MINUTES

To: FASB Board Members

From: FAS 157-Applying Fair Value to Alternative Investments Team (Martin x354)

Subject: Minutes of the August 5, 2009 Board Meeting: Estimating the Fair Value of Investments in Investment Companies That Have Calculated Net Asset Value per Share in Accordance with AICPA Audit and Accounting Guide, *Investment Companies*

Date: October 23, 2009

cc: FASB: Golden, Bielstein, Proestakes, Stoklosa, Mechanick, Anderson, Glotzer, Chookaszian, Posta, Lott, C. Smith, Gabriele, Inzano, Sutay, Mills, FASB Intranet, Martin, Klimek, Allen; GASB: Reese, Schermann; IASB: Leisenring

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Accounting Standards Update.

Topic:	Estimating the Fair Value of Investments in Investment Companies That Have Calculated Net Asset Value per Share in Accordance with AICPA Audit and Accounting Guide, *Investment Companies*
Basis for Discussion:	Memorandum No. 4
Length of Discussion:	9:35 a.m. – 11:30 a.m.
Attendance:	
Board members present:	FASB: Herz, Linsmeier, Seidman, Siegel, and Smith
Board members absent:	None

Staff in charge of topic: Inzano, Anderson, Mills

Other staff at Board table: Golden, Proestakes, Martin

Outside Participants: Leisenring (IASB)

Summary of Decisions Reached

The Board deliberated issues raised by respondents to proposed FSP 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. The following decisions were reached:

1. The Board affirmed its earlier decision that an investment with a readily determinable fair value should be excluded from the scope of the final Accounting Standards Update. Additionally, the Board decided to clarify in the final Accounting Standards Update that the guidance would apply to investments in entities that (a) have the attributes specified in paragraph 946-10-15-2 of the *FASB Accounting Standards Codification*™, (b) report net asset value (or its equivalent, such as partner's capital) to their investors, and (c) calculate net asset value (or its equivalent) consistent with the measurement principles of the Financial Services—Investment Companies Topic (Topic 946), that is, substantially all of the investment assets of the entity are reported at fair value.

2. The Board affirmed its earlier decision that an entity would be permitted, rather than required, as a practical expedient, to estimate the fair value of an investment within the scope of the Accounting Standards Update using the net asset value of the investment (or its equivalent) if the net asset value is calculated consistent with the requirements of Topic 946 as of the measurement date. Additionally, the Board decided that an entity would be permitted to apply the practical expedient to investments acquired when there is a difference between the transaction price and the net asset value and recognize a gain or loss in earnings. An entity would not be required to disclose separately such gains or losses.

3. The Board decided that an entity would be permitted to use net asset value as a practical expedient on an investment-by-investment basis. The entity would be required to apply the practical expedient consistently to its entire position in a particular investment.

4. The Board decided that an entity would not be permitted to use net asset value, as a practical expedient, to estimate fair value of an investment in the scope of the Accounting Standards Update if certain criteria are met that indicate that it is probable that the entity will sell the investment in a secondary market. The criteria to determine whether the investment is likely to be sold in the secondary market would be similar to those in the Property, Plant, and Equipment Topic (Topic 360) for determining whether a long-lived asset to be sold should be classified as held for sale. The Board also decided that an entity would be required to provide additional disclosures about situations in which the entity determines that it is probable that it will sell an investment (or investments) in the secondary market.

5. The Board decided to clarify that an entity may apply the practical expedient if the net asset value reported by the investee is not as of the reporting entity's measurement date. However, the entity would be required to adjust the latest available net asset value for significant events that occurred since the date the net asset value was calculated by the investee so that the adjusted net asset value is effectively calculated consistent with the requirements of Topic 946 as of the measurement date.

6. The Board decided to clarify that the disclosures are to be presented by major category, rather than by individual investment, and that those categories are intended to be consistent with existing guidance for major security types for debt and equity securities and major category of plan assets. The entity would be required to provide a general description of the terms and conditions for redemption of the investments in each major category. Additionally, for those otherwise redeemable investments that are restricted from redemption as of the reporting entity's measurement date (for example, due to a lockup or the imposition of a gate), the entity would be required to disclose its best estimate of when the restriction against redemption might lapse. If that estimate cannot be

made, the entity would disclose that fact as well as how long the restriction has been in place.

7. The Board decided to clarify that classification within the fair value hierarchy of an investment within the scope of the guidance requires judgment based on the existing principles of the Fair Value Measurements and Disclosures Topic (Topic 820) and that all attributes of the investment should be considered.

8. The Board decided that the disclosure provisions of the Accounting Standards Update would not be applicable to employers' disclosures about postretirement benefit plan assets required by the Compensation—Retirement Benefits Topic (Topic 715).

