfinancial asset takes into account the use of the asset that is physically possible, legally permissible, and financially feasible, as follows:

- a. A use that is physically possible takes into account the physical characteristics of the asset that market participants would take into account when pricing the asset (for example, the location or size of a property).
- b. A use that is legally permissible takes into account any legal restrictions on the use of the asset that market participants would take into account when pricing the asset (for example, the current zoning regulations applicable to a property).
- c. A use that is financially feasible takes into account whether a use of the asset that is physically possible and legally permissible generates resources (taking into account the costs of converting the asset to that use) to produce an investment return that market participants would require from an investment in that asset put to that use.

56. Highest and best use is determined from the perspective of market participants using relevant market data as of the measurement date, even if the government intends a different use for the nonfinancial asset. However, a government's current use of a nonfinancial asset that is measured at fair value is presumed to be its highest and best use unless market or other factors suggest that a different use by market participants would maximize the value of the asset.

57. The highest and best use of a nonfinancial asset is based on certain assumptions used to measure the fair value of an asset, as follows:

- a. The highest and best use of a nonfinancial asset may provide maximum value to market participants through its use in combination with other assets as a group (as installed or otherwise configured for use) or in combination with other assets and liabilities.
 - (1) If the highest and best use of the nonfinancial asset is for use in combination with other assets or with other assets and liabilities, the fair value of the asset is the price that would be received in a current transaction to sell the asset assuming that the asset would be used with other assets or with other assets and liabilities and that those assets and liabilities (that is, its complementary assets and the associated liabilities) would be available to market participants.
 - (2) Liabilities associated with the nonfinancial asset and with the complementary assets include liabilities that provide resources but do not include liabilities used to acquire assets other than those within the group of assets.
 - (3) Assumptions about the highest and best use of a nonfinancial asset should be consistent for all of the assets (for which highest and best use is relevant) of the group of assets or the group of assets and liabilities within which the nonfinancial asset would be used.
- b. The highest and best use of a nonfinancial asset may provide maximum value to market participants on a stand-alone basis. In that case, the fair value of the nonfinancial asset is the price that would be received in a transaction as of the measurement date to sell the nonfinancial asset to market participants that would use the nonfinancial asset on a stand-alone basis.

58. The measurement of the fair value of a nonfinancial asset assumes that an asset is sold consistent with the unit of account provision in paragraphs 7 and 8. This is the case whether the

fair value measurement assumes that the highest and best use of the nonfinancial asset is for use of an individual asset or for use of an asset in combination with other assets or with other assets and liabilities. If the highest and best use is for the asset in combination with other assets or with other assets and liabilities, a measurement of the fair value of a nonfinancial asset assumes that the market participant already holds the complementary assets and associated liabilities.

Liabilities

Basic Principles

59. Measurement of the fair value of a liability assumes that the liability is transferred to a market participant at the measurement date. The transfer of a liability assumes a liability would remain outstanding and the market participant transferee would be required to fulfill the obligation. The liability would not be settled with the counterparty or otherwise extinguished on the measurement date. Even if there is no observable market to provide pricing information about the transfer of a liability (for example, because contractual or other legal restrictions prevent the transfer of such items), there might be an observable market for such items if they are held by other parties as assets.

Liabilities Held by Other Parties as Assets

60. If a quoted price for the transfer of an identical or a similar liability is not available and the identical item is held by another party as an asset, a government should measure the fair value of the liability from the perspective of a market participant that holds the identical item as an asset at the measurement date. In such cases, a government should measure the fair value of the liability as follows:

- a. Using the quoted price in an active market for the identical item held by another party as an asset, if that price is available
- b. If the quoted price in (a) is not available, using other observable inputs, such as the quoted price in a market that is not active for the identical item held by another party as an asset
- c. If the observable prices in (a) and (b) are not available, using another valuation technique, such as the following:
 - (1) Quoted prices for similar liabilities held by other parties as assets (a market approach)
 - (2) A present value technique that takes into account the future cash flows that a market participant would expect to receive from holding the liability as an asset (an income approach).

61. A government should adjust the quoted price of a liability held by another party as an asset only if there are factors specific to the asset that are not applicable to the fair value measurement of the liability. A government should ensure that the price of the asset does not reflect the effect of a restriction preventing the sale of that asset. Some factors that may indicate that the quoted price of the asset should be adjusted to determine the liability include the following:

- a. The quoted price for the asset relates to a similar (but not identical) liability held by another party as an asset. For example, the liability may have a particular characteristic (such as the credit quality of the issuer) that is different from that reflected in the fair value of the similar liability held as an asset.

- b. The unit of account for the asset is not the same as for the liability. For example, consider an insured interest rate swap that is in a liability position. In some cases, the price for such an asset reflects a combined price for a financial instrument comprising both the amounts due from the issuer and a third-party credit enhancement (for example, debt that is used with a financial guarantee from a third party). If the unit of account for the swap liability is not the combined financial instrument, the objective is to measure the fair value of the issuer's liability, not the fair value of the combined package. Thus, in such cases, the government would adjust the observed price for the asset to exclude the effect of the third-party credit enhancement.

Nonperformance Risk

62. The fair value of a liability reflects the effect of nonperformance risk. Nonperformance risk includes, but may not be limited to, a government's own **credit risk**. Nonperformance risk is assumed to be the same before and after the transfer of the liability. When measuring the fair value of a liability, a government should take into account the effect of its credit risk (credit standing) and any other factors that might influence the likelihood that the obligation will or will not be fulfilled. That effect may differ depending on the liability, for example, (a) whether the liability is an obligation to deliver cash (a financial liability) or an obligation to deliver goods or services (a nonfinancial liability) and (b) the terms of credit enhancements related to the liability, if any.

Restrictions Preventing the Transfer of a Liability

63. When measuring the fair value of a liability, such as an interest rate swap, a government should not include a separate input or an adjustment to other inputs relating to the existence of a restriction that prevents the transfer of the item. The effect of a restriction that prevents the transfer of a liability is either implicitly or explicitly included in the other inputs to the fair value measurement. For example, at the transaction date, both the creditor and the obligor accepted the transaction price for the liability with full knowledge that the obligation includes a restriction that prevents its transfer. As a result of the restriction being included in the transaction price, a separate input or an adjustment to an existing input is not required at the transaction date to reflect the effect of the restriction on transfer. Similarly, a separate input or an adjustment to an existing input is not required at subsequent measurement dates to reflect the effect of the restriction on transfer.

Application of Fair Value to Certain Assets and Liabilities

64. 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. A capital asset held for sale is not an investment asset. In addition, debt securities reported as assets should be measured at fair value regardless of whether they meet the definition of an investment or they were acquired or originated by the government.

Present Service Capacity

65. Investments indirectly enable a government to provide services. Assets are resources with present service capacity that a government presently controls.² Present service capacity refers to a government's mission to provide services. While capital assets provide services directly, investments do not. Rather, investments are valuable to a government because investments can be used to pay for goods or services that in turn are used to provide services directly to its citizens. For example, when converted to cash, an investment may allow a government to acquire a capital asset, such as the construction of a bridge. The bridge provides services to a government's constituency.

Held Primarily for Income or Profit

66. A government acquires an investment with the expectation of future income or profit. Evidence that a government holds an asset for income or profit also may be found in the fund that reports the asset. For example, income-producing real property in a pension plan suggests that the asset is held primarily for income or profit.

Present Service Capacity Based Solely on an Asset's Ability to Generate Cash or to Be Sold to Generate Cash

67. Certain financial instruments may generate cash to finance the provision of services. However, the fact that a financial instrument generates cash does not, in itself, mean that it is an investment. For example, mortgage loans are not investments when the loans arise from a government's program that extends financing to first-time homebuyers.

Purpose Determined by a Government's Usage

68. The determination of whether an asset is held primarily for the purpose of income or profit or whether an asset's present service capacity is based solely on its ability to generate cash or to be sold to generate cash is based on actions by a government's management (that is, how the asset is used). How an asset is used may be determined in several ways, including investment policies, investment account separation (long-term strategy in one account versus short-term strategy in another), and historical practices. Accordingly, different governments holding similar asset types may arrive at different determinations based on the usage of the asset.

Investment Measurements and Other Statements

69. The provisions of this Statement should be applied to the measurement of investments reported at fair value, related recognition of gains and losses, and disclosures. The following investments should be measured as described below:

- a. Investments in nonparticipating interest-earning investment contracts should be measured using a cost-based measure as provided in paragraph 8 of Statement 31.

²Concepts Statement No. 4, *Elements of Financial Statements*, paragraph 8.

- b. Investments in unallocated insurance contracts should be reported as interest-earning investment contracts according to the provisions of paragraph 8 of Statement 31, and paragraph 4 of Statement No. 59, *Financial Instruments Omnibus*.
- c. Money market investments and participating interest-earning investment contracts that have a remaining maturity at time of purchase of one year or less and are held by governments other than external investment pools should be measured at amortized cost as provided in paragraph 9 of Statement 31.
- d. Investments in 2a7-like pools should be measured at the NAV per share determined by the pool as provided in paragraph 11 of Statement 31 and paragraph 5 of Statement 59.
- e. Synthetic guaranteed investment contracts that are fully benefit-responsive should be measured at contract value as provided in paragraph 67 of Statement 53.
- f. Investments in common stock described in paragraphs 202–210 of Statement 62 should be measured at fair value, unless they meet the criteria for the equity method. The cost method should not be applied to ownership in common stock that meets the definition of an investment; however, it should be applied when ownership in common stock does not meet the definition of an investment. The equity method of accounting should be applied to any investment that meets the criteria in paragraphs 205–208 of Statement 62 and is not specifically excluded in this paragraph. The following investments are excluded from using the equity method of accounting:
 - (1) Common stock held by:
 - (a) Governmental external investment pools
 - (b) Defined benefit pension or other postemployment benefit plans
 - (c) Internal Revenue Code Section 457 deferred compensation plans
 - (d) Endowments including permanent and term endowments, and permanent funds
 - (2) Investments in certain entities that calculate NAV per share (or its equivalent) as provided in paragraphs 73–76 of this Statement
 - (3) Investments in joint ventures or component units as provided in Statement 14, as amended.
- g. Investments in life insurance contracts should be measured at cash surrender value.

Life Settlement Contracts

70. Investments in life settlement contracts should be measured at fair value. Life settlement contracts have the following characteristics:
- a. The government-investor does not have an insurable interest (an interest in the survival of the insured, which is required to support the issuance of an insurance policy).
 - b. The government-investor provides consideration to the policy owner of an amount in excess of the current cash surrender value of the life insurance policy.
 - c. The contract pays the face value of the life insurance policy to the government-investor when the insured dies.
 - d. The government-investor is the policyholder.

Recognition and Reporting

71. All investment income, including changes in the fair value of investments, should be recognized as revenue as provided in paragraph 13 of Statement 31, as amended. That is, in

summary, all investment income, including changes in the fair value of investments, should be recognized as revenue in the flows statement. When identified separately as an element of investment income, the change in the fair value of investments should be captioned net increase (decrease) in the fair value of investments. Realized gains and losses should not be displayed separately from the net increase (decrease) in the fair value of investments in the financial statements, except that realized gains and losses may be separately displayed in the separate financial statements of governmental external investment pools. However, realized gains and losses, computed as the difference between the proceeds of sale and the original cost of the investments sold, may be disclosed in the notes to the financial statements.³ The disclosure also should state:

- a. The calculation of realized gains and losses is independent of the calculation of the net change in the fair value of investments.
- b. Realized gains and losses on investments that had been held in more than one reporting period and sold in the current period were included as a change in the fair value reported in the prior period(s) and the current period.

Acquisition Value

72. A measurement of an asset at the initial transaction date using the replacement cost measurement attribute is referred to as **acquisition value**. The following transactions should be measured at acquisition value:

- a. Donated capital assets, as provided in paragraph 18 of Statement 34, as amended
- b. Donated works of art, historical treasures, and similar assets as provided in paragraph 27 of Statement 34
- c. Capital assets that a government receives in a service concession arrangement as provided in paragraph 9 of Statement 60.

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

73. 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 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.

³The disclosure of default losses and recoveries on reverse repurchase agreements and securities lending transactions, as provided by paragraph 80 of Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*, and paragraph 15 of Statement No. 28, *Accounting and Financial Reporting for Securities Lending Transactions*, respectively, does not constitute a reporting of realized losses that under the provisions of this Statement would require disclosure of all realized gains and losses for the year.

74. If the NAV per share of the investment obtained from the investee is not as of the government's measurement date or is not calculated in a manner consistent with the measurement principles for investment companies, the government should consider whether an adjustment to the most recent NAV per share is necessary. The objective of any adjustment is to estimate a NAV per share for the investment that is calculated as of the government's measurement date in a manner consistent with the measurement principles for investment companies.

75. A government should determine on an investment-by-investment basis whether the method of estimating fair value in paragraph 73 should be applied. The method of estimating fair value should be applied consistently to the fair value measurement of the government's entire position in a particular investment, unless it is probable at the measurement date that the government will sell a portion of an investment at an amount different from NAV per share as described in the following paragraph. In those situations, the government should account for the portion of the investment that is being sold in accordance with other guidance in this Statement (that is, the government should not apply the guidance in paragraph 73).

76. The method of estimating fair value in paragraph 73 should not be applied if, as of the government's measurement date, it is probable that the government will sell the investment for an amount different from the NAV per share. A sale is considered probable only if all of the following criteria have been met as of the government's measurement date:

- a. The government, having the authority to approve the action, commits to a plan to sell the investment.
- b. An active program to locate a buyer and other actions required to complete the plan to sell the investment have been initiated.
- c. The investment is available for immediate sale subject only to terms that are usual and customary for sales of such investments (for example, a requirement to obtain approval of the sale from the investee, or a buyer's due diligence procedures).
- d. Actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

Disclosures

77. Disclosures required by this Statement should be organized by type or class of asset or liability. The level of detail and disaggregation, and how much emphasis to place on each disclosure requirement should take into account the following considerations:

- a. *The nature, characteristics, and risks of the asset or liability.* For example, U.S. Treasury notes should be disaggregated from U.S. Treasury strips.
- b. *The level of the fair value hierarchy within which the fair value measurement is categorized.* A greater degree of uncertainty and subjectivity suggests that the number of types and classes may need to be greater for fair value measurements categorized within Level 3 of the fair value hierarchy.
- c. *Whether this Statement or another Statement specifies a type or class for an asset or a liability.* For example, paragraph 69 of Statement 53 requires derivative instrument disclosures by hedging derivative instruments and investment derivative instruments.

- d. *The objective or the mission of the government.* For example, the objective of an external investment pool to achieve income or profit suggests greater disaggregation compared to a general purpose government.
- e. *The type of government.* A government may be composed of governmental and business-type activities, individual major funds, nonmajor funds in the aggregate, or fiduciary fund types and component units. Additional disclosures may be appropriate when the risk exposures are significantly greater than the deposit and investment risks of the primary government. For example, a primary government's total investments may not be exposed to concentration risk. However, if the government's capital projects fund has all of its investments in one issuer of corporate bonds, disclosure should be made for the capital projects fund's exposure to a concentration of credit risk.
- f. *Relative significance.* The relative significance of assets and liabilities measured at fair value compared to total assets and liabilities should be evaluated in terms of the government structure as discussed in subparagraph (e).
- g. *Whether separately issued financial statements are available.* For example, a state government may consider reduced disclosures of Level 3 inputs of hedging interest rate swaps if the state's housing finance authority (a discretely presented component unit) already provides detailed disclosures in its separately issued financial statements.
- h. *Line items presented in the statement of net position.*⁴ A class or type of asset or liability will often require greater disaggregation than the line items presented in the statement of net position.

