National Association of State Auditors, Comptrollers and Treasurers

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September 30, 2013

Mr. David Bean
Director of Research
Governmental Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

Dear Mr. Bean:

On behalf of the National Association of State Auditors, Comptrollers and Treasurers, we appreciate the opportunity to respond to the Governmental Accounting Standards Board's Preliminary Views (PV), *Fair Value Measurement and Application*.

We generally agree with the Board's views on the measurement and application of fair value and related disclosures. The proposed changes in this PV will increase consistency and comparability in government's fair value measurement and related disclosures.

Below are our responses to the Board's five Questions for Respondents.

Question 1
Definition of Fair Value: *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 new definition. The sale of the asset or liability would be considered a hypothetical transaction at the measurement date. This should be an orderly transaction between market participants and not a forced transaction, because in a forced transaction the government is at a disadvantage and likely willing to accept a lesser amount in exchange for the asset or liability.

However, we request that the Board provide clarification on the meaning of the term "measurement date" along with the definition of fair value.

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

We agree that transaction costs should be reported as an expenditure or expense in the period an investment is sold. Transaction costs do not meet the definition of an asset or a deferred outflow of resources. We further agree that the costs are entity-specific rather than market-based and, as such, should not be included in fair-value measurement.

Question 3
Definition of an Investment: *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 agree with the Board's proposed definition of an investment. It is consistent with the definition of an asset.

The examples of the application of the definition of an investment given in Chapter 3, paragraphs 5-13 are very helpful. However, we suggest the Board also include an example of the situation described in Chapter 3, paragraph 4 which states "An investment asset's service capacity also may be achieved without generating cash, such as when an investment asset is surrendered to procure services directly in an exchange transaction."

Question 4
Measurement of Investments: *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 and believe the consistent use of fair value would provide a more accurate snapshot of the investment value as of the measurement date. The fair value approach would report gains and losses as they occur through the life of the investment. This would aid financial statement users in their ability to compare the value of investments from one year to the next and to other investments held by the entity. We also agree that, unless specifically excluded, investments should no longer be valued at amortized cost or other measurers.

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

We believe the proposed disclosures are essential to the user's understanding of the financial position as it shows the reader the method used to calculate the value of the investments.

We do not believe any additional disclosures are necessary.

In addition to the responses to the Questions for Respondents, as this project moves forward, the following concerns should also be considered.

- Chapter 2, paragraph 3: We believe the Board should make it explicitly clear throughout the final standard that fair value determinations should be based solely on assumptions that market participants would use when pricing an asset or liability, including assumptions about risk. We agree with the Board's view that fair value should be a market-based measurement at the measurement date. We also agree that this measurement cannot be based on an entity- or government-specific measurement. This could be further emphasized by including language in the final standard to make it well understood that a reporting entity's future business plans and its intentions to hold an asset or settle a liability at some future date is not relevant when determining fair value. For example, a government's internal business plans to hold a bond to maturity or construct a commercial building on a vacant parcel of land at some future date should not directly impact the determination of fair value at the current measurement date.

- Chapter 2, paragraphs 16 and 17 and paragraphs 40 through 42: We request that the Board clarify what is meant by "most advantageous market" and "highest and best use." We are concerned that these terms and explanations might be interpreted to mean that an entity or government should take into account its own future plans for an asset. For example, if a government owns undeveloped land and has future plans to construct a commercial building on it and collect tenant rent, the government might believe this planned future use would result in a higher value based on the "most advantageous market" or its "highest and best use" and proceed to value the property as if the land had already been developed at the measurement date.

  Therefore, within paragraphs 16 and 17, regarding the use of principal or most advantageous market, the Board should explicitly reiterate that the market determination should be based on a current functioning market as of the measurement date and not an anticipated future market with potentially more favorable conditions. More importantly, within paragraphs 40 through 42, we are concerned that governmental entities may view the concept of highest and best use (HBU) as allowing an entity- or government-specific valuation, which is contrary to the Board's proposed definition of fair value. HBU is commonly defined by the real-estate valuation industry as a reasonably probable and legal use of vacant land or improved property, which is physically possible, appropriately supported, and financially feasible, and that results in the highest value. The Board should be clear that HBU must consider the assumptions of market participants using acceptable market data as of the measurement date.

- Chapter 2, paragraph 28 and Chapter 4, paragraph 8: The terms "observable inputs" and "unobservable inputs" are not sufficiently defined which could lead to errors in application and reduce comparability. In particular, "unobservable inputs" seems inadequate. We ask the Board to better convey the concept that some inputs used to determine fair value are not directly related to the item being measured.

- Chapter 2, paragraphs 35 and 38: We encourage the Board to include specific examples that demonstrate when Level 3 inputs would be permissible and reiterate in paragraph 38's last sentence that Level 3 assumptions would never be appropriate when Level 1 and 2 inputs are available.

- Chapter 2, paragraph 39: The paragraph discusses using quoted prices provided by third parties, however, it does not identify the input level. We recommend the Board include the input level(s) in the standard due to this being a required disclosure in the financial statements.

- Chapter 2, paragraph 45: The paragraph addresses the measurement of liabilities and states "the price paid to transfer the liability to a market participant would be a better measure of fair value than the amount needed to settle with the counterparty." It doesn't seem like there would be a common, or frequent, sale of similar liabilities by governments that would allow for measuring the fair value based on an active market (Level 1 inputs) or quoted prices for similar liabilities or market-corroborated observable inputs (Level 2 inputs). Therefore, it would appear that the amount to settle the liability with the counterparty would be more appropriate. We ask that the Board provide more guidance in this area to assist financial statement preparers in measuring the fair value of liabilities based on the price that would be paid to transfer liabilities to market participants.

- Chapter 3, paragraph 1: The paragraph states that the chapter presents the Board's preliminary views on which assets and liabilities should be measured at fair value. However, the chapter only discusses the application of fair value to assets. We suggest the paragraph be expanded to address the Board's preliminary views on which liabilities should be measured at fair value and that an example be provided.

- Chapter 3, paragraph 19: We recommend that investments that are held for in-substance defeased bonds be added to the list of exclusions. If investments are held in an irrevocable escrow account and are timed to meet the payments of the bonds, and the investment cannot be sold or liquidated prior to its maturity, and are essentially risk free (see GASB 7), then fair value adjustments may not be necessary for decision making by readers of the financial statements. While paragraphs 5 through 13 provide examples of what may or may not be an investment, paragraph 13 would seem to make the case that these would be considered investments. In addition, with regard to eliminating investments held for in-substance defeased bonds, we believe that investments for certain lottery annuitant winners should be eliminated from fair value pricing. In those cases where a Lottery is entering into an irrevocable trust with an annuitant winner to hold specific U.S. obligations until maturity, and these investments cannot be sold or liquidated, and are essentially risk free, then these investments should not be priced at fair value. Reporting fair value for these investments provides a meaningless net increase (or decrease) in fair value on the operating statements and provides for volatility in such statements when comparing net income between years.

- Chapter 3, paragraph 23: We ask that the Board provide additional clarification or guidance regarding assets that were previously reported at fair value, which would now be reported at acquisition value. Specifically clarifying if these assets need to be restated at acquisition value retrospectively to prior periods along with the possible depreciation, etc., and if so, if this change should be considered a change in accounting estimate.

We appreciate the opportunity to provide our comments. Should you have any questions or need additional information regarding our response, please contact Kim O'Ryan of NASACT at (859) 276-1147 or me at (505) 955-1120.

Sincerely,

James B. Lewis
NASACT President