GASB Statement No. 72 – Fair Value Measurement and Application

Scope

- Applicable to assets and liabilities that are required to be measured at fair value
- Required for financial statements of all state and local governments
- Effective for financial statements beginning after June 15, 2015. (Fiscal Year Ending June 30, 2016)

WHY MORE CHANGES?

Inconsistencies with other standards (FASB, IASB, GASB)

Structures of investments became more complex/Types of investments expanded

After credit crisis 2008/2009 the reported values of certain assets and liabilities became questionable

Lack of guidance for specific areas created diversity in how existing standards were applied
GASBS 72 - Overview

The Statement defines Fair Value, Investments, and Acquisition Value

Requires investments, with limited exceptions, to be measured at fair value

Changes measurement guidance for donated capital assets, donated works of art, historical treasures, and similar assets, and capital assets received in a service concession agreement

Provides guidance for determining a fair value measurement and applying fair value to certain investments

Requires disclosures to be made about fair value measurement

GASBS 72 - Overview

While you may not see a change in asset and liability amounts being reported on the financial statements, you are going to see;

- a number of changes in the definition associated with and ways to determine fair value
- a significant impact – disclosures in your financial statements

GASBS 72 – Fair Value Definition

Describes “Fair Value” as;

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 = exit price
"transfer a liability" does not mean to settle a liability. 
(GASB 72 ¶B38)

“orderly transaction” means:
✓ marketing activities that are usual and customary for transactions involving such assets or liabilities
✓ not a forced transaction (i.e. a forced liquidation or distress sale).

“measurement date” is the date as of which the fair value of an asset or liability is determined.
✓ the measurement date can be based on either an event, or transaction, or the financial statement reporting date.

Fair value would be considered from the perspective of market participants, not an entity-specific measurement, as evidenced by the change in GASB’s definition from “willing parties” to “market participants.”

The price is determined using the principal or most advantageous market and does not, if separable, include transaction costs (GASBS 72 ¶B19).

Principal market = market with greatest volume and activity for the asset or liability (i.e. quoted prices from stock exchanges)

Most advantageous market = market that maximizes the amount received or paid.
GASBS 72 – Fair Value using Net Asset Value (NAV)

Local governments may use the Net Asset Value (NAV) per share (or its equivalent) as a measure of fair value. An investment in STIP would be an example of this.

\[
(NAV = \text{FV of all assets} \ - \ \text{FV of all liabilities} \ / \ # \text{ of units (shares)})
\]

Investments measured using NAV are not subject to hierarchy input level classification but require additional disclosures in accordance with GASBS 72 ¶82.

GASBS 72 – Investment Definition

Describes "Investment" as:
A security or other asset that:
A government holds primarily for the purpose of income or profit, AND
Has present service capacity based solely on its ability to generate cash or to be sold to generate cash.
✔ Does not mean that the investment is required to be sold for cash. (GASB 72 ¶84)
The standard requires fair value measurement for all investments, with limited exceptions.

GASBS 72 – Unit of Account Definition

The unit of account is the level at which an asset or a liability is aggregated or disaggregated for measurement, recognition, or disclosure purposes.

Determination of the unit of account for investments held may be challenging depending on what you see on your custodial statements.

Sometimes custodial statements don’t reflect what the investment actual is. They may show one total amount that may be representative of several different investments lumped together.
**GASBS 72 – GASB’s examples of Unit of Account related to investments**

GASB’s examples:

- the unit of account for an investment in a mutual fund is each share in the mutual fund held by a government.

- the unit of account for investments held in a brokerage account is each individual security.

**GASBS 72 - MCA’s on investment of public funds**

Montana Code Annotated (MCA) limits the types of investments that can be made by local governments.

*Title 7 – Local Government*  
*Chapter 6 – Financial Administration and Taxation*  
*Part 2 – Deposits and Investment of Public Money*

**GASBS 72 - Investments**

Investments held by local governments *not* required to be measured at fair value:

- **Certificate of Deposits** (non-negotiable or nonparticipating) continue to be reported on a *cost basis* per GASBS 31 ¶8.

