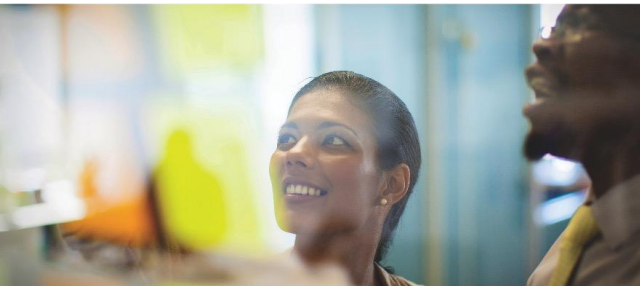




CPAs AND ADVISORS



Session Four:

Investment Accounting and Disclosures

Prepared by: Debbie Harper – LSL CPAs

Patricia Song – City of Corona

Focused
on YOU

CDIAC/CMTA January 19, 2017



CPAs AND ADVISORS



INVESTMENT ACCOUNTING





CPAs AND ADVISORS

Terminology/Definitions

- GASB – Government Accounting Standards Board
 - The source of generally accepted accounting principles (GAAP) used by state and local governments in the United States
- GASB 31 – Accounting and Financial Reporting for Certain Investments and for External Investment Pools (FY 1998)
- GASB 72 – Fair Value Measurement and Application (FY 2016)



CPAs AND ADVISORS

Definition of Investment (GASB 72)

- A security or other asset that:
 - A government holds primarily for the purpose of income or profit, and
 - Has present service capacity based solely on its ability to generate cash or to be sold to generate cash
 - Now will include real property held for development
 - Implementation guide gives guidance to look at the investment intent at the time of implementation, do not look back.





CPAs AND ADVISORS

Definition of Cost Basis/Purchase Price

- Cost basis is the original value of an asset, usually the purchase price.
- This value is used to determine the capital gain, which is equal to the difference between the asset's cost basis and the [current market value](#).
- The term can also be used to describe the difference between the [cash price](#) and the [futures](#) price of a given commodity.



Definition of Fair Value

- Price to be received to sell an asset or paid to transfer a liability (“Exit Price”)
- Not to be adjusted for additional costs relating to the transaction
- Market-based measurement, not entity-specific measurement





CPAs AND ADVISORS

Fair Value Measurement - Assets

- Value should be at the asset's highest and best use and assumes transaction takes place in the government's principal or most advantageous market
 - Government's current use is presumed to be highest and best use
 - Could be in combination with other assets and liabilities or on a stand-alone basis





CPAs AND ADVISORS

Fair Value Measurement – Liabilities

- Example of liability would be derivative liability (interest rate swap most common for government's)
- Fair value would take government's credit standing into account
- If no active market
 - Consider liabilities held by other parties as assets and value of those assets
 - If above not available, use most relevant valuation technique (Discussed later)



CPAs AND ADVISORS



GASB 31

ACCOUNTING AND FINANCIAL REPORTING FOR CERTAIN INVESTMENTS AND FOR EXTERNAL INVESTMENT POOLS



GASB 31 set Accounting and Financial Report Standards

- Valuation of investments
 - Fair Market Value (FMV)
- Exceptions
 - External investment pools investments may report at amortized cost money market investments that have a remaining maturity at the time of purchase of one year or less. (short-term, highly liquid debt instruments)
 - External investment pools – NOT 2a7-like pools, report at the fair value per share of the pool's underlying portfolio
 - 2a7-like pools report by the pool's share price



GASB 31 set Accounting and Financial Report Standards

- Recognition and Reporting
 - Investment Income – includes changes in the fair market value of investments
 - Earnings and changes in FMV stay in the fund in which the investment is reported, unless legal or contractual reasons (not management decision)
 - If management decision and no legal restriction, then should be reported as an operating transfer





CPAs AND ADVISORS

FMV CHANGE EXAMPLE

GASB 31 Allocation - LAIF

Market Value rate at 6/30/2016:

1.000621222

Cash and Investment - Pooled

| Fund | Fund Name | Cash Balance 6/30/2016 | Unrealized | FMV 6/30/2016 | FMV PY 6/30/2015 | Change in FMV |
|------|------------------|---------------------------|------------------|------------------------|------------------------|---------------------|
| 100 | General Fund | 1,100,000 | 683.34 | 1,100,683.34 | 1,009,543.34 | 91,140.00 |
| 120 | Gas Tax | 210,000 | 130.46 | 210,130.46 | 199,025.34 | 11,105.12 |
| 130 | Housing | 100,000 | 62.12 | 100,062.12 | 125,001.45 | (24,939.33) |
| 140 | Prop A | 78,000 | 48.46 | 78,048.46 | 85,435.45 | (7,386.99) |
| 200 | Capital Projects | 75,000 | 46.59 | 75,046.59 | 72,451.25 | 2,595.34 |
| 300 | Debt Service | 200 | 0.12 | 200.12 | 200.45 | (0.33) |
| | | \$ 1,563,200.00 | \$ 971.09 | \$ 1,564,171.09 | \$ 1,491,657.28 | \$ 72,513.81 |

