

BDC Roundtable

**Fair Value: The Continuing Development of FAS
157 (Topic 820)**

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Warren Hirschhorn

Ross Hostetter

Outline

- I. Implementation Assessment.
- II. FASB Exposure Draft: Improving Disclosures about Fair Value Measurements (Topic 820).
- III. Not yet final - FASB Accounting Standards Update (“ASU”) No. 2009-XX: Measuring the Fair Value of Investments in Certain Entities That Calculate Net Asset Value Consistent with Topic 946, Financial Services – Investment Companies.
- IV. FASB Accounting Standards Update (“ASU”) No. 2009-05: Measuring Liabilities at Fair Value.
- V. FASB Accounting Standards Codification Update (“ASCU”) 825-10-65, (formerly FSP FAS 107-1 and APB Opinion 28-1, Interim Disclosures about Fair Value of Financial Instruments).

Implementation Assessment

What has been addressed to date.....

- FAS 157 – Fair Value Measurements (now Topic 820).
- FSP FAS 157-3—Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active (Superseded).
- FSP FAS 157-4—Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly.

And what is on the horizon.....

- FASB Exposure Draft: Improving Disclosures about Fair Value Measurements (Topic 820).
- Not yet final - FASB Accounting Standards Update (“ASU”) No. 2009-XX: Measuring the Fair Value of Investments in Certain Entities That Calculate Net Asset Value Consistent with Topic 946, Financial Services – Investment Companies.
- Accounting for Financial Instruments (formerly Financial Instruments: Improvements to Recognition and Measurement and including the Accounting for Hedging Activities Project)—Joint Project of the IASB and FASB.

Other Fair Value Updates

- FASB Accounting Standards Update (“ASU”) No. 2009-05: Measuring Liabilities at Fair Value.
- FASB Accounting Standards Codification Update (“ASCU”) 825-10-65, (formerly FSP FAS 107-1 and APB Opinion 28-1, Interim Disclosures about Fair Value of Financial Instruments).

Implementation Assessment

Observations

- Very difficult year to determine Fair Value, much less address the transition to a new Standard.
- The guidance that ultimately resulted (FSP 157 – 4) essentially addressed “last transaction” bias – not exactly on point for BDCs and others that hold securities for which quoted prices in an active market never really existed.
- The guidance did affirm, however, the approach that many were taking already - consideration of multiple approaches to estimate the Fair Value of an investment, specifically a yield analysis or Income Approach in estimating the Fair Value of debt.
- On the positive side, the challenge of estimating Fair Value in this environment increased the focus and rigor of the Fair Value assessments.
- Syndicated loans / co-investments create a new challenge. Judgment is implicit in Level 3 inputs, judgments will vary. Creates the need for more awareness and possibly additional procedures to understand differences of opinions.

FASB Exposure Draft: Improving Disclosures about Fair Value Measurements (Topic 820)

Overview

- On August 28, 2009, the FASB issued an exposure draft for a proposed Accounting Standards Update (ASU): *Fair Value Measurements and Disclosures (Topic 820) - Improving Disclosures about Fair Value Measurements*.
- The proposed Update is intended to improve disclosures about fair value measurements and would affect all entities that are required to make disclosures about recurring and nonrecurring fair value measurements.
- Effective for interim and annual reporting periods ending after December 15, 2009, except for the sensitivity disclosures about Level 3 fair value measurements.
 - Level 3 sensitivity disclosures would be effective for interim and annual reporting periods ending after March 15, 2010.
- The comment period for the proposed update ends October 12, 2009.
- All entities that are required to make disclosures about recurring and nonrecurring fair value measurements would be affected by the amendments in the proposed Update.