78. A government should disclose the following information for each class or type of asset or liability measured at fair value in the statement of net position after initial recognition. Recurring fair value measurements of assets or liabilities are those that other Statements require or permit in the statement of net position at the end of each reporting period. Nonrecurring fair value measurements of assets or liabilities are those that other Statements require or permit in the statement of net position in particular circumstances (for example, when a government measures a mortgage loan held for sale at the lower of carrying value or fair value in accordance with paragraph 453 of Statement 62).

- a. For recurring and nonrecurring fair value measurements:
 - (1) The fair value measurement at the end of the reporting period
 - (2) The level of the fair value hierarchy within which the fair value measurements are categorized in their entirety (Level 1, 2, or 3)
 - (3) A description of the valuation techniques used in the fair value measurement
 - (4) If there has been a change in valuation technique that has a significant impact on the result (for example, changing from an **expected cash flow technique** to a relief from royalty technique or the use of an additional valuation technique), that change and the reason(s) for making it
 - (5) For fair value measurements categorized in Level 3, other than those that calculate NAV per share or its equivalent, the effect of those investments on investment income for the reporting period.
- b. For nonrecurring fair value measurements, the reason(s) for the measurement.

⁴Statement of net position includes governmental fund balance sheets.

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

79. For investments in entities that calculate a NAV per share (regardless of whether the method of determining fair value in paragraph 73 has been applied) and are measured at fair value on a recurring or nonrecurring basis during the period, a government should disclose information that addresses the nature and risks of the investments and whether the investments are probable of being sold at amounts different from the NAV per share. To meet that objective, a government should disclose the following information for each type of investment:

- a. The fair value measurement of the investment type at the reporting date and a description of the significant investment strategies of the investee(s) in that type.
- b. For each type of investment that includes investments that can never be redeemed with the investees, but the government receives distributions through the liquidation of the underlying assets of the investees, the government's estimate of the period of time over which the underlying assets are expected to be liquidated by the investees.
- c. The amount of the government's unfunded commitments related to that investment type.
- d. A general description of the terms and conditions upon which the government may redeem investments in the type (for example, quarterly redemption with 60 days' notice).
- e. The circumstances in which an otherwise redeemable investment in the type (or a portion thereof) might not be redeemable (for example, investments subject to a redemption restriction, such as a lockup or gate). Also, for those otherwise redeemable investments that are restricted from redemption as of the government's measurement date, the estimate of when the restriction from redemption might lapse should be disclosed. If an estimate cannot be made, that fact and how long the restriction has been in effect should be disclosed.
- f. Any other significant restriction on the ability to sell investments in the type at the measurement date.
- g. If a government determines that it is probable that it will sell an investment(s) for an amount different from NAV per share as described in paragraph 76, the total fair value of all investments that meet the criteria in paragraph 76 and any remaining actions required to complete the sale.
- h. If a group of investments would otherwise meet the criteria in paragraph 76 but the individual investments to be sold have not been identified (for example, if a government decides to sell 20 percent of its investments in private equity funds but the individual investments to be sold have not been identified), such that the investments continue to qualify for the method of estimating fair value in paragraph 73, the government's plans to sell and any remaining actions required to complete the sale(s).

EFFECTIVE DATE AND TRANSITION

80. The requirements of this Statement are effective for financial statements for reporting periods beginning after June 15, 2015. Earlier application is encouraged. In the period this Statement is first applied, changes made to comply with this Statement should be treated as an adjustment of prior periods, and financial statements presented for the periods affected should be

restated. However, restatement of assets that will no longer be measured at fair value is not required if restatement is not practical.

81. If restatement of the financial statements for all prior periods presented is not practical, the cumulative effect of applying this Statement, if any, should be reported as a restatement of beginning net position (or fund balance or fund net positions, as appropriate) for the earliest period restated (generally the current period). Also, the reason for not restating prior periods presented should be explained. In the period this Statement is first applied, the notes to the financial statements should disclose the nature of any restatement and its effect.

82. The use of acquisition value for transactions referred to in paragraph 72 should be applied prospectively to new transactions.

**The provisions of this Statement need
not be applied to immaterial items.**

GLOSSARY

83. This paragraph contains definitions of certain terms *as they are used in this Statement*; the terms may have different meanings in other contexts.

Acquisition value

The price that would be paid to acquire an asset with equivalent service potential in an orderly market transaction at the acquisition date, or the amount at which a liability could be liquidated with the counterparty at the acquisition date.

Active market

A market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

Brokered market

A market in which brokers attempt to match buyers with sellers but do not stand ready to trade for their own account. In other words, brokers do not use their own capital to hold an inventory of the items for which they make a market. The broker knows the prices bid and asked by the respective parties, but each party is typically unaware of another party's price requirements. Prices of completed transactions are sometimes available. Brokered markets include electronic communication networks, in which buy and sell orders are matched, and commercial and residential real estate markets.

Cost approach

A valuation technique that reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).

Credit risk

The risk that a counterparty will not fulfill its obligations.

Dealer market

A market in which dealers stand ready to trade (either buy or sell for their own account), thereby providing liquidity by using their capital to hold an inventory of the items for which they make a market. Typically, bid and ask prices (representing the price at which the dealer is willing to buy and the price at which the dealer is willing to sell, respectively) are more readily available than closing prices. Over-the-counter markets (for which prices are publicly reported, for example, by the National Association of Securities Dealers Automated Quotations systems or by OTC Markets Group, Inc.) are dealer markets. For example, the market for U.S. Treasury securities is a dealer market. Dealer markets also exist for some other assets and liabilities, including other financial instruments, commodities, and physical assets (for example, used equipment).

Exchange market

A market in which closing prices are both readily available and generally representative of fair value. An example of such a market is the New York Stock Exchange.

Exit price

The price that would be received to sell an asset or paid to transfer a liability.

Expected cash flow technique

The probability-weighted average (that is, mean of the distribution) of possible future cash flows.

Fair value

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.

Financial asset

Cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right to do either of the following:

- a. Receive cash or another financial instrument from a second entity
- b. Exchange other financial instruments on potentially favorable terms with the second entity (for example, an option).

Financial instrument

Cash, evidence of an ownership interest in an entity, or a contract that both:

- a. Imposes on one entity a contractual obligation to deliver cash or another financial instrument to a second entity or exchange other financial instruments on potentially unfavorable terms with the second entity (for example, an option)
- b. Conveys to that second entity a contractual right to receive cash or another financial instrument from the first entity or to exchange other financial instruments on potentially favorable terms with the first entity (for example, an option).

Financial liability

A contract that imposes on one entity an obligation to do either of the following:

- a. Deliver cash or another financial instrument to a second entity
- b. Exchange other financial instruments on potentially unfavorable terms with the second entity (for example, an option).

Highest and best use

The use of a nonfinancial asset by market participants that would maximize the value of the asset or the group of assets and liabilities within which the asset would be used.

Income approach

A valuation technique that converts future amounts (for example, cash flows or income and expenses) to a single current (discounted) amount. The fair value measurement is determined on the basis of the value indicated by current market expectations about those future amounts.

Inputs

The assumptions that market participants would use when pricing the asset or liability, including assumptions about risk, such as the following:

- a. The risk inherent in a particular valuation technique used to measure fair value (such as a pricing model)
- b. The risk inherent in the inputs to the valuation technique.

Inputs may be observable or unobservable.

Investee

An entity that issued an equity instrument of which all or a portion is held by an investor.

Investment

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.

Level 1 inputs

Quoted prices (unadjusted) in active markets for identical assets or liabilities that the government can access at the measurement date.

Level 2 inputs

Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 inputs

Unobservable inputs for the asset or liability.

Market approach

A valuation technique that uses prices and other relevant information generated by market transactions involving identical or comparable (similar) assets, liabilities, or a group of assets and liabilities, such as a business.

Market-corroborated inputs

Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Market maker

An entity or individual that provides both a bid and ask price and is willing and able to transact at those prices.

Market participants

Buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics:

- a. They are independent of each other, that is, they are not related parties, although the price in a related-party transaction may be used as an input to a fair value measurement if the government has evidence that the transaction was entered into at market terms.
- b. They are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual and customary.
- c. They are able to enter into a transaction for the asset or liability.
- d. They are willing to enter into a transaction for the asset or liability, that is, they are motivated but not forced or otherwise compelled to do so.

Market risk

The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises the following:

- a. Interest rate risk
- b. Currency risk
- c. Other price risks.

Matrix pricing

A valuation technique used to value securities based on the securities' relationship to benchmark quoted prices.

Most advantageous market

The market that maximizes the amount that would be received to sell the asset or minimizes the amount that would be paid to transfer the liability, after taking into account transaction costs and transportation costs.

Multiperiod excess earnings method

A valuation technique based on prospective financial information (for example, revenues, expenses, or cash flows) associated with a collection of assets, then reduced for the contributions of supporting assets, with the residual amount being the excess earnings associated with the asset being valued.

Net asset value per share

The amount of net assets attributable to each share of capital stock (other than senior equity securities, that is, preferred stock) outstanding at the close of the period. It excludes the effects of assuming conversion of outstanding convertible securities, whether or not their conversion would have a diluting effect.

Nonperformance risk

The risk that an entity will not fulfill an obligation. Nonperformance risk includes, but may not be limited to, the government's own credit risk.

Observable inputs

Inputs that are developed using market data, such as publicly available information about actual events or transactions, and that reflect the assumptions that market participants would use when pricing the asset or liability.

Option pricing model

A valuation technique used to value an option contract that is based on the critical terms of the contract and implied volatility.

Orderly transaction

A transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (for example, a forced liquidation or distress sale).

Present value

A technique used to link future amounts (cash flows or values) to a present amount using a discount rate (an application of the income approach).

Principal market

The market with the greatest volume and level of activity for the asset or liability.

Principal-to-principal market

A market in which transactions, both originations and resales, are negotiated independently with no intermediary. Little information about those transactions may be made available publicly.

Readily determinable fair value

An equity security has a readily determinable fair value if it meets any of the following conditions:

- a. The fair value of an equity security is readily determinable if sales prices or bid-and-asked quotations are currently available on a securities exchange registered with the U.S. Securities and Exchange Commission or in the over-the-counter market, provided that those prices or quotations for the over-the-counter market are publicly reported by the National Association of Securities Dealers Automated Quotations systems or by OTC Markets Group, Inc. Restricted stock meets that definition if the restriction terminates within one year.
- b. The fair value of an equity security traded only in a foreign market is readily determinable if that foreign market is of a breadth and scope comparable to one of the U.S. markets referred to above.
- c. The fair value of an investment in a mutual fund is readily determinable if the fair value per share (unit) is determined and published and is the basis for current transactions.

Relief from royalty technique

A valuation technique based on discounted cash flows of royalty payments that would be required to use an asset if the government did not own it.

Risk premium

Compensation sought by risk-averse market participants for bearing the uncertainty inherent in the cash flows of an asset or a liability. Also referred to as a risk adjustment.

Transaction costs

The costs to sell an asset or transfer a liability in the principal (or most advantageous) market for the asset or liability that are directly attributable to the disposal of the asset or the transfer of the liability and meet both of the following criteria:

- a. They result directly from and are essential to that transaction.
- b. They would not have been incurred by the entity had the decision to sell the asset or transfer the liability not been made.

Transportation costs

The costs that would be incurred to transport an asset from its current location to its principal (or most advantageous) market.

Unit of account

The level at which an asset or a liability is aggregated or disaggregated for recognition purposes.

Unobservable inputs

Inputs for which market data are not available and that are developed using the best information available about the assumptions that market participants would use when pricing the asset or liability.

Valuation technique

A specific method or combination of methods used to determine the fair value of an asset or liability.

Appendix A

BACKGROUND

A1. Past economic events have placed renewed focus on fair value measurements in financial statements, including when these measurements are or are not used and how they are measured. The Governmental Accounting Standards Board (GASB) first issued “fair value” guidance in Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*. The topic of fair value also has been incorporated in Statements No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, No. 40, *Deposit and Investment Risk Disclosures*, and No. 53, *Accounting and Financial Reporting for Derivative Instruments*. Since the publication of these Statements, inconsistencies with other standards, lack of guidance for specific areas, and diversity in how these standards are applied have been identified.

A2. Pre-agenda research on fair value measurement was added to the Board’s technical agenda in April 2008. The pre-agenda research phase included conducting a survey of preparers and auditors to assess the current practices related to which assets and liabilities are measured at fair value and the methods used to make that measurement. Financial statement users also were surveyed. That survey focused on the usefulness and perceived reliability of fair value measurements and disclosures.

A3. Based on the research findings, a project prospectus was discussed with the Governmental Accounting Standards Advisory Council (GASAC) in October 2010 and again in March 2011. Based on the GASAC feedback and perceived need for additional guidance in this area, a project was added to the Board’s current technical agenda in August 2011, and deliberations began in October 2011.

A4. In June 2013, a Preliminary Views, *Fair Value Measurement and Application*, was issued. The Preliminary Views proposed revised definitions of *fair value* and *investments*. General principles that address fair value were described, including a hierarchy of inputs that indicates a preference for market-observed prices. The application of fair value focused on investments and exceptions to fair value within that classification. Further, the Preliminary Views proposed that in certain instances, a fair value measurement should be replaced by a measurement based on acquisition value. Finally, additional fair value disclosures were described. Thirty-seven responses were received, and 11 individuals or groups testified at a public hearing held in November 2013. An Exposure Draft of a proposed Concepts Statement, *Measurement of Elements of Financial Statements*, that described a conceptual basis for fair value measurements was simultaneously released for comment. After considering due process feedback, the Board approved Concepts Statement No. 6, *Measurement of Elements of Financial Statements*, in March 2014.

A5. During the comment period of the Preliminary Views, a field test was conducted. Participants were asked to apply the provisions of the Preliminary Views to their most recently issued financial statements on a pro forma basis. Information was received that addressed

whether the provisions of the Preliminary Views would be operational, including the revised definitions of fair value and investments as well as costs to implement the Preliminary Views. Also during the comment period, a webinar was conducted for the benefit of financial statement users. A survey of those users was conducted following the webinar.

A6. The Board assembled a task force composed of members broadly representative of the GASB's stakeholders. The task force members were provided with papers describing the issues discussed by the Board and drafts of the Preliminary Views and this Statement, including illustrative disclosure examples for review and comment. In addition, further feedback was given by GASAC members at several of its meetings.

Appendix B

BASIS FOR CONCLUSIONS

Introduction

B1. This appendix discusses factors considered significant by Board members in reaching the conclusions in this Statement. It includes discussion of the alternatives considered, and the Board's reasons for accepting some and rejecting others. Individual Board members may have given greater weight to some factors than to others.

Overview

B2. The Board began considering a project on fair value based on stakeholders' requests for more consistent and comprehensive guidance in this area and the developments in the accounting standards on fair value measurements issued by the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB). The 2008 and 2009 credit crisis also highlighted issues related to measurement and application of fair value and related disclosures. The Board believes that the accounting and financial reporting guidance on fair value measurement, application, and disclosure provided by this Statement should result in increased consistency, improved comparability in accounting and financial reporting, and more understandable and useful information for financial statement users.