9. The final Accounting Standards Update will be effective for periods ending after December 15, 2009, with early adoption permitted. If an entity elects to early adopt the Accounting Standards Update, the entity would not be required to early adopt the disclosure provisions of the Accounting Standards Update.

Objective of the Meeting

The objectives of the meeting were (a) to discuss issues raised in respondents' comment letters on the proposed FASB Staff Position (FSP) 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 (the Guide), and any necessary adjustments to the proposed FSP as a result of the comments received, and (b) decide whether the proposed FSP should be issued as a final Accounting Standards Update (ASU). The objectives were met.

Matters Discussed and Decisions Reached

SCOPE

Investments with Readily Determinable Fair Value

1. **Staff recommendation**: The staff recommended that the Board affirm its decision to prohibit the use of net asset value as a practical expedient if a readily determinable fair value is

available. Additionally, the staff recommended not addressing whether specific investments, such as common or collective trust funds, securities lending pools, or stable value funds are within the scope, because this relates to judgments about whether there is a readily determinable fair value for those types of investments.

2. **Board vote**: The Board unanimously agreed that the staff recommendation.

Investments in Foreign Funds and Noninvestment Companies

3. **Staff recommendation**: The staff recommended clarifying in the final ASU that application of the practical expedient to investments in investment companies that do not apply U.S. GAAP is permitted, as long as the investee (a) is an entity that would qualify as an investment company under U.S. GAAP (if it were to apply U.S. GAAP) and (b) applies the principles of Topic 946 in arriving at the net asset value (or makes necessary adjustments to be consistent with Topic 946).
4. The staff recommended that the Board not expand the scope to entities that do not meet the definition of an investment company. Additionally, the staff recommended the Board not address when an entity is within the scope of Topic 946 as part of this project.
5. **Board vote**: The Board unanimously decided that the final ASU would apply to investments in entities that (a) have the attributes specified in paragraph 946-10-15-2 of the *FASB Accounting Standards Codification*™, (b) report net asset value (or its equivalent, such as partner's capital) to their investors, and (c) calculate net asset value (or its equivalent) consistent with the measurement principles of the Financial Services—Investment Companies Topic (Topic 946), that is, substantially all of the investment assets of the entity are reported at fair value.

6. **Board comments**: Mssrs. Herz and Linsmeier questioned whether it would be operational for an investor to determine that a foreign investee would qualify as an investment company if it were to apply U.S. GAAP. Mr. Linsmeier additionally questioned the investor's ability to determine whether the foreign investee that does not apply U.S. GAAP, and therefore is not required to apply principles of Topic 946, applies those principles in arriving at the net asset value.

7. Mr. Mills stated that such determination could be made by the investee's manager or general partner, who would review the requirements of Topic 946, determine whether the principles applied by the fund are consistent with the principles in the Topic 946, and communicate its conclusion to the investor.

8. Mr. Golden recommended the Basis for Conclusions section of the final ASU clarify that it was not the Board's intention to limit the scope of the ASU to only include investments in entities that are within the scope of the Guide.

MEASUREMENT

Net Asset Value as an Estimate of Fair Value and Whether the Guidance Should Be Required or Permitted

9. **Staff recommendation**: The staff recommended that the Board affirm the guidance in the proposed FSP that a reporting entity is permitted (rather than required), as a practical expedient, to estimate the fair value of an investment within the scope of the proposed FSP using the net asset value of the investment (or its equivalent) if the net asset value is calculated in accordance with Topic 946 as of the measurement date.

10. **Board vote**: The Board unanimously agreed with the staff recommendation.

Intent to Sell the Investments

11. **Staff recommendation**: The staff recommended that the Board not limit an entity's ability to use the practical expedient based on the entity's intent to sell the investments.

12. **Board vote**: The Board decided that an entity would not be permitted to use net asset value, as a practical expedient, to estimate fair value of an investment in the scope of the Accounting Standards Update if certain criteria are met that indicate that it is probable that the entity will sell the investment in a secondary market. The criteria to determine whether the investment is likely to be sold in the secondary market would be similar to those in the Property, Plant, and Equipment Topic (Topic 360) for determining whether a long-lived asset to be sold should be classified as held for sale. The Board also decided that an entity would be required to provide additional disclosures about situations in which the entity determines that it is probable that it will sell an investment (or investments) in the secondary market.

13. **Board comments**: Mr. Smith questioned the appropriateness of an entity continuing to measure an investment at net asset value if the management of the entity has made a decision to sell the investment in the secondary market, and it is clear that the investment would not be sold at net asset value.

14. Mr. Linsmeier agreed with Mr. Smith. Mr. Linsmeier additionally noted that a liquid market for the investments within the scope of the proposed guidance does not exist. Consequently, a significant amount of time may pass between the entity's decision to sell the investment and the sale. Mr. Linsmeier did not think it would be appropriate to continue measuring the investments held for sale at net asset value during this period.

