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GASB Proposes Measurement Concepts for Assets and Liabilities and Standards for Measuring, Applying, and Disclosing Fair Value.

In June, the GASB issued an Exposure Draft, Measurement of Elements of Financial Statements, and a Preliminary Views, Fair Value Measurement and Application. The Exposure Draft proposes new accounting concepts to guide how the GASB sets standards for the measurement of assets, liabilities, and other items reported in financial statements. The Preliminary Views presents the Board's initial thinking on how fair value should be determined, what should be measured at fair value, and what note disclosures should be included with those measurements.

The GASB also issued a Plain-Language Supplement that summarizes the proposals for users of governmental financial information. The GASB will be conducting a webcast on September 5 at 3:00 pm Eastern time to explain the proposals and collect feedback from users.

This article summarizes and explains the proposals in the due process documents at a very high level for users of governmental financial information. It addresses the Exposure Draft on measurement concepts first, and then discusses the Preliminary Views on fair value. Information about how to participate in the September 5 webcast and provide your feedback to the GASB is included.

Measurement Concepts

GASB Concepts Statements are meant to provide a framework of interrelated objectives and fundamental concepts that can be used as a basis for the GASB establishing consistent accounting and financial reporting standards. Measurement concepts will address how to calculate the appropriate amounts for assets and liabilities. As such, they will provide a foundation for depicting a government's financial health as of a specific point in time, referred to as the government's "financial position," and its financial activity during a certain period, referred to as the government's "results of operations" or "financial performance."

Measurement concepts help the Board to develop standards that require largely the same treatment for similar transactions. This promotes the user's ability to compare relevant, reliable, and understandable financial information across governments. Ultimately, accounting standards based on these concepts should maximize the likelihood that different governments would come up with comparable measurement amounts for comparable assets or liabilities obtained or incurred under comparable circumstances.

Measurement approaches

A measurement is associated with a point in time; a "measurement approach" tells you what that point in time is. The GASB is proposing that assets and liabilities be measured using one of two measurement approaches:

- **Initial Amount**—The transaction price or amount assigned when an asset was acquired or a liability

was incurred, including subsequent modifications (for example, depreciation) to that price or amount. Initial amounts also are known as initial-transaction-date-based measurements.

- Remeasured Amount—The amount assigned when an asset or liability is remeasured as of the financial statement date. Remeasured amounts also are known as current-financial-statement-date-based measurements.

While initial amounts may be adjusted in later years, such as through amortization or because of impairment, the original value of the asset or liability is not remeasured. Remeasured amounts, on the other hand, are newly measured as of the date of each year's financial statements. The GASB has proposed two approaches, rather than a single approach for all assets and liabilities, because it believes both are needed to meet the various objectives of financial reporting and to achieve balance among the qualitative characteristics (reliability, comparability, consistency, relevance, understandability, and timeliness) of information in government financial reporting.

The Board believes that the use of initial amounts is generally better suited to achieving reporting objectives associated with the cost of providing services. A capital asset—an elementary school, for example—is acquired at a given time but is used to provide services for many years afterward. Including the cost of the school in the cost of providing services in each of those years is more informative if the cost of the school is measured at the initial amount.

The Board also believes that remeasured amounts are better suited to achieve financial reporting objectives related to portraying financial position. For example, using the remeasured amount for a government's investments that will ultimately be converted to cash will provide a clear picture of a government's current financial health and the resources available to it for providing services or satisfying obligations.

The Board recognizes that it may not be possible to report some assets or liabilities using a measurement approach that promotes the objectives of both (a) providing information about the cost of current-year services and (b) providing information about the financial position of a governmental entity to be used in assessing the level of services that can be provided by the governmental entity. Because only one measurement approach should be applied for a specific asset or liability, one objective will necessarily be given priority over the other. In these circumstances, the Board believes that the cost-of-services information has greater relevance in the governmental environment than the service-potential information because of the importance of providing information that can be used to assess interperiod equity.

Measurement attributes

The GASB is proposing to place four basic measurement tools in its conceptual framework tool box that it can use in standards-setting. These tools are referred to as measurement attributes. A measurement attribute is a particular characteristic of the asset or liability that is being measured. The proposed Concepts Statement identifies and defines four measurement attributes:

- Historical cost is the price actually paid to acquire an asset or, with respect to a liability, the proceeds actually received when the liability was incurred.
- 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.
- Replacement cost is the price that would be paid to acquire an asset with equivalent service potential in an orderly market transaction at the measurement date.
- Settlement amount is the amount at which an asset could be realized or a liability could be liquidated with the counterparty, other than in an active market.

Historical cost can be used to measure initial amounts only, while the other measurement attributes can be used to measure both initial amounts and remeasured amounts.