Scope and Applicability

B3. The general principles and guidance set forth in this Statement should be applied when an asset or liability is measured at fair value. This Statement requires fair value measurements for certain investments not previously measured at fair value. It does not extend the application of fair value measurements to other assets or liabilities that previously were not measured at fair value. The Board weighed the ability to provide application guidance on investments against the comprehensive guidance that may have resulted from a full review of when fair value should or should not be applied, and it concluded that issuance of full fair value measurement guidance with limited application scope was the most appropriate path forward because of the additional time that a comprehensive review would require.

General Principles

Definition of Fair Value

B4. The definition of fair value in this Statement is updated to be consistent with the definition provided in *FASB Accounting Standards Codification*[®] Topic 820, Fair Value Measurement. This Statement's definition supersedes the definitions of fair value contained in paragraph 24 of Statement 25, paragraphs 7 and 22 of Statement 31, and other Statements. Fair value is defined in Statement 31 as "the amount at which an investment could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale" (paragraph 7). To enhance the relevance and representational faithfulness of fair value measurements and to

improve consistency in financial reporting, the revised definition in this Statement indicates that fair value is a market-based measurement, not an entity- or government-specific measurement. The revised definition emphasizes that a fair value measurement is determined at the measurement date, improving upon the definition in Statement 31, which refers only to a current transaction. The phrase *other than in a forced or liquidation sale* is replaced by *orderly transaction*. Finally, the revised definition replaces *willing parties* with *market participants* to put additional emphasis on markets.

B5. The definition of fair value in this Statement retains the exchange price notion contained in the earlier definition of fair value. This Statement, however, clarifies that the exchange price is the price in an orderly transaction between market participants to sell the asset or transfer the liability in the principal (or most advantageous) market for the asset or liability. The Board concluded that the transaction to sell the asset or transfer the liability should be based on an orderly transaction, not a forced transaction (for example, if the seller is experiencing financial difficulty). The transaction assumes exposure to the market for a period prior to the measurement date to allow for information dissemination and marketing in order to transact at the most advantageous price for the asset or liability at the measurement date. The transaction to sell an asset or transfer a liability on which the determination of fair value is based is a hypothetical transaction at the measurement date, considered from the perspective of a market participant that holds the asset or owes the liability. Therefore, the objective of a fair value measurement is to determine the price that would be received to sell the asset or paid to transfer the liability at the measurement date—that is, an exit price. The Board concluded that an exit price objective is appropriate because it embodies current expectations about the future inflows of resources associated with the asset and the future outflows of resources associated with the liability from the perspective of market participants. The emphasis on inflows and outflows of resources is consistent with the definitions of assets and liabilities in Concepts Statement No. 4, *Elements of Financial Statements*. Paragraph 8 of Concepts Statement 4 defines *assets* as “resources with present service capacity that the government presently controls,” and paragraph 17 defines *liabilities* as “present obligations to sacrifice resources that the government has little or no discretion to avoid.” By making these changes, the definition of fair value becomes more consistent with the notions and assumptions found in other definitions of valuation that are similar to fair value, such as market value and fair market value.

B6. Some respondents to the Preliminary Views expressed confusion between the term *measurement date* in the definition of fair value and the financial reporting date. The measurement date is determined by the standards that require the fair value measurement. While many times the measurement date is the same as the financial reporting date, the Board concluded that the measurement date can be a date different from the reporting date. For example, when an impaired capital asset that will no longer be used by the government is held for sale, such an impaired asset is remeasured at the lower of carrying value or fair value (paragraph 16 of Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*). In many cases related to this type of capital asset impairment, the measurement date of fair value will be different from the date of the financial report.

Relationship to Concepts Statement 6

B7. This Statement is consistent with Concepts Statement 6—measurement approaches and measurement attributes also are addressed in Concepts Statement 6. The two measurement approaches report assets and liabilities in a financial statement at either (a) an *initial amount* that reflects the value at the date when the asset was acquired or the liability incurred or (b) a *remeasured amount* that reflects that value at the date of the financial statements. A measurement attribute is the feature or characteristic of the asset or liability that is being measured with one of the two approaches. There are four measurement attributes for elements of traditional financial statements identified in Concepts Statement 6: historical cost, fair value, replacement cost, and settlement amount.

B8. Fair value is identified in Concepts Statement 6 as one of the four measurement attributes that is defined and further described as follows:

Fair value is 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. As such, fair value is an exit price. The market to which the definition of fair value refers is the principal market or, when there is not a principal market, the entity's most advantageous market. For nonfinancial assets, the price should represent the value of the asset at its highest and best use as determined by market participants. The highest and best use notion takes into account uses that are physically possible, legally permissible, and financially feasible. For liabilities, the price should take into consideration the credit standing of the entity. Multiple valuation techniques may be used to measure fair value.

Fair value is appropriate for use either as an initial amount or as a remeasured amount. Fair value could be applied as an initial amount in circumstances in which a historical cost amount is not available, typically because the asset or liability did not arise from an exchange transaction or because the asset or liability was acquired in a group without amounts assigned to the individual assets and liabilities in the group. Relevance of the use of fair value to presenting information that promotes the objectives of financial reporting is tied to (a) whether it is applied as an initial amount or a remeasured amount and (b) the nature of the asset or liability being measured. The extent to which a fair value is understandable, reliable, and timely depends upon the techniques and inputs used to measure fair value. Comparability of information in a statement of financial position is improved when fair value is used as a remeasured amount. Fair value generally is not appropriate for assets that will be used directly to provide services because fair value is an exit price and governments will not be selling or otherwise exiting from these assets. [paragraphs 38 and 39]

The Asset or Liability

B9. The Board concluded that fair value measurements should not be developed independent of market inputs for a particular asset or liability. Therefore, the measurement should consider attributes specific to the asset or liability. Because market participants also would take into

account the characteristics of that asset or liability, the government should consider those characteristics when making a fair value measurement.

Unit of Account

B10. This Statement introduces into the GASB authoritative literature the term *unit of account*, referring to the level at which an asset or a liability is aggregated or disaggregated as provided by accounting standards for recognition purposes. The Board concluded that a government should consider the unit of account at which the fair value measurement is made because accounting standards vary in the way assets and liabilities are measured. The unit of account may be a stand-alone asset or liability (for example, a financial instrument), a group of assets, a group of liabilities, or a group of related assets and liabilities (for example, a partnership). Whether the reported asset or liability is a stand-alone asset or liability or in a group depends on its unit of account. The unit of account is not unique to fair value measurements; once the unit of account is established—whether at an individual account level or an aggregated level—relevant measurement attributes can be applied.

Markets

B11. A fair value measurement assumes that a hypothetical transaction takes place in markets to which a government has access: either the principal market for that asset or liability or the most advantageous market (if there is no principal market). The Board concluded that the principal market for an asset or liability is the market with the greatest volume and level of activity in which a government would sell the asset or transfer the liability. The market in which the government normally would transact is presumed to be the principal market because the price in that market is the most likely price that the government would receive or pay. The most advantageous market is the market in which the government would sell the asset for the maximum amount or transfer the liability for the minimum amount. Transaction costs are considered in determining the most advantageous market.

Market Participants

B12. The Board believes it is important to emphasize that a fair value measurement is a market-based measurement, not an entity-specific measurement, because market-based measurements result in greater comparability. Therefore, a fair value measurement should be determined based on the assumptions that market participants—buyers and sellers in the principal (or most advantageous) market for the asset or liability—would use in pricing the asset or liability. To convey more clearly the idea of fair value measurement from the perspective of market participants, the Board replaced the term *willing parties* in the existing definition of fair value with *market participants* in the definition of fair value in this Statement, referring to buyers and sellers in the principal (or most advantageous) market for the asset or liability. These participants are independent of the reporting entity (unrelated), knowledgeable, and both able and willing to transact. The Board concluded that it is reasonable to presume that market participants that are both able and willing to transact for the asset or liability act in their own best interest and seek to maximize the fair value of an asset or minimize the fair value of a liability.

The Price and Transaction Costs

B13. The Board concluded that the price used in a fair value measurement should not be adjusted for transaction costs. Transaction costs represent the incremental direct costs incurred to sell an asset or transfer a liability in the principal (or most advantageous) market for the asset or liability, such as brokerage commissions. Incremental direct costs to sell an asset or transfer a liability refer to those costs that result directly from and are essential to that transaction. These costs would not have been incurred by the government had the decision to sell the asset (or transfer the liability) not been made. Because transaction costs relate to the current period, they should be reported as an expenditure or expense in that period. Such costs are specific to each transaction. These costs can vary from government to government; therefore, they are entity-specific rather than market-based. However, the Board believes that transaction costs should be considered to determine the most advantageous market, because the most advantageous market is the one that results in the greatest net benefit to the participant.

B14. Some respondents to the Preliminary Views requested that the Board clarify the reason that transaction costs are considered in the determination of the most advantageous market but are not considered when measuring fair value. The Board believes that a principal or most advantageous market approach is based on the assumption that the goal for most entities is to maximize income or minimize losses. As such, a market participant would take into account transaction costs in determining its most advantageous market, in order to maximize income or minimize losses. However, because transaction costs are not attributes of an asset or liability, the price in the principal (or most advantageous) market used to measure fair value of an asset or liability would not be adjusted for transaction costs.

B15. Some respondents to the Preliminary Views believe that transaction costs are similar to ancillary charges related to the acquisition of capital assets. The Board concluded that transaction costs in the context of fair value measurement are costs that arise from disposing of an investment (an exit-price notion) and are generally not treated the same in standards or practice as the costs related to the acquisition of an investment (an entry-price notion).

B16. The standards for measuring investments in pension and other postemployment benefit (OPEB) plans currently require that the fair value of those investments “reflect brokerage commissions and other costs normally incurred in a sale, if determinable” (footnote 7 of Statement 25; footnote 4 of Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*; and footnote 7 of Statement No. 67, *Financial Reporting for Pension Plans*). The Board concluded that fair value measurements should be applied, regardless of the type of government that is reporting them, because it enhances consistency in financial reporting.

Valuation Approaches and Techniques

B17. The Board believes that the techniques used to measure fair value should be based on three approaches—market, cost, and income. The objective of a valuation approach is to determine the price at which an orderly transaction to sell an asset or to transfer a liability would take place between market participants at the measurement date under current market conditions. A

valuation technique is a specific method or combination of methods used to determine the value of an asset or a liability. The Board recognizes that there can be many ways to determine the fair value of an asset or liability, and the valuation approaches allow for many possible valuation techniques. However, providing guidance on the approaches gives governments a framework for distinguishing between appropriate and inappropriate valuation techniques.

B18. If a transaction price is fair value at initial recognition and a valuation technique that uses unobservable inputs will be used to measure fair value in subsequent periods, the valuation technique should be calibrated so that at initial recognition, the result of the valuation technique equals the transaction price. Calibration ensures that the valuation technique reflects current market conditions, and it helps a government to determine whether an adjustment of the valuation technique is necessary. For example, adjustment is necessary when there is a characteristic of an asset or liability that is not captured by the valuation technique.

Inputs Based on Bid and Ask Prices

B19. The Board concluded that the use of a bid price for an asset and an ask price for a liability should be permitted but not required. The price most representative of fair value should be used to measure fair value. However, when no price is more representative than another, the use of bid and ask prices in such circumstances is justified because these are the prices that assure that an asset could be sold or a liability transferred. The optional use of bid and ask prices may provide a practical expedient that could assist in the application of fair value.

Fair Value Hierarchy

B20. The Board concluded that measurements of the fair value of assets and liabilities should be organized into a hierarchy based on the level of inputs used to measure fair value. The hierarchy is necessary because the Board concluded that there are qualitative differences among inputs used to measure fair value. These qualitative differences suggest that fair values based on those inputs should be prioritized. The fair value hierarchy prioritizes the inputs used to measure fair value into three broad categories—Level 1, Level 2, and Level 3 inputs—considering the relative reliability of the inputs. Introduction of a third category is a change from current requirements that allow for only two possibilities—market-observed prices and those that are not. The Board believes that three categories provide sufficient distinction to reflect the qualitative differences among inputs without the categories becoming too narrow.

Level 1 Inputs

B21. Inputs within Level 1 of the fair value hierarchy are unadjusted quoted prices in active markets for identical assets or liabilities. The Board concluded that quoted prices in active markets generally provide the most reliable evidence of fair value and should be used to measure fair value whenever available. Quoted prices in active markets are easy to obtain and reliable (verifiable and free from bias). They are used and relied upon regularly and are well understood by financial statement users. The Board also concluded that prices should come from markets that are accessible by governments.

Blockage Factor

B22. The Board concluded that a blockage factor—a premium or discount for the size of a government’s holding of an asset—should not be an input in pricing an asset. It is a characteristic of a government’s position in holding an asset rather than a characteristic of the asset itself. In the Board’s view, the use of a blockage factor would reduce the reliability and comparability of the fair value measurements.

Level 2 Inputs

B23. Inputs within Level 2 of the fair value hierarchy include inputs that are directly observable for an asset or a liability (including quoted prices for *similar* assets or liabilities), as well as inputs that are not directly observable for the asset or liability. These inputs are derived principally from or corroborated by observable market data through correlation or by other means (market-corroborated inputs). The concept of market-corroborated inputs is intended to incorporate observable market data (such as interest rates and yield curves that are observable at commonly quoted intervals) based on an assessment of factors relevant to the asset or liability. Because of these reasons, the Board concluded that market-corroborated inputs are observable inputs and, therefore, are more reliable than unobservable inputs. Fair value measurements using market-corroborated inputs (Level 2) should be distinguished from fair value measurements using unobservable inputs (Level 3) based on the difference in reliability between those types of inputs.

Level 3 Inputs

B24. Level 3 inputs are unobservable inputs for an asset or a liability and should be used only when relevant Level 1 and Level 2 inputs are not available. For example, a government holds a commercial mortgage-backed security as an investment and no observable inputs are available for measuring its fair value. Therefore, in determining the security’s fair value, assumptions are made by the government regarding the prepayment rates, probability of defaults, and loss severity. Because these assumptions are internally generated and cannot be observed in the market, the assumptions are *unobservable* and therefore should be classified as Level 3 inputs. In addition, the Board believes that the government may use its own data to develop unobservable inputs if there is no information available (without undue cost and effort) indicating that market participants would use different assumptions in pricing the asset or liability. In some cases, the best information available with which to develop unobservable inputs might be a government’s own data.

Categorizing Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent) within the Fair Value Hierarchy

B25. The Board concluded that governments should be permitted to calculate the fair value of certain investments that do not have a readily determinable fair value using a practical expedient based on the investment’s net asset value (NAV) per share (or its equivalent, such as member units or ownership interest in partners’ capital). Investments that calculate NAV per share, such as hedge funds, often cannot be traded and, therefore, market-based information regarding their

value may not exist. Many governments already use NAV per share as an approximation of fair value. The Board believes that this practical expedient acknowledges current practice and will allow that practice to continue.

B26. The Board believes that it is necessary to provide guidance on how to classify investments measured at NAV per share within the fair value hierarchy because the practical expedient does not include all aspects of the investment that a market participant would consider. Therefore, the Board concluded that classification within the fair value hierarchy should be based on whether it is possible to redeem the investment at the NAV per share at the measurement date and other restrictions.

