The Investment Companies Expert Panel serves the needs of AICPA members on financial and business reporting and audit and attest matters. The expert panel protects the public interest by bringing together knowledgeable parties in the investment companies industry to deliberate and come to agreement on key investment companies issues.

The following are brief highlights of the meeting:

I. AICPA/Administrative:
   1. The EP chair thanked outgoing members for their contributions to the AICPA EP and CPA profession over the past three years.
   2. The Expert Panel (EP) May and September meetings and July and November 2017 calls highlights are being finalized.
   3. The AICPA staff updated the EP on recent developments regarding the AICPA Asset Management Revenue Recognition Task force.
   4. The AICPA staff and the EP members considered various AICPA Audit and Accounting Guide Investment Companies (the Guide) matters. In particular,
      a. The EP considered whether the auditor’s report on internal control required by SEC under Form N-SAR should be updated to conform to the new reporting provisions prescribed by PCAOB Release No. 2017-001 (AS 3101, AS 3105, AS 1220, AS 1301, AS 2201, AS 2820, & AS 4105). The EP currently expressed a view that the report should not be updated but will continue to discuss as the EP members discuss within their firms.
         The EP also noted that Form N-SAR will be rescinded effective June 1, 2018, once Form N-CEN is effective.
      b. The EP also discussed potential enhance update to the Guide on cryptocurrency. The EP will monitor AICPA developments on this topic and will revisit this topic during future EP calls.

II. Accounting/Reporting Issues:
   1. The EP members discussed accounting methods for various loan fees that are received by BDCs or other types of funds with lending activities. Examples of types of loan fees received by BDCs include origination and upfront structuring fees, syndication fees, commitment fees, amendment or
restructuring fees and prepayment fees. An EP member inquired whether BDCs are adopting the new revenue recognition guidance in ASC 606, Revenue from Contracts with Customers, for these fees or applying FASB ASC 310-20 (formerly known as FAS 91) or other guidance. The EP members acknowledged certain diversity in practice in historic accounting for loan origination fees, yet, noted that certain BDCs and investment companies have been and are currently following guidance in FASB ASC 310-20, Nonrefundable Fees and Other Costs, and not necessarily revenue recognition guidance, if the activities are covered within FASB ASC 310-20. These entities have historically applied ASC 310-20 by analogy because ASC 946 is silent on the accounting for loan origination fees. The EP members discussed that financial instruments and other contractual rights or obligations within the scope of ASC 310 are specifically scoped out of ASC 606.

The EP will continue discussing this topic at the March EP conference call.

2. The Chicago Mercantile Exchange (CME) and LCH.Clearnet Limited (LCH) have amended their rulebooks to legally characterize variation margin payments for over-the-counter (OTC) derivatives they clear as settlements rather than collateral (“settled to market”). Some clearing members do not report the variation margin payments for each individual derivative contract, but on an aggregate basis. The EP discussed how nonregistered investment companies should present centrally cleared derivatives on the balance sheet and how the FASB ASC 820 fair value hierarchy disclosures required by ASC 820-10-50-2(a) and (b) may be affected. Additionally, the EP considered the effect, if any, on the ASC 815 derivative disclosures outlined by ASC 815-10-50-4A(a) and ASC 815-10-50-4B(c), which require derivative instruments to be presented as separate asset and liability values, segregated by type of contract (e.g. interest rate contracts, foreign exchange contracts, equity contracts, commodity contracts, credit contracts, etc.).

An EP member shared that historically, nonregistered investment companies presented the fair value of centrally cleared derivatives as a separate unit of account on the balance sheet, separate from the related variation margin payments. The variation margin payments have historically been presented as collateral on the balance sheet (i.e., balance sheet has been presented gross). However, due to the changes in the CME and LCH rulebooks, variation margin payments will be treated as legal settlement of open contracts between the clearing house and the clearing member. Investment companies should treat the fair value and related variation margin payments as a single unit of account and present the amounts net on the balance sheet when there is legal settlement between the fund and the clearing member, which is a legal determination that should be made by the fund.

With respect to the disclosures required under ASC 820 and ASC 815, the EP generally agreed that investment companies may analogize to the guidance in ASC 946-210-50-6(e) for futures contracts, consistent with the schedule of investments disclosures discussed in the November 2017 meeting, and show the cumulative appreciation/depreciation for open centrally cleared derivative contracts. One EP member acknowledged that for purposes of FASB ASC 820 and FASB ASC 815 disclosures, derivative assets and liabilities included in these disclosures are presented at fair value, as shown on the balance sheet, which under legal settlement would be zero or close to zero. For example, if a fund holds centrally cleared swaps with a gross unrealized depreciation of $675,000 and the fund has made margin payments to the counterparty in the same amount, the fair value of the centrally cleared swaps would be $0 on the balance sheet, as the swaps and related variation margin payment are viewed as a single unit of account. For the ASC 820 fair value hierarchy, the fund may elect to disclose the fair value of these centrally cleared swaps as an other financial instruments liability of $675,000 (i.e., gross fair value) or disclose the fair value as $0 (i.e. net presentation). For the ASC 815 asset/liability fair value disclosures, the fund may elect to disclose the gross value of the liability derivative (i.e. $675,000) or the net value which is presented on the balance sheet (i.e. $0). The EP members did not object to either presentation for ASC 820 or ASC 815 disclosures. One EP member noted it would be appropriate to consider materiality and also perform a qualitative and quantitative assessment.

