

Procedure 425 Fair Value: Accounting and Reporting for Certain Investments

Governmental Accounting Standards Board (GASB) Statement 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, establishes accounting and reporting standards for certain investments held by governmental entities, including school districts and county offices of education. GASB Statement 31 requires school districts and county offices to report their investments at fair value on the balance sheet.

Local educational agency (LEA) investments affected by this statement are as follows:

- Participating interest-earning investment contracts.
- External investment pools, including cash with county treasurer.
- Open-end mutual funds.
- Debt securities.
- Equity securities, option contracts, stock warrants, and stock rights.

The provisions of GASB Statement 31, as amended by GASB Statement 72, apply only to investments that (a) are held primarily for the purpose of income or profit and (b) have present service capacity based on their ability to generate cash or to be sold to generate cash. Most school districts and county offices deposit their receipts and collections of moneys with their county treasurer because they are required to by *Education Code* Section 41001, not “primarily for the purpose of income or profit.” The LEA’s cash is nonetheless in external investment pools, however, because most of the county treasurers in California sponsor external investment pools. An external investment pool commingles (pools) the moneys of more than one entity and invests, on the participants’ behalf, in an investment portfolio. Because GASB Statement 31 applies to external investment pools, LEAs should report their cash in the county treasury at fair value on the balance sheet.

GASB Statement 31 provides certain exceptions to the general rule requiring that investments be reported at fair value. These exceptions include:

- Investments with a remaining maturity of one year or less at the time of purchase
- Nonparticipating investment contracts, such as nonnegotiable certificates of deposit
- Investments in 2.a.7-like pools, which are external investment pools that adopt policies similar to those of private companies that operate under the Securities and Exchange Commission’s Rule 2.a.7 of the Investment Company Act of 1940. They invest only in short-term securities and are required to sell securities whose market values deviate more than a set percentage from amortized costs.

Determining Fair Value

Fair value is 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. Fair value is determined from the published market price in newspapers or trade journals and quotes from recognized stock exchanges or over-the-counter markets. For investments without a quoted

Procedure 425 Fair Value: Accounting and Reporting for Certain Investments

market price, the fair value may be determined by using the market price of similar instruments, discounted cash flow, or any other valuation technique that provides the best estimates. The fair value of investments in external pools (i.e., cash in the county treasury) is based on the fair value of the pools' underlying portfolio. LEAs should obtain this information from the county treasurer.

Recognition and Reporting of Investment Income

All investment income, including changes in the fair value of investments, should be recognized as revenue on the operating statement. The change in fair value of investments should be captioned "net increase (decrease) in the fair value of investments." Realized gains and losses should not be reported separately from unrealized gains and losses except in the notes to the financial statements.

There are two revenue object accounts for reporting investment income:

- Object 8660, Interest
- Object 8662, Net Increase (Decrease) in the Fair Value of Investments

All investment income other than changes in the fair value of investments should be reported in Object 8660. The change in the fair value of investments, which includes realized and unrealized gains and losses, should be reported in Object 8662.

The change in the fair value of investments is defined as the ending fair value, plus proceeds from investments maturing or sold during the year, less investment purchases made during the year, less the beginning fair value. The following examples illustrate how to calculate the changes in the fair value for cash in the county treasury and the accompanying accounting entries. The examples cover two fiscal years.

Note that Object 9110, although titled Cash in County Treasury, really represents the book value of the LEA's share of an external investment fund. However, for most purposes, Object 9110 is administered as a cash account. To avoid making noncash adjusting entries to this "cash" account, entries for unrealized gains or losses on the value of cash with the county treasurer are made to Object 9111, Fair Value Adjustment to Cash in County Treasury.

Fiscal Year 2013–14

Assume that on July 1, 2013, the school district had \$100,000 cash in the county treasury with a fair value of \$105,000. During the fiscal year, the district had deposits of \$900,000 and disbursements of \$925,000. On June 30, 2014, the district has \$75,000 cash in the county treasury with a fair value of \$78,000.

Procedure 425 Fair Value: Accounting and Reporting for Certain Investments

The change in fair value is calculated as follows:

Description	Amount
Fair value, ending 6-30-14	\$78,000
Add: Disbursements (comparable to proceeds of investments sold)	925,000
Less: Receipts (comparable to costs of investments purchased)	(900,000)
Less: Fair value, beginning 7-1-13	(105,000)
Net increase (decrease) in fair value for fiscal year 2013–14	\$(2,000)

Although the fair value of the cash in the county treasury at the end of the fiscal year is \$3,000 higher than the actual cash balance (\$78,000 minus \$75,000), the change in fair value during the year is a decrease of \$2,000. The reason is that the fair value of the cash in the county treasury at the beginning of the fiscal year was \$5,000 higher than the actual cash balance (\$105,000 minus \$100,000), and the \$5,000 difference would already have been recognized by the end of the prior year.