- **Money Market Investments** and participating interest-earning investment contracts, other than external investment pools, with remaining maturity at time of purchase of one year or less, may be reported at *amortized cost* per GASBS 31 ¶9.

- **Investments in 2a7-like external investment pools**. Net asset value (NAV) per share determined by the pool per GASB 59 ¶5.
**GASBS 31 – External Investment Pool Definition**

**External investment pool**
An arrangement that commingles (pools) the moneys of more than one legally separate entity and invests, on the participants’ behalf in an investment portfolio; one or more of the participants is not part of the sponsor’s reporting entity.

- An external investment pool can be sponsored by an individual government, jointly by more than one government, or by a nongovernmental entity.
- An investment pool that is sponsored by an individual state or local government is an external investment pool if it includes participation by a legally separate entity that is not part of the same reporting entity as the sponsoring government.
- If a government-sponsored pool includes only the primary government and its component units, it is an internal investment pool and not an external investment pool.

**GASBS 72 – Investments-Fair Value**

Unless otherwise directed by the Statement, all investments should be measured at fair value which include;

- **US Government Securities**
- **Money Market Mutual Funds**
  - Offered by investment companies
  - Offer safe, highly liquid short-term securities, such as US Treasury bonds and agency obligations
  - Not federally insured.

**GASBS 72 – STIP Fair Value measured using Net Asset Value(NAV)**

- **STIP**
  - Is an external investment pool
  - Fair value will be measured using NAV per membership unit
  - Will require additional note disclosures per GASB 72 ¶82

- No longer reported at amortized cost so any reference to such in note disclosures should be eliminated
- No longer a 2a7-like external investment pool so any reference to such in note disclosures should be eliminated
- Does not require disclosure of category of fair value hierarchy input level classification (Level, 1, 2 or 3)
**GASBS 72 – Acquisition Value definition**

Introduces and describes “Acquisition Value” as;

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.

Acquisition value = entry price

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**GASBS 72 – Donated Capital Assets & Acquisition Value**

*Donated capital assets*, works of art, historical treasures, and similar assets are now required to be reported at acquisition value per GASB 72 §79.

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**GASBS 72 – Capital Assets Historical Cost vs. Acquisition Value**

For clarification, the purchase of capital assets should continue to be reported at historical cost = no change from how they are currently valued.

The use of acquisition value is for *donated* capital assets, donated works of art, historical treasures and similar assets and should be applied prospectively to transactions occurring in the period that this Statement is first applied.
**GASBS 72 – Measurement of Nonfinancial Assets – Highest & Best Use**

Highest and best use of a nonfinancial asset such as real estate, buildings, etc. is limited to uses of the asset that are:
- physically possible,
- legally permissible, and
- financially feasible

**GASBS 72 – Nonfinancial Assets – Capital asset or investment?**

- Consideration of the local government’s mission and use of the asset to accomplish its mission comes into play.
- Just because an asset has the ability to generate or be sold to generate cash does not necessarily make it an investment.
- Will the asset be used by the local government to provide services to the government’s constituency?
  - If yes, definition of an investment because the present service capacity is not based solely on its ability to generate cash.
  - Capital assets provide services directly. Investments do not, but can be used to pay for goods or services.

Whatever determination was made at the purchase date and receipt of the asset, should be retained regardless of any future changes in usage.

**GASBS 72 – Nonfinancial Assets – Capital asset or investment?**

In early FY2016, a city began construction of a new municipal three-story building to house all government operations. Construction was completed in FY2016 and the building was classified as a capital asset.

At the beginning of FY2019, the city council decided to consolidate employees on floors two and three.

The city council then approved a plan to convert the first floor to retail and restaurant space. Tenants began moving in December 2018.

Should the municipal building continue to be classified as a capital asset or an investment at fiscal year ending June 30, 2019?
GASBS 72 – Nonfinancial Assets - Capital asset, investment, or both?