3. The FASB issued ASU 2017-01, Clarifying the Definition of a Business, which changes the definition of a business to assist entities with evaluating when a set of transferred assets and activities is a business. The guidance requires an entity to evaluate if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or a group of similar identifiable assets; if so, the set of transferred assets and activities is not a business. Given the amendments to ASC 805, Business Combinations, the EP considered whether fund mergers would be considered business combinations or rather asset acquisitions and whether revisions to TQA 6910.33, “Certain
Financial Reporting, Disclosure, Regulatory, and Tax Considerations When Preparing Financial Statements of Investment Companies Involved in a Business Combination” are needed.

An EP member questioned if the acquisition of advisory contracts may support an argument that a business was acquired, as the advisory contracts may give the acquiring entity rights to processes and inputs. However, some EP members believe that the advisory contracts do not survive when funds merge, as new contracts are issued which might suggest a business was not acquired.

The EP will continue discussing this topic at the March EP conference call.

4. The FASB issued final guidance in ASU 2016-18, *Restricted Cash*, to clarify how entities should present restricted cash and restricted cash equivalents in the statement of cash flows. For public business entities, the ASU is effective for fiscal years beginning after December 15, 2017, and interim periods within those years. For all other entities, the ASU is effective for fiscal years beginning after December 15, 2018 and interim periods within fiscal years beginning after December 15, 2019. Early adoption is permitted.

The ASU requires entities to show the changes in the total of cash, cash equivalents, restricted cash and restricted cash equivalents in the statement of cash flows; however, the ASU does not define restricted cash.

Given this new guidance, the EP discussed how investment companies determine whether certain amounts included in “due from broker” or “deposits for derivatives/securities sold short” are considered restricted cash and should be reflected as restricted cash on the statement of cash flows upon adoption of the ASU. The EP members noted the importance of understanding legal arrangements to determine whether broker balances or deposits are considered restricted cash.

III. Audit and Attest Issues

1. Custody Rule:
   a. The EP discussed the independent public accountant’s responsibility under the attestation standards to test the completeness of the population of client accounts over which the RIA is considered to have custody when performing an independent verification of client funds and securities pursuant to Rule 206(4)-2(a)(4). Certain EP members expressed a view that testing completeness of the population of client accounts is a legal determination, rather than a requirement under the attestation standards, as clients typically instruct accountants as to which accounts are subject to the custody rule.

   The EP will continue discussing this topic at the March EP conference call.

   b. The EP also considered the independent public accountant’s responsibility under the attestation standards with regard to previously issued surprise examination reports when an RIA is unable to comply with the SEC’s no-action letter (NAL) on the use of standing letters of authorization. The NAL states that the SEC believes an adviser has custody of a client’s assets if it has the power to dispose of the client’s funds or securities for any purpose other than authorized trading. The NAL also states that a letter of instruction or other similar asset transfer authorization arrangement established by a client with a qualified custodian constitutes an arrangement under which an investment adviser has custody. The NAL provided detailed actions the adviser must take to comply with the relief. The EP members noted compliance with the custody rule is a legal determination.

   The EP will continue discussing this topic at the March EP conference call.

IV. SEC Staff Update

Disclaimer

The following comments and observations were compiled by the AICPA Investment Companies Expert Panel and AICPA staff and are not authoritative positions or interpretations issued by the SEC or its staff. The comments and observations were not transcribed by the SEC or its staff and have not been considered or acted upon by the SEC or its staff. Accordingly, these comments and observations do not constitute a statement of the views of the SEC or its staff.

1. Agency Rule list:
The Fall 2017 SEC agency rule list includes, among others, forthcoming rules on ETFs, enhanced disclosure for separate accounts registered as UITs and offering variable annuities, auditor independence with respect to loans or debtor-creditor relationships, and investment company reporting modernization – option for website transmission of shareholder reports.

2. Initiatives in Investment Management (Investor Experience, Board Outreach, Valuation Guidance, and Cryptocurrency):

In her speech at the ICI Securities Law Developments Council on December 7, 2017, Dalia Blass, Director for the Division of Investment Management, highlighted the investor experience and board outreach as two current initiatives of the Division. Additionally, she commented that the Division of Investment Management anticipates working with the SEC’s Office of the Chief Accountant to look at valuation. Specifically, they would focus on identifying recommendations for updates to staff guidance on valuation of securities and other assets held by registered investment companies.

She also mentioned cryptocurrency as a new innovation in the asset management space and noted several recent filings for registered funds that would hold cryptocurrency. Dalia Blass noted several concerns regarding these new types of products, including whether retail investors would have sufficient information about these products and fully understand their risks, how these funds would fit into existing regulatory framework, and which regulatory structures apply to the market for the underlying instrument.

The SEC staff shared relevant SEC staff speeches and publications on cryptocurrency or related virtual assets:

- SEC Chairman Jay Clayton Statement on Cryptocurrencies and Initial Coin Offerings (Dec. 11, 2017)
- SEC Division of Enforcement and SEC Office of Compliance Inspections and Examinations Statement on Potentially Unlawful Promotion of Initial Coin Offerings and Other Investments by Celebrities and Others (Nov. 1, 2017)
- Investor Alert: Bitcoin and Other Virtual Currency-Related Investments (May 7, 2014)
- Investor Alert: Ponzi Schemes Using Virtual Currencies (July 23, 2013)

The staff highlighted that a legal and accounting framework exists and applies and that a holder, including an investment company, will need to consider the appropriate guidance based on the nature of its holdings. They discussed that there have been several registrants that want to invest in virtual assets and have attempted to register their products with the SEC. The staff discussed various concerns with virtual assets, including valuation (whether a fund’s Board would have adequate information on daily basis to value the token, lack of depth in trading markets and volatile markets), custody (whether a fund that invests directly into virtual assets would be able to verify existence, including exclusive ownership, and concerns about software functionality) and price volatility for these investments. In light of these considerations, all registration statements for new funds that would hold virtual assets which would have gone automatically effective were withdrawn. Subsequent to the January Expert Panel meeting, on January 18th, the staff issued a letter to the ICI and SIFMA detailing their concerns around cryptocurrency-related holdings.

