

GASB Statement 72 – Fair Value Measurement and Application Sample Disclosures

ARTICLE 06.09.15 DEAN DORTON

Part 2 of 2

Part 2 in our series on GASB Statement 72 provides two example footnote disclosures; Example 1 is for a General Purpose Government and Example 2 is for a Defined Benefit Pension Plan. These examples are designed to assist with application of Statement 72. These examples were pulled directly from Statement 72 and are purely for illustrative purposes only.

For questions regarding the GASB Statement 72, its application, or other measurement issues please contact Crissy Fiscus at cfiscus@deandorton.com or Simon Keemer at skeemer@deandorton.com.

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Background

Investment of public funds in Kentucky is governed by KRS 66.480, which provides limitations for the type of investments in which public funds may be invested. Example 1 is indicative of a disclosure for an agency in Kentucky following KRS 66.480. Defined benefit pension plans are not confined to the same investment limitations described in KRS 66.480; therefore Example 2 is a more robust application of the required disclosures required by GASB Statement 72.

Example 1—General Purpose Government

Facts and Assumptions

A city holds investments that are measured at fair value on a recurring basis. Because investing is not a core part of the city's mission, the city determines that the disclosures related to these investments only need to be disaggregated by major type. The city chooses a narrative format for the fair value disclosures.

Illustrative Disclosure

The City categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs.

The City has the following recurring fair value measurements as of June 30, 20X1:

- U.S. Treasury securities of \$45 million are valued using quoted market prices (Level 1 inputs)
 - Corporate bonds of \$12 million are valued using a matrix pricing model (Level 2 inputs).

The City also has a nonrecurring fair value measurement as of June 30, 20X1, for a closed performing arts hall that will no longer be used by the government and therefore is considered to be impaired. The hall has been written down from \$5.6 million to \$3.4 million based on an appraisal of the property (Level 3 inputs).

Example 2—Defined Benefit Pension Plan

Facts and Assumptions

A retiree pension defined benefit plan holds significant amounts of investments that are measured at fair value on a recurring basis. Because investing is a key part of the plan's activities, the plan shows greater disaggregation in its disclosures. The plan chooses a tabular format for disclosing the levels within the fair value hierarchy. All of the derivative instruments are investments, not hedging derivative instruments.

Illustrative Disclosure

The Plan categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The Plan has the following recurring fair value measurements as of December 31, 20X1:

Investments and Derivative Instruments Measured at Fair Value (\$ in millions)

Fair Value Measurements Using

		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	12/31/x1			
Investments by fair value level				
Debt securities				
U.S. Treasury securities	\$85	\$85		
Commercial mortgage-backed securities	50		\$45	\$5
Collateralized debt obligation	30		5	25
Residential mortgage-backed securities	149		24	125
Corporate bonds	<u>93</u>	<u>9</u>	<u>84</u>	
Total debt securities	<u>407</u>	<u>94</u>	<u>158</u>	<u>155</u>
Equity securities				
Financial service industry	150	150		
Healthcare industry	110	110		
Others	<u>15</u>	<u>15</u>		
Total equity securities	<u>275</u>	<u>275</u>		
Venture capital investments				
Direct venture capital – healthcare	53			53
Direct venture capital – energy	<u>32</u>			<u>32</u>
Total venture capital investments	85			85
Private equity funds – international	<u>43</u>			<u>43</u>
Total investments by fair value level	<u>810</u>	\$369 =====	\$158 =====	\$283 =====
Investments measured at the net asset value (NAV)				
Equity long/short hedge funds	55			
Event-driven hedge funds	45			
Global opportunities hedge funds	35			
Multi-strategy hedge funds	40			
Real estate funds	<u>47</u>			
Total investments measured at the NAV	<u>222</u>			
Total investments measured at fair value	\$1,032 =====			
Investment derivative instruments				
Interest rate swaps	\$57		\$57	
Foreign exchange Contracts (liabilities)	<u>(43)</u>		<u>(43)</u>	
Total investment derivative instruments	\$14 =====		\$14 =====	

Debt and equity securities classified in Level 1 of the fair value hierarchy are valued using prices quoted in active markets for those securities. Debt securities classified in Level 2 of the fair value hierarchy are valued using a matrix pricing technique. Matrix pricing is used to value securities based on the securities' relationship to benchmark quoted prices. Commercial and residential mortgage-backed securities classified in Level 3 are valued using discounted cash

flow techniques. Collateralized debt obligations classified in Level 3 are valued using consensus pricing.

Venture capital investments classified in Level 3 are valued using either a discounted cash flow or market comparable companies technique.

Private equity funds—international are valued as described in the following schedule, Note 6.

