

## MEMORANDUM

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September 13, 2010

**TO:** Board of Mayor and Aldermen

**FROM:** Eric S. Stuckey, City Administrator  
Russ Truell, Assistant City Administrator/CFO

**SUBJECT:** Agreement with Public Financial Management for Swap Valuation Services

### **Purpose**

The purpose of this memo is to present for consideration to the Board of Mayor and Aldermen (BOMA) an agreement with PFM Asset Management to use their "Swap Viewer" product for the purpose of conducting required outside valuation of existing structured debt arrangement ("swaps").

### **Background**

The Government Accounting Standards Board (GASB) statement #53 changes some of the reporting requirements for swap agreements. One issue involves determination of "fair value" on the agreements. The Comptroller's office has notified us that we must "enter a contract with an independent third-party specialist" to determine fair value.

Staff has contacted various entities, including the ones listed in the memo from the Division of Municipal Audit, and received quotes on the cost of the newly required services. The lowest cost provider was PFM Asset Management, which is the firm that staff is recommending.

### **Financial Impact**

There will be an additional cost of approximately \$2,300 per year that was not anticipated in the FY2011 budget.

### **Recommendation**

Staff recommends approval of the Agreement, subject to suggestions or modifications made by or agreed to by the City Attorney.



STATE OF TENNESSEE  
COMPTROLLER OF THE TREASURY  
DEPARTMENT OF AUDIT  
DIVISION OF MUNICIPAL AUDIT

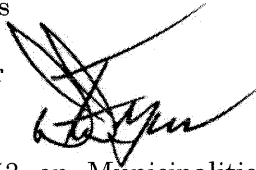
Justin P. Wilson  
Comptroller of the Treasury

BANK OF AMERICA PLAZA  
414 UNION STREET, SUITE 1100  
NASHVILLE, TENNESSEE 37243-1402  
PHONE (615) 532-4460  
FAX (615) 532-4499

Dennis F. Dycus, CPA, CFE, Director  
Division of Municipal Audit

MEMORANDUM

**TO:** Municipal Mayors and City Recorders

**FROM:** Dennis F. Dycus, CPA, CFE, Director  
Division of Municipal Audit 

**SUBJECT:** Impact of GASB Statement No. 53 on Municipalities that Have  
Derivative Instruments: Municipal Governments Should Provide an  
Independent Evaluation of Fair Value Calculations.

**DATE:** June 14, 2010

The purpose of this memorandum is to provide guidance to municipal governments that have derivative instruments requiring them to account for and make certain disclosures in accordance with Governmental Accounting Standards Board (GASB) Statement No. 53. This statement is effective for the year ending June 30, 2010. Therefore, this leaves a very short window of opportunity for municipal governments to prepare for implementation. **Paragraph four describes a new requirement for municipal governments, which will involve entering into a contract with an independent third-party derivative specialist.**

Derivative instruments are often complex financial arrangements used by municipal governments to manage specific risks. GASB Statement No. 53 requires that all derivative instruments be reported on the government-wide Statement of Net Assets at fair value. Previous to Statement No. 53, derivative instruments were not reported on the government-wide financial statements. Statement No. 53 describes the types of derivative instruments that fall within its scope and defines how fair value is calculated. Municipal governments that hold derivative instruments that meet the definition of *effective* hedging derivatives will be required to show the annual change in fair value of the instruments on the Statement of Net Assets. Municipal governments that hold *ineffective* hedging derivatives will reflect the annual change in fair value of derivative instruments on the Statement of Activities as investment revenue.

GASB Statement No. 53 provides guidance about acceptable methods of calculating fair value. Most municipal governments that currently hold derivative instruments also have a

financial adviser/derivative broker who determines fair value and provides additional information for financial statement note disclosures. Local governments will be responsible for determining that each derivative instrument meets the effectiveness test and is fairly valued using an approved calculation method. In most instances, this will require the services of an independent third-party investment/derivative specialist.

Local governments holding derivative instruments as of June 30, 2010 should obtain the services of a reputable third-party derivative specialist to evaluate whether each derivative instrument meets the effectiveness test and is fairly valued using an approved calculation method. The independent specialist should review the numbers and information prepared by the municipality's current financial advisor/derivative broker and report findings to the municipality and its auditors. Given the short time frame for implementation, this should occur as soon as possible. Auditors may have to qualify their opinion or issue an adverse opinion depending on the circumstances for each local government that is unable to verify the effectiveness and fair value of each derivative instrument based on an independent third-party evaluation.

The Division of Municipal Audit realizes the complexity of GASB Statement No. 53 and the difficulty local governments will have implementing the new standard. Feel free to contact us if you need assistance in understanding the requirements of Statement No. 53 or in locating a third party derivative specialist.