FASB Exposure Draft: Improving Disclosures about Fair Value Measurements (Topic 820) (continued)

Key Provisions

- The proposed Update would require new disclosures as follows:
 - *For fair value measurements using significant unobservable inputs (Level 3), if changing one or more of those inputs to **reasonably possible** alternative inputs would increase or decrease the fair value measurement significantly, the reporting entity would state that fact and disclose the total effect of the changes on the fair value measurement. (The proposed sensitivity disclosures are not required for Investors using NAV to estimate fair value).*
 - *The reporting entity would disclose the amounts of significant transfers in and/or out of Level 1 and Level 2 fair value measurements and the reasons for the transfers.*
 - *In the reconciliation for fair value measurements using significant unobservable inputs (Level 3), information about purchases, sales, issuances, and settlements would be required on a gross basis rather than as one net number.*
- The proposed Update provides amendments that would clarify existing disclosures:
 - *An entity is required to provide fair value measurement disclosures for each class of assets and liabilities. An entity would need to apply judgment in determining the appropriate classes of assets and liabilities.*
 - *An entity is required to provide disclosures about the evaluation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. Those disclosures are required for fair value measurements that fall in either Level 2 or Level 3.*

FASB Exposure Draft: Improving Disclosures about Fair Value Measurements (Topic 820) (continued)

FASB Questions for Respondents:

1. With respect to the disclosure of the effect of changes in reasonably possible, significant, alternative inputs for Level 3 fair value measurements, the Board is seeking input from:
 - A. Financial statement prepares about their operationality and costs.
 - B. IFRS financial statement prepares about the approach they plan to use to comply with a similar disclosure requirement in IFRS 7.
2. With respect to the reconciliation of fair value using significant unobservable inputs (Level 3), the amendments in this proposed Update would require separate disclosure of purchases, sales, issuances, and settlements during the reporting period.
 - A. Is this proposed requirement operational?
3. Is the proposed effective date operational?

Proposed FSP FAS 157-g, *Estimating the Fair Value of Investments in Investment Companies That Have Calculated Net Asset Value per Share in Accordance with the AICPA Audit and Accounting Guide, Investment Companies*

■ Timeline

- *Not yet final. Expected release is September 2009 – any day now. Will be ASU No. 2009-XX: Measuring the Fair Value of Investments in Certain Entities That Calculate Net Asset Value Consistent with Topic 946, Financial Services – Investment Companies.*
- Effective for periods ending after December 15, 2009.
- Early adoption is permitted; The disclosure provisions of the Update may be deferred until periods ending after December 31, 2009.

■ Scope

- The Update provides a practical expedient for determining the fair value of an interest in an alternative investment fund if three conditions are met.

■ Measurement

- As a practical expedient, fair value for the investor is permitted to be estimated by using NAV.

■ Disclosure

- Significant additional disclosure is required (aggregated by major security type) for all interests in alternative investments reported at fair value, even if NAV is not used to estimate fair value (ASU 2009-06, Paragraph BC18).

ASU 2009-XX – What does it address?

- The Update, as a practical expedient, permits an investor entity to estimate the fair value of an interest in an alternative investment fund by *“...using the net asset value per share (or its equivalent, such as member units or an ownership interest in partners’ capital) of the investment if the net asset value per share of the investment is calculated consistent with the measurement principles of Topic 946 and is as of the reporting entity’s measurement date”*.

Background

- In October 2007, FASB’s Valuation Resource Group (VRG) addressed the question as to whether NAV reported by an investment manager is deemed fair value for the investor. FASB Staff indicated not necessarily, because:
 - Unit of account is the interest in the fund, not proportional share of investments.
 - A limited secondary market exists for trading interests in funds.
 - Legal features exist such as restrictions on sale and lock-up periods.
 - The AICPA formed a taskforce to consider the issue and released a draft Issues Paper in January 2009.
 - The VRG discussed the draft Issues Paper in February 2009 and FASB added the topic to their agenda.
 - Exposure draft (FSP FAS 157-g) released on June 8, 2009, with comments due July 8, 2009.
 - The Board re-addressed the topic on August 5, 2009.

Impact of the Update

- Applicable for investments required to be recorded at fair value including interests in Fund-of-Funds, Hedge Funds, Real Estate Funds, Private Equity Funds (Buyout, Venture Capital, Mezzanine Debt) etc., which are not actively traded if the following conditions are met:
 - The fund *meets* the definition of an investment company as contained in the Investment Companies Guide (*AICPA Audit and Accounting Guide, Investment Companies*) (Topic 946).
 - Net Asset Value (“NAV”) has been calculated in accordance with Topic 946 (e.g., NAV is derived based on valuing underlying investments at fair value consistent with Topic 820 (FAS 157)).
 - NAV is as of the same date as the investors measurement date (e.g., no reporting lag).
- If the conditions above are met, as a practical expedient, fair value for the investor is permitted to be estimated by using NAV:
 - If the NAV of the investment obtained from the investee is as of the investor’s measurement date, the fair value for the investor is permitted to be estimated by using unadjusted NAV.
 - If the NAV of the investment obtained from the investee is NOT as of the investor’s measurement date, the investor must adjust the most recent NAV for significant market events that have occurred after the NAV value was calculated (i.e., bring “in phase”).

