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AI Accounting Matters

Accounting Reminder

FASB Accounting Standards Update No. 2015–07 (the ASU) eliminates the requirement to categorize investments in the fair value hierarchy if their fair value is measured at net asset value (NAV) per share (or its equivalent) using the practical expedient in the FASB's fair value measurement guidance.

The effective dates of the ASU are described below:

Public business entities	All other entities
Fiscal years beginning after December 15, 2015, and interim periods within those fiscal years	Fiscal years beginning after December 15, 2016, and interim periods within those fiscal years

Many investment companies, particularly funds-of-funds, are expected to elect early adoption of the ASU to simplify their financial statement disclosures for investments measured using the practical expedient. Although the adoption of the ASU may appear to be a simple exercise of removing those investments from the fair value hierarchy table, investment companies should consider the potential impact of adoption to other legacy financial statement disclosures.

Recently adopted accounting pronouncements

We recommend discussing the changes resulting from the ASU in the initial year of adoption. This will help users of the financial statements understand how the adoption affects financial statement disclosures, and how the changes affect comparability of disclosures between prior periods.

Fair value hierarchy

Although the ASU removes the requirement to categorize investments measured using the practical expedient in the fair value hierarchy, those investments continue to be measured at fair value. The ASU requires sufficient information to permit reconciliation of the fair value of assets categorized within the fair value hierarchy to the amounts measured at fair value presented in the statement of financial position.

The ASU does not prescribe a specific method to provide this reconciliation. **Example 1** presents an illustration of how an investment company may provide this reconciliation.

In some instances, all of the investments held by an investment company (such as a fund-of-funds) are measured using the practical expedient. For those entities, a narrative may be sufficient to provide this reconciliation.

In addition, the summary of significant accounting policies for investment companies typically defines the levels in the fair value hierarchy used to categorize the investment portfolio. Legacy disclosures should be updated to state that investments measured using the practical expedient are not categorized in the fair value hierarchy.

Legacy disclosures may include the reasons for transfers between levels of the fair value hierarchy. This disclosure no longer applies to investments measured using the practical expedient when the ASU is adopted.

Valuation techniques and inputs

Legacy disclosures may include an investment company's policy to categorize investments measured using the practical expedient as Level 2 or 3 in the fair value hierarchy, based on whether the reporting entity has the ability to redeem its investments in the *near term*. This disclosure no longer applies to investments measured using the practical expedient when the ASU is adopted.

Level 3 measurements

Upon adoption of the ASU, investments measured using the practical expedient previously categorized as Level 3 are no longer required to be categorized in the fair value hierarchy. As a result, the following legacy disclosures that apply to investments measured using the practical expedient previously categorized as Level 3 will no longer apply.

- Level 3 rollforward
- Disclosure of valuation processes
- Disclosure of significant unobservable inputs

Entities are required to adopt the ASU's amendments retrospectively, the effect of which removes investments measured using the practical expedient from the fair value hierarchy in all periods presented. As a result, the information disclosed for those investments in prior periods would no longer be carried forward in the Level 3 rollforward in the initial period of adoption.

Practical expedient disclosures

Existing guidance requires certain disclosures for investments eligible to use the practical expedient, regardless of whether the practical expedient has been applied. The ASU amends the scope of disclosures in FASB ASC paragraph 820-10-50-6A to exclude investments that are not measured using the practical expedient.

The ASU also removes certain disclosures related solely to investments that were determined probable of being sold for amounts different from NAV.

Although investments not measured using the practical expedient would no longer apply paragraph 820-10-50-6A upon adoption, those investments remain subject to the applicable fair value disclosure requirements of paragraph 820-10-50-2.

Statement of cash flows

Under existing guidance in paragraph 230-10-15-4, one of the conditions for certain investment companies to meet the exemption to present a statement of cash flows is that substantially all of the investments are measured at fair value and categorized as Level 1 or Level 2 in the fair value hierarchy.

As a result of the exclusion of investments measured using the practical expedient from the fair value hierarchy, the ASU includes a conforming amendment to this condition to include investments measured using the practical expedient and are redeemable in the near term ***at all times***. The remaining conditions to be exempt from presenting the statement of cash flows remain unchanged and also must be met to qualify for the exemption.

Upon adoption, the benefits may not justify the cost of evaluating this condition on an investment-by-investment basis at all times. From a practical standpoint, this evaluation may be feasible in limited circumstances when the reporting entity holds few investments measured using the practical expedient, or for a feeder fund where its sole investment is in a master fund and the master fund is exempt from presenting a statement of cash flows. As a result, many investment companies may simply elect to present a statement of cash flows instead of performing the exemption analysis.

Example 1: Illustrative Disclosures – Fair Value Hierarchy

[Note: certain investment categories have been condensed to simplify the illustration]

(in thousands)	Level 1	Level 2	Level 3	Investments measured at net asset value	Total
Investments in securities	$635,197	$95,541	$51,198	$ –	$781,936
Investments in private investment companies					
Value	–	–	–	72,424	72,424
Growth	–	–	–	55,100	55,100
Merger arbitrage	–	–	–	24,799	24,799
High-yield debt	–	–	–	38,223	38,223
Total investments in private investment companies	$ –	$ –	$ –	$190,546	$190,546
Derivative contracts	$25,966	$135,743	$1,879	$ –	$163,588

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