3. Staff Accounting Bulletin (SAB) No. 118:

On December 22, 2017, the SEC announced publication of staff guidance for publicly traded companies, auditors, and others to help ensure timely public disclosures of the accounting impacts of the Tax Cuts and Jobs Act (the Act) recently signed into law. Specifically, the staff of the Office of the Chief Accountant and the Division of Corporation Finance issued the following interpretations:

a. Staff Accounting Bulletin (SAB) No. 118 expresses views of the staff regarding the application of U.S. GAAP when preparing an initial accounting of the income tax effects of the Act.
b. **Compliance and Disclosure Interpretation 110.02** expresses views of the staff regarding the applicability of Item 2.06 of Form 8-K with respect to reporting the impact of a change in tax rate or tax laws pursuant to the Act.

Under the staff guidance in SAB 118, companies may report provisional amounts in their financial statements based on reasonable estimates for items for which the accounting is incomplete. A company that cannot make a reasonable estimate for an income tax effect should not account for that effect until the first reporting period for which it can make such an estimate. Any provisional amounts recorded either initially or subsequent to the reporting period that includes the Act’s enactment date may be subject to adjustment during a measurement period where an entity obtains, prepares, and analyzes the information needed to complete the accounting requirements under ASC 740 that should not exceed one year beyond the enactment date. The staff’s guidance also describes supplemental disclosures about the material financial reporting effects of the Act for which the accounting under ASC 740 is incomplete.

Following issuance of SAB 118, the Division of Investment Management confirmed in **Information Update 2017-07** (IM-INFO-2017-07) that investment companies can rely on SAB 118 guidance for purposes of calculating their daily NAV and reporting measurement period adjustments. The IM-INFO-2017-07 also noted that each registrant must disclose relevant information to investors to provide information about the material impacts of the Act to its calculation of NAV and material provisions for which the accounting is incomplete, if applicable. The disclosure about those impacts may be made in a press release, website disclosure, or some other reasonable manner.

The SEC staff further noted that FASB staff issued a **Q&A** indicating that the FASB staff would not object to private companies applying SAB 118 and that those private companies applying SAB 118 would be in compliance with GAAP. The Q&A also states that private companies applying SAB 118 should apply all relevant aspects of SAB 118 in its entirety including disclosures and such private companies should disclose their accounting policy of applying SAB 118 in accordance with ASC 235-10-50-1 through 50-3.

4. **Frequently asked questions (FAQs) for Liquidity Rules**

The staff of the Division of Investment Management has prepared responses to frequently asked question related to the investment company liquidity risk management program requirements.
The Investment Companies Expert Panel serves the needs of AICPA members on financial and business reporting and audit and attest matters. The expert panel protects the public interest by bringing together knowledgeable parties in the investment companies industry to deliberate and come to agreement on key investment companies issues.

The following are brief highlights of the call:

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1. Investment Company Reporting Modernization implementation discussion:

The SEC staff of the Division of Investment Management (SEC staff) is performing a targeted review to assess registrants’ compliance with the S-X amendments in connection with the Investment Company Reporting Modernization final rule adopted in October 2016 and effective for periods ending after August 1, 2017. The SEC staff has observed variation in implementation for certain disclosure requirements within the following four thematic areas:

a. Agreement of Article 12 Schedules to Balance Sheet (§210.12-12 – 12-14):

A note instruction to certain of the schedules in Article 12 requires that the total of certain columns agree with correlative amounts shown on the related balance sheet including the following generally:

- For investments in securities and options, the total value on the schedules should agree with correlative amounts on the balance sheet.
- For investments in derivatives, generally the total unrealized appreciation and depreciation on the schedules should agree with correlative amounts on the balance sheet.
However, there is no such requirement for the schedule required by rule 12-13A Open futures contracts; although registrants may elect to do so.

A reconciliation demonstrating that agreement may assist a reader in understanding how the information in the schedules affects the NAV of a fund.

For example, rule 12-13C Open swap contracts, note instruction 7, states that the total of the upfront payments/receipts and the total of the unrealized appreciation/depreciation should agree with the total of correlative amount(s) shown on the related balance sheet. However, the total of different amounts for different types of swap contracts may appear in numerous line items on the balance sheet for amounts such as upfront premiums paid/received, variation margin for centrally cleared swaps, and unrealized appreciation/depreciation for non-exchange traded swaps.

The adopting release discussed an example of how registrants may accomplish the agreement required by Article 12 by outlining one commenter’s suggestion that the appreciation/depreciation for non-exchange traded derivatives such as forward foreign currency contracts and swap contracts be disclosed in two separate columns or include subtotals, rather than in one column. However, the requirement suggested by the commenter was not adopted in order to allow flexibility in the manner in which registrants meet the requirement, acknowledging that an extra column may not be necessary to comply.

