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Project	<b>Fair Value Measurement</b>
Topic	<b>Measuring the fair value of alternative investments (IASB only)</b>

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### Purpose of this paper

1. This paper addresses measuring the fair value of alternative investments, such as investments in investment company entities, that calculate a ‘net asset value’ (NAV) per share.<sup>1</sup>
2. **This paper is for the IASB only.** The IASB needs to discuss whether to include similar guidance on such investments to that in FASB Accounting Standards Codification Topic 820 (Fair Value Measurements and Disclosures). The boards are discussing this at a joint meeting so that (a) the IASB can understand why the FASB included this guidance in Topic 820 and (b) the FASB can understand the IASB’s decision.
3. This paper asks the IASB whether to allow a practical expedient for entities with investments in investment company entities to use reported net asset values as long as they meet specific criteria (as described in this paper).
4. The attachment to this paper is FASB Accounting Standards Update (ASU) 2009-12 *Investments in Certain Entities that Calculate Net Asset Value per Share (or its Equivalent)*.

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<sup>1</sup> Net asset value per share is generally calculated as the value of the assets less the value of the liabilities, divided by the number of shares or units.

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This paper has been prepared by the technical staff of the FASB and the IASCF for discussion at a public meeting of the FASB or the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the FASB or the IASB.

Comments made in relation to the application of IFRSs or U.S. GAAP do not purport to be acceptable or unacceptable application of IFRSs or U.S. GAAP.

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## Measuring the fair value of alternative investments in Topic 820

### **Background**

5. In September 2009, the FASB issued ASU 2009-12, which amended Topic 820<sup>2</sup>, to provide guidance on measuring the fair value of alternative investments (eg investments in private equity funds, hedge funds or venture capital funds).
6. The FASB issued ASU 2009-12 in response to questions about how the guidance in Topic 820 should be applied to measure the fair value of investments in entities that calculate NAV (the investee). Before the issuance of ASU 2009-12, it was common for investors in alternative investments to estimate the fair value of their investment using the net asset per share (or its equivalent, such as member units or an ownership interest in partners' capital to which a proportionate share of net assets is attributed) provided by the investee without further adjustment.
7. This guidance is relevant for investments for which there are redemption restrictions and the investor (reporting entity) will not exit in a primary or secondary market transaction. In such cases, the FASB concluded that NAV is the "most relevant estimate of fair value available that would not require undue cost and effort for an investor that holds investments within the scope [of the ASU]...given that substantially all of the underlying investments of the investee are measured at fair value".
8. This guidance applies to investments in entities that meet both of the following criteria at the reporting date:
  - (a) the fair value of the investment is not 'readily determinable'<sup>3</sup>
  - (b) the investment is in an entity that has all attributes of an investment company that are specified in FASB Accounting Standards

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<sup>2</sup> Topic 820 codified FASB Statement of Financial Accounting Standards No. 157 *Fair Value Measurements* (SFAS 157).

<sup>3</sup> In US GAAP, fair value is 'readily determinable' if, for example, sales prices or bid-ask quotations are currently available on a securities exchange registered with the US SEC or in the over-the-counter market, as long as those price quotations are publicly reported by NASDAQ or Pink Sheets LLC. Restricted shares meet the definition of 'readily determinable' if the restriction terminates within one year.

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Codification Topic 946 (Financial Services—Investment Companies), or if it lacks one of those attributes it is industry practice to issue financial statements that follow the measurement principles in Topic 946 (ie the underlying investments are measured at fair value in accordance with Topic 820).

### **Summary of guidance in Topic 820**

9. Topic 820 allows an entity that is an investor in an alternative investment to use, as a practical expedient, the reported NAV per share (or its equivalent) of the investee if:
  - (a) the underlying investments of an investment company are measured at fair value in accordance with Topic 820 per the requirements in Topic 946
  - (b) that NAV has been determined as of the reporting entity's measurement date.
10. If either of those conditions is not met, the entity considers whether adjustments to the reported net asset value per share are necessary. The objective of any adjustment is to estimate a net asset value per share for the investment that is calculated in a manner consistent with Topic 946 (ie at fair value) as of the reporting entity's measurement date.
11. An entity is prohibited from using the practical expedient if it is probable that the reporting entity will sell the investment (or a portion thereof) at a price other than NAV. The criteria for determining whether a sale is probable are similar to those for determining whether a non-current asset is held for sale in US GAAP.
12. Topic 820 also states where within the fair value hierarchy, an investment will be classified (ie in Level 2 or in Level 3). The classification within the hierarchy depends on the ability of the entity to redeem the investment (ie because of the type of investment it holds) and the existence of any restrictions on redemption or sale.
13. Topic 820 also requires additional disclosures about these investments.

## Staff analysis and recommendation

14. ASU 2009-12 was issued after the IASB issued its *Fair Value Measurement* exposure draft and after the comment letter deadline. Respondents to the exposure draft did not mention the ASU, although it was raised in the round-table meetings in the context of convergence. The issue of using NAV when measuring the fair value of an investment in an investment company has not been raised as a practice issue in IFRSs.
15. IFRSs do not define an investment company or net asset value. To make such guidance work under IFRSs, two issues would need to be addressed:
  - (a) The IASB would need to define ‘investment company’ for IFRSs
  - (b) The IASB would need to develop specific investment company accounting requirements that include how to calculate an NAV
16. Once those two issues had been addressed, the IASB could then consider whether that NAV could be deemed representative of fair value.

### ***Defining an investment company in IFRSs***

17. ‘Investment company’ is defined in US GAAP. This means that the practical expedient in Topic 820 only applies to a particular set of investments in specific circumstances. IFRSs do not define an investment company. Although work is being done in the consolidation project on the issue of investment company accounting, the fair value measurement project cannot use that work unless a definition or description is agreed on by the IASB.
18. Without a definition of ‘investment company’, it would be difficult to identify the types of entities to which guidance about using NAV would apply and when investors in such entities can use NAV as the best estimate of fair value.

### ***How to measure NAV***

19. US GAAP contains specific guidance on how an investment company calculates NAV, including the values of the underlying assets and liabilities. This means that in the US, consistency in reporting NAV is ensured.

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20. IFRSs do not define NAV or what is included in its calculation. The staff's understanding is that NAV is calculated differently throughout the world.
21. The staff has spoken with investment companies and investors in investment companies in the process of developing this paper. In those discussions, it was evident that depending on the specific type of company/fund and the legal framework in which it operates, the approaches to calculating a NAV (if any) differ significantly. Although under US GAAP all assets are measured at fair value in accordance with Topic 820, in many countries NAV is calculated based on local GAAP (or regulatory requirements). Even if current values are used (which is not always a requirement), they are sometimes not in line with the fair value measurement guidance currently in IAS 39 *Financial Instruments: Recognition and Measurement* or as proposed in the IASB's exposure draft *Fair Value Measurement*.

### **Staff recommendation**

22. To provide the practical expedient in Topic 820 in IFRSs, the IASB would need to create specific accounting requirements for investment companies (once defined), including how to calculate NAV. Doing this is outside the scope of the fair value measurement project.
23. **Therefore, the staff recommends not providing a practical expedient allowing entities applying IFRSs to use net asset value as an estimate of fair value for alternative investments in the IASB's fair value measurement standard.**

#### **Question for the IASB**

Does the IASB agree with the staff recommendation in paragraph 23?

If not, what do you propose and why?