GASB Issues Standard on Valuing Pool Investments

By Stephen J. Gauthier

GASB had relied on SEC Rule 2a7 to determine when external investment pools can use amortized cost, rather than fair value. However, certain recent changes in this rule have made continued reliance on this rule impractical.

In December 2015, the Governmental Accounting Standards Board (GASB) issued GASB Statement No. 79, *Accounting and Financial Reporting for Certain External Investment Pools*. The GASB is promulgating this new standard to establish its own independent criteria for determining: 1). Until now, the GASB has relied on the Securities and Exchange Commission (SEC) Rule 2a7 (money market funds) for this purpose. However, certain recent changes in this rule have made continued reliance on it impractical.

Criteria. GASB Statement No. 79 establishes criteria that permit, but do not require: 1) a qualifying investment pool to report all investments at amortized cost; and 2) pool participants to report their position based on share values calculated using amortized cost. The GASB originally proposed that if a pool elected to use fair value it would be precluded from subsequently changing to amortized cost. The final standard, however, allows for a change to amortized cost, subject to the general rule that applies to any change in accounting principles (the application of the new principle must be preferable in the circumstances).

Specifically, GASB Statement No. 79 allows the use of amortized cost for all of the investments of a pool if the pool uses a stable net asset value (NAV) per share and meets *all* of the following five requirements:

1. *Maturity*. Three criteria must be met in regard to the maturity of investments:
   - The *remaining maturity* of an investment at acquisition may not exceed 397 days.
   - The *weighted average maturity* of the portfolio of investments may not exceed 60 days.
   - The weighted average life of the portfolio of investments may not exceed 120 days.
2. *Quality*. All investments must be denominated in U.S. dollars, and:
   - *At acquisition* all investments must be classified in the highest category of short-term credit ratings (or its long-term equivalent category), or, if unrated, be comparable based on the pool's analysis.
   - *At the reporting date* no more than 3 percent may be rated lower than the second-highest category (or comparable based on the pool's analysis if unrated), and none may be rated below that level.
3. *Diversification*. No single issuer (other than the U.S. government and its agencies and instrumentalities) may account for 5 percent or more of total assets; nor may any single issuer of credit support account for more than 10 percent.

4. *Liquidity.* A pool must hold sufficient liquid assets to meet reasonably foreseeable redemptions. In addition, the acquisition of a security must not cause:
   - Total liquid assets to drop below 95 percent of total assets.
   - Daily liquid assets to drop below 10 percent of total liquid assets.
   - Weekly liquid assets to drop below 30 percent of total assets.
5. *Shadow price requirement.* The shadow price (= NAV per share calculated using total investments measured at fair value at the calculation date) must deviate by no more than 0.5 percent from the share price at amortized cost. This shadow price must be calculated within five business days of the end of each month.

Significant noncompliance with any of these criteria during a given period would prevent the use of amortized cost *for that period* (except for short-term debt investments with remaining maturities of 90 days or less at year's end, which are always eligible for reporting at amortized cost). Determining whether noncompliance was *significant* will be a matter of professional judgment.

Disclosure and effective date. Whenever fair value is used, pools will be required to provide the note disclosures currently mandated for investments presented at fair value (GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, and GASB Statement No. 72, *Fair Value Measurement and Application*).

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Both pools and pool participants will be required to disclose any limitation or restriction on participant withdrawals, such as:

- Mandated notice period prior to withdrawal.
- Maximum transaction amounts.
- Ability to impose a special fee for access to cash in times of market stress (*liquidity fees*).
- Ability to set a short-term limitation on redemptions in time of market stress (*redemption gates*).

Most of the provisions of GASB Statement No. 79 will first take effect for the fiscal year ending June 30, 2016. However, the application of the shadow pricing criterion will take effect starting with the fiscal year ending December 31, 2016.

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