The SEC staff noted that there may be various ways to demonstrate agreement and meet the objective of informing investors about how the schedules relate to the balance sheet including subtotals, reconciliation, or other qualitative disclosures, etc.; further, the SEC staff acknowledged that, in some cases where few columns or line items are presented either in the schedules or the balance sheet, additional disclosure may not be necessary in order to demonstrate agreement. The SEC staff did not prescribe one method over another and intends to comment on financial statements where the agreement of the schedules required by Article 12 with the balance sheet is unclear.

b. Required disclosures for affiliate investments table (§210.12-14):

Q&A #5 of Regulation S-X section of the SEC staff Investment Company Reporting Modernization FAQs, released in July 2017, indicates that disclosures required by rule 12-14 of Regulation S-X regarding investments in and advances to affiliates may be presented in the schedule of investments (SOI) or in the notes to the financial statements. Rule 12-14 requires certain disclosures to be provided in the schedule of affiliated investments, including the categorization of investments by industry or geography, denoting restricted securities, securities valued using significant unobservable inputs, etc. The changes to rule 12-14 resulted in additional disclosure for affiliated investments.

The SEC staff observed that some registrants have not included information required by rule 12-14 if they have already provided such information in the SOI as required by rules 12-12 through 12-13D. The SEC staff observed that where a registrant’s investments in affiliates are concentrated in an industry or geography, are restricted, or are valued using significant unobservable inputs, for example, it may be meaningful for investors to view that disclosure in aggregation on the affiliated investments schedule. Where there are a small number of affiliated holdings presented on a SOI with a small number of investments, for example, registrants may determine that such additional information may not be necessary to reasonably inform investors since it is easily identifiable on the SOI.

The SEC staff encourages registrants to evaluate facts and circumstances to determine whether that disclosure is meaningful to investors. The SEC staff intends to comment regarding how a registrant complied with the requirements of rule 12-14 if such
information is missing and it believes it may be helpful for a reader to better understand the context of the registrant’s affiliated investments.

c. **Variable rate securities (§210.12-12 fn. 4,12-12A fn. 3, 12-12B fn. 3, 12-14 fn. 3) and derivatives with reference assets as variable rate securities (§210.12-12B fn. 5, 12-13 fn. 3, 12-13C fn. 3)**

In accordance with the footnotes to certain schedules in Article 12, variable rate securities should include a description of the reference rate and spread and either the end of period interest rate or the end of period reference rate for each reference rate described in the schedule.

The SEC staff noted variation on how registrants provided disclosures on variable rate securities and highlighted certain effective disclosures:

i. **Step coupon bonds and securities with caps/floors:**
   - Effective disclosures identified included the current rate and date through which it is effective, the date when the rate steps up or down, and what the rate would be at those dates.
   - Effective disclosure may also include qualitative description of the direction and range of rates where a bond has multiple steps and a registrant has determined that disclosure of each step would not provide additional significant information to an investor about the return profile.
   - The SEC staff observed that disclosure indicating whether the rate will step up or step down, may be an important indicator of a different return profile in contrast to just showing one rate and the maturity date when that rate will not be earned through maturity.
   - Similarly, for securities with caps and floors, the SEC staff observed effective disclosure concerning the existence and description of a cap/floor, as well as, the amount of the cap/floor. Disclosure of such information regarding a cap/floor may be indicative of a different return profile.

ii. **Asset-backed securities:**
   - Where the effective interest rate is constantly changing based on performance of underlying assets, the SEC staff observed an effective disclosure that included disclosure of the current rate and disclosure about how the investment works (e.g., how payments are made).

iii. **Bank loans with multiple tranches and weighted average rates:**
   - Where there are investments with different tranches and rates but for an investment which is depicted as one unit of account, the SEC staff observed effective disclosure which included additional information about the various rates rather than including only a weighted average rate.

iv. **Derivatives where the underlying asset is a variable rate security:**
   - The SEC staff observed effective disclosure which included a description sufficient for a user to understand the terms of the payments to be received and paid, for example, in the case of an interest rate swap, disclosure where both the reference rate and spread, and either the end of period rate or the end of period reference rate for each reference rate described was disclosed in a note to the schedule.

The SEC staff may comment where disclosures are unclear or insufficient for an investor to understand the investment in consideration of the overall portfolio.

d. **Custom baskets disclosures (§210.12-13 and 12-13C):**

Q&A #2 and 3 of Regulation S-X section of the SEC staff Investment Company Reporting Modernization FAQs discuss certain questions around disclosure of custom baskets. During the February 2018 call, the SEC staff highlighted certain additional observations
concerning custom basket disclosure from discussions with registrants and from their review of registrants’ financial statements.

The SEC staff discussed inquiries received:

- Specifically, regarding how registrants should treat notional values when custom baskets hold both long and short positions when determining whether a fund is required to disclose the components of the custom basket. Footnotes 3 in rules 12-13 and 12-13C states the following:

  *If the reference instrument is an index or basket of investments, the components are not publicly available on a Web site as of the balance sheet date, and the notional amount of the option/swap contract does not exceed one percent of the net asset value of the registrant as of the close of the period, identify the index or basket. If the reference instrument is an index or basket of investments, the components are not publicly available on a Web site as of the balance sheet date, and the notional amount of the option/swap contract exceeds one percent of the net asset value of the registrant as of the close of the period provide a description of the index or custom basket and list separately: (i) The 50 largest components in the index or custom basket and (ii) any other components where the notional value for that components exceeds 1% of the notional value of the index or custom basket.*

The SEC staff clarified that treating the notional values of the short positions of the custom basket in terms of their absolute values may be appropriate in order for a registrant to determine if the notional amount of the option/swap contract exceeds the threshold prescribed. The view that a fund should treat the notional values of short positions in terms of their absolute values when evaluating individual components to identify the top 50 largest components and any other components that exceed 1% of the notional value of the index or custom basket has already been expressed in Q&A #2 of Regulation S-X section of the SEC staff Investment Company Reporting Modernization FAQs.

