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**Subject:** Market Fluctuation Reserve - Agenda Item #9

Finance Committee Members,

GASB 72 "Fair Value Measurement and Application" requires the Town's investments to be recorded at fair value. This is disclosed in Note 1 of the CAFR. Accordingly, the change in fair value of investments is recognized as an increase or decrease to investment assets and investment income as of the balance sheet date. Historically the Town's fair value of investments has closely approximated original cost.

For FY 2020, the Town recorded \$1.2m (total investment earnings was \$2.4m) as investment earnings resulting from fair value measurement. The Staff memo discusses the need to segregate these earnings in the Town's General Fund Market Fluctuations Reserve to avoid having these earnings potentially flowing to the Town's Reserve for Capital and Special Projects. This is a reasonable approach.

However, the Staff memo does not disclose that since recording the \$1.2m in unrealized investment gain as of June 30, 2020, the fair value of investments as of March 31, 2021, has decreased by \$576k to \$642k. Assuming no change for the remainder of the current fiscal year, this will result in a \$576 loss in investment income being recorded for FY 2021. This loss will eventually flow to the General Fund Reserve which will reduce the Market Fluctuation Reserve.

The important point is to remember that fair value measurement will create "unrealize" gains and losses at the time of measurement which are then reported in the Statement of Activities as investment earnings. The only way to prevent the "whip saw" impact on investment valuations and earnings is to actually monetize the "unrealized" gain. If the Town had sold the investments which had increased in market value, the gain on the sale would be turned into cash and Town would have realized a true gain of \$1.2m. Barring any other concerns, this would have been a reasonable action to take, rather than to continue to hold the investment until maturity and have the market value gain disappear as the bond values approach par value.

Please let me know if you have any questions.

Phil Koen