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November 18, 2021

Ms. Hillary Salo  
Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
PO Box 5116  
Norwalk, CT 06856-5116

### File Reference No. 2021-005

Dear Ms. Salo:

RSM US LLP is pleased to provide feedback on the Financial Accounting Standards Board's (FASB) proposed Accounting Standards Update (ASU), *Fair Value Measurement (Topic 820): Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions*.

We appreciate the FASB's efforts to clarify the guidance in Topic 820 and acknowledge that the FASB's proposal would reduce measurement complexity and cost, and may result in the least disruption to valuation practices outside the investment company industry. Nevertheless, overall, we favor the alternative approach presented in the ASU's Basis for Conclusions because we believe that approach would (a) better reflect what would be taken into account by market participants when pricing an equity security subject to a selling restriction and (b) provide information that financial statement users would consider relevant and decision-useful. However, we recognize that the cost of complying with an accounting framework that requires estimating the fair value of a contractual selling restriction may outweigh the benefits for those entities that report their assets and liabilities based on a mixed-attribute model. As a result, we would not oppose allowing certain entities (specifically, those that are not subject to specialized accounting practices that require accounting for substantially all investments at fair value with changes in value recognized in earnings or the change in net assets) to ignore the effects of a contractual selling restriction when measuring the fair value of the related equity security.

Our responses to each of the questions posed in the proposal are included in the remainder of this letter.

### Responses to Questions for Respondents

**Question 1:** Restriction type: Do you agree with the Board's decision on scope to include all contractual restrictions that prohibit the sale of an equity security? Please explain why or why not.

We agree that the scope of the proposed ASU should address all transactions involving contractual sale restrictions that are characteristics of the holder, and not just equity securities subject to a contractual sale restriction stemming from an underwriter lock-up agreement. However, as more fully explained in our response to Question 2 below, we believe that, for an equity security, the distinction of whether the selling restriction is considered a characteristic of the holder or the asset is arbitrary from an economic point of view because in both instances the holder is prevented from selling the asset for a period of time.

If the Board moves forward with the proposed ASU, we believe additional guidance should be provided on when a contractual sale restriction should be considered an entity-specific versus an asset-specific characteristic. We believe the proposed definition of a restricted security is too narrow to fully capture the population of equity securities with contractual selling restrictions that would be considered characteristics

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of the asset. See our response to Question 7 below for additional comments regarding the Board's proposed definition of a restricted security.

Given the unit of account question highlighted by this project, which is a fundamental consideration in any fair value measurement, we believe it would be helpful for the Board to give consideration (if such consideration has not previously been given) to whether the proposed amendments would cause differences in how fair value is measured under U.S. GAAP versus International Financial Reporting Standards (IFRS), particularly given the issuance of ASU 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*, in May 2011. That ASU resulted from a multi-year project with the International Accounting Standards Board (IASB), the objective of which was to develop a common set of high-quality accounting standards. We encourage the FASB to continue to work with the IASB on standards that are already substantially converged (as well as future standard-setting activities) to avoid unnecessary differences.

**Question 2:** Measurement: Do you agree with the Board's decision that a contractual restriction prohibiting the sale of an equity security is not considered part of the unit of account of the equity security and, therefore, should not be considered in measuring fair value? Alternatively, should the Board amend the guidance in Topic 820 (or elsewhere in GAAP) such that contractual sale restrictions would be required to be considered in determining fair value?

We see the merits of the Board's proposal, as well as the alternative view presented in the proposed ASU's Basis for Conclusions.

We believe the Board's proposal would reduce measurement complexity and the need for subjective management judgment. However, we also agree with the dissenting Board members that the distinction of whether a legal or contractual restriction on a sale of an equity security is asset-specific or entity-specific is arbitrary from an economic point of view. A fair value measurement of an asset subject to a sale restriction that differs based on whether the restriction would transfer with a sale of the asset is not particularly meaningful because the sale of such an asset is only hypothetical regardless of whether the selling restriction is determined to be a characteristic of the asset or the holding entity. Moreover, the "economic fair value" impact of an entity-specific contractual lock up is consistent with that of a selling restriction considered to be a characteristic of the asset.