The SEC staff shared additional financial statement review observations:

- Rule 12-13C, footnote 3, requires registrants to disclose the percentage value of the component when compared to the custom basket net assets:
  - While the SEC staff believes that the use of a component’s “value” in the numerator is clear, they acknowledged there have been questions about what the “custom basket’s net assets” (the denominator of the calculation) represents.
  - The SEC staff observed some registrants utilizing the value of the derivative as the denominator in the calculation.
  - The SEC staff observed some registrants disclosing the percentage value as a component of the fund’s net assets, similar to the requirement in rule 12-12, footnote 5.
  - The SEC staff observed ineffective disclosure where a percentage is presented but it is unclear what the percentage represents.
  - Without further published guidance, the SEC staff intends to be flexible but may comment where disclosure is unclear or does not provide meaningful information.

- Rule 12-13C, footnote 3, requires registrants to disclose the 50 largest components and any other components where the notional value of the component exceeds 1% of the notional value of the basket.
  - The SEC staff observed disclosures where it is difficult for a reader to determine how the components of the basket that are disclosed relate to the derivative as a whole.
The SEC staff observed effective disclosure where registrants are only providing the top 50 components and any component whose notional > 1% of the basket’s notional and:

- The registrant identified that the disclosure represented a subset of the basket (e.g., top 50 and > 1%) and not all of the contents of the basket were included; and/or,
- Included a line item encompassing the totals of “other components” to agree to the total value of the swap.
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The following are brief highlights of the call:

1. **Accounting/Reporting Issues:**
   1. The Expert Panel (EP) members discussed the SEC staff comments provided during the February EP conference call regarding implementation of Regulation S-X amendments.
   2. The EP discussed the accounting treatment of investment research costs under the second Markets in Financial Instruments Directive (MiFID II) for U.S. entities. One of the directives under MiFID II is the unbundling of commissions into execution and research costs. Historically, investment research provided to the asset manager by a broker-dealer or a bank has not been a separately identifiable cost and has been bundled within trading commission rates.

   According to ASC 946-320-30-1, “An investment company shall initially measure its investments in debt and equity securities at their transaction price. The transaction price shall include commissions and other charges that are part of the purchase transaction.” Accordingly, investment companies typically capitalized these commission transaction costs into the cost basis of the security purchased. One of the goals of MiFID II regulation is to provide greater transparency into execution and research costs. The firms may not be able to link research costs to transaction volume or transaction value.

   The EP considered whether research costs under MiFID II would qualify as direct incremental transaction costs that can be capitalized. When considering whether or not such costs can be capitalized an entity would need to consider if the research cost can be linked directly to a transaction. The EP members will discuss with asset managers to better understand current practice and what options for accounting treatment may be available. The EP will revisit at a future meeting.

   3. During the May 2017 EP meeting, the EP noted that they believe investment companies may be impacted by guidance in FASB ASU 2016-13 Financial Instruments: Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (CECL) and have highlighted several broad areas for investment companies as potentially being affected by this ASU. One of the topics discussed at the July and November 2017 EP conference calls was beneficial interests accounted for under FASB ASC 325-40 and the related creation and release of an allowance account for all future expected credit losses. During the November 2017 EP conference call, the EP noted that generally an investment company would record interest income based on the interest method and would update the effective yield based on expectations of timing and the amount of cash flows to be collected.

   During the March 2018 EP conference call, the EP revisited this topic, as there has been discussion within the industry on the application of ASC 325-40 to beneficial instruments reported at fair value through net income. These discussions have focused on the impact of the application of ASC 325-40 to income statement geography (i.e., interest income vs. unrealized/unrealized gains and losses).

   ASC 325-40-15-7 indicates that beneficial interests classified as trading are within the scope of ASC 325-40 for purposes of income recognition:

   "For income recognition purposes, beneficial interests classified as trading are included in the scope of this Subtopic because it is practice for certain industries (such as banks and investment companies) to report interest income as a separate item in their income statements, even though the investments are accounted for at fair value."
ASC 325-40-15-1 states:
The guidance in this Subtopic applies to all entities.

There is no additional guidance in ASC 325-40 that is specific to securities that are recorded at fair value through net income. Previous guidance in ASC 325-40-35-2 had indicated that the same amount of interest income shall be recognized each period regardless of whether the beneficial interest is classified as held to maturity (“HTM”), available for sale (“AFS”) or trading.

“The method used for recognizing and measuring the amount of interest income on a beneficial interest shall not differ based on whether that beneficial interest is classified as held to maturity, available for sale, or trading debt security. The same amount of interest income shall be recognized each period regardless of whether the beneficial interest is classified as held to maturity, available for sale, or trading debt security.”

However, that guidance has been superseded by ASU 2016-13. ASU 2016-13 added new guidance for how to account for changes in cash flows expected to be collected for HTM and AFS securities, but no additional guidance was added specifically for trading securities.

ASC 325-40-35-1 would appear to apply to trading securities (as well as HTM and AFS), it states:

“The holder shall recognize accretable yield as interest income over the life of the beneficial interest using the effective yield method. The holder of a beneficial interest shall continue to update, over the life of the beneficial interest, the expectation of cash flows to be collected.”

BC96 of ASU 2016-13 also appears to be relevant, it states:

“The Board also acknowledges that practice related to interest income recognition on beneficial interests within the scope of Subtopic 325-40 will be different when the allowance for credit losses is present. When a beneficial interest within the scope of 325-40 has an allowance for credit losses, favorable or unfavorable changes in cash flows must first be considered as adjustments to the allowance for credit losses. Only the remaining portion of favorable or unfavorable changes in cash flows would be reflected in accretable yield.”