Measuring Fair Value When the Volume or Level of Activity for an Asset or a Liability Has Significantly Decreased—Active and Inactive Markets

B27. During the credit crisis of 2008 and 2009, experience suggested that there can be occasions when markets are not active. The Board believes that the fair value of an asset or liability might be affected when there is a significant decrease in the volume or level of activity for that asset or liability in relation to its normal market activity. If a government's evaluation of factors confirms this occurrence, further analysis of the transactions or quoted prices may be necessary. If the government then determines that a transaction or quoted price does not represent fair value, an adjustment may be necessary when the government uses that price as a basis for measuring fair value. A change in valuation technique also may be appropriate in these circumstances. This Statement does not prescribe a methodology for adjusting the transactions or quoted prices.

Identifying Transactions That Are Not Orderly

B28. The definition of fair value is based on an orderly transaction. Because not all transactions are orderly, the Board believes that prices arising from transactions that are not orderly are not fair values and therefore should be adjusted. The Board concluded that the indicators that transactions are not orderly included in this Statement provide a basis for governments to identify whether a transaction is orderly.

B29. The Board concluded that governments should consider readily available information as to whether transactions used in fair value measurements are orderly. The Board believes this consideration is necessary, because reliance on transactions that are not orderly in the measurement of fair value could result in a significantly different amount than if prices from orderly transactions were considered.

Using Quoted Prices Provided by Third Parties

B30. The Board is aware that some governments use pricing services or brokers to obtain fair value measurements. The Board concluded that quoted prices provided by third parties, such as pricing services or brokers, are acceptable ways to measure fair value, as long as the government has determined that those prices have been developed in accordance with the guidance in this Statement. The same considerations of market volume and orderly transactions apply, and the government should understand the inputs used by the third parties in developing the quotes. To

remove uncertainty regarding the acceptability of using such services, the Board believes this provision should assist governments in making their fair value measurements.

Measurement of Nonfinancial Assets—Highest and Best Use

B31. The Board believes that a government's use of real property, held as an investment and evaluated consistent with its current zoning, is its highest and best use. The highest and best use refers to a market participant's ability either to use the asset or to sell it to another market participant to maximize economic benefits. The notion is limited, however, to uses of the asset that are physically possible, legally permissible, and financially feasible.

B32. The Board observes that some governments are in a unique position to affect highest and best use through their ability to change what is legally permissible. For example, a government may hold industrial land that could be rezoned for multi-family housing. However, the presumption is that a government's use of nonfinancial property as it is currently zoned is its highest and best use.

B33. The highest and best use of a nonfinancial asset may provide maximum value to market participants as a stand-alone asset, in combination with other assets as a group, or in combination with other assets and liabilities. The valuation approach used to measure a nonfinancial asset could differ depending on whether its highest and best use is based on the asset as a stand-alone asset, in combination with other assets as a group, or in combination with other assets and liabilities.

Measurement of Liabilities

B34. The Board believes that a fair value measurement of a liability assumes that the liability is transferred to another party at the measurement date. The other party would then be required to fulfill the obligation; the liability would not be settled with the counterparty or otherwise extinguished at that time. Because fair value is being defined as a market-based price, the Board believes that the price received to transfer a liability to a market participant is a better measure of fair value than the amount needed to settle with the counterparty.

Liabilities Held by Other Parties as Assets

B35. If a quoted price for a transfer of an identical or similar liability is not available but an identical item is held by another party as an asset, the Board believes it is appropriate for a government to measure the fair value of its liability based on the fair value of the other party's asset. In the Board's view, the fair value of a liability should equal the fair value of a properly defined corresponding asset (that is, an asset that has features that mirror those of the liability), assuming an exit from both positions in the same market at the same time. The Board concluded that there is no conceptual reason why the liability value should diverge from the corresponding asset value in the same market if the contractual terms are the same, unless (a) the unit of account for the liability is different from the unit of account for the asset or (b) the quoted price for the asset relates to a similar (but not identical) liability held as an asset.

Nonperformance Risk and Liabilities Issued with Third-Party Credit Enhancement

B36. The Board believes that the fair value of a liability should reflect nonperformance risk, including, but not limited to, a government's own credit risk, because a market participant may place a premium or discount on the price paid to a transferor of a liability based on those risk factors. For example, a credit enhancement (also referred to as a guarantee) may be purchased by a government-issuer that combines the enhancement with a financial instrument, such as an interest rate swap. Generally, if the government fails to meet its payment obligations to the swap counterparty, the credit enhancer (also referred to as a guarantor) has an obligation to make swap payments on the issuer's behalf and the government has an obligation to the guarantor.

Restrictions Preventing the Transfer of a Liability

B37. The Board concluded that the measurement of the fair value of a liability should not consider any restrictions that would prevent the liability from being transferred. Such restrictions would implicitly or explicitly be included in the other inputs used in the measurement and would not require a separate consideration.

Application of Fair Value to Assets and Liabilities

Definition of an Investment

B38. In conjunction with its deliberations regarding fair value, the Board evaluated the definition of an investment. The Board believes that a government acquires an investment asset primarily for future income or profit and the asset's present service capacity is based solely on its ability to generate cash or to be sold to generate cash.

Procure Services versus Provide Services

B39. The proposed definition of an investment in the Preliminary Views was "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." The phrase *to procure services for the citizenry* was included in the definition of an investment because of a concern that the references to generating cash might cause some practitioners not to consider certain assets as investments if those assets were traded directly for goods or services, instead of being sold for cash to pay for those goods or services, such as transactions in a barter system. Many respondents to the Preliminary Views cited that phrase as a source of confusion. During redeliberations, the Board considered the barter situation that introduced the phrase *to procure services for the citizenry* into the definition of an investment. The Board concluded that the present service capacity based on the ability to generate cash or to be sold to generate cash does not mean that the investment is required to be sold for cash. A government could barter an investment, exchanging the investment directly with a vendor for services for the citizenry, rather than selling the investment and paying cash to the vendor. However, the government still had the ability to sell the investment for cash, even though it did not actually do so. Because this type of transaction rarely exists in practice, the

Board concluded that the phrase *to procure services for the citizenry* introduced more confusion than clarity. As a result, the Board deleted that phrase from the definition of an investment.

Investments or Capital Assets

B40. Some respondents to the Preliminary Views were concerned that an asset could simultaneously meet the existing definition of a capital asset and the definition of an investment. In paragraph 19 of Statement 34, capital assets are defined as “land, improvement to land, easements, buildings, building improvements, vehicles, machinery, equipment, works of art and historical treasures, infrastructure, and all other tangible or intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period.” An example of a type of tangible asset that could be characterized as a capital asset and an investment at the same time is an apartment building held for income by a pension plan or an endowment. In the Board’s view, for the asset in that example to meet the definition of a capital asset and the definition of an investment simultaneously, it would require one to believe that a pension plan or endowment’s operation is characterized as managing an apartment building.

B41. Based on comments received from respondents to the Preliminary Views, the Board also considered the notion of a “mixed-use” or “multi-use” asset that some respondents believe meets the definition of both a capital asset and an investment. A common example of a mixed-use asset is a city hall in a downtown area, in which the first floor is rented to retail stores by the city to generate rental income, and the rest of the building is occupied by the city government for its day-to-day operations. One may argue that because the building is partially used to generate income for the city and partially used to facilitate the operational needs of the city government, the building is a mixed-use asset and, therefore, should be split between a capital asset and an investment. The Board does not agree with this view because of the unit of account. The unit of account to be measured is the entire building, rather than the different parts of the building. The entire building is either an investment or a capital asset. While the retail space on the first floor is used to generate income, the primary purpose of the building is to provide office space for the city government for its operational needs. The present service capacity of the building is not based *solely* on its ability to generate cash; therefore, the building does not meet the revised definition of an investment. Even though the building is a mixed-use asset, the unit of account that should be measured is at the aggregate level. Because of these reasons, the Board concluded that mixed-use assets do not simultaneously meet the definition of a capital asset and an investment.

Application to Liabilities

B42. The definition of an investment starts with “a security or other asset.” Some respondents expressed concern about how the definition of an investment would apply to liabilities. According to the existing guidance in Statements No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*; No. 28, *Accounting and Financial Reporting for Securities Lending Transactions*; and 53; as well as in the June 30, 2013 edition of the *Comprehensive Implementation Guide* (6.21.1), there can be transactions in which an investor expects to profit from the decline in value of a liability. Such transactions have been classified as liabilities on the basis of the unit of account. The Board does not believe it is within the scope of this Statement to consider whether those transactions should

be netted with investment assets. While the Board believes that those liabilities should be measured at fair value, the Board also believes those transactions that have been classified as liabilities should continue to be classified as liabilities rather than investments. Therefore, the application of the definition of an investment is limited only to assets. The application of fair value measurement to liabilities would have to be addressed in amendments to the existing guidance.

Real Property

B43. One Preliminary Views respondent expressed concern about how the definition of an investment would affect the reporting of real estate assets and suggested the fair value model be extended to real property that can be converted into investments. 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 and investments that are not measured at fair value. To develop the accounting treatment for an asset that could be reclassified would not meet the agreed upon scope of this Statement.

Investments to Be Measured at Fair Value

B44. The Board believes that any asset that meets the definition of an investment should be measured at fair value, provided that the investment's measurement is not specified in this Statement to be some other basis, such as contract value. The Board believes that fair value measurements should bring consistency and comparability to the reporting of items that are held as investments. Governments with investments that have significant fair value changes should report those changes as gains and losses on the basis that those gains and losses represent increases and decreases, respectively, of that government's ability to finance its activities and of the financial resources available to finance claims on that government's resources. In the Board's view, cost-based measurements have the potential to mislead financial statement users because unrealized losses could become realized losses if a government chooses or is forced to sell debt investments prior to their scheduled maturities.

B45. The Board concluded that securitized debt obligations should be measured at fair value. The Board believes that fair value is the most relevant measure for these types of assets because securitization indicates a different motivation for holding the assets. That is, securitized debt obligations are liquid securities that could be readily sold.

B46. The alternatives to fair value measurements in current practice generally are cost-based—cost or amortized cost. Under cost-based measurements, when a debt instrument's fair value declines, practitioners are required to consider whether a financial instrument's fair value decline will become a realized loss. Two factors in this consideration are the government's ability and intent to hold a debt instrument to maturity. Credit risk—the possibility that a debtor may not be able to make debt service payments in the future—is another consideration. Experience suggests that recognition of unrealized losses—impairments—may not precede a government reporting realized losses. While some observe that fair value requires the application of judgment, cost-based measures are not immune from judgment. Determining whether to report impairment or unrealized losses can be difficult. Different governments holding the same instrument may arrive at different conclusions. Cost-based measures of the same investment can vary among

governments; fair value measurements (at the per-unit level) vary to a lesser degree. The Board concluded that fair value is the more relevant measurement of most investment assets and more faithfully represents the resources available to provide services, because it portrays the market's estimate of the net future cash flows of investments, discounted to reflect both time value and risk.

Measurement Focus and Basis of Accounting

B47. The Board believes that fair value provides the best measure of a government's financial resources available to finance operations, regardless of the measurement focus or basis of accounting used by a government in its financial reporting. Therefore, the Board concluded that fair value should be applied to investments in the financial statements prepared using the economic resources measurement focus and the accrual basis of accounting—government-wide, proprietary funds, and fiduciary funds. In addition, investments reported in governmental fund financial statements, prepared using the current financial resources measurement focus and modified accrual basis of accounting, should be measured at fair value. The Board also believes that gains and losses from the changes in fair value cannot be separately realized from the underlying investment and, therefore, the changes in fair value are a faithful reflection of the increase or decrease in the financial resources available to the government to fund its activities.

Volatility

B48. Some respondents to the Preliminary Views expressed concern that reporting investments at fair value would introduce excessive volatility. That is, these respondents observed that asset values would fluctuate in the absence of transactions made by the government and questioned whether it is conservative to report such changes. The Board considered those concerns but believes that volatility is a faithful representation of the increased or diminished resources available to finance a government's operations. The Board also believes that appeals to conservatism are at the expense of reliability—the faithful representation of what it purports to report—and notes that conservatism is not a stated objective of financial reporting.

Held-to-Maturity

B49. Some respondents raised the question of whether governments should report certain investments at fair value when a government is able to or plans to hold those investments to maturity. These respondents suggested that certain investments could be considered held-to-maturity by a government and not measured at fair value. The Board believes a held-to-maturity category is not appropriate in the government environment, for the same reasons the Board expressed when it addressed investment measurement in Statement 31 as follows:

Many respondents to the [Exposure Draft] objected to the manner in which fair value accounting is applied. Objections included the omission of a cost-based held-to-maturity category and a cost-based category for investments purchased with maturities that match projected cash outflows, the inclusion of the net increase or decrease in the fair value of investments in the operating statement, the volatility fair value accounting could introduce into the financial statements, and the belief that current note disclosure of fair value—without presentation in the financial statements—is adequate. However, only a few respondents

advocated a complete abandonment of fair value. . . . The Board reconsidered whether amortized cost should be acceptable for reporting debt investments when a government has the ability and intent to hold those investments to maturity. If debt investments are held to maturity, absent a default by the issuer, the holder will recover the full face amount of the investment, and any interim increase or decrease in the fair value of investments will reverse. Supporters of alternative approaches argued that it would be inappropriate to report fair value changes in debt securities that will be held until they mature. However, the Board finds fair value as relevant for debt securities to be held to maturity as for other investments. Recognizing changes in value when they occur, rather than when they are realized, provides a measure of current performance. Users of financial statements are also provided with a basis for assessing the decisions not just to sell, but also to buy and hold. The Board believes that fair value information is consistent with the basis used for rational investment management practices. Further, the Board believes that a measurement standard that varies according to whether a government does or does not have the ability and intent to hold a particular investment to maturity would be even more difficult to apply and to verify in the government environment. [paragraph 51]

B50. The Board believes that the reasons for rejecting a held-to-maturity category in Statement 31 are still valid. In the Board's view, the most difficult part of the amortized cost measurement is the determination of when a decline is other than temporary. Also, the companion concept is difficult to apply—whether management has the ability and the intent to hold to maturity. The Board has agreed to continue some cost-based measurements in the exceptions to fair value that are found in Statement 31 and elsewhere. The most significant exception provides that money market investments—commercial paper, banker's acceptances, and U.S. Treasury securities—that have a remaining maturity of one year or less upon acquisition may be reported at amortized cost. This exception is subject to an impairment test (paragraph 9 of Statement 31). An additional cost-based measurement also is provided in the form of nonparticipating interest earning investment contracts. For example, most certificates of deposit fall into this category and are not measured at fair value. The Board believes that by not allowing a held-to-maturity classification, transparency and comparability is enhanced in the reporting of investments.

Controls and Restrictions

B51. Some respondents to the Preliminary Views expressed concern regarding the measurement of restricted investments at fair value when a government does not control those investments. The Board believes that the notion of control is implied in the proposed definition of an investment, given that Concepts Statement 4 indicates that all assets are resources with present service capacity that a government presently controls (paragraph 8). If a government does not control the service capacity of the security, the security would not be considered an asset of the government, investment or otherwise.