Municipal governments may contact the Municipal Technical Assistance Service (MTAS) for more information about GASB 53 or in locating a third party derivative specialist. A plain language summary of GASB Statement No. 53 can be obtained at <http://www.gasb.org/jsp/GASB/Page/GASBSectionPage&cid=1175804831178>.

We have enclosed a list of derivative valuation companies who we understand have done valuations for local governments. **The Division of Municipal Audit does not recommend the listed companies. The Division of Municipal Audit does not vouch for the quality of services provided by the listed companies. The Division of Municipal Audit has not verified the accuracy of representations made by the listed companies.**

Enclosure

**GASB 53**  
**Derivative Valuation Specialist**  
**Contact Information**  
**Updated 6-29-10**

**Disclaimer:** The Division of Municipal Audit does not recommend the listed companies. The Division of Municipal Audit does not vouch for the quality of services provided by the listed companies. The Division of Municipal Audit has not verified the accuracy of representations made by the listed companies.

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**PFM Asset Management**

Alfred Mukunya  
Senior Managing Consultant  
PFM Asset Management LLC  
Two Logan Square, Suite 1600  
18<sup>th</sup> & Arch Street  
Philadelphia, PA. 19103

Tel. (215)-557-1477  
Fax (215)-567-4180  
Email: [mukunyaa@pfm.com](mailto:mukunyaa@pfm.com)

Company Website: [pfm.com](http://pfm.com)

The Company has a Memphis Office, but this is the contact information we were presented.

**DerivActiv**

Jim Towne  
DerivActiv  
6400 Flying Cloud Drive, Suite 200  
Minneapolis, MN. 55344

Tel. (952)-746-6049  
Fax (952)-996-0188  
Mobile (651)-253-1918  
Email: [jtowne@derivactiv.com](mailto:jtowne@derivactiv.com)

Company Website: [www.derivactiv.com](http://www.derivactiv.com)

**Stonemont Financial Group**

Chris Kornatowski, Principal  
Stonemont Financial Group  
Main 404-846-3200  
Direct 404-924-2020  
Cell 404-502-8223  
Email: [chris.kornatowski@stonemontfinancial.com](mailto:chris.kornatowski@stonemontfinancial.com)

Company Website: [www.stonemontfinancial.com](http://www.stonemontfinancial.com)



**The PFM Group**

Public Financial Management, Inc.  
PFM Asset Management LLC  
PFM Advisors

The Logan Square  
Suite 1000  
1311 South Street  
Philadelphia, PA  
19103-3770

PH 215-630-0300  
PH 215-674-1000 fax  
www.pfm.com

June 29, 2010

Russell B. Truell  
Chief Financial Officer  
The City of Franklin, Tennessee  
109 Third Avenue  
South Franklin, TN 37064

Re: Swap Valuation and GASB 53 Compliance Services

Dear Russ,

This letter confirms the engagement of PFM Asset Management LLC ("PFMAM") by The City of Franklin, Tennessee ("Franklin") for the purpose of performing calculations relating to the valuation of certain interest rate exchange agreements, which may include swaps, swaptions, caps, floors, or other similar contracts. The calculations are to be performed with respect to all swap transactions in which Franklin is a party (each, a "Transaction").

Whereas such day starting with June 30, 2010 being a "Calculation Date", PFMAM will calculate on a monthly basis the mark-to-market of certain Transactions as of the close of business (each calculation, a "Monthly Mark-to-Market Calculation"), based on market levels at such time as obtained from generally recognized pricing sources and PFMAM's valuation models. The results shall be made available for viewing by Franklin through PFMAM's online service known as SwapViewer®. The results will also contain the publicly available credit ratings of the Transaction counterparties as of the Calculation Date. In addition, PFMAM will make available online, selected Transaction documents to Franklin.

To facilitate the preparation of the calculations and documents, Franklin will provide or cause to be provided to PFMAM all relevant data requested by PFMAM from time to time, with respect to each Transaction and Calculation Date, and Franklin agrees to cooperate with all reasonable requests in connection herewith. PFMAM will rely on this information in preparing the calculations of the mark-to-market for each Transaction. PFMAM may rely on market information services which are used generally by market-makers for pricing instruments similar to the Transactions, including information furnished by one or more brokers who engage in such transactions. The calculated mark-to-market will be based upon available mid-market levels. The mark-to-market is not an indication of a level where Franklin could enter into an actual Transaction, nor is it indicative of the level where Franklin could liquidate a Transaction. PFMAM shall not have any obligation to update any valuation calculated hereunder because of events occurring or data or information received subsequent to the Calculation Date.