Impact of the Update (continued)

- The Update does not apply to an investment with a readily determinable fair value.
- A reporting entity is not permitted to estimate the fair value of an investment using NAV if it is probable that the entity will sell the investment (or a portion of the investment) for an amount other than the NAV. A sale is considered probable if all of the following criteria have been met:
 - Management commits to a plan to sell the investment.
 - An active program to locate a buyer and other actions required to complete the plan to sell the investment have been initiated.
 - The investment is available for immediate sale subject only to usual and customary terms.
 - Actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or the plan will be withdrawn.

Accounting for Financial Instruments (formerly Financial Instruments: Improvements to Recognition and Measurement and including the Accounting for Hedging Activities Project)—Joint Project of the IASB and FASB

Objective*:

- Significantly improve the decision usefulness of financial instrument reporting for users of financial statements.
- Replace the FASB's and IASB's respective financial instruments standards with a common standard.
- Simplification of the accounting requirements for financial instruments.

The Boards believe that this project will*:

- Reconsider the recognition and measurement of financial instruments .
- Address issues related to impairment of financial instruments and hedge accounting.
- Increase convergence in accounting for financial instruments.

* FASB Project Update - Accounting for Financial Instruments (formerly Financial Instruments: Improvements to Recognition and Measurement and including the Accounting for Hedging Activities Project)—Joint Project of the IASB and FASB

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Status*

- The FASB and IASB issued for comment a Discussion Paper, *Reducing Complexity in Reporting Financial Instruments*, in March 2008. The comment period ended September 19, 2008.
- The IASB issued an Exposure Draft, *Financial Instruments: Classification and Measurement*, on July 14, 2009 with a 60-day comment period ending on September 14, 2009.
- The FASB expects to issue one Exposure Draft that addresses the measurement, classification, and impairment of financial instruments, as well as hedge accounting, by the end of this year or early 2010.

Issues

- Timing
- Significant differences to resolve
- Amortized cost vs. Fair Value
- Implications for loans held to maturity

* FASB Project Update - Accounting for Financial Instruments (formerly Financial Instruments: Improvements to Recognition and Measurement and including the Accounting for Hedging Activities Project)—Joint Project of the IASB and FASB

ASU No. 2009-05: Measuring Liabilities at Fair Value

Overview

- **On August 27, 2009, the FASB issued Accounting Standards Update 2009-05, *Fair Value Measurements and Disclosures (Topic 820) - Measuring Liabilities at Fair Value*.**
- **The Update provides clarification for circumstances in which a quoted price in an active market for the identical liability is not available.**
 - In such circumstances a reporting entity is required to measure fair value using one or more of the following techniques:
 - A valuation technique that uses: (a) the quoted price of the identical liability when traded as an asset; or (b) quoted prices for similar liabilities or similar liabilities when traded as assets; or
 - Another valuation technique that is consistent with the principles of Topic 820 such as an income approach or a market approach.
 - The guidance in this update is effective for the first reporting period (including interim periods) beginning after August 27, 2009.
- **The amendments in this Update apply to all entities that measure liabilities at fair value within the scope of Topic 820.**

ASC 825-10-65 Overview

- In April 2009, the FASB issued Accounting Standards Codification Update 825-10-65, (formerly FSP FAS 107-1 and APB Opinion 28-1, Interim Disclosures about Fair Value of Financial Instruments).
- The ASC 825-10-65:
 - Amends former FAS No. 107, “Disclosures about Fair Value of Financial Instruments,” to require disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements.
 - Amends former APB Opinion No. 28, “Interim Financial Reporting”, to require those disclosures in summarized financial information at interim reporting periods.
- The ASC 825-10-65 is effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009.

