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Mr. David R. Bean
Director of Research and Technical Activities
Project No. 26-5P
Governmental Accounting Standards Board
401 Merritt 7
P.O. Box 5116
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Dear Mr. Bean:

The American Institute of Certified Public Accountants (AICPA) has reviewed the Governmental Accounting Standards Board (GASB) Preliminary Views (PV), *Fair Value Measurement and Application,* and is pleased to offer its comments. While we support the Board's efforts to address the issues associated with measurement and application of fair value, we are concerned with the proposed definition of an investment both in terms of its clarity and intended scope. As further discussed in our response to Issue 3 below, we recommend the Board reexamine the proposed definition and consider separating the measurement and application aspects of the project. Our responses to the questions posed in the PV are in the section that follows. We have included other comments and observations on the PV in the section of this letter titled, "Other Comments."

RESPONSE TO QUESTIONS FOR RESPONDENTS

Issue 1—Definition of Fair Value

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

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

Issue 2—Transaction Costs

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

We agree with the Board that transaction costs to sell an investment should be reported as expenses or expenditures in the period incurred and not considered in the actual fair value measurement. Our rationale to support this treatment is the same as the Board's view that these costs may vary from government to government and thus are entity-specific, not market-based.

However, we are concerned that the aspect of the definition of fair value which states, "fair value should be the price that would be received to sell an asset or paid to transfer a liability" could be misinterpreted to mean the amount of cash received or paid net of transaction costs. Therefore, we suggest the Board clarify the definition of fair value to indicate that the price received or paid only includes amounts related to the asset or liability and not transaction costs (i.e., transaction costs should be considered as a separate transaction).

Finally, as discussed in paragraph 17 of Chapter 2 of the PV, we support the Board's view that transaction costs be considered when determining the most advantageous market. However, we recommend the Board more clearly state the reason that transaction costs should be included in the determination of the most advantageous market and not in considering fair value. That is, because they do not directly result in the recording of a financial statement item.

Issue 3—Definition of an Investment

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

We have several concerns with the proposed definition of an investment. We support and understand the portion of the proposed definition that relates to 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 or to be sold to generate cash. However, we are concerned that the latter portion of the definition covering present service capacity based "solely on the ability to procure services for the citizenry" is not clear and will be misunderstood in terms of the types of transactions that the GASB is attempting to scope in. We also believe that the examples provided in paragraphs 5-13 of Chapter 3 of the PV do not provide sufficient guidance to interpret the Board's intent for a security or other asset with a present service capacity based solely on its ability to procure services for the citizenry and are unclear which of the examples provided are intending to illustrate this concept.

Additionally, Chapter 3 of the PV is titled, *Application of Fair Value to Assets and Liabilities*. Therefore, it would appear that the Board is intending the definition of an investment to cover investments that have taken a negative position (e.g., reported as a liability). However, the PV is not clear in that regard. Further, as it relates to the scope of the definition, we are unclear whether other transactions such as certain derivatives are intended to be scoped in.

A key aspect of the PV is defining which types of transactions to measure at fair value. Unfortunately, we believe the PV does not do an adequate job of defining an investment such that it will be clearly understood. The Board should reexamine the definition in light of these concerns, in particular the aspect relating to procuring government services. While we understand the Board may have added that aspect as a result of existing guidance in GASB Conceptual Statement No. 4, *Elements of Financial Statements*, we recommend the Board consider dropping it from the definition of an investment. If it is retained, the Board should provide more explanation around the concept and enhance the listing of examples to include various types of transactions that would better illustrate the Board's intent. The Board should also clarify whether it is intending to scope in other types of transactions such as those in a negative position.

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

Issue 4—Measurement of Investments

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

We agree with the Board's view that investments generally should be measured at fair value on a recurring basis. However, we strongly encourage the Board to include examples in the next due process document to illustrate valuation of investments that have unobservable inputs (i.e., Level 3).

Issue 5—Disclosures

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

In general, we support the disclosures proposed in the PV with one major exception. We believe that the sensitivity disclosures described in paragraph 11 of Chapter 4 of the PV are not essential to users of the financial statements and question whether users would be able to convert the information in the disclosure to determine the range of the valuation.

Therefore, we suggest this disclosure be eliminated. We also think it is important to highlight that FASB ASC Topic 820*,* does not require the sensitivity disclosures for nonpublic entities because of the characteristics of the users of the financial statements of those entities.

If the Board retains the sensitivity disclosures, we ask the Board to consider the following issues. First, vendors that provide valuations often have proprietary pricing models. Therefore, it may be difficult, if not impossible in certain circumstances, for an entity to effectively determine reasonably possible alternative Level 3 inputs in these situations. The Board should provide guidance on how to comply with the disclosure requirements in such circumstances. Second, investments measured using a practical expedient should be exempt from this disclosure based on the difficulties cited in paragraphs 43 and 44 of Chapter 2 of the PV. Third, inputs to models often are interrelated. Changing one input in many cases will require that other inputs also be modified. The number of permutations in even simple models will lead to the disclosure of significant amounts of information with questionable value. The Board should provide better defined parameters regarding the extent of this disclosure.

Finally, as the GASB's fair value project proceeds, we also recommend that the Board closely follow feedback that FASB receives from the Financial Accounting Foundation's post-implementation review of FASB Statement No. 157, *Fair Value Measurements,* with regard to constituents' feedback on fair value disclosures. Such feedback may be useful to the Board as it further develops a proposed standard on fair value.

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

We did not identify any other fair value related disclosures for the Board to consider.