As noted by the dissenting Board members, valuation specialists agree that an entity contractually prohibited from selling an equity security is exposed to the liquidity and volatility risk of that investment in a manner that differs from holding an equity security that is not subject to a contractual sale restriction. As a result, requiring an entity to ignore the economic fair value impact of a contractual selling restriction on an equity security when the restriction is considered a characteristic of the holding entity results in the overstatement of an entity's net assets.

Paragraph BC22 of the proposed ASU states in part:

[...] systematically overstating the accounting fair value of equity securities subject to contractual sales restrictions is particularly problematic for investment companies. As described in Topic 946, one of the fundamental elements of an investment company is that it is managed on a fair value basis. ... Unlike with most entities, the valuation of securities directly affects the price at which the shares of the investment company are sold to or redeemed from investors, in particular, individual investors. In addition to an overstatement of investments and, thus, net asset value (NAV), this proposed conclusion has the potential to result in excess compensation to investment managers and may result in less meaningful reporting of investment company performance.

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While we acknowledge that the proposed ASU is consistent with the existing fair value measurement framework in Topic 820 that requires characteristics of the holder of the asset to be excluded from the fair value measurement of the asset, we question the decision usefulness of such a framework that ignores the existence of contractual sale restrictions that valuation specialists believe typically would be considered by market participants in a hypothetical sale of the asset. Consider the following excerpt from paragraph 13.12 of the AICPA valuation and accounting guide, *Valuation of Portfolio Company Investments of Venture Capital and Private Equity Funds and Other Investment Companies*:

Fundamentally, the assumptions that a market participant would take into account drive the determination of fair value. A restriction under the SEC's Rule 144A or an underwriter's lock-up that effectively prevents the sale of the securities is considered a characteristic of the asset because the hypothetical transaction could only take place if the restriction or lock-up accompanies the shares when they are sold to a market participant. Thus, the restriction or lock-up would be considered in valuing the asset. Such market participants typically would not pay the full traded price for locked up shares and, therefore, an adjustment typically would be necessary.

For the reasons stated above, we believe the valuation approach proffered by the dissenting Board members would (a) better reflect what would be taken into account by market participants when pricing an asset subject to a selling restriction and (b) provide information that financial statement users would consider relevant and decision-useful. We believe this is particularly true for entities such as investment companies that report substantially all of their activities on a fair value basis, transact with investors on the basis of net asset value per share and charge asset-based fees, all of which are based on the fair value of investments held.

We believe an entity's accounting for a contractual sale restriction considered to be a characteristic of the holding entity (that would be taken into account by market participants when pricing the asset) should be treated as a separate unit of account. Treating such a sale restriction as a separate unit of account may avoid unintended consequences and minimize conflicts with other unit-of-account guidance in Topic 820. Presenting the estimate of the economic impact of the selling restriction as a contra-asset in the same line item with the related security would enable a user of the financial statements to more easily assess management's estimate of the net fair value theoretically realizable by the entity in a hypothetical transaction as of the reporting date. Regardless of the approach, the existence of the sale restriction and where its estimated value is reflected in the financial statements should be disclosed when significant to the financial statements.

**Question 3:** Entity Type: Should all types of entities use the same unit of account when measuring the fair value of an equity security subject to a contractual sale restriction, or should certain types of entities (for example, investment companies, broker dealers, and pension plan financial statements) have a different unit of account? Please explain your response.

We believe all types of entities should use the same unit of account when measuring the fair value of an equity security subject to a contractual sale restriction, and as previously mentioned, we are in favor of the alternative view set forth in the Basis for Conclusions. However, we recognize that the cost of complying with an accounting framework that requires estimating the fair value of a contractual selling restriction may outweigh the benefits for those entities that report their assets and liabilities based on a mixed attribute model (i.e., some assets and liabilities are carried at cost, while others are carried at fair value). As a result, we would not oppose allowing certain entities (specifically, those that are not subject to specialized accounting practices that require accounting for substantially all investments at fair value, with changes in value recognized in earnings or the change in net assets) to ignore the effects of a

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contractual selling restriction when measuring the fair value of the related equity security. For those entities, following the guidance in paragraph 820-10-35-44 as a practical expedient to estimating fair value, coupled with enhanced disclosures, may be sufficient to meet the information needs of the stakeholders. Refer to our response to Question 4 for more information regarding the type of information that we believe should be disclosed.

