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Alert

Proposal on the Fair Value of Investments in Investment Companies

Investors would be permitted, as a practical expedient, to estimate the fair value of investments in investment companies for which the investment does not have a readily determinable fair value using net asset value per share or its equivalent, such as partners' capital per share for an investment in a partnership, if a proposed FASB Staff Position is adopted without change.[1] The comment period for the proposal ends July 8, 2009.

Applicability

The proposed Staff Position would apply to investments in entities that meet the definition of an investment company in the AICPA's investment-companies Guide for which the investment does not have a readily determinable fair value based on the provisions of Statement 115.[2] According to Statement 115, the fair value of an equity security is readily determinable if sales prices or bid-and-asked quotations are currently available on a securities exchange registered with the SEC or if sales prices or bid-and-asked quotations are currently available in the over-the-counter market and are publicly reported by the National Association of Securities Dealers Automated Quotations systems or by Pink Sheets LLC. For example, the proposal would not apply to an investment in a registered, closed-end investment company whose fair value can be determined using prices from the markets just cited.

Investment companies are defined in paragraph 1.06 of the Guide as having the following characteristics:

- The investment company's primary business activity involves investing its assets, usually in the securities of other entities not under common management, for current income, appreciation, or both.
- Ownership in the investment company is represented by units of investment, such as shares of stock or partnership interests, to which proportionate shares of net assets can be attributed.

[1] Proposed FASB Staff Position No. FAS 157-g, Estimating the Fair Value of Investments in Investment Companies That Have Calculated Net Asset Value per Share in Accordance with the AICPA Audit and Accounting Guide, Investment Companies, June 8, 2009, available at www.fasb.org, and AICPA Audit and Accounting Guide, Investment Companies, May 2008.

[2] FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities, available at www.fasb.org.

- Funds of the investment company's owners are pooled to avail owners of professional investment management.
- The investment company is the primary reporting entity.

Entities that issue ownership interests that may be within the scope of the proposed Staff Position include hedge funds and other investment vehicles such as real-estate, private-equity, and venture-capital funds.

Using net asset value per share under the proposed Staff Position could apply to investments in investment companies for which the investment does not have a readily determinable fair value in the following circumstances:

- A reporting entity within the scope of the Guide invests in another entity within the scope of the Guide.
- An entity measures investments at fair value under Statement 159 or provides fair-value disclosures under Statement 107.[3]
- A not-for-profit entity following the AICPA Guide on not-for-profit organizations elects fair value as the subsequent measurement attribute or when testing an investment subsequently measured at cost or using the equity method for other-than-temporary impairment.[4]
- A for-profit entity measures an equity-method investment for other-than-temporary impairment (including Opinion 18 and EITF D-46).[5]
- An entity measures its pension plan assets at fair value (including when applying Statements 35 and 158).[6]

Measurement

As a practical expedient, the Staff Position would permit an investor to estimate the fair value of an investment within the scope of the Staff Position using the net asset value of the investment without further adjustment if the net asset value is calculated in accordance with the Guide as of the reporting entity's measurement date. Such a measurement represents a practical expedient to the fair value measurement framework set forth in Statement 157 because that Statement defines the fair value of an asset as its current exit price (i.e., its estimated selling price at the measurement date) and an investment's net asset value may differ from its current exit price.[7] However, the Board concluded that the cost and effort involved in evaluating potential adjustments to net asset value to refine an entity's fair-value estimate would outweigh the financial reporting benefits for investments within the scope of the proposal.

The financial-reporting carrying amount resulting from measuring investments in investment companies within the scope of the proposal at their net asset values would likely be similar to the outcome of applying the equity method of accounting to those investments.

[3] FASB Statements No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, and No. 107, Disclosures about Fair Value of Financial Instruments, both available at www.fasb.org.

[4] AICPA Audit and Accounting Guide, Not-for-Profit Entities, March 1, 2009.

[5] APB Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock, and EITF Issue No. D-46, Accounting for Limited Partnership Investments, both available at www.fasb.org.

[6] FASB Statements No. 35, Accounting and Reporting by Defined Benefit Pension Plans, and No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, both available at www.fasb.org.

[7] FASB Statement No. 157, Fair Value Measurements, available at www.fasb.org.

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Disclosures

The following disclosures would be required in each interim and annual period to help users understand the nature and terms of the investments to which the Staff Position applies.

- The fair value of investments within the scope of the Staff Position, separately disclosing the fair value of investments to which the reporting entity has applied the Staff Position's measurement provisions, and a description of the significant investment strategies of the investee(s);
- The reporting entity's best estimate of the remaining life of a finite-lived investment;
- The estimated amount and timing of unfunded commitments related to the reporting entity's investment;
- The terms and conditions under which the investor may redeem its investment (for example, quarterly redemption with 60 days' notice);
- The circumstances in which an otherwise redeemable investment or a portion of it might not be redeemable (for example, due to a lockup or the imposition of a gate);
- The reporting entity's best estimate of when a restriction against redemption of an otherwise redeemable investment that is in place as of the reporting entity's measurement date might lapse; and
- Any other significant restriction on the ability to redeem or sell the investment at the measurement date.

Effective Date

The Staff Position would be effective when issued and applied prospectively, including for prior periods for which financial statements have not been issued. Disclosures for earlier periods presented for comparative purposes are not required at initial adoption, but are required for periods ending after initial adoption. Revisions from a change in the valuation technique or its application would be included in the period of adoption as a change in accounting estimate in accordance with Statement 154.[8] However, Statement 154's disclosure requirements for a change in accounting estimate would not apply.

[8] FASB Statement No. 154, Accounting for Changes and Error Corrections, available at www.fasb.org.