B52. The Board also considered whether fair value is a representative measure of a restricted asset. Restrictions “change the nature or normal understanding of the availability of the asset” (paragraph 99 of Statement 34). However, the Board believes that fair value measurements, and the changes therein, represent the resources available to a government. In the example of

invested bond proceeds, those investments would not be available to pay any liabilities but would be available only to pay the debt service requirements. The comparison of the fair value of those investments to the liability for which they are restricted should provide information about the adequacy of those investments to satisfy the liability. In turn, changes in the measurement of a restricted asset also represent increases and decreases in fund balance or net position. Nevertheless, the potential for restricted fund balance is addressed in Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. Restricted net position is addressed in Statement 34, as amended by Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. The Board concluded that fair value is the appropriate measure for restricted assets that meet the definition of an investment.

Life Settlement Contracts

B53. The Board believes that there should be a distinction between, and different measurements for, a life insurance policy that is entered into to indemnify a loss and a life settlement contract that is entered into as an investment. A life settlement contract that is acquired when there is no insurable interest meets the definition of an investment asset and, therefore, should be measured at fair value. That is, the purpose of the instrument is solely to generate cash. Governments that hold life insurance policies that do not meet the definition of a life settlement contract should continue to measure such policies at cash surrender value.

Investments That Are Not Measured at Fair Value

B54. The Board believes that although investments generally should be measured at fair value, certain types of investments should be excluded from measurement at fair value and should be measured in accordance with existing literature. The Board believes it is appropriate to continue the current measurement approaches for these investments because of the following reasons:

- a. Investments in money market investments and participating interest-earning investment contracts that have a remaining maturity at time of purchase of one year or less, and investments in 2a7-like external investment pools, when measured at amortized cost are so close to fair value that they are generally equivalent.
- b. Investments in life insurance other than investments in life settlement contracts, nonparticipating interest earning investment contracts, unallocated insurance contracts, and synthetic guaranteed investment contracts that are fully benefit-responsive do not participate in fair value changes. Participation is defined as “the ability of an investment to capture market (interest rate) changes through the investment’s negotiability or transferability, or redemption terms that consider market rates” (paragraph 22 of Statement 31). Current literature does not require measurement at fair value when those investments do not participate. The notion of participation, in the Board’s view, continues to be valid.
- c. Investments in common stocks that meet the revised criteria for applying the equity method of accounting are allowed to continue to be accounted for using the equity method because of the high costs often involved with determining a fair value for the investee business.

Matched Positions

B55. Some respondents to the Preliminary Views suggested that an exception be provided for matched positions. Many governments report financial assets and liabilities that have matching maturities. The Board believes that this is the norm in many situations. The most obvious application of the notion would be in the context of lottery payouts (investments are purchased that match lottery payouts) and housing finance debt (securitized mortgage bonds are held that match a housing finance agency's debt). In the Board's view, fair value gains and losses are adequately addressed by the notion of restricted fund balance most recently addressed when the Board issued Statement 54. The Board also believes that many matched investments held by governments are held for a specific purpose other than income or profit. If that were the case, few of these assets would meet the definition of an investment or otherwise be required to be measured at fair value. Therefore, the Board believes the notion of a matched position or matched maturities should not be a basis for an exception to fair value measurements.

Structured Payouts

B56. Some respondents suggested that when risk-free investments for lottery annuitant winners are held in an irrevocable trust, those investments should be added to the list of exclusions to the fair value measurements. Structured payouts are addressed in paragraph 61 of Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*. In the Board's view, though addressed in Statement 10, structured lottery payouts that meet the requirements of paragraph 61 may receive the derecognition treatment described in that paragraph. The Board believes, however, that some structured payouts may not meet the criteria for derecognition, perhaps because investments were acquired but are not held in the name of the claimant. The Board is not persuaded that these investments should be exempted from fair value measurement. Similar to the matched positions described in paragraph B55, the Board believes that the restrictions on these investments are adequately addressed in existing literature and should not preclude fair value treatment.

Use of Equity and Cost Methods

B57. In paragraphs 202–210 of Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, there is a provision for certain investments in common stock to be measured according to the equity or cost method. Those paragraphs do not apply to investments in common stock held by (a) governmental external investment pools, (b) defined benefit pension or OPEB plans, or (c) Internal Revenue Code Section 457 deferred compensation plans. Those paragraphs also do not apply to investments in joint ventures or component units as provided in Statement No. 14, *The Financial Reporting Entity*, as amended. Paragraphs 202–210 also do not apply to investments in common stock other than those described in those paragraphs.

B58. This Statement further limits the equity method. The Board believes that investments in certain entities that calculate NAV per share (or its equivalent) and common stock investments held by endowments should not be eligible for the equity method. The Board believes that these types of investments should be measured at their fair values and added to the exclusionary

provisions of paragraph 202 of Statement 62. The intention of the exclusions to applying the equity method in this Statement is to limit the use of the equity method and thereby limit the exceptions to investment at fair value.

B59. The Board believes that if a government owns common stock that meets the criteria for either the equity or cost method but that ownership does not meet the proposed definition of an investment, the equity or cost method should continue to be applied. The Board was concerned about the use of the term *investment* in relation to the equity method of accounting, in light of the proposed new definition. The Board considered amending Statement 62 to use a different term but concluded that investment was the best description of the arrangement. However, the Board acknowledges that some governments might own common stock that is not an investment. Therefore, the Board decided to keep the term *investment* but specify that the equity and cost methods are available for ownership of common stock that does not meet the definition of an investment.

B60. For investments in common stocks that do meet the definition of an investment and do not have readily determinable fair values, the Board believes that the cost method should be eliminated. The Board believes that the use of the cost method in practice is limited. The Board prefers fair value measurements for most investments and believes that eliminating the cost method for *investments* in common stock will bring greater consistency in financial reporting. The Board is aware, however, that in connection with economic development activities, such as providing venture capital, some governments receive common stock. The ownership of stock or another equity interest in these circumstances does not meet the definition of an investment because the asset is held primarily to further the economic development objectives of the government program. In those circumstances, the Board concluded that the cost method is the appropriate measurement basis.

Acquisition Value

B61. Consistent with Concepts Statement 6, many assets are measured based on measurement attributes other than fair value. The Board believes that fair value should be replaced by acquisition value for certain transactions. Acquisition value is a market-based entry price; that is, the price that would be paid to acquire an asset or received to assume a liability. Fair value, on the other hand, is an exit price; that is, the price that would be received to sell an asset or paid to transfer a liability. Acquisition value is referred to as a measurement at the initial transaction date using the replacement cost measurement attribute. The Board believes that for the following assets, an entry price measurement is more appropriate than an exit price because the transaction represents the government acquiring the asset:

- a. Donated capital assets
- b. Donated works of art, historical treasures, and similar assets
- c. Capital assets that a government receives in a service concession arrangement.

The notion of an acquisition price is further supported by the view that those assets generally will be used in providing services, rather than converted to cash.

Split-Interest Agreements

B62. Some respondents to the Preliminary Views requested that the Board address split-interest agreements in this Statement. The Board acknowledges the significance of split-interest agreements but concluded that addressing the accounting and financial reporting for such transactions should not be within the scope of this project.

Disclosures

B63. In paragraph 35 of Concepts Statement No. 3, *Communication Methods in General Purpose External Financial Reports That Contain Basic Financial Statements*, the Board indicates that notes to the financial statement are “integral to financial statements and are essential to a user’s understanding of financial position or inflows and outflows of resources.” Notes to the financial statements provide descriptions of the accounting policies underlying amounts recognized in the financial statements and more details about or explanations of those amounts.

B64. The Board believes that when fair value measurements are used in determining the amounts recognized in the financial statements, a note disclosure should be made regarding how those amounts are determined. Such disclosures provide users with essential information regarding the reliability of the amounts recognized, which may vary depending on the type of the asset or liability.

B65. The Board notes that the current literature already requires significant disclosures for certain fair value measurements. For example, paragraph 15a of Statement 31 requires disclosure of “the methods and significant assumptions used to estimate the fair value of investments, if that fair value is based on other than quoted market prices.” Also, Statements 3, 40, and 53 require disclosure of credit risk, custodial credit risk, and interest rate risk. However, other fair value measurements may not have such disclosure requirements. Therefore, the Board decided to require in this Statement disclosures applicable to all fair value measurements.

B66. The Board believes that financial information should be expressed as simply as possible; information, however, should not be excluded merely because it is difficult to understand. Fair value measurements often involve judgment but, with effective disclosure of the factors used in making those judgments, the characteristic of understandability and reliability can be met. The Board believes that disclosures that communicate the relative qualities of fair value inputs are appropriate to achieve the objectives of financial reporting.

Level of Detail

B67. The Board concluded that disclosures should be organized by type or class of asset or liability. This is different from the guidance currently required in Statement 40, which focuses on various segments of the reporting entity, such as governmental activities, major fund types, and component units. The Board believes that guidance on the level of detail in Statement 40 that focused on a segment of a reporting entity should be replaced by the guidance in this Statement that provides a general disclosure principle by asking a government to consider various factors

when deciding the level of detail. Those factors provided in this Statement should be the basis for a government to gauge how much emphasis to place on each disclosure requirement and how much disaggregation to undertake. The Board believes that replacing the guidance currently required in Statement 40 on the level of detail with the proposed provisions in the Preliminary Views would enhance the disclosure requirements in Statement 40, extending the scope of the applicability to assets and liabilities measured at fair value that are not investments and providing essential information to the users of government financial statements. Further, the investment-type disclosure is one way of communicating the characteristics of an asset or liability. For example, describing an investment as a U.S. Treasury note impounds notions of relatively limited credit risk and interest rate risk because the notes are issued by the U.S. government and are fairly short term. Likewise, a mortgage-backed debt security communicates notions of relatively greater interest rate risk and the potential for mortgage defaults. And certain mortgage-backed investments will have disclosures of terms that make such an investment have a fair value that is highly sensitive to interest rate changes.

B68. The Board believes that providing general guidelines such as these should help provide transparency when a government has complex fair value measurements. The Board also believes that specific criteria for level of detail are impractical due to the diversity of assets and liabilities that may be measured at fair value and the facts and circumstances unique to each government. A government's specific circumstances should dictate the level of disaggregation and amount of detail to disclose. The Board believes this is best left to professional judgment after consideration of the factors described in this Statement.

B69. Several respondents questioned the volume of disclosure requirements and the resultant cost-benefit impact of the proposals in the Statement on the level of detail. The Board believes that disaggregation at some level is necessary to make fair value disclosure information useful. However, the Board also believes that each government will need to exercise its professional judgment in determining the appropriate level of disaggregation and the amount of detail to disclose in its financial statements, based on considerations of the various factors in this Statement. For example, the greater the importance of the assets and liabilities measured at fair value to the reporting government (such as a pension plan as opposed to a general government), the greater the disaggregation of asset and liability classes that may be necessary for the government. Each government's circumstances should dictate the volume of information and the appropriateness of the disaggregation that a government considers essential to disclose in its financial statements.

Recurring and Nonrecurring Measurements

B70. The Board concluded that disclosures should be made for recurring and nonrecurring fair value measurements. Recurring fair value measurements are measurements required in the statement of financial position at the end of each reporting period. Nonrecurring fair value measurements should be required in the statement of net position only in particular circumstances, such as impaired capital assets that will no longer be used by the government. Such capital assets are measured at the lower of carrying value or fair value. The Board believes that information regarding the level of disclosure within the fair value hierarchy would indicate the relative reliability of the inputs used to determine fair value, and a description of valuation techniques would indicate the selection of one or more estimation techniques among acceptable

choices. The information regarding fair value measurement is considered essential information, even if that measurement is made only once.

B71. The Board concluded that governments should disclose the information required in this Statement for each class or type of asset and liability measured at fair value in the statement of financial position. The Board chose not to prescribe either tabular or narrative format to allow governments flexibility in presenting the information. The Board believes that information regarding the level of inputs for each class of asset or liability should greatly benefit financial statement users. Requiring a narrative or table that communicates input levels should provide information as to the sources of inputs and the implied reliability of fair value measurements.

B72. Some respondents to the Preliminary Views questioned the value of the hierarchy of inputs. The Board believes that the hierarchy provides important qualitative information about the fair value measurements and maintains important consistency with FASB Codification Topic 820. Part of the economies that come from adopting the FASB requirements related to the input hierarchy is that the FASB input hierarchy already have a level of understanding shared by custodial banks, pricing services, many auditors, and some financial statement users.

B73. Some respondents to the Preliminary Views expressed concerns that users may draw inappropriate conclusions about investment quality based on the fair value hierarchy. The Board believes that there are qualitative differences in inputs among the three levels, and the required disclosure on the inputs hierarchy provides meaningful information about the relative subjectivity and reliability of that fair value measurement. The absence of such disclosure may lead to improper conclusions about the nature, characteristics, and risks associated with the assets and liabilities measured at fair value. In addition, the Board believes the increased familiarity with the input hierarchy associated with FASB Codification Topic 820 and experience with this Statement will limit misinterpretation. The Board concluded that the benefits provided by the information in the disclosure outweigh any potential misinterpretations.

B74. Some respondents to the Preliminary Views expressed concerns about the complexity and effort to produce the hierarchy of inputs disclosure. The Board believes that the fair value hierarchy disclosure is an elaboration of an existing disclosure requirement. That is, when fair values are not based on quoted market prices, the methods and assumptions used to estimate the fair value of investments should be disclosed (paragraph 15a of Statement 31). If the fair value hierarchy disclosure is considered complex, the Board believes the complexity flows from the complexity of developing fair value estimates. Investments in some derivative instruments and certain mortgage-backed securities require judgments that significantly affect their fair values. In the Board's view, a disclosure indicating that these inputs were of a certain level, for example, Level 3, is essential information.

Valuation Techniques

B75. The Board believes that the disclosure of valuation techniques used in fair value measurements is essential because it helps users to understand how a government determined the fair value of its assets and liabilities. It also helps users to assess the relative subjectivity of the government's fair value measurements.

Disclosures Considered, but Not Required

B76. In the development of the Preliminary Views, several disclosures were considered but ultimately the Board concluded that those disclosures should not be required to be provided in the government environment. Potential disclosures included (a) the amounts and reasons for transfers among Levels 1, 2, and 3; (b) a reconciliation of Level 3 inputs presenting an opening balance, purchases, sales, settlements, transfers, and ending balances; and (c) for fair value measurements categorized with the Level 3 fair value hierarchy, a description of valuation processes used (including, for example, how an entity decides its valuation policies and procedures and analyzes changes in fair value measurements from period to period). The Board was not persuaded that this volume of information was essential to a user's understanding of the underlying amounts recognized in the financial statements. The disclosure of transfers among the levels was perceived to be required by operation of the levels of inputs. That is, if a fair value moves from a Level 1 input to a Level 2 input, transfer of that amount from Level 1 to 2 is required. There is no policy election and the reason is impounded in the definitions found in the levels. The Board also did not require a disclosure reconciling Level 3 fair value measurements. 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. Finally, the Board concluded that descriptions of valuation processes, policies, and procedures used have the potential to lengthen significantly disclosures without providing essential information to financial statement users.

Level 3 Quantitative Information

B77. In the Preliminary Views, it was proposed that for fair value measurements categorized within Level 3 of the fair value hierarchy, a government should disclose certain additional information in the notes. That information included a description of the significant unobservable inputs, the numerical range of inputs used, and the weighted average of inputs used. The Board believed that when limited or no information is publicly available, disclosures about the unobservable inputs used in a measurement categorized within Level 3 should help users to understand the measurement uncertainty inherent in the fair value measurement.

