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## Alert

## FASB Decisions on the Fair Value of Investments in Investment Companies

The FASB will expand the circumstances in which a “practical expedient” may be used in estimating fair value to include investments in foreign and other entities (e.g., real estate funds) that have the attributes of investment companies, report net asset value or its equivalent (e.g., partners’ capital) to their investors, and calculate net asset value or its equivalent consistent with the measurement principles of the AICPA Investment Companies Guide (i.e., their assets are measured generally at fair value).<sup>1</sup> The Board decided to retain the prohibition against using net asset value as a practical expedient to estimate fair value for investments that have a readily determinable fair value. The “practical expedient” would allow companies to use the investment’s net asset value as an estimate of fair value when the investment does not have a readily determinable fair value.

The decisions were among several made in deliberating a recently exposed draft standard, which is expected to be issued by the end of September. The Board also addressed whether the practical expedient, net asset value, can be used as an estimate of fair value when it is probable the investor will sell the investment in a secondary market transaction, differences between the reporting dates of the investor and investee, and determining the level of classification in the fair value hierarchy.

This report is based on decisions made at the FASB meeting that are subject to further consideration.

### Applicability

The exposure draft’s applicability would have been limited to investments in entities that meet the Guide’s definition of an investment company for which the investee does not have a readily determinable fair value. Constituents pointed out that the proposal’s scope could be understood to apply only to investments in investees that are applying the Guide and reporting under U.S.

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<sup>1</sup> 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](http://www.fasb.org). FASB ASC Topic 946, Financial Services-Investment Companies, available at [www.fasb.org](http://www.fasb.org), and AICPA Audit and Accounting Guide, Investment Companies, May 2008.

GAAP, thereby excluding investments in foreign entities that report net asset value using other accounting principles that are consistent with the Guide's and investments in entities applying U.S. GAAP other than the Guide but that nevertheless have the attributes of investment companies and report net asset value consistent with the measurement provisions of the Guide. The proposal will be revised to include investments in such entities that do not have a readily determinable fair value.

### Measurement

The revised proposal will address measurement in situations where it is probable as of the reporting date that an investment will be sold in a secondary market transaction.<sup>2</sup> In that circumstance the investment would no longer qualify for the practical expedient. Instead, the investor would be required to estimate the fair value of the investment considering all of the rights and obligations inherent in the investment and other market data applicable to the investment interest. To determine when it has become probable that an investment will be sold in a secondary market transaction, it is expected that investors would consider criteria similar to the following, which are required when assessing whether long-lived assets qualify as assets held for sale.<sup>3</sup>

- Management commits to a plan to sell the asset and has the authority to approve the action.
- The asset is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets.
- An active program to locate a buyer and other actions required to complete the plan to sell the asset have been initiated.
- The sale of the asset is probable and transfer of the asset is expected to qualify for recognition as a completed sale within one year.
- The asset is being actively marketed for sale at a price that is reasonable in relation to its current fair value.
- Actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

Additional disclosures would be required for those investments that are probable of being sold in a secondary market.

The Board also decided that if the investee's reporting date is different from the investor's, the investor would be allowed to use the practical expedient based on the latest net asset value reported by the investee, adjusted for significant events that have occurred since the date the investee calculated the net asset value. An investor would be required to make all necessary adjustments to the previously reported net asset value necessary to arrive at an adjusted net asset value that is calculated consistent with the Guide as of the investor's measurement date.

The final standard will state that the election to use net asset value as a practical expedient should be made on an investment-by-investment basis and applied consistently to the investor's entire position in a particular investment.

<sup>2</sup> The term probable is used consistent with its meaning in the FASB ASC Master Glossary (paragraph 3(a) of FASB Statement No. 5, Accounting for Contingencies), available at [www.fasb.org](http://www.fasb.org). It refers to a future sale that is "likely to occur."

<sup>3</sup> FASB ASC Topic 360, Property, Plant, and Equipment (FASB Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets), available at [www.fasb.org](http://www.fasb.org).



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**Disclosures**

In addition to the disclosures proposed in the exposure draft, the Board decided that disclosure guidance was needed on classifying investments to which the practical expedient has been applied within the fair value hierarchy. The guidance will generally require reporting entities to consider all attributes of the investment. The Board concluded that if the investor has the ability to redeem the investment with the investee on the measurement date at net asset value, the investment would likely be classified as Level 2. Investments that cannot be redeemed with the investee at net asset value would generally be classified as Level 3. The investment would be classified as Level 3 if it is not redeemable with the investee on the measurement date but will be at a future date, and it is determined based on key factors, including the duration of the redemption restrictions, that significant adjustments to net asset value using unobservable inputs would have been required to measure fair value exclusive of the practical expedient.

The disclosure requirements will not apply to employers' disclosures about postretirement benefit plan assets required by GAAP.<sup>4</sup>

**Effective Date and Transition**

The final standard is expected to be released by the end of September and effective for periods ending after December 15, 2009. Early adoption would be permitted, but it is expected that early adopters would not be required to provide the new disclosures until the effective date. We believe it would be appropriate for early adopters to disclose the carrying value of investments valued using the practical expedient in addition to the disclosures otherwise required by existing GAAP. Early adopters may also want to provide other disclosures included in the final standard to present a full picture of their financial position and the assumptions made to value these types of assets.

The descriptive and summary statements in this newsletter are not intended to be a substitute for the proposed FASB Staff Position, the minutes of the Board meeting, or any other cited or potential accounting literature or SEC regulations. Companies applying GAAP or filing with the SEC should apply the texts of the relevant laws, regulations, and accounting requirements, consider their particular circumstances, and consult their accounting and legal advisors.

<sup>4</sup> FASB ASC Topic 715, Compensation-Retirement Benefits, available at [www.fasb.org](http://www.fasb.org).