The EP members discussed whether an investment company that holds a beneficial interest should maintain an allowance for credit losses for beneficial interests or should future cash flows be adjusted through interest income and/or unrealized/realized gains and losses. Specifically, the EP members discussed the following views:

View A – The entity should maintain an allowance for credit losses.

Proponents of View A believe that ASC 325-40 has and continues to be an integrated interest income and impairment model. The amount of interest income that a company records, and the degree to which the effective yield is updated on a prospective basis, depends first on whether or not an adjustment to the allowance for credit losses (either on a favorable or unfavorable basis) would be required. The model does not work unless a company is applying both the interest recognition and the impairment model.

Proponents of View A do not believe that the deletion of the guidance indicating interest income should be the same for available-for-sale, trading and held-to-maturity securities is determinative that the impairment model does not apply to instruments reported at fair value through net income. Interest income may be different between classes of securities because the impairment models for AFS and HTM are different. In addition, the bifurcation of derivatives from an AFS or HTM security would make interest income different from a trading instrument where such bifurcation is not required.

Some proponents of View A would require a security measured at fair value through net income subject to 325-40 to apply the AFS impairment model in ASC 326-30. Other proponents of View A would permit an accounting policy choice to apply either the AFS impairment model (ASC 326-30) or the HTM impairment model (ASC 326-20).

Proponents of View A note that an entity should also have a policy for charging off allowance balances against the amortized cost basis of the instrument.

Some proponents of View A believe that the allowance does not need to be separately included on the face of the balance sheet and that changes in the allowance do not need to be separately reported in the income statement as the instrument is carried at fair value with all changes recorded in net income. Other proponents of View A believe that the allowance should be separately reported in the financial statements consistent with how HTM or AFS allowances will be reported.

View B – The entity should not maintain an allowance for credit losses.

Proponents of View B believe that the computation of an allowance for credit losses is not required for instruments reported at fair value through net income, even for instruments subject to ASC 325-40. Under this approach, all changes in future estimated cash flows would result in prospective yield adjustments.

Some proponents on View B believe that, in situations involving a decline in cash flows that there should be some limitations on prospective yield adjustments. For example, some proponents of View B do not believe that the effective yield should be reduced below 0%.

Proponents of View B point to the lack of any discussion in ASC 325-40 about trading securities requiring an allowance as evidence that it is not required. Proponents of View B also note that ASC 325-40 directs companies to ASC 326-20 for HTM investments and ASC 326-30 for AFS investments to determine impairment. 326-20-15-3 states that the guidance in this subtopic does not apply to instruments reported at fair value through net income. Similarly 326-30-15-2 limits the applicability of that subtopic to instruments classified as available-for-sale.

Some proponents of View B point to the language in BC96

“When a beneficial interest within the scope of 325-40 has an allowance for credit losses, favorable or unfavorable changes in cash flows must first be considered as adjustments to the allowance for credit losses.”

which acknowledges that a beneficial interest may not have an allowance for credit losses as support for View B. They believe
that this language was not referring only to situations where an event that would have required the establishment of an allowance had not occurred.

**Differences in views**

At a high level (setting aside some specific issues if the available-for-sale impairment model as opposed to the held-to-maturity impairment model is applied), in a number of circumstances the differences in these views can be summarized as follows:

- **Decline in cash flows:**
  - Under View A, if a decline in cash flows would cause an impairment, yield would not be adjusted and instead, the company would record an allowance for credit losses.
  - Under View B, it would be treated as a prospective yield adjustment.
- **Increase in cash flows – both View A and View B would have prospective yield adjustment.**
- **Increase in cash flows after there was a previous decline in cash flows:**
  - Under View A, the increase in cash flows would result in the reversal of the allowance and only result in a yield adjustment after the allowance is reversed.
  - Under View B, the yield would adjust.

The EP members will consider Views A and B presented and will reconvene on this topic at a future meeting.

4. During the January 2018 meeting, the EP discussed the accounting for various loan fees that are received by BDCs or other types of funds with lending activities. Examples of these types of loan fees received by such entities include origination and upfront structuring fees, syndication fees, commitment fees, amendment or restructuring fees and prepayment fees. The EP discussed whether funds are adopting the new revenue recognition guidance in ASC 606 for these fees or whether they are applying ASC 310-20 by analogy or other guidance. The EP continued this discussion during the March EP conference call. EP members believe that these types of loan fees collected by BDCs or similar funds with lending activities are more associated with financial instruments and would generally fall outside of ASC 606; thus, ASC 310-20 would generally be more appropriate for these investment companies.

5. The SEC staff inquired whether the EP has been discussing accounting and presentation of EU tax reclaims or has formed any views given we are seeing some variance in practice. For more information, refer to the SEC Staff Update below.

6. The EP considered accounting for a business development company consolidating a wholly owned subsidiary. A BDC purchases 100% of a finance company that historically was not considered to be an investment company. After the acquisition, the operations of the finance company continue to be separate from the operations of the BDC. FASB ASC 946-810-45-2 states that consolidation by an investment company of an investee that is not an investment company is not appropriate. FASB ASC 946-10-25-1 states that an entity shall reassess whether it meets (or does not meet) the assessment of investment company status in paragraphs 946-10-15-4 through 15-9 only if there is a subsequent change in the purpose and design of the entity. However, ASC 946-810-45-3 provides guidance for when an investment company should consolidate an operating company that is not an investment company, but provides services to the investment company, such as investment adviser or transfer agent services, and the purpose of the investment is to provide services to the investment company, rather than realize a gain on the sale of the investment. If the investment company holds a controlling financial interest in the operating company that provides services to the investment company, it should consolidate the entity rather than measuring the interest at fair value. Further, SEC IM Guidance Update 2014-11 states that a BDC should consolidate a wholly owned subsidiary when the design and purpose of the subsidiary is to act as an extension of the BDC’s investment operations and to facilitate the execution of the BDC’s investment strategy.