Implications for users

The proposed concepts will not directly affect the information that is reported in governmental financial reports because Concepts Statements do not set standards. Indirectly, however, the concepts guide the GASB when it is establishing standards and, therefore, will help to ensure that the standards adequately balance the need for understandable, relevant, and reliable information that is prepared consistently and comparably and presented in a timely fashion.

Fair Value Measurement and Application

Defining fair value

The notion of fair value has been used for many years in the governmental accounting environment to measure investments predominantly, as well as some other assets and liabilities. Under the Preliminary Views, fair value would be defined 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. In the Board's view, fair value is a market-based measurement and represents an exit price.

Implications for users.

The primary result of the new definition should be to improve the comparability and consistency of governments' measures of fair value. It clarifies certain issues that are important to pinpointing fair value, such as the fact that it is an exit price rather than an entry price, which under certain circumstances can be very different amounts. The fair value definition also is consistent with the Financial Accounting Standards Board's definition of fair value—one that many users are already familiar with.

Measuring fair value

The GASB's Preliminary Views describes three acceptable "valuation approaches" for measuring fair value:

- The market approach uses information resulting from market transactions for identical or comparable assets or liabilities (for example, the stock exchange).
- The cost approach bases fair value on the amount necessary to replace an asset's present capacity for providing service (for example, an appraisal).
- The income approach calculates fair value by converting future amounts to a single current amount. A government might project cash flows from an asset—like a royalty interest in an oil-producing property—and discount them to their present value, for example.

The GASB's preliminary view is that the use of a variety of "valuation techniques" for establishing fair value could be acceptable, depending on the specific circumstances of the measurement, provided that:

- The valuation technique used by a government is consistent with the three valuation approaches, and
- The valuation technique is based as much as possible on "observable inputs."

"Inputs" are the assumptions market participants make when deciding on the price for an asset or liability, such as the degree of perceived risk. Observable inputs are those that are readily accessible

to the public, such as the previously mentioned stock exchange. Unobservable inputs are based on assumptions a government uses to best estimate the fair value of an asset or liability in the absence of market data.

The Preliminary Views describes a three-level hierarchy of inputs for measuring fair value:

- Level 1 inputs are quoted prices from markets with many transactions for identical assets and liabilities. When market information that qualifies as a Level 1 input is available for measuring fair value, a government would use the market valuation approach rather than the cost or income approach.
- Level 2 inputs are either directly observable, like quoted market prices but for similar assets and liabilities, or correlated or corroborated from observable market information. Level 2 inputs generally would not be used unless Level 1 inputs are not available.
- Level 3 inputs are assumptions a government develops based on the best information available to it.

Level 3 inputs would not be used unless Level 1 inputs and Level 2 inputs are unavailable.

The distinction between the three levels relates to the reliability of the measurement of an asset or liability's fair value. Observable inputs are more reliable than unobservable inputs because it is easier to verify observable inputs.

Alternative investments. Some governmental entities hold investments for which there is not a "readily determinable fair value." These often relate to "alternative investments," such as shares in a hedge fund. Governments with investments in hedge funds and certain other entities that calculate "net asset value per share" would be allowed to use a practical expedient to determine the value of those investments. In other words, governments would not establish the fair value of their investment themselves but would calculate an amount based on their proportion of the fair value determined by the issuer of the investment (the hedge fund, for example).

Implications for users. The valuation techniques and hierarchy of inputs, which form the basis for determining fair value, are applicable to all investments and, thereby, promote consistency and comparability. They also are consistent with the FASB's requirements, which are familiar to many users.

A principle concern among users when looking at fair value amounts reported in financial statements is where they came from. Certain sources of fair value, such as market data, are considered inherently more reliable by users, whereas users are more uncertain about fair value determined by governments internally using unobservable inputs. When combined with disclosure requirements that are detailed below, this proposal should have the effect of making it easier for users to assess the acceptability of fair value measures and reduce the degree of uncertainty they face.

Applying fair value

The Board's preliminary view is that investments generally should continue to be measured at fair value. The GASB has proposed defining an investment as a security or other asset that a government holds primarily for the purpose of income or profit, the present service capacity of which is based solely on its ability to generate cash, to be sold to generate cash, or to procure services.

Exceptions to fair value. At present, several types of investments are not required to be reported at fair value. These include investments with a maturity of one year or less at the time of purchase,

investments in 2a7-like external investment pools (which are a type of government-sponsored, short-term investment pool), and most investments in life insurance. Under the GASB's preliminary view, these exemptions to applying fair value would continue.

Under the preliminary view of the GASB, certain assets currently required to be measured at fair value would be measured at acquisition value instead. These include:

- Capital assets received in a nonexchange transaction, such as capital assets received by donation
- Works of art and historical treasures received by donation
- Certain assets received in nonmonetary transactions.

