Case 20-7

Real Value Corporation

Real Value Corporation (the “Company”), is a public company (and an SEC registrant) that creates augmented reality technology. The Company’s primary source of revenue is currently from universities that use the Company’s products to superimpose computer-generated images in the classroom to enhance learning. In addition to its ordinary business activities, the Company invests in equity securities (described below) to generate investment income, which is the case for all investments made by the Company as described herein. The Company’s fiscal year-end is December 31. The Company files quarterly and annual financial statements with the SEC.

The Company purchases equity securities in the form of Series A preferred stock of Company X (a private company) on February 1, 2019. The Company concludes that the equity security does not have a readily determinable fair value and that it does not qualify for the practical expedient to estimate fair value in accordance with ASC 820-10-35-59. In its Q1 2019 financial statements, the Company accounts for this investment in accordance with ASC 321, as amended by ASU 2018-03 and ASU 2019-04;1 the Company elects the measurement alternative in ASC 321-10-35-2 on the date of purchase, as it does for all its investments described herein.

The terms for the Company X Series A preferred stock are as follows:

- Has substantive liquidation preference over any other class of shares Company X has outstanding (these Series A shares would retain its substantive liquidation preference over any class of shares Company X may issue at any point in the future).
- Has no voting rights.
- Can elect two members of the board of directors.
- Receives dividends that are cumulative and participatory.
- Can be converted to common stock at any time at the holder’s option.

Second Quarter Events

On April 1, 2019, the Company purchases additional shares of Series A preferred stock of Company X as a part of an offering that Company X made to multiple investors; the price paid is greater than what the Company paid in its purchase on February 1, 2019.

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1 As noted above, the Company accounts for this investment in accordance with ASC 321 as amended by ASU 2018-03, Technical Corrections and Improvements to Financial Instruments — Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities; and ASU 2019-04, Codification Improvements to Topic 326, Financial Instruments — Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments. Note that for the provisions in ASU 2019-04 that are not effective until fiscal years and interim periods beginning after December 15, 2019 (i.e., January 1, 2020, for the Company), assume that the Company has early adopted ASU 2019-04, which is allowable if the related ASUs have been adopted.
On May 1, 2019, the Company purchases equity securities in the form of Series A preferred stock of Company Y (a private company). This Company Y Series A preferred stock provides for similar rights and obligations provided for by the Company X Series A preferred stock, but the price paid for the Company Y Series A preferred stock is greater than what the Company paid when it purchased Company X Series A preferred stock on April 1, 2019.

On June 1, 2019, the Company purchases shares of Series B preferred stock of Company X as a part of an offering that Company X made to multiple investors. The price paid is less than what the Company paid when it purchased Series A preferred stock of Company X on February 1, 2019.

The terms for the Company X Series B preferred stock are identical to the Company X Series A preferred stock except for the following:

- Series A has a substantive liquidation preference over Series B.
- Can only elect one member of the board of directors.
- Receives dividends that are noncumulative.
- Series A has dividend preference over Series B (i.e., Series A will receive dividends, if declared, before Series B).
- Shares cannot be converted to common stock.

**Fourth Quarter Events**

On November 1, 2019, Company Y issues additional shares of Series A preferred stock only to Company Y’s original investor (no additional shares were offered the Company given that the Company was not the original investor).

**Required:**

1. For purposes of the Q1 2019 financial statements, what criteria must the investment in Series A preferred stock of Company X meet to be eligible for the measurement alternative in ASC 321-10-35-2?

2. Given its election of the measurement alternative in ASC 321-10-35-2, how is the Company required to measure the equity security as of March 31, 2019?

3. For purposes of the Q2 2019 financial statements, how would the additional shares of Series A preferred stock purchased of Company X on April 1, 2019, affect the measurement of the Series A preferred stock purchased of Company X on February 1, 2019?

4. For purposes of the Q2 2019 financial statements, how would:

   a. The observable transactions related to the shares of Series A preferred stock purchased of Company Y on May 1, 2019, affect the measurement of the Series A preferred stock purchased of Company X?
b. The shares of Series B preferred stock purchased of Company X on June 1, 2019, affect the measurement of the Series A preferred stock purchased of Company X? Assume that evaluating the terms of Series A and Series B preferred stock, to consider the significance of the impact on the fair value of the Series A preferred stock, would require very complex valuation work.

5. For purposes of the 2019 annual financial statements, how would the additional shares of Series A preferred stock issued from Company Y to Company Y’s original investor on November 1, 2019, affect the measurement of the Series A preferred stock purchased of Company Y on May 1, 2019?