B78. Some respondents to the Preliminary Views questioned the decision-usefulness of this information, particularly compared to the burden to prepare it. Results from the field test also indicated a significant cost to prepare these disclosures. The Board considered those concerns and believes that the quantitative information is most meaningful when presented on an investment-by-investment basis, which would suggest lengthy disclosures. When aggregated, the Board believes the value of this information diminishes rapidly. In the Board's view, while the proposed disclosures were intended to provide information on the risks and uncertainties associated with Level 3 measurements, the risk disclosures in Statements 40 and 53 adequately addressed such needs. Paragraphs 7–16 of Statement 40 provide specific disclosure requirements that address credit, interest, and foreign currency risks, and within the interest rate risk disclosures requirements there is a provision for information about the terms of a debt investment that may cause its fair value to be highly sensitive to interest rate change. Paragraphs 73 and 76 of Statement 53 require similar risk disclosures. The Board concluded that in light of the risk disclosures already required by Statements 40 and 53, additional quantitative disclosures for Level 3 fair value measurements are not necessary and, therefore, should not be required.

Level 3 Narrative Description of Fair Value Sensitivity

B79. The Preliminary Views proposed that governments disclose a narrative description of the sensitivity of fair value measurements to changes in unobservable inputs used in recurring fair value measurements categorized in Level 3 of the fair value hierarchy. This disclosure would have been made when a change in those inputs might result in a significantly higher or lower fair value measurement. For example, as interest rates increase (decrease), fair values of debt instruments decrease (increase). The Board believed that this disclosure would provide a description of the relationships of inputs to fair value and the effect of changes in the unobservable inputs on the fair value measurement.

B80. Some respondents to the Preliminary Views believed the narrative information is not essential to decision making. The Board considered those concerns and believes that this information serves as a primer on investment finance rather than essential information. The Board believes that knowledgeable users would understand these relationships without them being stated in the disclosure. In the Board's view, the disclosure of investment type (for example, a mortgage-backed security) and the valuation technique applied to develop a fair value would be sufficient to alert an interested reader to potential pricing issues. Therefore, the Board concluded that narrative description of the sensitivity of fair value measurements to changes in unobservable inputs for fair value measurements categorized in Level 3 of the fair value hierarchy should not be required.

Disclosures for Fair Value Measurements of Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)

B81. Some governments place a significant portion of their assets into alternative investments. Many of these investments will be measured using NAV per share (or its equivalent) provided by the investee. Due to the uncertainty and subjectivity involved in measurements of these investments, the Board believes there should be disclosures that address them in further detail. For investments in entities that calculate a NAV per share or its equivalent (regardless of whether the NAV per share provided by the entities was used) and are measured at fair value on a recurring or nonrecurring basis during the period, a government should disclose information that helps users of its financial statements to understand the nature and risks of these investments and whether these investments are likely to be sold at amounts different from NAV per share. In the Board's view, the additional disclosures required for these investments should provide more information about the estimated values in a manner that better fits the nature of the investments. Additionally, the Board believes that because fair value is an exit price, these additional disclosures should be useful when it is likely that the investment could be sold at an amount different from the NAV per share.

B82. Some respondents to the Preliminary Views found the NAV disclosures to be overly extensive and questioned their usefulness. The Board acknowledges the level of detail required by these disclosures. However, the Board also believes that the risks that are inherent in these investments suggest detailed disclosures are essential information. The Board concluded that these disclosures are essential for users to understand the nature and risks inherent in these investments and would help the users to assess the overall risks from the investments that a government holds.

Effective Date and Transition

B83. The provisions of this Statement are effective for reporting periods beginning after June 15, 2015. The Board believes the effective date allows adequate time for the financial statement preparers to plan for the transition and implementation. Some governments may wish to implement earlier than that date. Accordingly, this Statement encourages early application.

B84. The Board believes that this Statement should be applied retrospectively. However, the Board considered the potential for the lack of readily available information for the presentation of the restatement of all prior periods and for similar disclosure requirements. Accordingly, the Board concluded that those presentations and disclosure requirements may be provided prospectively if it is not practical to restate all prior periods.

B85. The phrase *if not practical* has been used in other GASB standards under a similar context as used in this Statement, when an alternative is allowed in certain circumstances that are not workable or feasible. However, the Board believes that inconvenient should not be considered equivalent to not practical. In other words, reasonable efforts should be deployed before a government determines the required action is not practical. For the purposes of this Statement, the Board believes that with planning, retrieval of necessary historical records from archival storage (for example, hard copy, microfilm, or digital media) in order to reprice certain assets at historical cost during the transition should not be considered not practical, even though it may be inconvenient for the government.

Considerations Related to Benefits and Costs

B86. The overall objective of financial reporting by state and local governments is to provide information to assist users (the citizenry, legislative and oversight bodies, and investors and creditors) in assessing the accountability of governments and in making economic, social, and political decisions. One of the principles guiding the Board's setting of standards for financial reporting is the assessment of expected benefits and perceived costs. The Board strives to determine that standards (including disclosure requirements) address a significant user need and that the costs incurred through the application of its standards, compared with possible alternatives, are justified when compared to the expected overall public benefit.

B87. Present and potential users are the primary beneficiaries of improvements in financial reporting. Individuals within governments who are responsible for keeping accounting records and preparing financial statements, as well as managers of public services, also benefit from the information that is collected and reported in conformity with GASB standards. The costs to implement the standards are borne primarily by governments and, by extension, their citizens and taxpayers. Users also incur costs associated with the time and effort required to obtain and analyze information to inform their assessments and decisions.

B88. The Board's assessment of the expected benefits and perceived costs of issuing new standards is unavoidably more qualitative than quantitative because no reliable and objective method has been identified for quantifying the value of improved information in financial statements. Furthermore, it is difficult to measure accurately the costs of implementing new standards until implementation has actually taken place. Nonetheless, the Board undertakes this

assessment based on the available evidence regarding expected benefits and perceived costs with the objective of achieving an appropriate balance between maximizing benefits and minimizing costs.

B89. The Board gathered information on the expected benefits of improving the existing fair value standards primarily through the extensive pre-agenda research conducted prior to deliberations. The Board concluded, based on the results of that research, that a substantial need for better information about fair value exists and that need can be fulfilled through standards setting. The research results were complemented by comments from respondents to the Preliminary Views and from participants in the public hearing conducted in November 2013. Further input on expected benefits was provided by members of the project task force and the GASAC.

B90. This Statement (a) will lead to greater consistency of application of fair value, including consistency of the definition of fair value across standards setters; (b) provides guidance on how to measure fair value, including the implications of illiquid markets; and (c) requires enhanced disclosure information. These benefits are expected to result in greater comparability and increased transparency.

B91. Information that the Board considered regarding the perceived costs came primarily from two sources—due process comments received on the Preliminary Views and the related field test. Participants in the field test—a mix of state and local governments, retirement plans, school districts, universities, and utilities—provided the Board with their estimates of the initial costs to implement the proposed standards and the recurring annual costs in subsequent years. The Board also received considerable input through comment letters and public hearing testimony regarding the potential costs associated with implementing the new standards.

B92. The Board considered the anticipated costs in two categories: general costs of applying the standards and costs of applying particular provisions. For general costs of applying the standards, the Board anticipates that some of the costs of adopting the Statement will be incurred by a majority of governments. Most of these costs will be nonrecurring. Based on feedback received, these costs will likely include staff training, system changes, and custodial reporting. Implementation also will require education time for all parties (preparers, users, and auditors). However, the Board notes the required time likely will be tempered by some stakeholders' familiarity with similar existing FASB and IASB requirements. Regarding costs of applying particular provisions, the participants in the field test listed several costs associated with applying the Preliminary Views to their financial statements in the initial and subsequent years, which include applying fair value measurement to investments, classifying and disclosing fair value input levels, and preparing the disclosures for Level 3 inputs. However, participants also expect these costs to decrease in subsequent years. The Board acknowledges that those incurring the most costs are retirement plans, noting those costs relate to accounting and financial reporting software, custodial fees, and audit fees. However, the Board believes those costs are mostly initial costs that would likely decline in subsequent years. Additionally, in redeliberations, the Board chose not to propose certain disclosures related to Level 3 inputs based in part on the cost-benefit feedback. These rejected disclosures are (a) a description of the significant unobservable inputs, the numerical range, and the weighted average of the unobservable inputs used in Level 3 fair value measurements and (b) a narrative description of the sensitivity of fair value

measurements to changes in unobservable inputs used for recurring fair value measurements categorized in Level 3 of the fair value hierarchy.

B93. The Board considered the aggregate expected benefits and perceived costs associated with the entirety of the requirements in this Statement. The Board is cognizant that the costs of implementing the changes required by this Statement may be significant, though principally in terms of the initial implementation effort rather than ongoing compliance in subsequent years. However, the Board believes that the expected benefits—improved guidance on how to measure fair value and what to apply it to, greater consistency on the definition of fair value across standards setters, increased comparability and transparency, and enhanced disclosure information—that would result from the information provided through implementation of the Statement, both initially and on an ongoing basis, are significant.

Appendix C

ILLUSTRATIONS

C1. The facts assumed in these examples are illustrative only and are not intended to modify or limit the requirements of this Statement or to indicate the Board's endorsement of the policies or practices shown. Application of the provisions of this Statement may require assessment of facts and circumstances other than those illustrated here. Existing standards may require disclosures in addition to those illustrated. In some instances, amounts that may be considered immaterial are used to illustrate specific requirements or alternatives. No inferences about determining materiality should be drawn from these illustrations.

Illustration 1—Examples of the Application of the Unit of Account

This Statement provides that recognition or disclosure of an asset or liability—whether a single asset or liability, a group of assets, a group of liabilities, or a group of related assets and liabilities—depends on the unit of account of the asset or liability. The unit of account refers to the level at which an asset or a liability is aggregated or disaggregated for measurement purposes as provided by the accounting standards. Amounts reported vary depending on measurement attributes described in relevant accounting standards. Those standards prescribe measurement attributes such as historical cost, fair value, acquisition value, and settlement value. Once accounting standards establish the unit of account—whether at an individual item level or an aggregated level—relevant measurement attributes and disclosures can be applied. Examples are as follows:

1. *Multiple investments.* Multiple investments may be held in one brokerage account, but the unit of account would be each individual security rather than the account as a whole.
2. *External investment pool.* A government holds a position in an external investment pool that is not a 2a7-like external investment pool. The unit of account is each share held, and the value of the position would be the fair value of the pool's share price multiplied by the number of shares held. The government-investor does not "look through" the pool to report a pro rata share of the pool's investments, receivables, and payables.
3. *Mutual fund.* A government holds a position in a mutual fund. Similar to Example 2, the unit of account is each share held, and the value of the position would be the stated price of the mutual fund multiplied by the number of shares held.
4. *Government acquisition.* A government acquires another government in an acquisition. The units of account to the acquiring government are the same as they were to the acquired government, but the measurement attributes for the acquisition are prescribed by Statement No. 69, *Government Combinations and Disposals of Government Operations*. Some acquired assets, deferred outflows of resources, liabilities, and deferred inflows of resources are measured at acquisition value. Some are measured at fair value, and others are measured at carrying value.

Illustration 2—Examples of Level 2 Inputs

Level 2 inputs are inputs—other than quoted prices included within Level 1—that are observable for the asset or liability, either directly or indirectly. Examples of Level 2 inputs for particular assets and liabilities include the following:

1. *Bond valued by a pricing service that uses matrix pricing.*
2. *Pay-fixed, receive-variable interest rate swap based on the London Interbank Offered Rate (LIBOR) swap rate.* A Level 2 input would be the LIBOR swap rate if that rate is observable at commonly quoted intervals for substantially the full term of the swap.
3. *Three-year option on exchange-traded shares.* A Level 2 input would be the implied volatility for the shares derived through extrapolation to Year 3 if both of the following conditions exist:
 - a. Prices for one-year and two-year options on the shares are observable.
 - b. The extrapolated implied volatility of a three-year option is corroborated by observable market data for substantially the full term of the option. In that case, the implied volatility could be derived by extrapolating from the implied volatility of the one-year and two-year options on the shares and corroborated by the implied volatility for three-year options on comparable entities' shares, provided that correlation with the one-year and two-year implied volatilities is established.
4. *Valuation multiple.* A Level 2 input would be a valuation multiple (for example, a multiple of earnings or revenue or a similar performance measure) derived from observable market data, for example, multiples derived from prices in observed transactions involving comparable (that is, similar) businesses, taking into account operational, market, financial, and nonfinancial factors.

Illustration 3—Examples of Level 3 Inputs

Level 3 inputs are unobservable inputs for the asset or liability. Examples of assets and liabilities that use Level 3 inputs include the following:

1. *Long-dated currency swap.* A Level 3 input would be an interest rate in a specified currency that is not observable and cannot be corroborated by observable market data at commonly quoted intervals or otherwise for substantially the full term of the currency swap. The interest rates in a currency swap are the swap rates calculated from the respective countries' yield curves.
2. *Three-year option on exchange-traded shares.* A Level 3 input would be historical volatility, that is, the volatility for the shares derived from the shares' historical prices. Historical volatility typically does not represent current market participants' expectations about future volatility, even if it is the only information available to price an option.
3. *Interest rate swap.* A Level 3 input would be an adjustment to a midmarket consensus (nonbinding) price for a swap developed using data that are not directly observable and cannot otherwise be corroborated by observable market data.
4. *Commercial real estate.* A Level 3 input would be a financial forecast (for example, of cash flows or earnings) developed using a government's own data if there is no reasonably available information that indicates that market participants would use different assumptions.

Illustration 4—Examples of Application of the Definition of an Investment

An investment is a security or other asset (1) that a government holds primarily for the purpose of income or profit and (2) with a present service capacity that is based solely on its ability to generate cash or to be sold to generate cash. The following are examples of assets that a government might hold, evaluated using the definition of an investment:

1. A public university holds student loan receivables. The loans were made as part of a governmental program to encourage higher education. The service capacity of the loans is to provide a service that allows students to obtain an education. Because the service capacity is not based solely on the loan's ability to generate cash, these loans would not meet the definition of an investment.
2. A housing finance agency holds mortgage loan receivables. These loans were made as part of a governmental program to encourage home ownership. The service capacity of the loans is to provide a service that allows residents to purchase a home. Because the service capacity is not based solely on the loan's ability to generate cash, these loans would not meet the definition of an investment.
3. A city owns life insurance policies on certain key employees. If an insured individual dies while still employed, a portion of the proceeds is paid to the individual's beneficiary and a portion is paid to the city. The city's purpose for holding the policies is both to collect the proceeds as indemnification of loss of the employee and to provide a benefit to the employee. Because the service capacity is not based solely on the ability to generate cash, these policies would not meet the definition of an investment.
4. A pension plan owns a life settlement contract. Because the plan (investor) does not have an insurable interest, the contract is held primarily for the purpose of profit (the proceeds received over the consideration paid) and the present service capacity is solely the contract's ability to generate cash for the plan. Therefore, this contract meets the definition of an investment.
5. A state owns royalty interests in certain oil and gas properties. It holds these interests in order to generate income for providing funding to schools within the state. It does not own the tangible land associated with the oil and gas rights. There is no governmental program or service associated with the ownership of the interests. Because the primary purpose of holding the royalty interests is for the purpose of income, and the service capacity is based solely on the ability to generate cash, these assets would meet the definition of an investment.
6. A state owns land and timber resources in an undeveloped part of the state. The state holds the resources in order to preserve the natural environment. The state occasionally enters into contracts for a company to cut and sell the timber, for which the state receives a fee. Because the land and timber resources are held primarily for preservation and not for the purpose of income or profit, they would not meet the definition of an investment.