15. Mr. Anderson asked how the entity would measure the investments within the scope of the proposed guidance that are held for sale. Mr. Anderson stated that it would be challenging for preparers to reliably estimate the fair value of these investments. Mr. Anderson did not think that secondary market transaction prices would be a reliable indication of fair value in many circumstances due to the nature of these transactions, which are typically highly negotiated and lack transparency into the transaction price.

16. Mr. Siegel stated that a lot of uncertainty surrounds transactions in the secondary market. Mr. Siegel recommended the entity continue measuring investments held for sale at net asset value because until the transaction is completed, it is difficult to estimate the price the investments would be sold at. Additionally, Mr. Siegel recommended requiring the entity to disclose the fact the investments are being actively marketed and that the investor cannot estimate the amount the investments will be sold at.

17. Mr. Golden recommended the entity continue measuring investments held for sale at net asset value, unless the entity is required or committed to sell the investments.

18. Mr. Herz stated that if the entity is required or committed to sell an investment, the entity should measure that investment using its best estimate of the amount the investment would be exited at because it is highly likely that this amount would be less than the investment's net asset value.

19. Mr. Leisenring suggested the criteria for determining whether the investment is likely to be sold in the secondary market could be similar to those in the Property, Plant, and Equipment

Topic (Topic 360) for determining whether a long-lived asset to be sold should be classified as held for sale

Date of Calculation of Net Asset Value vs. the Reporting Entity's Measurement Date

20. **Staff recommendation**: The staff recommended that the Board clarify that an entity is not prohibited from applying the practical expedient if the net asset value reported by the investee is not as of the reporting entity's measurement date. Instead, the reporting entity should adjust the latest available net asset value for significant events that have occurred, since the date the net asset value was calculated by the investee so that the adjusted net asset value is effectively calculated consistent with Topic 946 as of the reporting entity's measurement date.

21. **Board vote**: The Board unanimously agreed with the staff recommendation.

Application on Investment-by-Investment Basis

22. **Staff recommendation**: The staff recommended that the election to use net asset value as a practical expedient be permitted on an investment-by-investment basis. The staff also recommended that an entity's decision about whether to apply the practical expedient be applied consistently to its entire position in a particular investment.

23. **Board vote**: The Board unanimously agreed with the staff recommendation.

24. **Board comments**: Mr. Seidman recommended the disclosure requirements of the final ASU apply to all investments within the scope of the ASU, including those investments for which the entity does not use the practical expedient.

25. Mr. Linsmeier recommended that if an entity intends to sell a portion of a class of investments in the secondary market, but has not yet determined which investments would be sold, the entity should disclose its intent to sell that portion of its investments.

Day One Gain (Loss)

26. **Staff recommendation**: The staff recommended that the Board allow an entity to apply the practical expedient to investments acquired when there is a difference between the transaction price and the net asset value and recognize a gain or loss in earnings. Some staff

members recommended not requiring specific disclosure of the difference between net asset value and the transaction price for investments recorded at net asset value as a practical expedient. Other staff members recommended that in the period of acquisition, entities be required to disclose the difference between the net asset value used to estimate fair value as of the measurement date and the transaction price on the date of acquisition.

27. **Board vote**: The Board unanimously decided that an entity would be permitted to apply the practical expedient to investments acquired when there is a difference between the transaction price and the net asset value and recognize a gain or loss in earnings. An entity would not be required to disclose separately such gains or losses.

28. **Board comments**: Ms. Seidman noted that it is not uncommon for a transaction price negotiated between two parties to be different from readily observable market prices. For example, the transaction may be a bargain purchase or include a block discount. This difference is generally recognized in subsequent measurement. Ms. Seidman did not think the day one gain or loss for investments in scope of the proposed guidance should be treated differently than similar gains and losses for other investments.

DISCLOSURES

Scope of the Disclosure Requirements and Level of Disaggregation

29. **Staff recommendation**: The staff recommended requiring the disclosures in paragraph 16 of the proposed FSP for all investments in the scope of the proposed FSP and eliminating the requirement to separately disclose the fair value of investments to which the reporting entity has applied the practical expedient.

30. The staff recommended clarifying that the disclosures are to be presented by major category, rather than by individual investment, and that those categories were intended to be consistent with existing guidance for major security types for debt and equity securities and major category of plan assets. The staff also recommended including an example of the disclosures in the final ASU.

31. **Board vote**: The Board unanimously agreed with the staff recommendation.

32. **Board comments**: Ms. Seidman noted that if an entity measures some of its investments using net asset value, that fact should be included in the disclosure of valuation techniques required by Topic 820.

Additional Disclosure Recommendations

33. **Staff recommendation**: The staff recommended that paragraph 16(d) of proposed FSP FAS 157-g only require that a reporting entity provide a general description of the terms and conditions for redemption of the investments in each major category.