As applicable and pursuant to the Statement No. 53 of the Governmental Accounting Standards Board, Accounting and Financial Reporting for Derivative Instruments (GASB 53), and Board issued guidance, to the extent deemed appropriate, PFMAM shall assess the transactions for effectiveness and hedge accounting. GASB 53 is effective for reporting periods beginning after June 15, 2009, and Franklin will comply with GASB 53 for its reporting period beginning July 1, 2009. After the end of the reporting period, PFMAM shall deliver to Franklin an annual report with results on the assessments made pursuant to GASB 53 ("Annual GASB 53 Report").

For services outlined above, PFMAM shall invoice Franklin on an annual basis a fee of \$2,300 for the Monthly Mark-to-Market Calculation and Annual GASB 53 Report with a first Calculation Date of June 30, 2010. The first invoice shall be due upon delivery of the first calculation and report. In excess of 2 Transactions, PFMAM and Franklin may negotiate a new fee schedule acceptable to both parties. This engagement is terminable by either party hereto upon thirty (30) days' written notice to the other party.



Additional services performed by PFMAM and not described above, such as responding to questions by Franklin or its auditors regarding the methods and results of PFMAM's calculations shall be compensated separately. Fees for such additional services shall be calculated based on an hourly rate of \$300 per hour.

Franklin acknowledges that it is engaging PFMAM hereunder only for those services specifically set forth in this letter agreement. However, Franklin may request PFMAM in writing to advise on matters not covered by this letter agreement. Should PFMAM undertake to provide such additional services it will do so for a separate fee based on a separate written agreement.

PFMAM may rely upon the advice of counsel, who may be counsel to Franklin, and upon information supplied by accountants, swap dealers, inter-dealer brokers and other persons believed by it in good faith to be experts in the matters upon which they are consulted including market information services which are used generally by market-makers for pricing instruments similar to the Transactions. ~~Franklin agrees that PFMAM will be subject to no liability based on its performance under this letter agreement except for PFMAM's own negligence or misconduct.~~

PFMAM is an investment advisor registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940, and does not hold a position or act as market-maker in any of the financial instruments described herein.

PFMAM warrants that it has delivered to Franklin at least forty-eight hours prior to the execution of this letter agreement, PFMAM's current Securities and Exchange Commission Form ADV, Part II (disclosure statement). Franklin acknowledges receipts of this disclosure statement at least forty-eight hours prior to the execution of this letter agreement.

Our obligations and responsibilities as described in this letter agreement are not assignable without the prior written consent of Franklin. If this engagement letter is satisfactory, please have an authorized official of Franklin acknowledge below and return one copy to the undersigned.

Sincerely,  
PFM ASSET MANAGEMENT LLC

*Jeffrey M. Pearsall*  
Jeffrey M. Pearsall  
Managing Director

Cc: Lauren Lowe, Sr. Managing Consultant, Public Financial Management, Inc.

Accepted:  
THE CITY OF FRANKLIN, TENNESSEE

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

Date: \_\_\_\_\_

# Addendum to Agreement with PFM Group Swap Valuation and GASB 53 Compliance

CONF # 2010-018

This addendum shall modify and supersede the attached document Swap Valuation and GASB 53 Compliance Services (the "Agreement") and entered into on the \_\_\_ day of \_\_\_\_\_, 2010, by the City of Franklin, Tennessee and PFM Assest Management LLC ("Vendor"). The Agreement together with this Addendum and the attached document(s) constitute the entire agreement ("Contract"). Acceptance of payment as stated in the Agreement constitutes Vendor's acceptance of all terms and conditions stated herein.