The valuation method for investments measured at the net asset value (NAV) per share (or its equivalent) is presented on the following table.

Derivative instruments classified in Level 2 of the fair value hierarchy are valued using a market approach that considers benchmark interest rates and foreign exchange rates.

Investments Measured at the NAV (\$ in millions)

	<u>Fair Value</u>	<u>Unfunded Commitments</u>	<u>Redemption Frequency (If Currently Eligible)</u>	<u>Redemption Notice Period</u>
Equity long/short hedge funds(1)	\$55		Quarterly	30-60 days
Event-driven hedge funds(2)	45		Quarterly, annually	30-60 days
Global opportunities hedge funds(3)	35		Quarterly	30-45 days
Multi-strategy hedge funds(4)	40		Quarterly	30-60 days
Real estate funds(5)	<u>47</u>	\$20		
Total investments Measured at the Nav	<u>\$222</u>			
Private equity funds—international(6)	43	15		

¹ *Equity long/short hedge funds.* This type includes investments in 12 hedge funds that invest both long and short primarily in U.S. common stocks. Management of each hedge fund has the ability to shift investments from value to growth strategies, from small to large capitalization stocks, and from a net long position to a net short position. The fair values of the investments in this type have been determined using the NAV per share of the investments. Investments representing approximately 22 percent of the value of the investments in this type cannot be redeemed because the investments include restrictions that do not allow for redemption in the first 12 to 18 months after acquisition. The remaining restriction period for these investments ranged from three to seven months at December 31, 20X1.

² *Event-driven hedge funds.* This type includes 3 investments in hedge funds that invest in approximately 60 percent equities and 40 percent bonds to profit from economic, political, corporate, and government-driven events. A majority of the investments are targeted at economic policy decisions. The fair values of the investments in this type have been determined using the NAV per share (or its equivalent) of the investments.

³ *Global opportunities hedge.* This type includes investments in 5 hedge funds that hold approximately 80 percent of the funds' investments in non-U.S. common stocks in the healthcare, energy, information technology, utilities, and telecommunications sectors and approximately 20 percent of the funds' investments in diversified currencies. The fair values of the investments in this type have been determined using the NAV per share (or its equivalent) of the investments. For one investment, valued at \$8.75 million, a gate has been imposed by the hedge fund manager, and no redemptions are currently permitted. This redemption restriction has been in place for six months, and the time at which the redemption restriction might lapse cannot be determined.

⁴ *Multi-strategy hedge funds.* This type invests in 15 hedge funds that pursue multiple strategies to diversify risks and reduce volatility. The hedge funds' composite portfolio for this type includes investments in approximately 50 percent U.S. common stocks, 30 percent global real estate projects, and 20 percent arbitrage investments. The fair values of the investments in this type have been determined using the NAV per share (or its equivalent) of the investments. Investments representing approximately 15 percent of the value of the investments in this type cannot be redeemed because the investments include restrictions that do not allow for redemption in the first year after acquisition. The remaining restriction period for these investments ranged from four to six months at December 31, 20X1.

⁵ *Real estate funds.* This type includes nine real estate funds that invest primarily in U.S. commercial real estate. The fair values of the investments in this type have been determined using the NAV per share (or its equivalent) of the Plan's ownership interest in partners' capital. These investments can never be redeemed with the funds. Distributions from each fund will be received as the underlying investments of the funds are liquidated. It is expected that the underlying assets of the funds will be liquidated over the next 7 to 10 years. Twenty percent of the total investment in this type is expected to be sold. However, the individual investments that will be sold have not yet been determined. Because it is not probable that any individual investment will be sold, the fair value of each individual investment has been determined using the NAV per share (or its equivalent) of the Plan's ownership interest in partners' capital. Once it has been determined which investments will be sold and whether those investments will be sold individually or in a group, the investments will be sold in an auction process. The investee fund's management is required to approve of the buyer before the sale of the investments can be completed.

⁶ *Private equity funds—international.* This type includes two private equity funds that invest primarily in foreign technology companies. These investments can never be redeemed with the funds. Instead, the nature of the investments in this type is that distributions are received through the liquidation of the underlying assets of the fund. If these investments were held, it is expected that the underlying assets of the fund would be liquidated over five to eight years. However, as of December 31, 20X1, it is probable that all of the investments in this type will be sold at an amount different from the NAV per share (or its equivalent) of the Plan's ownership interest in partners' capital. Therefore, the fair values of the investments in this type have been determined using recent observable transaction information for similar investments and nonbinding bids received from potential buyers of the investments. As of December 31, 20X1, a buyer (or buyers) for these investments has not yet been identified. Once a buyer has been identified, the investee fund's management is required to approve of the buyer before the sale of the investments can be completed.