34. The staff recommended that paragraph 16(e) of the proposed FSP be modified to indicate that if an estimate of when the restriction might lapse cannot be made, the entity must disclose that fact as well as how long the restriction has been in place.

35. The staff believes the requirement to disclose investment strategies by major category is consistent with the requirements in Section 715-20-50 (FSP FAS 132(R)-1). Therefore, the staff recommended making no modifications to this proposed disclosure.

36. The staff recommended not requiring an entity to disclose the fact that net asset value may not always be representative of fair value or why the net asset value has been used to estimate fair value as opposed to some other measurement technique. Additionally, the staff recommended not requiring disclosure of the cost of the investment and the entity's ownership percentage in the investment vehicle.

37. Because a number of external reviewers indicated it would not be practicable to disclose the timing of the expected capital commitment calls, the staff recommended not requiring entities to disclose the expected timing of unfunded commitments.

38. **Board vote**: The Board unanimously agreed with the staff recommendations.

39. **Board comments**: Mr. Herz noted that net asset value is not a practical expedient in all circumstances and that it could be an estimate of fair value. An example of the former would be an investment in a hedge fund, reported at net asset value close to the redemption date, and an example of the latter would be an investment in a private equity fund.

40. Mr. Linsmeier agreed with Mr. Herz and recommended including this argument in the Basis of Conclusions section of the final ASU.

Applicability to Employers' Disclosures about Postretirement Benefit Plan Assets

41. **Staff recommendation**: Some staff members recommended amending Topic 715 to include the disclosures required by paragraph 16 of the proposed FSP. Other staff members believed it would be more appropriate to consider whether to amend Topic 715 for the disclosures required by paragraph 16 in a broader project that would consider the need to amend Topic 715 for any changes made to the disclosure requirements in Topic 820, including the project on improving disclosures about fair value measurements.

42. **Board vote**: Mssrs. Herz, Linsmeier, and Smith disagreed with the staff recommendation and voted that the disclosure provisions of the Accounting Standards Update would not be applicable to employers' disclosures about postretirement benefit plan assets. Ms. Seidman agreed with the staff recommendation.

43. **Board comments**: Mr. Smith stated that the disclosures regarding investments within the scope of the final ASU in the pension plan financial statements would be sufficient and that duplicating these disclosures in the employer's financial statements would not be necessary.

44. Mssrs. Herz and Linsmeier agreed with Mr. Smith.

Classification within the Fair Value Hierarchy

45. **Staff recommendation**: The staff recommended that the Board clarify in the final ASU that classification within the fair value hierarchy of an investment within the scope of the proposed FSP requires judgement based on the existing principles of Topic 820 and that all attributes of the investment should be considered. The staff suggested the Board could consider the following application guidance:

    a. If an entity has the ability to redeem its investment with the fund at net asset value on the measurement date, the investment would likely be categorized as Level 2 within the hierarchy.

    b. If the entity will never have the ability to redeem its investment with the fund at net asset value (for example, if the entity is only able to exit the fund through distributions from the fund), the investment would be categorized as Level 3 within the hierarchy.

c. If the entity cannot redeem its investment at the measurement date but it may be redeemable at a future date (for example, investments subject to a lockup or a gate or investments whose redemption period does not coincide with the measurement date), the entity should evaluate whether a market participant would require a significant adjustment to net asset value to measure fair value. If the reporting entity concludes that market participants would make a significant adjustment to net asset value using unobservable inputs, the investment should be classified as Level 3 within the hierarchy.

46. **Board vote**: The Board unanimously agreed with the staff recommendation to clarify in the final ASU that classification within the fair value hierarchy of an investment within the scope of the proposed FSP requires judgment based on the existing principles of Topic 820 and that all attributes of the investment should be considered.

47. **Board comments**: Mr. Herz agreed that if an entity has the ability to redeem its investment with the fund at net asset value on the measurement date, the investment would likely be categorized as Level 2 within the hierarchy, and if the entity will never have the ability to redeem its investment with the fund at net asset value, the investment would be categorized as Level 3. Mr. Herz suggested that for all other investments within the scope of the final ASU, the length of time the entity would be required to hold the investment until it can redeem the investment at net asset value would be an important factor in determining the level within the fair value hierarchy the investment would be categorized in.

EFFECTIVE DATE

48. **Staff recommendation**: The staff recommended that the final ASU be effective for periods ending after December 15, 2009, with early adoption permitted. The staff recommended that if an entity elects to early adopt the ASU, the entity not be required to adopt early the disclosure provisions of the ASU.

49. **Board vote**: The Board unanimously agreed with the staff recommendation.

Follow-up Items

The Board directed the staff to proceed to a draft of the final ASU for vote by written ballot.

General Announcements

None.