## Standard Terms and Conditions

1. Time of the Essence. The parties agree that TIME IS OF THE ESSENCE with respect to the parties' performance of all provisions of the Agreement.
2. Confidentiality and Proprietary rights. Vendor waives any right to confidentiality of any document, e-mail or file it fails to clearly mark on each page (or section as the case may be) as confidential or proprietary. Proprietary rights do not extend to the data created by the City's users of the System; all rights to that data (including derivative or hidden data such as metadata) shall vest solely in City at the moment of creation and City shall retain exclusive rights, title, and ownership of all data and images created thereform at the moment of creation and utilization, through and including image creation. City may be required to disclose documents under state or federal law. City shall notify Vendor if a request for documents has been made and shall give Vendor a reasonable opportunity under the circumstances to respond to the request by redacting proprietary or other confidential information. In exchange, Vendor agrees to indemnify, defend, and hold harmless City for any claims by third parties relating thereto or arising out of (i) the City's failure to disclose such documents or information required to be disclosed by law, or (ii) the City's release of documents as a result of City's reliance upon Vendor 's representation that materials supplied by Vendor (in full or redacted form) do not contain trade secrets or proprietary information, provided that the City impleads Vendor and Vendor assumes control over that claim.
3. Warranties/Limitation of Liability/Waiver. The City reserves all rights afforded to local governments under law for all general and implied warranties. The City does not waive any rights it may have to all remedies provided by law and therefore any attempt by Vendor to limit its liability shall be void and unenforceable.
4. Arbitration/Mediation. No arbitration shall be required as a condition precedent to filing any legal claim arising out of or relating to the Contract. No arbitration or mediation shall be binding.
5. No Taxes, No Interest Payments. As a tax-exempt entity, the City shall not be responsible for sales or use taxes incurred for products or services. The City shall supply Vendor with its Sales and Use Tax Exemption Certificate upon Vendor's request. Vendor shall bear the burden of providing its suppliers with a

# Addendum to Agreement with PFM Group Swap Valuation and GASB 53 Compliance

copy of the City's tax exemption certificate and shall assume all liability for such taxes, if any, that should be incurred. The City does not agree to pay any interest for late payments, having agreed to pay in a timely manner.

6. Notices. Any notice provided pursuant to the Contract, if specified to be in writing, will be in writing and will be deemed given: (a) if by hand delivery, then upon receipt thereof; (b) if mailed, then three (3) days after deposit in the mail where sender is located, postage prepaid, certified mail return receipt requested; (c) if by next day delivery service, then upon such delivery; or (d) if by facsimile transmission or electronic mail, then upon confirmation of receipt. All notices will be addressed to the parties at the addresses set forth below (or set forth in such other document which the Agreement or this Addendum may accompany, or such other address as either party may in the future specify in writing to the other):

In the case of the City:

City of Franklin  
Attn: Russell Truell  
109 Third Ave. South  
P.O. Box 305  
Franklin, TN 37065-0305  
Phone: 615/791-1457  
E-mail: russellt@franklintn.gov

In the case of Vendor:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

7. Waiver. Neither party's failure or delay to exercise any of its rights or powers under the Contract will constitute or be deemed a waiver or forfeiture of those rights or powers. For a waiver of a right or power to be effective, it must be in writing signed by the waiving party. An effective waiver of a right or power shall not be construed as either (a) a future or continuing waiver of that same right or power, or (b) the waiver of any other right or power.
8. Severability. If any term or provision of the Contract is held to be illegal or unenforceable, the validity or enforceability of the remainder of the Contract will not be affected.
9. Precedence. In the event of conflict between this Addendum and the provisions of the Agreement, or any other contract, agreement or other document to which the Agreement or this Addendum may accompany or incorporate by reference, the provisions of this Addendum will, to the extent of such conflict (or to the extent the Agreement is silent), take precedence unless such document expressly states that it is amending this Addendum.
10. Entire Agreement. The Contract between the parties and supersedes any prior or contemporaneous communications, representations or agreements between the parties, whether oral or written, regarding the subject matter of the entire



## **Addendum to Agreement with PFM Group Swap Valuation and GASB 53 Compliance**

Contract. The terms and conditions of this Addendum may not be changed except by an amendment expressly referencing this Addendum by section number and signed by an authorized representative of each party.

11. Additions/Modifications. If seeking any addition or modification to the Contract, the parties agree to reference the specific paragraph number sought to be changed on any future document or purchase order issued in furtherance of the Contract, however, an omission of the reference to same shall not affect its applicability. In no event shall either party be bound by any terms contained in any purchase order, acknowledgement, or other writings unless: (a) such purchase order, acknowledgement, or other writings specifically refer to the Contract or to the specific clause they are intended to modify; (b) clearly indicate the intention of both parties to override and modify the Contract; and (c) such purchase order, acknowledgement, or other writings are signed, with specific material clauses separately initialed, by authorized representatives of both parties.
12. Applicable Law; Choice of Forum/Venue. The Contract constitutes the entire agreement and is made under and will be construed in accordance with the laws of the State of Tennessee without giving effect to any state's choice-of-law rules. The choice of forum and venue shall be exclusively in the Courts of Williamson County, Tennessee.
13. Breach. Upon deliberate breach of the Contract by either party, the non-breaching party shall be entitled to terminate the Contract without notice, with all of the remedies it would have in the event of termination, and may also have such other remedies as it may be entitled to in law or in equity.
14. Survival. This Addendum shall survive the completion of or any termination of the Contract, agreement or other document to which it may accompany or incorporate by reference.