Illustration 5—Disclosures

This illustration depicts disclosures associated with a general purpose government and a defined benefit pension plan.

Example 1—General Purpose Government

Facts and Assumptions

The General City holds investments that are measured at fair value on a recurring basis. Because investing is not a core part of the City's mission, the City determines that the disclosures related to these investments only need to be disaggregated by major type. The City chooses a narrative format for the fair value disclosures.

Illustrative Disclosure

The City categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs.

The City has the following recurring fair value measurements as of June 30, 20X1:

- U.S. Treasury securities of \$45 million are valued using quoted market prices (Level 1 inputs)
- Corporate bonds of \$12 million are valued using a matrix pricing model (Level 2 inputs).

The City also has a nonrecurring fair value measurement as of June 30, 20X1, for a closed performing arts hall that will no longer be used by the government and therefore is considered to be impaired. The hall has been written down from \$5.6 million to \$3.4 million based on an appraisal of the property (Level 3 inputs).

Example 2—Defined Benefit Pension Plan

Facts and Assumptions

The Retiree Pension Defined Benefit Plan holds significant amounts of investments that are measured at fair value on a recurring basis. Because investing is a key part of the Plan's activities, the Plan shows greater disaggregation in its disclosures. The Plan chooses a tabular format for disclosing the levels within the fair value hierarchy. All of the derivative instruments are hedging derivative instruments and not investments.

Illustrative Disclosure

The Plan categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The Plan has the following recurring fair value measurements as of December 31, 20X1:

(\$ in millions)

	Fair Value Measurements Using			
	12/31/X1	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investments				
Debt securities				
U.S. Treasury securities	\$ 85	\$ 85		
Commercial mortgage-backed securities	50			\$ 50
Collateralized debt obligations	35			35
Residential mortgage-backed securities	149		\$ 24	125
Corporate bonds	93	9	84	
Total debt securities	<u>412</u>	<u>94</u>	<u>108</u>	<u>210</u>
Equity securities				
Financial services industry	150	150		
Healthcare industry	110	110		
Other	15	15		
Total equity securities	<u>275</u>	<u>275</u>		
Hedge fund investments				
Equity long/short	55		55	
Event-driven hedge funds	45		45	
Global opportunities	35		26	9
Multi-strategy hedge funds	40		40	
Real estate funds	47			47
Private equity funds—international	43		43	
Total hedge fund investments	<u>265</u>		<u>209</u>	<u>56</u>
Venture capital investments				
Direct venture capital—healthcare	53			53
Direct venture capital—energy	32			32
Total venture capital investments	<u>85</u>			<u>85</u>
Total investments	<u>\$ 1,037</u>	<u>\$ 369</u>	<u>\$ 317</u>	<u>\$ 351</u>
Derivative instruments				
Interest rate swaps	\$ 57		\$ 57	
Foreign exchange contracts	43		43	
Total derivative instruments	<u>\$ 100</u>		<u>\$ 100</u>	

Debt and equity securities classified in Level 1 of the fair value hierarchy are valued using prices quoted in active markets for those securities. Debt securities classified in Level 2 of the fair value hierarchy are valued using a matrix pricing technique. Matrix pricing is used to value securities based on the securities' relationship to benchmark quoted prices. Commercial and residential mortgage-backed securities classified in Level 3 are valued using discounted cash flow techniques. Collateralized debt obligations classified in Level 3 are valued using consensus pricing.

The valuation method for hedge fund investments is either net asset value (NAV) per share for fair value or a value determined through recent observable transaction information for similar investments.

Venture capital investments classified in Level 3 are valued using either a discounted cash flow or market comparable companies technique.

Derivative instruments classified in Level 2 of the fair value hierarchy are valued using a market approach that considers benchmark interest rates and foreign exchange rates.

The investment income for the year ended December 31, 20X1, related to investments classified in Level 3 of the fair value hierarchy, other than those measured at NAV per share, was \$18.1 million.

The following table provides details about investments that calculate NAV per share (or its equivalent):

(\$ in millions)

	<u>Fair Value</u>	<u>Unfunded Commitments</u>	<u>Redemption Frequency (If currently eligible)</u>	<u>Redemption Notice Period</u>
Equity long/short hedge funds ⁽¹⁾	\$ 55		Quarterly	30–60 days
Event-driven hedge funds ⁽²⁾	45		Quarterly, annually	30–60 days
Global opportunities hedge ⁽³⁾	35		Quarterly	30–45 days
Multi-strategy hedge funds ⁽⁴⁾	40		Quarterly	30–60 days
Real estate funds ⁽⁵⁾	47	\$ 20		
Private equity funds—international ⁽⁶⁾	<u>43</u>	<u>15</u>		
Total	<u>\$ 265</u>	<u>\$ 35</u>		

1. This class includes investments in 12 hedge funds that invest both long and short primarily in U.S. common stocks. Management of each hedge fund has the ability to shift investments from value to growth strategies, from small to large capitalization stocks, and from a net long position to a net short position. The fair values of the investments in this class have been estimated using the NAV per share of the investments. Investments representing approximately 22 percent of the value of the investments in this class cannot be redeemed because the investments include restrictions that do not allow for redemption in the first 12 to 18 months after acquisition. The remaining restriction period for these investments ranged from three to seven months at December 31, 20X1.
2. This class includes 3 investments in hedge funds that invest in approximately 60 percent equities and 40 percent bonds to profit from economic, political, corporate, and government-driven events. A majority of the investments are targeted at economic policy decisions. The fair values of the investments in this class have been estimated using the NAV per share of the investments.
3. This class includes investments in 5 hedge funds that hold approximately 80 percent of the funds' investments in non-U.S. common stocks in the healthcare, energy, information technology, utilities, and telecommunications sectors and approximately 20 percent of the funds' investments in diversified currencies. The fair values of the investments in this class

have been estimated using the NAV per share of the investments. For one investment, valued at \$8.75 million, a gate has been imposed by the hedge fund manager, and no redemptions are currently permitted. This redemption restriction has been in place for six months, and the time at which the redemption restriction might lapse cannot be estimated.

4. This class invests in 15 hedge funds that pursue multiple strategies to diversify risks and reduce volatility. The hedge funds' composite portfolio for this class includes investments in approximately 50 percent U.S. common stocks, 30 percent global real estate projects, and 20 percent arbitrage investments. The fair values of the investments in this class have been estimated using the NAV per share of the investments. Investments representing approximately 15 percent of the value of the investments in this class cannot be redeemed because the investments include restrictions that do not allow for redemption in the first year after acquisition. The remaining restriction period for these investments ranged from four to six months at December 31, 20X1.
5. This class includes nine real estate funds that invest primarily in U.S. commercial real estate. The fair values of the investments in this class have been estimated using the NAV of the Plan's ownership interest in partners' capital. These investments can never be redeemed with the funds. Distributions from each fund will be received as the underlying investments of the funds are liquidated. It is estimated that the underlying assets of the funds will be liquidated over the next 7 to 10 years. Twenty percent of the total investment in this class is expected to be sold. However, the individual investments that will be sold have not yet been determined. Because it is not probable that any individual investment will be sold, the fair value of each individual investment has been estimated using the NAV of the Plan's ownership interest in partners' capital. Once it has been determined which investments will be sold and whether those investments will be sold individually or in a group, the investments will be sold in an auction process. The investee fund's management is required to approve of the buyer before the sale of the investments can be completed.
6. This class includes eight private equity funds that invest primarily in foreign technology companies. These investments can never be redeemed with the funds. Instead, the nature of the investments in this class is that distributions are received through the liquidation of the underlying assets of the fund. If these investments were held, it is estimated that the underlying assets of the fund would be liquidated over five to eight years. However, as of December 31, 20X1, it is probable that all of the investments in this class will be sold at an amount different from the NAV of the Plan's ownership interest in partners' capital. Therefore, the fair values of the investments in this class have been estimated using recent observable transaction information for similar investments and nonbinding bids received from potential buyers of the investments. As of December 31, 20X1, a buyer (or buyers) for these investments has not yet been identified. Once a buyer has been identified, the investee fund's management is required to approve of the buyer before the sale of the investments can be completed.

Appendix D

CODIFICATION INSTRUCTIONS

D1. The sections that follow update the June 30, 2013, *Codification of Governmental Accounting and Financial Reporting Standards*, for the effects of this Statement. Only the paragraph number of this Statement is listed if the paragraph will be cited in full in the Codification.

* * *

[Update cross-references throughout.]

* * *

SUMMARY STATEMENT OF PRINCIPLES

SECTION 1100

.106 [Replace *estimated fair value* with *acquisition value*¹; renumber subsequent footnotes. In sources of section, add GASBS XX, ¶72, as an amending source of GASBS 34, ¶18.]

¹Acquisition value is the price that would be paid to acquire an asset with equivalent service potential in an orderly market transaction at the acquisition date, or the amount at which a liability could be liquidated with the counterparty at the acquisition date. [GASBS XX, ¶83]

* * *

REPORTING CAPITAL ASSETS

SECTION 1400

Sources: [Add the following:] GASB Statement XX

[In Statements of Principle, Valuation of Capital Assets, replace *estimated fair value* with *acquisition value*¹; renumber subsequent footnotes.] [GASBS 34, ¶18, as amended by GASBS XX, ¶72; GASBS 37, ¶6]

¹Acquisition value is the price that would be paid to acquire an asset with equivalent service potential in an orderly market transaction at the acquisition date, or the amount at which a liability could be liquidated with the counterparty at the acquisition date. [GASBS XX, ¶83]

.102 [Replace *estimated fair value* with *acquisition value*.] [GASBS 34, ¶18, as amended by GASBS XX, ¶72; GASBS 37, ¶6]

.109 [Replace *fair value* with *acquisition value*.] [GASBS 34, ¶27, as amended by GASBS XX, ¶72]

.139 [In subparagraph a, replace *primarily for the purpose of directly obtaining income or profit* with *as investments*. Insert the following at the end of subparagraph a:] That is, the asset is a

security or other asset (i) that a government holds primarily for the purpose of income or profit and (ii) with a present service capacity that is based solely on its ability to generate cash or to be sold to generate cash. [GASBS 51, ¶3, as amended by GASBS XX, ¶64; GASBS XX, ¶64]

.155 [Replace *fair value* with *acquisition value*.] [GASBS 34, ¶18, as amended by GASBS XX, ¶72; GASBS 34, ¶50 and ¶52; GASBS 34, ¶103, as amended by GASBS 63, ¶8]

* * *

NOTES TO FINANCIAL STATEMENTS

SECTION 2300

Sources: [Add the following:] GASB Statement XX

.107 [Add new subparagraph hhh as follows; add GASBS XX, ¶77–¶79 to sources:]

hhh. Fair value measurements. (See Section 3100, “Fair Value Measurement,” paragraphs .161 and .162.)

* * *

REPORTING ENTITY AND COMPONENT UNIT PRESENTATION AND DISCLOSURE

SECTION 2600

Sources: [Add the following:] GASB Statement XX

.116 [In the last sentence, replace *for the purpose of income or profit* with *as an investment*. Insert new last sentence:] 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. [GASBS 14, ¶55, as amended by GASBS 61, ¶10 and GASBS XX, ¶64; GASBS 14, ¶73, as amended by GASBS 61, ¶10; GASBS 31, ¶5, as amended by GASBS 62, ¶202–¶210; GASBS XX, ¶64]

* * *

[Insert new section as follows:]

FAIR VALUE MEASUREMENT

SECTION 3100

Source: GASB Statement XX

Scope and Applicability of This Section

.101 This section establishes general principles for measuring **fair value**.¹ [GASBS XX, ¶2]

¹Terms defined in the glossary (paragraphs .501–.546) are shown in **boldface type** the first time they are used in this section. [GASBS XX, fn1]

.102–.160 [GASBS XX, ¶5–¶63, including headings and footnotes; change *Statement* to *section*.]

GLOSSARY

.501–.546 [GASBS XX, ¶83, omit the terms *acquisition value* and *readily determinable fair value*; include GASBS XX, ¶83 as source of all definitions.]

* * *

[Create new section as follows:]

COMMON STOCK OWNERSHIP—COST METHOD

SECTION C55

Source: GASB Statement 62, GASB Statement XX

.101 Ownership of common stock that meets neither the definition of an investment nor the criteria for the equity method should be measured according to the cost method as described below. Ownership of common stock that does not meet the definition of an investment but otherwise meets the criteria for the equity method (I50.112–.115) should be accounted for according to the equity method. [GASBS XX, ¶69]

.102 [Amend GASBS 62, ¶203 as follows:] Under the cost method, ownership in common stock is recorded at cost. Dividends that are distributed from net accumulated earnings of the company since the date of acquisition by the government are recognized as revenue. The net accumulated earnings of the company subsequent to the acquisition date are recognized by the government only to the extent distributed by the company as dividends. Dividends received in excess of earnings subsequent to the date of acquisition are considered a return of investment and are recorded as reductions of cost of the acquisition. A series of operating losses of a company or other factors may indicate that a decrease in value of the common stock acquisition has occurred that is other than temporary and should accordingly be recognized. [GASBS 62, ¶203, as amended by GASBS XX, ¶69]

* * *

DEBT EXTINGUISHMENTS AND TROUBLED DEBT RESTRUCTURING

SECTION D20

.128 [Replace the last four sentences with the following; delete footnote 19 and renumber subsequent footnotes:] Fair value should be determined consistent with the requirements of Section 3100, “Fair Value Measurement.” [GASBS 62, ¶137, as amended by GASBS 65, ¶15 and GASBS XX, ¶5–¶63]

* * *

DERIVATIVE INSTRUMENTS

SECTION D40

Sources: [Add the following:] GASB Statement XX

.107 [In the first sentence, bold the term *fair values*.]

.117 [Replace current paragraph .117, including footnote, with the following; renumber subsequent footnotes:] Fair value should be determined consistent with the requirements of Section 3100, “Fair Value Measurement.” [GASBS XX, ¶5–¶63]

.165 [Add new subparagraph e as follows:] e. the fair value disclosures required by Section I50, paragraphs .139–.158, as applicable. [GASBS 53, ¶69, as amended by GASBS XX, ¶77 and ¶78]

[Insert as new paragraph .518 as follows; renumber subsequent paragraphs:]

.518 **Fair value.** 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. [GASBS XX, ¶5]

.534 [In current paragraph .533, replace the phrase *entered primarily for the purpose of obtaining income or profit* with (a) *held 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*.] [GASBS 53, ¶82, as amended by GASBS XX, ¶64]

.538 [In current paragraph .537, revise the definition of market risk as follows:] The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises the following:

- a. Interest rate risk
- b. Currency risk
- c. Other price risks.

[GASBS XX, ¶83]

* * *

INVESTMENTS

SECTION I50

[Staff comment: Earlier version of I50 replaced in its entirety.]

