

**MEMO# 11540**

January 11, 2000

# **FASB ISSUES PRELIMINARY VIEWS ON REPORTING FINANCIAL INSTRUMENTS AT FAIR VALUE**

1 To access the Preliminary Views on the FASB web site, first select Publications, then select Exposure Drafts. [11540] January 11, 2000 TO: ACCOUNTING/TREASURERS COMMITTEE No. 2-00 SEC RULES COMMITTEE No. 4-00 RE: FASB ISSUES PRELIMINARY VIEWS ON REPORTING FINANCIAL INSTRUMENTS AT FAIR VALUE

The Financial Accounting Standards Board is currently considering whether all issuers should report financial instruments in their financial statements at fair value, and whether changes in fair value should be reported in current earnings. The FASB has reached preliminary decisions on the definition of a financial instrument, the definition of fair value, and general guidance for determining fair value. These decisions are described in the recently released "Preliminary Views" on major issues related to Reporting Financial Instruments and Certain Related Assets and Liabilities at Fair Value. The purpose of the Preliminary Views is to solicit comments on the FASB's preliminary decisions. Comments on the Preliminary Views will be used to develop an Exposure Draft of a proposed Statement of Financial Accounting Standards. When adopted, the Statement of Financial Accounting Standards will be part of generally accepted accounting principles. As you know, investment companies currently report their holdings in their financial statements at market or fair value, with changes in value reflected in earnings. Accordingly, the contemplated change to fair value based reporting will have no effect on funds. However, the FASB's preliminary decisions on determining market or fair value differ from current SEC guidance in certain respects. These differences are summarized below. The Preliminary Views is available at the FASB web site, [www.fasb.org](http://www.fasb.org).<sup>1</sup> Comments on the Preliminary Views should be received by the FASB by May 31, 2000. If you have comments on the Preliminary Views you would like to be considered for the Institute's comment letter, please submit them to Greg Smith at 202/326-5851 or [smith@ici.org](mailto:smith@ici.org) no later than April 14. Market Value versus Exit Value FASB Statement No. 107, Disclosure About Fair Value of Financial Instruments, describes fair value of a financial instrument as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Further, if a quoted market price is available for the instrument, the fair value for that instrument is the market price. The Preliminary Views modifies the concept of fair value described in FASB No. 107 by substituting "exit price" for market price. Paragraph 47 of the Preliminary Views describes fair value as "an estimate of the price an entity would have realized if it had sold an asset, or paid if it had been relieved of a liability, on the reporting date in an arm's-length exchange motivated by normal business considerations." For securities actively traded on exchange markets, the exit price is the closing price on the

last trading day of the period less any commissions. Paragraph 53 of the Preliminary Views indicates that assumptions about expected commissions are necessary and should be based on commissions observed in market transactions. In contrast, SEC Accounting Series Release No. 118 indicates that for securities traded on national securities exchanges, the last quoted sale price should be used to determine value. For securities actively traded over-the-counter in dealer markets, where bid and asked prices are quoted regularly by dealers, exit prices are based on what would have been realized or paid on the reporting date. In dealer markets, exit prices for assets are based on bid prices and exit prices for liabilities are based on asked prices, adjusted for any direct exit costs. Accounting Series Release No. 118 indicates that a fund may adopt a policy of using a mean of the bid prices, or of the bid and asked prices; or it may use a valuation within the range of bid and asked prices considered best to represent value in the circumstances. Gregory M. Smith Director – Operations/ Compliance & Fund Accounting

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