

To the Point

FASB – final guidance

FASB requires investment companies to consider contractual sale restrictions in fair value

The ASU requires investment companies to apply a discount for contractual sale restrictions in the fair value measurement of equity securities.

What you need to know

- ▶ The FASB issued final guidance requiring investment companies in the scope of ASC 946 to incorporate the effect of contractual sale restrictions when measuring the fair value of equity securities subject to those restrictions.
- ▶ Investment companies need to disclose the discount attributable to contractual sale restrictions included in the fair value measurement of affected equity securities.
- ▶ The guidance is effective for annual reporting periods beginning after 15 December 2027, including interim periods within those annual periods. Early adoption is permitted.
- ▶ Entities will apply the guidance prospectively to all equity securities, including those subject to contractual sale restrictions that exist on the adoption date, with any adoption adjustment recognized in current-period earnings.

Overview

The Financial Accounting Standards Board (FASB or Board) issued a final **Accounting Standards Update** (ASU) to amend the guidance in Accounting Standards Codification (ASC) 820, *Fair Value Measurement*, for investment companies in the scope of ASC 946, *Financial Services – Investment Companies* (“investment company” or “investment companies”). Under existing guidance, entities, including investment companies, generally measure an equity security subject to a contractual sale restriction using the same fair value as an otherwise identical unrestricted security.



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The Board received stakeholder feedback that current guidance can produce values that do not reflect economic reality for equity securities subject to contractual sale restrictions, particularly for investment companies where fair value directly affects net asset value (NAV).

The guidance is intended to improve the decision-usefulness of investment company financial reporting by better aligning the fair value measurement of equity securities subject to a contractual sale restriction with how market participants would value those shares.

Key considerations

A narrow exception to ASC 820

The amendments create a narrow exception to ASC 820's existing fair value framework for investment companies. An investment company that cannot sell an equity security on the measurement date because of a contractual sale restriction is required to incorporate the effect of that restriction into the fair value measurement of the security. The amendment is limited in scope to equity securities with contractual sale restrictions and does not apply to other types of assets.

The amendments are limited to investment companies and do not change the accounting for other entities.¹ As a result, identical securities could be measured differently, depending on whether they are held by an investment company or another reporting entity. The Board said this exception is warranted because fair value measurements directly affect NAV of investment companies, which in turn influences investor purchases and redemptions, management fee calculations, and performance reporting.²

Determining the discount

Investment companies will be required to apply a discount that reflects the amount market participants would demand because of the risk associated with being unable to sell a security during the restriction period. The ASU does not prescribe a specific valuation methodology. Management will need to exercise judgment in estimating the effect of the restriction.

Investment companies will need to consider the nature and duration of the restriction and other factors that a market participant would evaluate when pricing the investment. The Board noted that contractual sale restrictions may expose holders to liquidity and price-volatility risks that are not faced by holders of otherwise identical unrestricted securities.³ As a result, valuation policies and supporting documentation will be important areas of focus.

Expanded disclosure requirements

Investment companies will be required to disclose the amount of the discount attributable to contractual sale restrictions included in the fair value measurement, in addition to existing disclosures about the fair value of restricted equity securities, the nature and duration of restrictions, and circumstances that may cause a restriction to lapse. When multiple equity investments subject to contractual sale restrictions exist, entities will continue to apply the existing guidance in ASC 820-10-50-1D to determine the appropriate level of aggregation or disaggregation in their disclosures.

How we see it

Because the ASU does not prescribe a valuation methodology, investment companies will need to exercise judgment when estimating discounts for contractual sale restrictions. They should evaluate whether existing valuation policies, controls and documentation processes are sufficient to support the new measurement and disclosure requirements.

Effective date and transition

For investment companies, the amendments are effective for annual reporting periods beginning after 15 December 2027, and for interim reporting periods within those annual periods. Early adoption is permitted.

Entities will apply the amendments prospectively to all equity securities, including those subject to contractual sale restrictions that exist on the date of adoption. Any adjustment resulting from adoption is recognized in current-period earnings on the adoption date. Entities need to disclose the amount recognized as an adjustment to earnings in the period they first apply the amendments.

Endnotes:

- ¹ The Board added a separate project, *Fair Value-Contractual Sale Restrictions*, to their agenda to address the fair value measurement of equity securities subject to contractual sale restrictions for all entities.
- ² Paragraph BC14 of ASU 2026-03's Background Information and Basis of Conclusions.
- ³ Paragraph BC12 of ASU 2026-03's Background Information and Basis of Conclusions.