The EP noted the following questions would be relevant to the determination whether or not the BDC should consolidate the wholly owned finance company:

- a. What is the purpose and design of the finance company?
- b. Does the BDC have any other similar investments?
- c. Is this investment in a finance company different from other BDC’s investments? How?
- d. Does the finance company appear to act as an extension of the BDC?
- e. Does the finance company have employees?
- f. Is the BDC a passive investor in the finance company?
- g. Is the BDC investing in the finance company to get access to a portion of the loan market that the BDC hasn’t traditionally had which gets integrated into the BDC’s operations?
- h. Is the finance company a regulated entity?
- i. Who is going to manage the finance company?
j. Does the finance company have an independent board?

k. Is employee compensation for the finance company separate from employee compensation for the BDC?

l. Is there an exit plan for the BDC's investment in the finance company?

The EP members discussed that whether or not the BDC consolidated the wholly owned finance company would depend on the facts and circumstances. An important factor in reaching the conclusion would be the consideration of an exit strategy for the finance company.

7. The EP considered a question regarding nonregistered investment companies with ownership interests in the form of debt. FASB ASC 946-10-55-26 states “In addition, having significant ownership interests that are not considered equity interests in accordance with other Topics (for example, ownership interests in the form of debt) does not necessarily preclude an entity from being an investment company provided that the holders are exposed to variable returns from changes in the fair value of the underlying investments of the entity. The economic substance of the entity, rather than its legal form, should be evaluated to determine whether the entity has that characteristic of an investment company.” As a result, certain entities (such as a CDO or CLO) with ownership interests in the legal form of debt may be considered to be investment companies.

The EP discussed the financial statement presentation impact on the schedule of investments and the financial highlights for these types of investment companies (nonregistered). The EP noted that although FASB ASU No. 2013-08 stated that having ownership interests of the investment company could be in the form of equity or debt, it did not consider implications for the schedule of investments and the financial highlights of ownership in the form of debt. The entity would also consider how material debt holders are to the fund, and whether debt ownership and equity ownership should be treated as one or separate legal classes.

II. Audit and Attest Issues

1. During March EP conference call, the EP members shared that they continued discussions within their organizations regarding an independent public accountant’s responsibility under the attestation standards to test the completeness of the population of client accounts over which the registered investment adviser (RIA) is considered to have custody when performing an independent verification (surprise exam) of client funds and securities under the Custody Rule. The EP members noted that whether a RIA is deemed to have custody of a client account under the custody rule is a legal determination. The EP members also noted that as part of the surprise exam, the accountant should understand the client’s process and controls for determining which accounts they have custody of (including the clients’ consultation with legal counsel, as applicable) and therefore which accounts are included in the population of accounts within the scope of the surprise exam. The EP will revisit this topic at its May meeting.

III. SEC Staff Update

Disclaimer

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1. The SEC staff discussed Custody Rule related matters pertaining to the SEC's no-action letter on the use of standing letters of authorization (NAL). The SEC staff acknowledged there have been questions about material non-compliance notification requirements and potential surprise exam opinion qualifications, for both historical surprise exams and prospective surprise exams as it relates to clients for which standing letters of authorization (SLOA) exist. The SEC staff indicated they did not originally anticipate a significant number of notifications or opinion qualifications as a result of the NAL. Ultimately, the determination of a material non-compliance or a qualification of the surprise exam opinion is up to the auditor’s judgement. For material non-compliance notifications or qualifications of surprise exam opinions related to clients under SLOA, the SEC staff recommends using clear, standardized language either in the notification or in the qualified opinion, so that the source of the notification or qualification relating to SLOA specifically is evident.

2. The Internal Revenue Service Notice 2016-10 addresses the treatment of foreign withholding tax refunds received by U.S. regulated investment companies (RICs) due to recent court rulings that were favorable to RICs, where certain European countries have paid refunds (reclaims) of dividend withholding taxes previously withheld by these European countries. The Notice provides RICs with two alternative reporting methods under certain conditions: netting the reclaims against current foreign withholding tax or obtaining a closing agreement to estimate aggregate adjustments due (and pay a related closing fee).

The SEC staff discussed the accounting treatment and presentation of compliance fees paid to the IRS and professional fees paid to accountants and lawyers to assist funds in receiving these reclaims where the closing agreement path is selected. The SEC staff has seen diversity in practice in presentation of the professional fees and compliance fees on the income statement, as some funds net these fees against dividend income, while others treat these fees as operating expenses. The SEC staff noted that they have observed some cases where the fees are neither broken out separately on the income statement nor separately disclosed in the footnotes, which may be due to materiality.
The SEC staff acknowledged the variance in current practice, noting the conclusion may depend on facts and circumstances, and indicated that they may comment on the accounting framework utilized.

3. The SEC staff offered the following comments on crypto assets:

   a. The SEC staff of Investment Management Division issued a letter to ICI and SIFMA on cryptocurrency and fund innovation. The letter identified some questions the Division had around existence, valuation, custody, liquidity and arbitrage for registered investment companies proposing to invest in crypto assets and related products. The SEC staff is focused on, among other things, the following accounting and auditing questions:

      - Existence – How does an entity validate the existence of cryptocurrency? How are private keys stored and how is exclusive ownership or control of the keys validated?