In early FY2016, a city began construction of a new municipal three-story building. The city council plans to use floors two and three to house all government operations and rent out space on the first floor to retail and service companies. Construction was completed in June 2017.

Should the municipal building be classified as a capital asset, classified as an investment, or possibly both at fiscal year ending June 30, 2017?

GASBS 72 – Nonfinancial Assets – Unit of Account

First, the city would determine at initial recognition of the building whether;
- the unit of account is one asset (the entire building)
- OR
- two assets (the government space and the rental space).

Then, the city would determine whether the asset(s) recognized should be classified as a capital asset or an investment.

GASB 72 - Understanding how Fair Value is determined

- Determine the appropriate valuation techniques to use
- Determine the appropriate valuation approach to use.
- Determine appropriate valuation inputs using fair value hierarchy
**GASBS 72 – Fair Value - Definition of Valuation Technique**

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

**GASBS 72 – Fair Value – Valuation Techniques**

- Valuation techniques should be consistently applied from period to period. However, a change is appropriate if it results in a measurement more representative of fair value.

- Changes in valuation techniques should be accounted for as a change in accounting estimate.
GASBS 72 – Fair Value – Valuation Approaches

There can be many ways to determine the fair value of an asset or liability, and the standard allows for many possible valuation techniques using one or more of three approaches:

- **Market approach** - Uses prices and other relevant information generated by market transactions involving identical or similar assets, liabilities, or a groups of assets and liabilities.
- **Income approach** - Discounts future amounts (for example, cash flows) to a single current amount; the discount rate should reflect current market expectations about risks associated with those future cash flows.
- **Cost approach** - Reflects the amount that would be required currently to replace or rebuild an asset (i.e., current replacement cost). (rarely used)

GASBS 72 – Fair Value Hierarchy of Valuation Input Levels

Valuation inputs are assumptions that market participants use in pricing an asset or liability. The standard establishes a hierarchy of inputs used to measure fair value that prioritizes the inputs into three levels.

**Observable;**
- **Level 1 inputs**
  - Quoted prices (unadjusted) in active markets for identical assets or liabilities that a government can access at the measurement date.
  - Stock Market
- **Level 2 inputs**
  - Inputs other than quoted prices included within Level 1 that are observable for an asset or liability, either directly or indirectly.

**Unobservable;**
- **Level 3 inputs**
  - Unobservable inputs for an asset or liability.

GASBS 72 – Fair Value Measurement Hierarchy Input Levels

The input level is determined based on the lowest level of input significant to the measurement in its entirety.

Local governments should;
- **maximize** use of observable inputs = level 1 & 2 inputs
- **minimize** use of unobservable inputs = level 3 inputs.
Use of quoted prices provided by third parties is permitted to arrive at the fair value of an asset, as stipulated in the standard:

“...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.” (GASB 72 ¶B34)

The local government should access information received and understand the inputs used to arrive at the fair value by considering the following:

- Are the inputs based on bid and ask prices?
- Are the inputs to the price observable?
- Has there been any significant decrease in the volume or level of market activity for the asset?
- Are the transactions on which the prices are based orderly transactions?

Disclosures required by this Statement should be organized by type of asset or liability.

Fair Value Disclosures requirements include:

- Fair Value measurement at the end of the reporting period
- Level of the fair value hierarchy (not applicable to investments measured at NAV)
- Description of valuation techniques used
- Changes in valuation techniques that has a significant impact on result and reason(s) for the change
- For non-recurring fair value measurements: reason for measurement.

Refer to GASB 72 §80 for considerations when applying the requirements above.
GASBS 72 – Fair Value Disclosures

If you use a format provided by the State to prepare your annual financial report, the cash & investments notes to the financial statements will be revised and contain stock disclosures to aid in GASB 72 disclosure requirements.

However, the local government will have to complete the disclosure(s) according to their assessment of third party information received pertaining to investments held.