Increase in FMV

Debit - Cash

Credit - Investment Income

Decrease in FMV

Debit - Investment Income

Credit - Cash

GASB 31 sets accounting and financial report standards

- Disclosures

- Methods and significant assumptions used to estimate the FMV, if other than quoted market price
- Policy for reporting at amortized costs, if any
- Investments in external investment pools that are not SEC-registered, provide a brief description of any regulatory oversight (LAIF)
- Any involuntary participation in external investment pools
- Any income from investments associated with one fund that is assigned to another fund (legal or contractual provisions)





Disclosure Example – State Investment Pool

The City is a voluntary participant in the California Local Agency Investment Fund (LAIF) that is regulated by California Government Code Section 16429 under the oversight of the Treasurer of the State of California. LAIF is overseen by the Local Agency Investment Advisory Board, which consists of five members, in accordance with State statute. The State Treasurer's Office audits the fund annually. The fair value of the position in the investment pool is the same as the value of the pool shares.



CPAs AND ADVISORS



GASB 72

FAIR VALUE MEASUREMENT AND APPLICATION



Valuation Techniques

- Apply techniques that best represent fair value in the given circumstances
- The goal is to maximize observable inputs and minimize unobservable inputs when deciding which technique is best



Valuation Techniques (Continued)

- Techniques:
 - Market Approach
 - Cost Approach
 - Income Approach
- Techniques should always be applied consistently across periods; changes required in certain circumstances
- Revisions to fair value due to change in technique is considered a change in accounting estimate
 - Applied in current period and disclosed in footnotes

Valuation Technique – Market Approach

- Uses prices and other relevant information generated by market transactions involving identical or similar assets and/or liabilities



- Examples would be sale price of identical investment or price listed on stock market

Valuation Technique – Cost Approach

- The amount that would be required to currently replace the asset, or the service capacity of an asset
- Often used to measure fair value of tangible assets such as plant and equipment

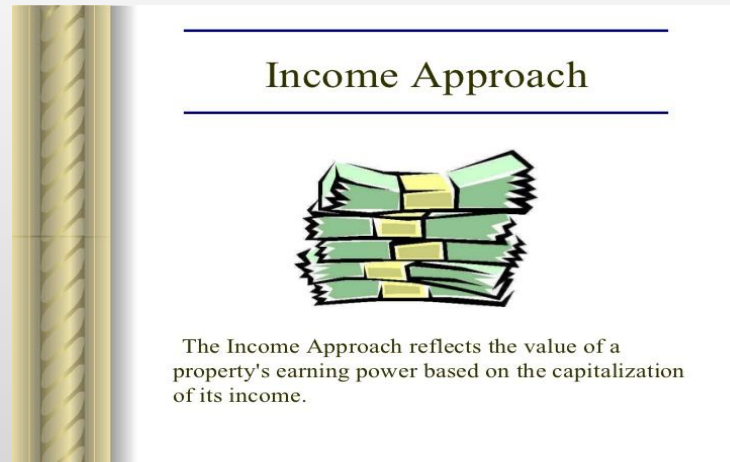




CPAs AND ADVISORS

Valuation Technique – Income Approach

- Converting expected future amounts (cash flows or earnings) into a single current discounted amount
- Consideration of future amounts can extend in many periods or few
 - Would include present value techniques, option-pricing models, etc.





CPAs AND ADVISORS

Fair Value Hierarchy

- Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities
 - Most reliable
- Level 2 – Quoted prices for similar assets or liabilities, quoted prices for identical or similar assets or liabilities that are not active, or other than quoted prices that are still observable
- Level 3 – Unobservable inputs
 - Least reliable (Management assumptions often involved)



CPAs AND ADVISORS

Fair Value Hierarchy (Continued)

- If fair value of asset/liability is measured using inputs from more than one level of the fair value hierarchy, measurement is considered based on lowest priority level input significant to the entire measurement
- Example – If three inputs are significant to fair value measurement, two of them being level 2 and one being level 3, fair value measurement would be categorized as level 3



CPAs AND ADVISORS

Fair Value Application – Definition of Investment

- Security or other asset that a government holds primarily for the purpose of income or profit and with a present service capacity that is based solely on its ability to generate cash or to be sold to generate cash