While fair value is an exit price, acquisition value is an entry price—that is, the price a government would have to pay to acquire a similar asset with similar service capacity.

Transaction costs.

Currently, many defined benefit pension plans and retiree health insurance plans subtract significant related transaction costs when measuring fair value. Under the preliminary view of the GASB, transaction costs would instead be reported as expenses when incurred and not netted against the fair value of investments.

Implications for users. Under the proposed definition of an investment, some items not currently reported as investments could be considered investments going forward. Consequently, governments would have to measure their fair value going forward. Similarly, some assets currently reported as investments would no longer be reported at their fair value. However, it is not expected that the changes would be substantial.

Fair value disclosures

In order to allow users to better understand how governments calculate fair values when they are not based on observable market data, the GASB has proposed a more detailed set of disclosures than is currently required that take into account the levels of inputs a government uses to measure fair value and their characteristic degrees of uncertainty and subjectivity.

These disclosures would be organized by type or class of asset or liability. The extent of disaggregation would depend on a number of factors, including the nature, characteristics, and risks of the assets or liabilities, the level of inputs used to measure the assets or liabilities, whether other standards specifically require separate disclosure (such as derivative instruments), and the value of the assets or liabilities measured at fair value relative to all the assets or liabilities. The GASB is proposing that governments disclose:

- The fair value amounts as of the date of the financial statements and the levels of inputs used in their determination
- The valuation techniques and assumptions used
- Changes in techniques and inputs having a significant impact on the measurement of fair value and the reasons behind the changes
- Additional quantitative information that describes the nature of any significant Level 3 inputs used to measure fair value
- A narrative description of the degree to which fair value measurements are sensitive to changes in Level 3 inputs.

Importantly, the amount of disclosure is greater when Level 3 inputs are used because they are harder to verify. The proposed disclosures would give users the information needed to evaluate the

measurement techniques used and the resulting fair value measurements themselves.

To reiterate, governments would be able to use a practical expedient to value certain alternative investments because these investments do not have a readily determinable fair value. Consequently, their value would be less certain and more subjective than the fair value measurements of other investments. As a result, the GASB believes additional disclosures are necessary for alternative investments. These disclosures would include the following for each type of alternative investment:

- The fair value amounts as of the date of the financial statements
- Significant investment strategies of the entities in which the government has invested
- The amount of any related commitments the government has for which it has not set aside resources
- Terms and conditions under which the government may redeem the investments
- Restrictions preventing the government from redeeming an investment that is otherwise redeemable and the expected duration of the restriction
- Other significant restrictions on the government's ability to sell the investments.

Implications for users.

If the proposals related to fair value disclosures are ultimately reflected in final standards, the fair value information about assets and liabilities by type, class, valuation approach, and input levels would significantly enhance the depth and breadth of users' understanding of governmental entities' financial health. Disclosures about the assumptions made in estimating fair value, particularly for alternative investments, directly address the concerns that users have about understanding how fair value is determined.

Disclosures related to Level 3 inputs, particularly those related to more complex items, such as securitized fixed income and alternative investments, would assist users in analyzing the financial condition and activity of governments. For example, these disclosures would potentially provide a clearer understanding of the extent of an entity's diversification among alternative investments, other inherent risk factors, and the nature and quality of the measurements involved.

How Can Users Help the GASB with These Projects?

When the GASB sets standards and establishes concepts, a critical part of its due process activities involves publishing documents for public discussion and comment. Users of financial statements are in the best position to assist the GASB in understanding whether or not the information that would result from the proposals would be important for fulfilling their informational needs. You can help the GASB by reviewing the Plain-Language Supplement prepared specifically for users of financial statements, and commenting on the questions posed throughout the supplement. You are also invited to comment on the Exposure Draft and the Preliminary Views themselves.

Copies of the Plain-Language Supplement, Exposure Draft, and Preliminary Views may be downloaded free of charge from www.gasb.org. The comment deadline for all three documents is September 30.

As previously noted, the GASB has scheduled a webcast designed specifically with financial statement users in mind for September 5, 2013, at 3:00 p.m. Eastern time. The webcast will summarize the proposals described in this document and provide an opportunity for users to ask questions. The webcast will be followed immediately by a web-based survey allowing users to offer their views. The webcast may be viewed and the survey completed on that date or on any day following through the September 30 comment deadline.

A public hearing on the Exposure Draft and Preliminary Views is scheduled for November 1, 2013, at the Sheraton LaGuardia East Hotel, 135-20 39th Avenue, Flushing, NY. The deadline for providing written notice of intent to participate in the public hearing is September 30.

Additional details on how to provide comments to the GASB and about participating in the public hearing are available in the front of the Exposure Draft and the Preliminary Views.

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