NACUBO

National Association of College and University Business Officers

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September 30, 2013

Mr. David Bean
Director of Research and Technical Activities
Governmental Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116

Re: Project No. 26-5P

Dear David:

On behalf of the National Association of College and University Business Officers (NACUBO), we submit the following comments on the Preliminary Views (PV) of the Governmental Accounting Standards Board (GASB), "Fair Value Measurement and Application." NACUBO's comments on the PV were developed with input from our member institutions and our Accounting Principles Council (APC). The APC consists of experienced business officers from independent and public higher education institutions who, collectively, possess a thorough knowledge of higher education accounting and reporting issues and practices.

NACUBO is a nonprofit professional organization representing chief financial and administrative officers at more than 2,100 not-for-profit and public colleges and universities. In its capacity as a professional association, NACUBO issues accounting and reporting guidance for the higher education industry and educates over 2,000 higher education professionals annually on accounting and reporting issues and practices.

We are pleased that the Board is examining assets and liabilities currently measured at fair value and tackling investments that previously have not been measured at fair value. Such investments are significant in higher education. According to the latest NACUBO-Commonfund Study of Endowments, an annual survey with 831 institutional participants in 2012, colleges and universities collectively manage $406 billion of endowment investments of which 54% are divested in alternative investment strategies. Further, the alternative investment allocation for public universities (not including affiliated not-for-profit foundations) is 52%. Alternative investments do not have a readily determinable market price and there is no current guidance for valuing or explaining these assets in GASB's literature.

We value the time that the board and staff have spent researching the work of the Financial Accounting Standards Board (FASB) on fair value measurement and the extensive time and effort that the Board and staff have devoted to this important effort. We agree that Topic 820 of FASB's Codification was the correct place to start evaluating measurement and disclosure issues for alternative investments. On a related note, the Financial Accounting Foundation is currently conducting a post-implementation review of FASB Statement 157 (Codification Topic 820). We urge the Board to consider the results of that review, in conjunction with comments on the PV, before issuing an exposure draft on fair value measurement and application.

We appreciate the use of a PV to gather additional feedback for the fair value measurement and application project. We look forward to participating in the New York public roundtable on November 1, 2013.

Issue 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 Board's preliminary view but seek clarification for certain assets that do not have markets. For example, public colleges and universities have various benefactors that support the institution. Support may originate in the form of a pledge (e.g., a promise to give that typically carries an expendable restriction) or a split-interest agreement (e.g., charitable annuities or remainder trusts). Split interest agreements are investments (with both an asset and liability component), pledges are not investments, and neither financial instrument has an available market.

Pledges and split interest agreements have not been identified as deferrals in Statement 65, "Items Previously Reported as Assets and Liabilities." Consequently we believe that these instruments would fall under the Exposure Draft, "Measurement of Financial Statement Elements." As such we seek clarification regarding the measurement approach for financial statement presentation when the asset / liability is (a) acquired / initially recorded and (b) remeasured in subsequent reporting periods.

The PV refers to the "priority" of data in the fair value hierarchy. We believe that the PV is referring to the prevalence of observable input data in the fair value hierarchy and are concerned that use of the word "priority" may be misunderstood by financial statement users who could equate the level of the fair value hierarchy with the quality of the investment.

Chapter 2, paragraph 12, states that "Movements in fair value during the period that an investment asset is held would provide a benchmark with which to assess the results of a government's decisions and to assess its ability to continue to meet obligations and provide services." We interpret this to mean that changes in the fair value of investments can be used to assess the success of a government's investment strategies. While this may be true for some investments, it may not be true for all, especially those that are long-term such as private equity.

Issue 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 are period costs as they are entity, and not investment, specific. Transactions costs are expenses of a governmental entity and do not conform to the definitions of assets, liabilities, or deferrals in Concept Statement 4, "Elements of Financial Statements."

Issue 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?

Except for the last phrase in the proposed definition (*procure services for the citizenry*), we agree with the clarity of the definition. We struggle with the following sentence in paragraph 4 of chapter 3:

> *"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."*

We cannot think of an example of such an exchange transaction.

We also seek clarity concerning the use of the term "other asset" in the proposed definition. Specifically, would assets previously considered capital assets that meet the proposed definition of "other asset" (not a security) be considered investments? Paragraph 23 in chapter 3 reviews changes to existing fair value guidance and states that "it is the Board's preliminary view that fair value should be replaced by acquisition value for (a) capital assets received in nonexchange transactions, (b) donated capital assets, or (c) donated works of art, historical treasures, or similar." There are instances where higher education institutions receive buildings or land as donations and the buildings are not used in operations but are held as investments. There are also times when buildings used in operations are converted to investment property. Works of art may also be held as investments. Real estate or works of art can be part of an institution's true endowment fund, designated by the board as a quasi-endowment or held as investments outside of the endowment.