ASC 825-10-65 Overview (continued)

- Who is affected by ASC 825-10-65?
 - Generally, all publicly traded companies, all companies with securities traded on a public market and all companies that file with the SEC in preparation of a public sale of securities.
- What does ASC 825-10-65 mean to me?
 - Disclosures relating to the fair value of a public company's financial instruments shall be included whenever it issues summarized financial information for interim reporting periods.
 - In addition to disclosing fair value, companies shall disclose the method(s) and significant assumptions used to estimate fair value, as well as describe the changes in method(s) and significant assumptions, if any, during the period.

ASC 825-10-65 Overview (continued)

- Why has this become a hot button issue?
 - Traditionally, companies reported in the notes to their financial statements that the book value of debt was an approximation of the fair value due to the variable rate of interest on such debt.
 - Considering only interest rate risk is not appropriate anymore because market perceived credit risk has changed so substantially.
 - Given significant widening of credit spreads, along with increasing financial distress for many companies, the impact of credit risk in the valuation of debt must be considered in the assessment of fair value.
 - Book value of variable rate debt may no longer be an appropriate approximation of fair value.

Professional Credentials



Warren I. Hirschhorn
Managing Director
Duff & Phelps, LLC

Tel 212-871-0422

Fax 212-523-0854

warren.hirschhorn@duffandphelps.com

- Mr. Hirschhorn is a Managing Director in the New York office of Duff & Phelps, LLC and the leader of the Portfolio Investment Valuation practice.
- Mr. Hirschhorn has nearly thirty years of financial service and valuation experience and currently provides an array of valuation services to a diverse spectrum of companies, including both public and private, on a domestic and international basis.
- Focus includes analyzing the value of both equity and debt securities and investment portfolios. In particular, Mr. Hirschhorn specializes in valuing illiquid financial securities, private placement and other financial assets in connection with financial reporting requirements.
- Mr. Hirschhorn specializes in advising clients on transactions related to mergers and acquisitions, corporate reorganizations and workouts, joint ventures, financing, recapitalizations, and other strategic business issues.
- Mr. Hirschhorn was previously a Managing Director with Standard & Poor's Corporate Value Consulting. Prior to joining Standard & Poor's Corporate Value Consulting, Mr. Hirschhorn was a Director at Houlihan, Lokey, Howard & Zukin, where he provided various financial advisory and corporate financial services to numerous Fortune 500 clients including solvency and fairness opinions as well as intangible assets valuations.
- While at Houlihan Lokey, Mr. Hirschhorn served as the National Solvency Director responsible for a national marketing effort of the product as well as the Chairman of the National Review Committee.
- Recent testimony experience – Lipper Convertibles L.P. NASD Arbitration.

Education & Certifications:

- M.B.A. - Finance, Adelphi University
- Undergraduate Degree, Rider University



Ross Hostetter
Managing Director
Duff & Phelps, LLC

Tel 212-871-5977
Mobile 843-813-0538
Fax 212-523-0907
Ross.hostetter@duffandphelps.com

Ross Hostetter is a Managing Director in the New York office of Duff & Phelps, LLC and a member of its Portfolio Valuation Group.

Professional Experience:

- As a member of the Portfolio Valuation Group, Ross specializes in assisting a wide variety of clients in the alternative investment industry including private equity firms, hedge funds, and Business Development Companies. He works almost exclusively in assisting clients from reviewing, establishing and implementing “best practices” valuation policies through to reviewing and valuing a wide range of illiquid securities.
- Ross has also performed business valuations and intangible asset valuations for a diverse range of companies, including: regional and multinational banks, investment banks, asset managers, hedge funds, bond traders, mortgage originators, real estate companies as well as numerous other consumer and industrial product companies.
- Prior to Duff & Phelps, Ross was a Director at Standard & Poor’s Corporate Value Consulting (“CVC”). Prior to CVC Ross worked at Price Waterhouse Coopers (“PwC”), first as a tax associate in the PwC Charlotte office Financial Services Industry Practice for three years advising on federal and state corporate tax issues. He then completed a two year secondment to PwC London as a Tax Manager in the Banking and Capital Markets where he focused on advising financial services clients on U.K. corporate tax and international tax issues.

Education & Certifications:

- MTX - Georgia State University
- Undergraduate Degree, University of Georgia