Other Comments

Rationale for Divergences from FASB Fair Value Measurement Guidance Would Assist Future Comment Efforts. We understand the Board utilized the FASB's guidance on fair value measurement as a starting point for the PV. While we noted a number of divergences from the FASB's approach in the PV, we had difficulty in forming an opinion about the appropriateness of those divergences without further explanation from the Board. It would be very helpful in the next due process document if discussion was added to provide the Board's rationale for any significant divergences between the Board's proposed guidance and the FASB's ASC. A table presenting FASB versus GASB requirements would be especially helpful. To assist the Board, we have provided the divergent topics we noted below. It is possible there are additional differences we did not identify.

- **Market approach**. Paragraph 29 of Chapter 2 of the PV discusses market approach. The second sentence, "The use of a quoted price from an active market is a technique that is consistent with the market approach" is not discussed in the FASB ASC. Instead, FASB's discussion is as follows, "For example, valuation techniques consistent with the market approach often use market multiples derived from a set of comparables. Multiples might be in ranges with a different multiple for each comparable. The selection of the appropriate multiple within the range requires judgment, considering qualitative and quantitative factors specific to the measurement."

- **<u>Valuation Techniques</u>**. The concept of using multiple valuation techniques is not discussed in paragraph 28 of Chapter 2 of the PV whereas the FASB guidance discusses when single valuation or multiple valuation techniques are appropriate. We also noted that the concept of calibration was left out of the GASB discussion.
- **<u>Fair Value Hierarchy of Inputs</u>**. Paragraphs 34 and 35 of Chapter 2 of the PV discuss the hierarchy of inputs used to measure fair value. This discussion excludes an explanation of Level 3 inputs which is included in FASB's ASC as follows, "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 resulting measurement would be categorized within Level 3 of the fair value hierarchy."
- **<u>Practical Expedient</u>**: Page x of the Summary of the PV states, "This expedient would be available if the net asset value per share of the investment (or its equivalent) is calculated in a manner consistent with the measurement principles for investment companies as of the government's measurement date." However, the detailed PV does not go on to address this matter further. For FASB, the practical expedient applies only if the net asset value is calculated under the accounting guidance specific to investment companies as defined by FASB. We are unclear whether GASB will use these same principles. Further, we noted that the GASB did not discuss as precisely as FASB when the practical expedient may or may not be used. FASB also allows for an adjustment to the net asset value which was not discussed by the Board.
- **<u>Investments Excluded from Fair Value.</u>** The list of exclusions in paragraph 19 of Chapter 3 of the PV differs from FASB exclusions from fair value (e.g., money market investments are not excluded from fair value by FASB).
- **<u>Disclosures</u>**. Many of the disclosures have been modified for application to a government.
- **<u>Definitional Differences</u>**. We noted the following terms defined in the PV Glossary which differ from the definitions in the FASB Glossary: credit risk, entry price, income approach, and present value.

More Robust Discussion of "Unit of Account" Suggested. The discussion of "Unit of Account" should be more robust to make clear that the "Unit of Account" is representative of what the investor owns. The example in paragraph 15 of Chapter 2 of the PV is simplistic. It would be helpful to include additional discussion or examples to explain that when the government's investment is in a fund that holds multiple investments what the investor owns is a share of the fund, not a share of each individual investment held by the fund.

"Unit of Account" Definition Inconsistency. We noted that the discussion in paragraph 15 of Chapter 2 of the PV lacks a reference to "recognition purposes" which is included in the PV Glossary. Therefore, we recommend that the second sentence of paragraph 15 be modified as follows: "The unit of account refers to the level at which an asset or a liability is aggregated or disaggregated <u>for recognition purposes</u> as provided by an accounting standard."

"Market Participants" Definition Inconsistency. The PV is inconsistent in the definition of market participants with regard to the independence of parties. The PV Glossary definition mirrors FASB's wording which is "independent of each other, that is, they are not related parties." However, paragraph 20 of Chapter 2 of the PV uses the phrase "independent of the reporting entity," which is based on a superseded FASB definition. Therefore, we suggest the wording in paragraph 20 be modified to align to the Glossary definition. Further, we recommend the Board also clarify whether market participants are governmental and nongovernmental entities.

Quoted Prices in Active Markets Should Consistently Indicate "Without Adjustment." The discussion of Level 1 inputs in paragraph 36 of Chapter 2 of the PV states that inputs within Level 1 would be unadjusted quoted prices in active markets for identical assets or liabilities. We suggest the Board consistently incorporate the notion of quoted prices "without adjustment" as in the second sentence of paragraph 36.

Use of Equity Method Discussion Should be Clarified. It was challenging to follow the various thoughts in paragraph 20 of Chapter 3 of the PV. It starts by explaining that certain entities that calculate net asset value per share would not be eligible for the equity method of accounting. Then the second sentence explains what the equity method is. The third sentence then begins with "also" as it if is a continuation of the thoughts on the equity method. However, it appears to be an example of an investment not eligible for the equity method. We recommend the Board clarify this discussion in the next due process document. Additionally, the last sentence would be better phrased, "investments not eligible for the equity method would be measured…"

Government as Contract/Policy Owner. We believe that a government would be the contract/policy holder with regard to life settlement contracts discussed in paragraph 17 of Chapter 3 of the PV, but would appreciate clarification.

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The AICPA appreciates the opportunity to comment on the PV. This comment letter was prepared by members of the AICPA's State and Local Government Expert Panel and was reviewed by representatives of the Financial Reporting Executive Committee who did not object to its issuance. Representatives of the AICPA would be pleased to discuss these comments with you at your convenience.

Sincerely,

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