

GASB Statement 72 – Fair Value Measurement and Application



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Part 1 of 2

In February 2015 the Governmental Accounting Standards Board (GASB) issued GASB Statement 72, *Fair Value Measurement and Application*. The Statement is designed to bring more clarity to areas of uncertainty related to fair value measures – including direction on how to apply fair value when market values cannot be obtained and where management judgments are necessary.

The goal of the changes required by GASB 72 is to improve the consistency and comparability in how governments measure and apply fair value and disclose information about those measurements. The purpose for the additional disclosures about the assets and liabilities measured at fair value is to help financial statement users make better informed decisions about the potential effect of those measurements.

The Statement is very similar to FASB Accounting Standards Codification Topic 820, *Fair Value Measurement*, but is not identical; therefore governments should ensure that they are specifically following the requirements of Statement 72.

Fair Value Defined

Fair value is 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. The Statement makes it clear that fair value is an exit price. The definition is consistent with the definition of fair value as stated in FASB Accounting Standards Codification Topic 820, *Fair Value Measurement*.

The Statement extends the application of fair value reporting to most investments and defines an investment as a security or other asset that a government holds primarily for the purpose of income or profit.

Major provisions of Statement 72

The Statement describes how fair value should be defined and measured, what assets and liabilities should be measured at fair value and what information about fair value should be reported in the notes to the financial statements.

Measurement

Statement 72 requires governments to measure fair value in a manner consistent with one of three approaches:

1. Market approach – measure fair value using prices and relevant market information
2. Cost Approach – measure fair value using an amount that would be required to replace the asset and its service capacity
3. Income approach – measure fair value by converting future amounts, such as future cash flows, in a single current amount

Measuring fair value also requires the government to collect information regarding the inputs that were used to measure fair value. Statement 72 uses the fair value hierarchy which is also used in FASB Topic 820, *Fair Value*

Measurement. The hierarchy includes 3 levels of inputs based on the reliability and objectivity of the information:

Level 1 – inputs are quotes prices in active markets for assets or liabilities identical to the ones being measured

Level 2 – inputs are inputs that are observable for similar assets or liabilities

Level 3 – inputs are unobservable inputs for example, management's assumption of the default rate among underlying mortgages of a mortgage-backed security

Application

Statement 72 requires that most investments be measured at fair value. Certain exceptions remain, such as:

- Investments in certain external investment pools
- Money market investments
- Investments in life insurance contracts
- Common stock meeting the criteria for the equity method
- Unallocated insurance contracts
- Synthetic guaranteed investment contracts

If a government has investments in alternative investments that calculate the net asset value (NAV) and the investment does not have a readily determinable fair value, the government would be permitted to report a fair value of those investments based on the NAV per share.

Statement 72 would require a change in how governments place a value on donated capital assets, donated works of art and historical treasures, and capital assets received in service concession arrangements. Going forward those assets will be measured at acquisition value (an entry price) – the price that would be paid to acquire an asset with equivalent service potential in an orderly market transaction at the acquisition date – rather than at fair value (an exit price).

Disclosure

The Statement requires disclosures to be made about the fair value measurements, including the level of the fair value hierarchy, and a discussion of the valuation techniques used. Governments should organize these disclosures by type of assets or liability reported at fair value. It also requires additional disclosures regarding investments in certain entities that calculate net asset value per share.

Effective Date

The requirements of Statement 72 are effective for periods beginning after June 15, 2015.

Coming Up

Part 2 of this email series will feature a sample financial statement disclosure for the requirements of GASB Statement No. 72.

For more information regarding GASB Statement No. 72, please contact Crissy Fiscus at cfiscus@deandorton.com or 859.425.7631 or Simon Keemer at skeemer@deandorton.com or 502.566.1036.

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