

FASB Clarifies Fair Value Guidance for Equity Securities Subject to Contractual Sale Restrictions

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On June 30, 2022, the Financial Accounting Standards Board (FASB) issued [Accounting Standards Update \(ASU\) 2022-03](#) in an attempt to clarify financial reporting for financial statement users – especially investors. The new standard increases the comparability of financial information amongst reporting entities who own investments in equity securities that are reported at fair value but are subject to contractual restrictions surrounding the sale of those securities.

Accounting Standards Code (ASC) 820 was originally released in 2006. It emphasizes that fair value is a market-based measurement which is not entity-specific. However, it also asserts that a reporting entity should consider certain characteristics of an asset or liability – including any restrictions on their sales – which a market participant would take into account.

Some investors noted that ASC 820 contained inconsistent guidance on what the unit of account should be when determining the fair value of a security. This has led to a significant diversity in practice about whether the effects of a contractual restriction, which prohibits the sale of an equity security, should be considered when measuring an equity security's fair value.

In this recent update, the FASB asserts that contractual restrictions should not be considered in measuring the fair value of an equity security, thus providing clarification as to whether a contractual restriction on the sale of an equity security should be considered a part of the unit of account. ASU 2022-03 also introduces new disclosure requirements intended to provide investors with information about the restriction, including the nature and timing of the restriction.

ASC 820-10-55-52 provides the following example of a restriction on the sale of an equity instrument: A reporting entity holds an equity instrument for which sale is legally or contractually restricted for a specified period. The restriction is a characteristic of the instrument that would transfer to market participants. As such, the fair value of the instrument would be measured based on the quoted price for an otherwise identical unrestricted equity instrument that trades in a public market, adjusted for the effect of the restriction. The adjustment would reflect the discount market participants would demand for the risk relating to the inability to access a public market for the instrument for the specified period. The adjustment would vary depending on:

- The nature and remaining duration of the restriction
- The extent to which buyers are limited by the restriction
- Qualitative and quantitative factors specific to both the instrument and the issuer

In addition, ASU 2022-03 requires specific disclosures pertaining to equity securities that are subject to contractual sale restrictions, including:

1. The fair value of such equity securities presented in the balance sheet
2. The nature and remaining duration of the corresponding restrictions
3. Any circumstances that could cause a lapse in the restrictions to be lifted

The effective dates and transition for ASU 2022-03's amendments are:

Effective Dates

- For public business entities – fiscal years beginning after December 15, 2023, and interim periods with those fiscal years, with early adoption permitted.

- For all other entities – fiscal years beginning after December 15, 2024, and interim periods within those fiscal years, with early adoption permitted.

Transition

For investment companies as defined per ASC 946, the 2022-03 amendments should be applied to equity securities with a contract containing a sales restriction that is executed or modified on or after the adoption date. For equity securities with a contract containing a sales restriction that was implemented prior to the adoption date, investment companies should continue to use their existing accounting policies for determining fair value of these securities until the contractual limitation expires or is changed.

For more information on the Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2022-03 and how it may impact your firm, please reach out to your Anchin Relationship Partner.