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Abstract

This research examines cost accounting for financial instruments held by closed-end mutual funds to provide evidence on the reliability of fair value estimation. Closed-end funds are considered because their balance sheets and income statements typically are reported at fair value and there is great variation in the types of securities held by various funds. For a sample of 143 closed-end mutual funds during 1982–1997, we find a significant association between stock prices and the fair value of investment securities, as well as between stock returns and fair value securities gains and losses, even after controlling for historical costs. To examine whether differences in the perceived reliability of the investment securities fair values affect investors' assessments of the usefulness of the information, we examine the association between stock price metrics and fair values across different fund types (e.g., publicly held equity securities from G7 countries, equity securities other than those publicly held from G7 countries, U.S. government or municipal securities, corporate bonds). We find that in all cases there is a significant association between the stock price metrics and fair values. This suggests that the need to estimate fair values for securities traded in thin markets, such as private or non-G7 equities, does not cause the incremental value-relevance of fair value information to be eliminated. Our strong and consistent findings in the closed-end fund setting suggest that reliability problems in measuring the fair values of investment securities are not the primary explanation for the inconsistency in prior research results; instead such inconsistency may be attributed to the incomplete availability of fair value measures in other settings.

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