Sources: [Add the following:] GASB Statement XX

See also: [Add the following:] Section 3100, “Fair Value Measurement”

[Replace remainder of section as follows:]

Scope and Applicability of This Section

.101 This section establishes accounting and financial reporting standards for all **investments**¹ (including repurchase agreements). It also provides guidance for disclosures by governmental entities about deposits with financial institutions and investments. [GASBS 3, ¶1; GASBS 31, ¶2, as amended by GASBS 32, ¶5, GASBS 43, ¶22, GASBS 52, ¶4, and GASBS XX, ¶2; GASBS 53, ¶19–¶21, ¶67, ¶76, and ¶79]

¹[Insert current footnote 1.] [GASBS 31, fn1; GASBS XX, fn1]

.102 This section does not apply to securities or other instruments if they are not held by the government for investment purposes, either for itself or for parties for which it serves as investment manager or other fiduciary. In addition, this section does not apply to ownership of equity interests in joint ventures or component units as provided in Section 2100, “Defining the Financial Reporting Entity.” Unless otherwise specified, the requirements of this section apply to financial reports of all state and local governmental entities, including public benefit corporations and authorities, public employee retirement systems, and governmental utilities, hospitals and other healthcare providers, colleges, and universities. [GASBS 31, ¶5, as amended by GASBS 61, ¶10 and GASBS 62, ¶202–¶210; GASBS 52, ¶5; GASBS XX, ¶2]

Definition and Characteristics of an Investment

.103–.107 [GASBS XX, ¶64–¶68, including headings and footnote; in paragraph .106, bold the term *financial instruments*.]

Accounting and Financial Reporting for Investments

Valuation

.108 Except as provided in paragraphs .109–.116, .118, .121, .123, .125, and .126 of this section, investments should be measured at **fair value**. Fair value measurements should be made consistent with the provisions of Section 3100. Examples of investments that should be measured at fair value include investments in the following:

- a. Common stock not measured according to the equity or cost method as provided in paragraphs .109–.116.
- b. Debt securities that do not meet the cost-based measurement provided in paragraph .123.
- c. External investment pools that are not 2a7-like external investment pools. (See paragraph .117.)
- d. Life settlement contracts. (See paragraph .119.)
- e. Open-end mutual funds. (See paragraph .120.)
- f. Participating interest-earning investment contracts. (See paragraphs .121 and .122.)

- g. Land and other real estate held as investments by endowments.³ (See paragraph .124.)
- h. Investment derivative instruments. (See Section D40, paragraphs .115–.117 and .172.)

[GASBS 31, ¶2; GASBS 31, ¶7, as amended by GASBS 34, ¶6 and GASBS XX, ¶5; GASBS 32, ¶5; GASBS 52, ¶4; GASBS 53, ¶20 and ¶67; GASBS 67, ¶18; GASBS XX, ¶64, ¶69, and ¶70]

³[Insert current footnote 4.]

Common Stock

.109 Paragraphs .110–.116 establish accounting and financial reporting standards for investments in common stock using the equity method. The following investments are excluded from those paragraphs:

- a. Common stock held by the following government types:
 - (1) Governmental external investment pools
 - (2) Defined benefit pension or other postemployment benefit plans
 - (3) Internal Revenue Code Section 457 deferred compensation plans
 - (4) Endowments including permanent and term endowments, and permanent funds
- b. Investments in certain entities that calculate net asset value per share (or its equivalent) as provided in paragraphs .127–.130 of this section
- c. Investments in joint ventures or component units as provided in Section 2100
- d. Investments in common stock other than those described in paragraphs .110–.116.

[GASBS 62, ¶202; GASBS 62, ¶204; GASBS XX, ¶69]

.110 The equity method of accounting should be applied to any investment that meets the criteria in paragraphs .112–.115 and is not specifically excluded in paragraph .109. [GASBS XX, ¶69]

Equity method

.111 Under the equity method, an investor initially records an investment in the stock of an **investee** at cost and adjusts the carrying amount of the investment to recognize the investor’s share of the earnings or losses of the investee after the date of acquisition. The amount of the adjustment is included in the determination of the changes in net assets by the investor. Such amount reflects adjustments including adjustments to eliminate inter-entity gains and losses, and to amortize, if appropriate, any difference between investor cost and underlying equity in net assets of the investee at the date of investment. The investment of an investor is also adjusted to reflect the investor’s share of changes in the investee’s capital. Dividends received from an investee reduce the carrying amount of the investment. A series of operating losses of an investee or other factors may indicate that a decrease in value of the investment has occurred that is other than temporary and that should be recognized even though the decrease in value is in excess of what would otherwise be recognized by application of the equity method. [GASBS 62, ¶203, as amended by GASBS XX, ¶69]

Criteria for Applying the Equity Method

.112–.115 [Insert current paragraphs .123–.126, including footnote.]

Applying the Equity Method

.116 [Insert current paragraph .127, including footnotes.]

External Investment Pools

.117–.118 [Insert current paragraphs .110 and .111, including footnote; add GASBS 67, ¶18 to sources.]

Life Settlement Contracts

.119 [GASBS XX, ¶70; add GASBS 67, ¶18 to sources.]

Open-End Mutual Funds

.120 [Insert current paragraph .109; add GASBS 67, ¶18 to sources.]

Interest-Earning Investment Contracts

.121 [Insert current paragraph .107.] [GASBS 31, ¶8; GASBS 67, ¶18; GASBS XX, ¶69]

.122 Investments in unallocated insurance contracts should be reported as interest-earning investment contracts according to the provisions of paragraph .121. [GASBS 59, ¶4; GASBS 25, ¶24 and GASBS 43, ¶22, as amended by GASBS 59, ¶4; GASBS 67, ¶18; GASBS XX, ¶69]

.123 [Insert current paragraph .108, including footnotes; add GASBS 67, ¶18 to sources.]

Land and Other Real Estate Held as Investments by Endowments

.124 Land and other real estate held as investments by endowments should be reported at fair value at the reporting date. Changes in fair value during the period should be reported as investment income.¹¹ [GASBS 52, ¶4]

¹¹[Insert current footnote 3.]

Synthetic Guaranteed Investment Contracts That Are Fully Benefit-Responsive

.125 Synthetic guaranteed investment contracts that are fully benefit-responsive should be measured at contract value as provided in paragraph .163 of Section D40. [GASBS 67, ¶18; GASBS XX, ¶69]

Life Insurance Contracts

.126 Investments in life insurance contracts should be measured at cash surrender value. [GASBS 67, ¶18; GASBS XX, ¶69]

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

.127 A government is permitted to determine the fair value of an investment that does not have a **readily determinable fair value**¹² 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 estimating fair value is permitted if the NAV per share of the investment (or its equivalent) is calculated as of the government's measurement date in a manner consistent with the measurement principles for investment companies. [GASBS XX, ¶73]

¹²The fair value of restricted stock is not readily determinable. The fair value of option contracts, stock warrants, and stock rights traded only in a foreign market is readily determinable if that foreign market is of a breadth and scope comparable to one of the U.S. markets referred to in paragraph .522. [GASBS 31, ¶3]

.128–.130 [GASBS XX, ¶74–¶76]

Recognition and Reporting

.131 [Insert current paragraph .112, including footnotes; in current footnote 9, add GASBS 67, ¶25 to sources.] [GASBS 31, ¶13; GASBS 67, ¶24; GASBS XX, ¶71]

.132 [Insert current paragraph .113, including footnote.]

Repurchase Agreements

.133–.134 [Insert current paragraphs .114 and .115.]

Reverse Repurchase Agreements and Securities Lending Transactions

.135 [Insert current paragraph .116.]

Additional Standards for Reporting External Investment Pools and Individual Investment Accounts by Sponsoring Governments

External Investment Pools

.136–.137 [Insert current paragraphs .117 and .118.]

Individual Investment Accounts

.138 [Insert current paragraph .119, including footnote.]

Disclosures

Valuation and Reporting

.139 [Insert GASBS XX, ¶77, change *Statement* to *Section*.]

.140 Governmental entities should make the following disclosures in the notes to the financial statements:

- a. [Insert GASBS XX, ¶78.]
- b. The policy for determining which investments, if any, are reported at amortized cost
- c. For any investments in external investment pools that are not SEC-registered, a brief description of any regulatory oversight for the pool and whether the fair value of the position in the pool is the same as the value of the pool shares
- d. Any involuntary participation in an external investment pool
- e. If an entity cannot obtain information from a pool sponsor to allow it to determine the fair value of its investment in the pool, the methods used and significant assumptions made in determining that fair value and the reasons for having had to make such an estimate
- f. Any income from investments associated with one fund that is assigned to another fund.

An entity may disclose realized gains and losses in the notes to the financial statements¹⁷ computed as the difference between the proceeds of the sale and the original cost of the investments sold.¹⁸ External investment pools that elect to report—and other entities that disclose—realized gains and losses should also disclose that:

- a. The calculation of realized gains and losses is independent of a calculation of the net change in the fair value of investments.
- b. Realized gains and losses on investments that had been held in more than one fiscal year and sold in the current year were included as a change in the fair value of investments reported in the prior year(s) and the current year.

[GASBS 31, ¶15, as amended by GASBS XX, ¶71; GASBS 25, fn10; GASBS 43, fn6; GASBS 67, ¶24; GASBS XX, ¶71, ¶77, and ¶78]

¹⁷[GASBS XX, fn3] [GASBS 25, fn10; GASBS 43, fn6; GASBS 67, fn8; GASBS XX, fn3]

¹⁸[Insert current footnote 17.]

.141 [Insert current paragraph .130, including footnote.]

Investments in Common Stock

.142 [Insert current paragraph .128, including footnote.]

Commitments to Resell Securities under Yield Maintenance Repurchase Agreements

.143 [Insert current paragraph .144.]

Losses Due to Default by Counterparties

.144 [Insert current paragraph .145.]

Investments in Certain Entities That Calculate NAV per Share (or Equivalent)

.145 [GASBS XX, ¶79]

Other Disclosures

General disclosure principles

Level of detail

.146–.158 [Insert current paragraphs .131–.143, including headings and footnote.]

DEFINITIONS

.501–.572 [Insert current paragraphs .501–.563; add the following terms from GASBS XX, ¶83: financial instrument, investee, market participants, most advantageous market, net asset value per share, orderly transaction, principal market, readily determinable fair value, and transaction costs; revise current paragraphs .522 and .531 as follows:]

[In current paragraph .522, revise definition as follows:] 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. [GASBS XX, ¶5; GASBS XX, ¶83]

[In current paragraph .531, revise definition as follows:] [GASBS 31, ¶22, as amended by GASBS XX, ¶64; GASBS XX, ¶83]

* * *

SECURITIES LENDING

SECTION I60

Sources: [Add the following:] GASB Statement XX

.104 [Insert new second sentence as follows:] Invested collateral and investments made with that cash should be measured according to Section I50. [GASBS 28, ¶6; GASBS XX, ¶64]

.114 [Insert new sentence as follows before subparagraph a:] For investments measured at fair value, the disclosures required by Section I50, “Investments,” paragraphs .139–.158 should be made. [GASBS 40, ¶10, as amended by GASBS 63, ¶8; GASBS XX, ¶77 and ¶78]

* * *

REAL ESTATE

SECTION R30

.506 [Replace the first sentence of the definition with the following:] 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. [GASBS 62, ¶373, as amended by GASBS XX, ¶5]

* * *

SERVICE CONCESSION ARRANGEMENTS

SECTION S30

.105 [Replace *fair value* with *acquisition value*⁶; renumber subsequent footnotes.] [GASBS 60, ¶9, as amended by GASBS XX, ¶72]

⁶Acquisition value is the price that would be paid to acquire an asset with equivalent service potential in an orderly market transaction at the acquisition date, or the amount at which a liability could be liquidated with the counterparty at the acquisition date. [GASBS XX, ¶83]

* * *

**INSURANCE ENTITIES—OTHER THAN
PUBLIC ENTITY RISK POOLS**

SECTION In3

.119 [Replace the first two sentences with the following:] Real estate acquired in settling mortgage guaranty claims should be reported at fair value as provided in Section 3100, “Fair Value Measurement.” [GASBS 62, ¶409, as amended by GASBS 63, ¶8 and GASBS XX, ¶5–¶63]

.133 [Replace the first sentence with the following:] Mortgage loans that are not investments should be reported at outstanding principal balances if acquired at par value, or at amortized cost if purchased at a discount or premium, with an allowance for estimated uncollectible amounts, if any. Mortgage loans that are investments should be measured at their fair values as provided in Section 3100. [GASBS 62, ¶424, as amended by GASBS XX, ¶64]

.134 [Replace with the following:] Real estate that meets the definition of an investment should be reported at fair value. [GASBS 62, ¶425, as amended by GASBS XX, ¶64]

* * *

INVESTMENT POOLS (EXTERNAL)

SECTION In5

Sources: [Add the following:] GASB Statement XX

.103 [Add new subparagraph g as follows:] g. The fair value disclosures required by Section I50, “Investments,” paragraphs .139–.158. [GASBS 31, ¶17; GASBS 34, ¶139, as amended by GASBS 63, ¶8; GASBS XX, ¶77–¶79]

* * *

**PENSION PLANS ADMINISTERED THROUGH
TRUSTS THAT MEET SPECIFIED CRITERIA—
DEFINED BENEFIT**

SECTION Pe5

Sources: [Add the following:] GASB Statement XX

See also: [Add the following:] Section I50, “Investments”

.115 [Delete all except first sentence and renumber subsequent footnotes.] [GASBS 67, ¶18]

.121 [Delete all except first sentence and renumber subsequent footnotes.] [GASBS 67, ¶24]

[Delete paragraph .122 and renumber subsequent paragraphs.]

.126 [In current paragraph .127, delete subparagraph b(2) and renumber subsequent subparagraphs.] [GASBS 67, ¶30]

* * *

**PENSION PLANS NOT ADMINISTERED THROUGH
TRUSTS THAT MEET SPECIFIED CRITERIA—
DEFINED BENEFIT**

SECTION Pe7

.116 [Replace second through fourth sentences and footnote 7 with the following; renumber subsequent footnotes:] Pension investments generally should be measured at **fair value** (Section 3100, “Fair Value Measurement”) and consistent with Section I50, “Investments.” [GASBS 67, ¶18, as amended by GASBS XX, ¶64–¶76]

.531 [Replace definition with the following:] 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. [GASBS 25, ¶44 and GASBS 43, ¶46, as amended by GASBS XX, ¶5]

* * *

PUBLIC ENTITY RISK POOLS

SECTION Po20

Sources: [Add the following:] GASB Statement XX

.139 [Replace paragraph with the following:] Investments should be measured consistent with the requirements of Section I50, “Investments.” [GASBS 10, ¶42 and ¶43, as amended by GASBS XX, ¶64–¶76]

[Delete paragraphs .141 and .143; renumber subsequent paragraphs.]

[Insert new paragraph .143, including heading, as follows:]

Lending Assets

.143 [GASBS XX, ¶64]

.144 [Delete the following from current paragraph .145: *(except those that are accounted for as foreign currency or futures contract hedges).*] [GASBS 10, ¶46, as amended by GASBS 31, ¶13 and GASBS XX, ¶71]

* * *

**POSTEMPLOYMENT BENEFIT PLANS OTHER
THAN PENSION PLANS—DEFINED BENEFIT**

SECTION Po50

Sources: [Add the following:] GASB Statement XX

.118 [Replace second through sixth sentences and footnote 4 with the following; renumber subsequent footnotes:] Investments should be measured consistent with the requirements of Section I50, “Investments.” [GASBS 31, ¶4; GASBS 43, ¶22, as amended by GASBS 53, ¶20, GASBS 59, ¶4, and GASBS XX, ¶64–¶76; GASBS 53, ¶67; GASBS 43, fn4, as amended by GASBS XX, ¶16]

* * *