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FASB update clarifies fair value measurement

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Based upon feedback from the SEC and other regulatory groups in the wake of the economic downturn, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-06, *Improving Disclosures about Fair Value Measurements*, in January 2010. This ASU amends *FASB Accounting Standards Codification*™ (ASC) 820, *Fair Value Measurements and Disclosures* (formerly FASB Statement 157, *Fair Value Measurements*), to add certain disclosure requirements related to fair value measurements. These disclosures include transfers between Levels 1 and 2, including reasons for the transfers, new requirements surrounding the Level 3 reconciliation, and the presentation of assets and liabilities by "class." The amendments clarify a fund's process for applying valuation techniques to its fair-valued securities.

Disclosing transfers

This amended guidance requires funds to disclose significant transfers between Levels 1 and 2, similar to the disclosure requirement for Level 3 securities. Funds are also required to discuss the reasons for such transfers. The ASU requires that the fund present these transfers in and out on a gross basis. There must also be language surrounding these transfers as to the consistency of how management is following their valuation policies. This new policy will help readers of the financial statements to understand the degree of subjectivity in the valuation between Levels 1, 2 and 3.

Level 3 reconciliation

ASU 2010-06 also changes how the Level 3 reconciliation is shown. Prior to these amendments, purchases, sales and transfers in and out were netted; however, the FASB is now requiring these items to be reflected on a gross basis. This new format will provide more information to readers of financial statements regarding transactions occurring throughout the year in Level 3. Funds will also be required to disclose significant inputs and valuation techniques used in both recurring and nonrecurring fair value measurements for Levels 2 and 3 securities. Reasons for valuation technique changes must be disclosed.

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This new policy will help readers of the financial statements to understand the degree of subjectivity in the valuation between Levels 1, 2 and 3.

Presenting assets and liabilities by class

The final change is to disaggregate disclosures by presenting assets and liabilities by "class" (for example, equities, bonds, swaps, etc.). Please see the example below. An asset or liability's class is determined by its nature and risk, as well as the level of disaggregated information required to be disclosed under other applicable U.S. GAAP. This will require significant judgment by management.

Effective date

The effective date of this guidance is for fiscal years and interim periods beginning after Dec. 15, 2009, except for the requirement for disaggregated information in the Level 3 reconciliation, which will be effective for periods beginning after Dec. 15, 2010. In developing this ASU, the FASB held discussions with the International Accounting Standards Board (IASB), and these new requirements are similar to those being required under International Financial Reporting Standards (IFRS).

The amendments will result in management working more closely with their fund administrator to reassess valuation techniques. Funds should be prepared to discuss these valuation techniques with investors. Examples are provided below on the revised tabular disclosure and Level 3 reconciliations. The funds should consider this format when preparing the disclosures. •

Example 1: Tabular disclosure

	Fair Value Measurements at Dec. 31, XXXX			
	Level 1	Level 2	Level 3	Total
Cash	$ 1,000,000			$ 1,000,000
Equity securities:				
United States	500,000			500,000
France	200,000			200,000
Germany	40,000			40,000
China	50,000	$ 50,000		100,000
Taiwan	90,000	30,000		120,000
Fixed income securities:				
Corporate bonds		500,000		500,000
Foreign currency contracts		100,000		100,000
Total	**$ 1,880,000**	**$ 680,000**	**$ —**	**$ 2,560,000**

Example 2: Level 3 reconciliation

	Level 3 Securities		
	Private Equity Funds	Real Estate Funds	Total
Beginning balance	$ —	$ 3,000,000	$ 3,000,000
Transfers into Level 3	5,000,000	7,500,000	12,500,000
Transfers out of Level 3	—	(2,000,000)	(2,000,00)
Realized gains / (losses)	300,000	—	300,000
Unrealized gains / (losses)	120,000	3,000,000	3,120,000
Purchases	2,000,000	—	2,000,000
Sales	(1,500,000)	—	(1,500,000)
Ending balance	$ 5,920,000	$ 11,500,000	$ 17,420,000

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