In a similar vein, we ask the Board to confirm that the guidance in Statement 52, "Land and Other Real Estate Held as Investments by Endowments," (mentioned as background in chapter 2, paragraph 4) needs to be expanded. Land or other real estate can meet the definition of an investment if held by a governmental entity primarily for the purpose of income or profit, and its present service capacity is based solely on its ability to generate income or be sold to generate cash. In these cases, such assets should be considered investments and subject to fair value measurement and application – regardless of whether the assets are held in true endowment funds, quasi endowments funds designated by the public institution's governing board or non-endowment funds.

Issue 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 as mentioned in our response to Issue 1, we seek clarity concerning split-interest agreements.

We appreciate the Board's inclusion of the use of a practical expedient for measuring investments where a Net Asset Value per share (NAV) is calculated. In the Summary, the use of a practical expedient is discussed and said to be available if the NAV is calculated in a manner consistent with the "measurement principles for investment companies as of the government's measurement date." That statement raises two questions. First, FASB guidance allows use of NAV as a practical expedient only if the NAV is calculated consistent with the measurement principles for investment companies as defined in FASB Topic 946. Is GASB assuming these same principles will be used? Second, for investments where the practical expedient is used, would "rolling forward" a NAV, calculated at a date other than the government's measurement date, to correspond with the governmental entity's financial statement reporting date be acceptable? In other words, if the most recent NAV for an investment is December 31, and the governmental entity has a June 30 year end, is it acceptable to roll forward the December 31 NAV for activity or other significant known valuation changes in order to estimate the fair value at June 30?

The discussion of Unit of Account should be more expansive and consider the many complexities of alternative investment structures. It is important to explain that the Unit of Account is representative of what the investor owns. The provided example of multiple investments in one brokerage account only demonstrates investor ownership of individual accounts in a brokerage account pool – which over simplifies the unit of account. Perhaps the Board should consider an example that does not involve individual account ownership. For instance in a fund of funds investment structure, the investor owns a share of the overall fund that holds multiple investments and not a share of each individual investment held by the fund.

We are concerned that no transition guidance is mentioned. Because the measurement of investments at fair value may require significant time and effort by many governments, we would like the opportunity to comment on the Board's transition views.

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?

We agree that disclosures should be organized by type or class of asset or liability and applaud the Board's recognition that specific criteria for the level of asset and liability detail should not be prescriptive. We support the Board's belief that relevant facts and circumstances regarding assets and liabilities that are measured at fair value are unique to each government and that the amount of detail is best left to professional judgment. It is with this spirit that we recommend that the example in paragraph 6 be eliminated (i.e., disaggregating U.S. Treasury notes from U.S. Treasury Strips). There may be governmental entities for which such disaggregation does not provide valuable information; the professional judgment of the preparer must be considered and this example could lead others to a different conclusion.

As noted in the PV, the estimate of fair value for many alternative investments is based on NAV; many of which would qualify for the use of the practical expedient. There are, however, alternative investments that are valued on a basis other than NAV. For example, direct investments in real estate, mineral rights, and other natural resources are typically valued based on the present value of the expected cash flows. Under the guidance as written, those investments would not be subject to the disclosure requirements of Chapter 4, paragraph 14 as it is limited to "investments in entities that calculate a net asset value per share or its equivalent (regardless of whether the practical expedient is used)." We would like the Board to confirm our understanding.

We do not believe that the proposed quantitative disclosures about significant unobservable inputs would provide decision-useful information to readers of a government's financial statements. In Chapter 4, paragraph 10, the Board makes an exception to the quantitative input disclosures for investments where the fair value is developed by a pricing service. We believe that investments which are measured using the practical expedient should also be exempt from this disclosure as the investor is not privy to the unobservable inputs used in calculating NAV. For the remaining level 3 investments that would be subject to the quantitative disclosures, we reiterate that we do not think that such a disclosure would be valuable to users of a government's financial statements. This is made clear by the example disclosure on page 35 of the PV. While there is some value in the qualitative disclosure about unobservable inputs used in estimating fair value, the quantitative information is too high-level and broad to allow a user to make informed conclusions about the reliability of the fair value measurements.

As with the quantitative disclosures about unobservable inputs, we do not believe that the proposed sensitivity disclosures would provide useful information to financial statement users. Where similar disclosures are required under FASB guidance, we have observed that they tend to be boiler-plate statements that provide no real insight into the possible volatility resulting from changes in the unobservable inputs used to estimate fair value. In addition, because the financial statements are as of a point in time, we do not believe that a discussion of risks and uncertainties pertaining to specific amounts is appropriate. This discussion would be more suited to an MD&A discussion. Finally, we believe that investments for which the fair value is not developed by the government, (those developed by third-party pricing services or where the practical expedient is used) should be exempt from the proposed sensitivity disclosures.

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

Because investment maturity information is currently a disclosure requirement, we assume that investment maturity information would be required by asset class and valuation input level. We ask for confirmation from the Board.

In closing, we wish to express our appreciation for the opportunity to comment. We look forward to answering any questions the Board or the staff may have about our response. Please direct your questions to Sue Menditto at 202-861-2542 or sue.menditto@nacubo.org.

Sincerely,

Susan M. Menditto
Director, Accounting Policy