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# To the Point

**FASB — final guidance**

## FASB clarifies guidance on measuring fair value of equity securities subject to contractual sale restrictions

The guidance clarifies that a contractual sale restriction does not affect the fair value of an equity security.

### What you need to know

- The FASB issued final guidance to clarify that a contractual restriction on the sale of an equity security is not considered part of the unit of account of the equity security and, therefore, is not considered when measuring fair value. Recognizing a contractual restriction on the sale of an equity security as a separate unit of account is not permitted.
- The guidance applies to all entities that have investments in equity securities measured at fair value that are subject to contractual sale restrictions.
- Entities that hold equity securities subject to contractual sale restrictions are required to make additional disclosures.
- The guidance will be applied prospectively, with special transition provisions for entities that qualify as investment companies under ASC 946.
- For public business entities, the guidance is effective for fiscal years beginning after 15 December 2023, and interim periods within those fiscal years. For all other entities, it is effective for fiscal years beginning after 15 December 2024, and interim periods within those fiscal years. Early adoption is permitted.

## Overview

The Financial Accounting Standards Board (FASB or Board) issued **final guidance**[1] to clarify that a contractual restriction on the sale of an equity security is not part of the unit of account of the equity security and, therefore, is not considered when measuring fair value. The new guidance also clarifies that a contractual sale restriction should not be recognized as a separate unit of account.

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The guidance is intended to eliminate diversity in practice in the measurement of the fair value of equity securities subject to contractual sale restrictions (e.g., restrictions on the sale of securities issued in capital-raising and other transactions such as business combinations). To value these securities, some stakeholders previously applied a discount to the fair value of an identical equity security that is not subject to a contractual sale restriction, while others believed the application of such a discount was inconsistent with the fair value measurement principles in Accounting Standards Codification (ASC) 820.[2]

The guidance applies to all entities that have investments in equity securities measured at fair value that are subject to contractual sale restrictions.

## Key considerations

The amendments to ASC 820 clarify that an entity should measure the fair value of an equity security subject to a contractual sale restriction the same way it measures an identical equity security that is not subject to such a restriction (e.g., based on the quoted price). The FASB said the contractual restriction on the sale of an equity security is not considered part of the unit of account of the equity security and, therefore, should not affect its fair value. This is because the contractual sale restriction is viewed as a characteristic of the entity holding the security rather than a characteristic of the asset.

Under the new guidance, applying a discount to reflect a contractual sale restriction that is not a characteristic of the asset is not permitted. Recognizing such a restriction as a separate unit of account is also not permitted.

The new guidance requires entities that hold equity securities subject to contractual sale restrictions to disclose the following:

- The fair value of equity securities subject to contractual sale restrictions
- The nature and remaining duration of the restriction(s)
- The circumstances that could cause a lapse in the restriction(s)

Entities that have multiple investments subject to contractual sale restrictions should consider the guidance in ASC 820-10-50-1D[3] when making judgments about the level of aggregation or disaggregation to provide in their disclosures. Entities should exclude from these disclosures equity securities that are restricted from sale because they are pledged as collateral and already subject to other disclosure requirements (i.e., requirements outside of ASC 820).

## Transition and effective date

All entities, except entities that qualify as investment companies under ASC 946, should apply the new guidance prospectively to all equity securities subject to a contractual sale restriction that they hold. Adjustments resulting from the adoption of the guidance should be recognized in current period earnings and disclosed in the period of adoption.

Investment companies should apply the guidance prospectively to equity securities that become subject to a contractual sale restriction (or when a modification to an existing contractual restriction is executed) on or after the date of adoption. Adjustments that result from applying the guidance to a modified contractual sale restriction should be recognized in current period earnings and disclosed in the period of the modification.

For equity securities that become subject to a contractual sale restriction before the date of adoption of the amendments, the investment company should continue to apply its existing accounting policy (before the adoption of the amendments) until the expiration or modification of the contractual restriction and disclose the following:

- The fair value of equity securities subject to a contractual sale restriction to which the entity continues to apply a discount
- The nature and remaining duration of the contractual sale restriction
- The circumstances that could cause a lapse in the restriction

The information provided in these disclosures should be excluded from the disclosures required for equity securities that become subject to new or modified contractual sale restrictions on or after the date of adoption.

For public business entities, the guidance is effective for fiscal years beginning after 15 December 2023, and interim periods within those fiscal years. Early adoption is permitted. For all other entities, it is effective for fiscal years beginning after 15 December 2024, and interim periods within those fiscal years. Early adoption is permitted for both interim and annual financial statements that have not yet been issued or made available for issuance.

## Endnotes:

[1] Accounting Standards Update No. 2022-03, *Fair Value Measurement (Topic 820): Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions.*

[2] ASC 820, *Fair Value Measurement*.

[3] ASC 820-10-50-1D provides factors to consider when determining whether the nature and extent of the fair value information disclosed are sufficient to meet the disclosure objectives in ASC 820.