CPAs AND ADVISORS

Level 1 Inputs

- Exchange markets (NYSE)
- Brokered markets (Real estate market)
- Dealer market (Market for U.S. Treasury Securities)
- Principal-to-principal markets
- May be available for many financial assets and liabilities



Level 2 Inputs

- Quoted prices for similar assets/liabilities in active markets
- Quoted prices for similar assets or liability in inactive markets
- Observable inputs other than quoted prices:
 - Interest rates and yield curves
 - Implied volatilities
 - Credit spreads
- Market-corroborated inputs





CPAs AND ADVISORS

Acquisition Value

- This statement requires measurement at acquisition value for the following:
 - Donated capital assets
 - Donated works of art, historical treasures, and similar assets
 - Capital assets received through a service concession arrangement





CPAs AND ADVISORS

Footnote Disclosures

- Should be organized by type or class of asset or liability based on:
 - Nature, characteristics, and risks of the asset or liability
 - Level of fair value hierarchy within which fair value measurement is categorized (Level 1, 2, 3)
 - Relevant significance of assets and liabilities measured at fair value compared to total assets and liabilities
 - Whether separately issued financial statements are available
- Can be shown in table or narrative format





CPAs AND ADVISORS

Disclosure Example

“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.”



Disclosure Example (Continued)

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

| Investment Type | 6/30/2016 | Level | | |
|----------------------------|-----------------------|-------------|----------------------|----------------------|
| | | 1 | 2 | 3 |
| US Treasury Securities | \$ 1,000,000 | \$ - | \$ 1,000,000 | \$ - |
| Mutual Funds | 10,000,000 | - | 10,000,000 | - |
| Corporate Bonds | 12,000,000 | - | 12,000,000 | - |
| LAIF | 55,000,000 | - | 55,000,000 | - |
| Mortgage-backed securities | 25,000,000 | - | - | 25,000,000 |
| TOTALS | \$ 103,000,000 | \$ - | \$ 78,000,000 | \$ 25,000,000 |



Disclosure Support “FAIR VALUE LEVELING REPORT”

GASB 72 Level Pricing Report

As of 06/30/2016

Dated: 11/17/2016

| Security Type Category | Level 1 | Level 2 | Level 3 | Other | Total |
|------------------------|---------|----------------|---------|-------|----------------|
| Agency | 0.00 | 27,937,150.00 | 0.00 | 0.00 | 27,937,150.00 |
| Agency MBS | 0.00 | 239,488.62 | 0.00 | 0.00 | 239,488.62 |
| Asset Backed | 0.00 | 2,001,060.00 | 0.00 | 0.00 | 2,001,060.00 |
| CD | 0.00 | 4,454,818.92 | 0.00 | 0.00 | 4,454,818.92 |
| Corporate | 0.00 | 15,888,367.50 | 0.00 | 0.00 | 15,888,367.50 |
| MM Fund | 0.00 | 28,134,815.79 | 0.00 | 0.00 | 28,134,815.79 |
| US Gov | 0.00 | 33,842,929.55 | 0.00 | 0.00 | 33,842,929.55 |
| --- | 0.00 | 112,498,630.38 | 0.00 | 0.00 | 112,498,630.38 |

Level 2

| Description, Security Type, Final Maturity | Identifier | Fair Value Level | Current Units | S&P Rating, Moody's Rating | Book Yield, Yield | Original Cost, Book Value, Market Value | Market Value + Accrued |
|-------------------------------------------------------------|------------|------------------|---------------|----------------------------|-------------------|----------------------------------------------|------------------------|
| CHAIT 138 A ABS 10/15/2018 | 161571GC2 | Level 2 | 2,000,000.00 | AAA Aaa | 0.874 0.833 | 2,003,437.50 2,000,697.00 2,001,060.00 | 2,001,957.78 |
| FEDERAL HOME LOAN BANKS AGCY BOND 11/28/2016 | 3133832L4 | Level 2 | 1,000,000.00 | AA+ Aaa | 0.632 0.646 | 995,430.00 999,462.73 999,400.00 | 999,858.33 |
| FEDERAL NATIONAL MORTGAGE ASSOCIATION AGCY BOND 06/20/2019 | 3135G0ZE6 | Level 2 | 1,500,000.00 | AA+ Aaa | 1.154 0.822 | 1,526,865.00 1,526,012.62 1,540,800.00 | 1,541,602.08 |
| FEDERAL FARM CREDIT BANKS FUNDING CORP AGCY BOND 03/12/2018 | 3133ECHS6 | Level 2 | 1,000,000.00 | AA+ Aaa | 1.155 1.027 | 993,940.00 997,902.74 1,000,000.00 | 1,003,118.61 |
| FEDERAL HOME LOAN BANKS AGCY BOND 12/19/2017 | 3130A6SW8 | Level 2 | 1,500,000.00 | AA+ Aaa | 1.00 0.664 | 1,500,000.00 1,500,000.00 1,507,350.00 | 1,507,850.00 |
| FEDERAL FARM CREDIT BANKS FUNDING CORP AGCY BOND 06/05/2017 | 3133ECKV5 | Level 2 | 1,000,000.00 | AA+ Aaa | 0.898 0.603 | 991,930.00 998,174.48 1,000,900.00 | 1,001,405.56 |
| FEDERAL NATIONAL MORTGAGE ASSOCIATION AGCY BOND 01/21/2020 | 3135G0A78 | Level 2 | 1,000,000.00 | AA+ Aaa | 1.743 0.921 | 994,840.00 995,946.64 1,024,600.00 | 1,031,822.22 |