The entry is as follows:

Date	Object Title	Object Code	Debit	Credit
6-30-14	Net Increase (Decrease) in the Fair Value of Investments	8662	\$2,000	
	Fair Value Adjustment to Cash in County Treasury	9111		\$2,000
	To report the ending cash balance at fair value and the current year decrease in the fair value of investments.			

Procedure 425 Fair Value: Accounting and Reporting for Certain Investments

Fiscal Year 2014–15

Assume that during fiscal year 2014–15, the district had deposits of \$1,000,000 and disbursements of \$985,000. On June 30, 2015, the district has \$90,000 cash in the county treasury with a fair value of \$94,000.

The change in fair value is calculated as follows:

Description	Amount
Fair value, ending 6-30-15	\$94,000
Add: Disbursements (comparable to proceeds of investments sold)	985,000
Less: Receipts (comparable to costs of investments purchased)	(1,000,000)
Less: Fair value, beginning 7-1-14	(78,000)
Net increase (decrease) in fair value for fiscal year 2014-15	\$1,000

Although the fair value of the cash in the county treasury at the end of the fiscal year is \$4,000 higher than the actual cash balance (\$94,000 minus \$90,000), the change in fair value during the year is an increase of \$1,000. The other \$3,000 difference between the fair value of cash and the actual cash balance was already recognized at the end of the prior fiscal year.

The entry is as follows:

Date	Object Title	Object Code	Debit	Credit
6-30-15	Fair Value Adjustment to Cash in County Treasury	9111	\$1,000	
	Net Increase (Decrease) in the Fair Value of Investments	8662		\$1,000
	To report the ending cash balance at fair value and the current year increase in the fair value of investments.			

To achieve an understanding of the cumulative effect of the preceding entries and those following, it is helpful to consider the entries from the perspective of the account for Object 9111, a permanent account.

Procedure 425 Fair Value: Accounting and Reporting for Certain Investments

Following is a recap of the changes in Object 9111:

Account 9111 – Fair Value Adjustment to Cash in County Treasury

Activity Type and Date	Amount	Adjustment
Ending balance 6-30-13:	\$5,000	(\$105,000 Fair Value versus \$100,000 “Cash” in County Treasury)
2013–14 Change in fair value:	\$(2,000)	
Ending Balance 6-30-14:	\$3,000	(\$78,000 Fair Value versus \$75,000 “Cash” in County Treasury)
2014–15 Change in fair value:	\$1,000	
Ending balance 6-30-15:	\$4,000	(\$94,000 Fair Value versus \$90,000 “Cash” in County Treasury)

Alternative Method for Adjusting Fair Value

As an alternative, LEAs may choose to reverse their prior-year fair value adjustments for cash in the county treasury at the beginning of each fiscal year. If the LEA chooses to reverse the prior-year adjustments, the entries for 2014–15 would be as follows:

Date	Object Title	Object Code	Debit	Credit
7-1-14	Net Increase (Decrease) in the Fair Value of Investments	8662	\$3,000	
	Fair Value Adjustment to Cash in County Treasury	9111		\$3,000
	To reverse the 6-30-14 fair value adjustment to cash in county treasury.			

Procedure 425 Fair Value: Accounting and Reporting for Certain Investments

Date	Object Title	Object Code	Debit	Credit
6-30-15	Fair Value Adjustment to Cash in County Treasury	9111	\$4,000	
	Net Increase (Decrease) in the Fair Value of Investments	8662		\$4,000
	To report the ending cash balance at fair value and the current year increase in the fair value of investments.			

The effect on the account balances is the same by either method.

Fund Balance Classification for Unrealized Gains

The fair value of unrealized gains of investments is reported in the same fund balance classification as the underlying investment.

Materiality of Adjustments to Fair Value

Generally accepted accounting principles (GAAP) require that LEAs report their cash in the county treasury at fair value. However, like all other GASB statements, GASB Statement 31 states that it does not apply to nonmaterial items. For many LEAs, the difference between the fair value and the book value of their cash in the county treasury may not be material.

If an LEA chooses not to record the adjustment necessary to report its cash with the county treasurer at fair value, the LEA's independent auditor must determine whether the omission is material enough to the financial statements to require an adjustment and whether the LEA's departure from GAAP is significant enough to impact the auditor's opinion on the financial statements.