**Question 4:** Disclosures: Would qualitative or quantitative disclosures (for example, describing the nature of a contractual sale restriction on an equity security and the related amount recognized on the balance sheet) help users in understanding the effects of a contractual restriction on the sale of an equity security held by a reporting entity? Please explain why or why not. For reporting entities, what costs would be incurred to disclose that information?

We believe disclosures should be required if the Board decides to move forward with its proposal. To help users understand the effects of a contractual restriction on the sale of an equity security, disclosures should include information about (a) the nature and duration of the restriction and (b) the carrying amount (i.e., fair value) of the instrument based on the product of the quoted price for the equity security and the quantity held by the reporting entity.

We believe the existing disclosure requirements for Level 3 measurements under Topic 820 are generally sufficient for those that already incorporate the contractual selling restrictions in their fair value estimates; however, an illustrative example may further enhance or improve the consistency of relevant information disclosed across reporting entities.

**Question 5: Transition: Do you agree with the transition guidance in this proposed Update? Please explain why or why not.**

We agree with the proposed ASU's transition provisions, which would require the amendments to be applied prospectively. However, we also would be in favor of permitting all entities to apply the transition provisions specifically proposed for entities that meet the definition of an investment company because those provisions prevent recognition of earnings unrelated to market activity in the current period.

**Question 6:** Implementation: How much time would be necessary to implement the proposed amendments? Should the amount of time needed to implement the proposed amendments by entities other than public business entities be different from the amount of time needed by public business entities? Please explain your response.

We defer to the views of preparers of financial statements to provide feedback on the amount of time that would be necessary to implement the proposed amendments. However, if the FASB decides to move forward with an approach more in line with that recommended by the dissenting Board members, we recommend that entities that are not public business entities be given an additional year to implement, with the ability to early adopt.

**Question 7:** Clarity and Operability: Do you agree that the proposed amendments and, in particular, the definition of a restricted security provide the necessary clarity to resolve existing diversity in

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practice? Please explain why or why not. Are the proposed amendments operable and auditable? If not, which proposed amendment or amendments pose operability or audibility issues and why?

Although we favor the alternative view described in the proposed ASU's Basis for Conclusions, we believe the proposed amendments are generally operable and auditable. However, we believe the proposed definition of a restricted security (shown below) is confusing and may be too narrow to capture all of the types of selling restrictions that a market participant would typically consider when measuring the fair value of an asset.

**Restricted Security**

An {add glossary link to 1st definition} **equity security** {add glossary link to 1st definition} that is not registered for sale with a national securities exchange or an over-the-counter market, either domestic or foreign, when other equity securities from the same class of stock are registered for sale with a national securities exchange or an over-the-counter market. To be legally sold on a national securities exchange or an over-the-counter market, the unregistered security must be registered or satisfy the conditions necessary for an exemption from registration. An equity security is no longer considered a restricted security if the conditions necessary for an exemption from registration have been met even if the security remains unregistered.

In the context of the proposed definition, it is unclear what is meant by "other equity securities from the same class of stock are registered for sale with a national securities exchange or an over-the-counter market." We understand that the proposed definition may be intended to capture selling restrictions similar to those of Rule 144 of the U.S. Securities and Exchange Commission (SEC); however, without the additional guidance provided by that SEC rule, the referenced term is confusing and could result in mixed application of the definition.

We are concerned that the proposed definition may inadvertently imply that a restricted security is limited to an equity security that cannot be traded on a national securities exchange or an over-the-counter market. We believe a restricted security also should include any equity security subject to a selling restriction that is a characteristic of the asset, including a legal or contractual selling restriction that limits the population of potential buyers (e.g., only qualified or accredited investors). Also, because the proposed definition contemplates that there are other equity securities from the same class of stock registered on a national securities exchange or in an over-the-counter market, it is unclear how the proposed definition would apply to investments in equity securities of a private company.

We believe the points above, and others, should be clarified by the Board to avoid unintended consequences.

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We appreciate the efforts the Board has put forth to clarify the accounting for contractual selling restrictions in a fair value measurement in accordance with Topic 820. We would be pleased to respond to any questions the Board or its staff may have concerning our comments and ask that questions be directed to Joseph Cascio at 212.372.1139 or Faye Miller at 410.246.9194.

Sincerely,

*RSM US LLP*

RSM US LLP