CPAs AND ADVISORS

Exceptions

- New standard expands use of fair value, some of existing exceptions continue to be excluded
 - Money Market Investments
 - 2a7 External Investment Pools
 - Investments in Life Insurance Contracts
 - Unallocated Insurance Contracts
 - Synthetic Guaranteed Investment Contracts



CITY OF CORONA
INTERNAL PERSPECTIVE

www.discovercorona.com



Understand GASB 72

- Goal
 - Improve Financial Reporting
 - Enhance Comparability
- Applicability
 - Does not apply to assets other than investments
 - Limited to liabilities that are currently measured at fair value





Impact to the City

- Re-evaluate on what should be considered as investment
 - Capital assets
 - Inventory
 - Investment
- Unit of Account
 - Primary purpose of asset (lease of City Hall)
- Additional Disclosure – Fair Value Level





Responsibility of the City

- Use of Investment Advisory Firm and/or Investment Custodian
- Ways to Review and Determine the proper classification
 - Discussion with consultants
 - Look up securities online
 - Check with fund managers





Challenges with Implementation

- Limited Challenges on Identifying Items Subject to Fair Value Reporting
 - Strict CA Government Code, very limited nontraditional investment (Private Equity, Hedge Funds etc.)
 - Original Intent and Unit of Account provisions in GASB 72 allows for exemption on certain unique situations (Lease of City Hall, rental of sports fields etc.)
- Challenges on Classifying Fair Value Levels
 - Level 1 vs. Level 2
 - Level 3 vs. Net Asset Value (NAV)





From 2016 City of Corona CAFR

f. Fair Value Measurement and Application

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.

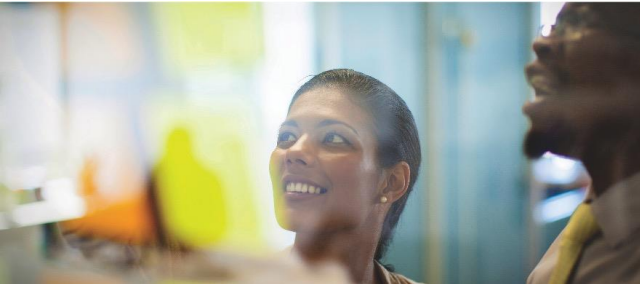
The City has the following recurring fair value measurements as of June 30, 2016:

| | June 30, 2016 | Investments not Measured at Fair Value | Level | |
|-------------------------------------|-----------------------|----------------------------------------------|-------------|-----------------------|
| | | | 1 | 2 |
| Investments: | | | | |
| US Treasury | \$ 44,667,988 | \$ - | \$ - | \$ 44,667,988 |
| Federal Government Agency | 88,652,930 | - | - | 88,652,930 |
| Medium-Term Corporate Notes | 52,608,859 | - | - | 52,608,859 |
| Asset-Backed Securities | 15,865,538 | - | - | 15,865,538 |
| Money Market Funds | 53,021 | 53,021 | - | - |
| Local Agency Investment Fund | 44,669,235 | - | - | 44,669,235 |
| Total Cash Investments | 246,517,571 | 53,021 | - | 246,464,550 |
| Restricted Investments: | | | | |
| Local Agency Investment Fund | 3,488,500 | - | - | 3,488,500 |
| Federal Government Agency | 998,330 | - | - | 998,330 |
| Medium-Term Corporate Notes | 38,853,704 | - | - | 38,853,704 |
| Total Restricted Investments | 43,340,534 | - | - | 43,340,534 |
| Total Investments | \$ 289,858,105 | \$ 53,021 | \$ - | \$ 289,805,084 |



CPAs AND ADVISORS

Thank you



Questions

Focused
on YOU