      - Valuation – How do funds approach valuation of cryptocurrency in accordance with ASC 820? The SEC staff is interested in how the principal or most advantageous market concepts are being applied, given there are many markets which may be volatile and fragmented, which includes how market selections are being made and how frequently they are being reassessed.

   b. The SEC staff indicated that issues related to crypto assets are a focus of the Division and the SEC IM staff is working closely with the Division’s Analytics Office to identify targeted areas of interest and certain funds for targeted reviews. The SEC staff performs targeted reviews of funds investing in Fintech instruments. Part of the focus of these reviews is on funds invested in instruments that would give exposure to crypto assets (e.g., grantor trusts or similar vehicles) and how the funds’ accounting policies address significant events like forks or air drops. The SEC staff noted several factors to consider for investment companies invested in these instruments, including initial and subsequent fair value measurements in accordance with current fair value policies and procedures and whether operationally and legally the fund is positioned to receive such assets. The SEC staff also highlighted a focus on tax considerations and whether or not crypto assets would be considered non-qualifying assets under subchapter M.
Investment Companies Expert Panel  
May 15, 2018 Meeting

The Investment Companies Expert Panel serves the needs of AICPA members on financial and business reporting and audit and attest matters. The expert panel protects the public interest by bringing together knowledgeable parties in the investment companies industry to deliberate and come to agreement on key investment companies issues.

The following are brief highlights of the meeting:

I. AICPA/Administrative:
   1. The Expert Panel (EP) March 2018 call highlights are being finalized.
   2. The EP members considered certain AICPA Audit and Accounting Guide Investment Companies (the Guide) matters.

II. Accounting/Reporting Issues:
   1. One EP member inquired if there were any additional implementation issues relating to Investment Company Reporting Modernization. The EP was not aware of any new developments. EP members shared that certain registrants received financial statement review comments that were either exploratory in nature or related to reconciling financial statements to prospectus and overall consistency in filings and disclosures. Certain EP members shared that financial statement review comments they had observed were similar in nature to those shared by the SEC staff in the February 2018 EP meeting.
   2. Interest paid to private equity funds – Private equity funds often have multiple closes of investors where the later subscribed investors may have to pay “interest” to the earlier subscribed investors. These amounts may be paid to investors outside the private equity fund or as an additional payment into the fund and allocated to the earlier subscribed investors. ASC 946-320-30-1 states “An investment company shall initially measure its investments in debt and equity securities at their transaction price. The transaction price shall include commissions and other charges that are part of the purchase transaction.” The EP discussed that if the interest charge is paid by a fund of funds into an underlying private equity fund (and allocated specifically to earlier subscribed investors), a fund of funds that subscribes to a later close may record the “interest” paid as an adjustment to the cost basis of its investment, essentially paying a premium to NAV. One EP member noted that from an income tax perspective, this could be an interest expense. Certain EP members believed it was more appropriate to record the charge through the fund of fund’s statement of operations as an unrealized loss.
   3. Investment company determination for carried interest vehicle – Advisers of private equity funds often set up separate legal entities to invest as a limited partner in the private equity funds they manage. The adviser may also set up a separate legal entity for the benefit of its employees who are able to invest in the private equity fund and receive a portion of the carried interest. ASC 946-10-55-21 states “Having investors that are related parties of the parent or the investment manager does not necessarily preclude an entity from being an investment company. For example, an investment manager may form an investment company for its employees in conjunction with another investment company. Although the employees may be related parties of the investment manager, the investment company formed for its employees mirrors the business purpose and activities of the main investment company.”

The EP members considered a scenario where an adviser gave its employees the ability to invest in a private equity fund, via an employee-only fund- that was also receiving a portion of the carried interest earned by the adviser. The majority of the earnings in the employee only fund were from its portion of carried interest, rather than from investing activities. The EP members discussed whether the separate legal entity that is held by employees may be considered an investment company or an extension of the adviser (i.e., an operating company). The EP members expressed a view that since the economics of the employee-only fund are more heavily skewed towards the carried interest it earns, it would appear this legal entity is acting as an extension of the adviser of private equity funds (i.e., an operating company), rather than as an investment company.
III. Audit and Attest Issues

1. The EP discussed the auditor’s report on mutual fund or separate account financial statements when reporting on numerous funds/subaccounts within one report (under the recently effective PCAOB AS 3101), specifically as it relates to all reporting entities and periods covered by each statement. Certain EP members noted they add a table between first and second paragraph of the report to identify numerous funds/subaccounts and periods for each, or add an appendix to the opinion.

2. The PCAOB standard on new audit report model states:

   “Because of the unique structure of investment companies, which typically includes common accounting, internal control, and oversight functions at the group level, the reproposed standard required that, for an investment company that is part of a group of investment companies[^82], the auditor’s statement regarding tenure will contain the year the auditor began serving consecutively as the auditor of any investment company in the group of investment companies.”

[^82]: “A group of investment companies, as defined by Section 12(d)(1)(G)(ii) of the Investment Company Act of 1940 ("Investment Company Act"), means any two or more registered investment companies that hold themselves out to investors as related companies for purposes of investment and investor services. For purposes of determining auditor tenure, any tenure with other entities that may be part of an investment company complex, such as investment advisers or private investment companies, is not included.”

The EP discussed that generally, only registered investment companies would fall under the definition of “investment company group” in practice. The EP also considered how audit firms are thinking about the auditor tenure disclosures where the funds have been acquired and have either same or different auditors. The EP noted the importance of judgement and acknowledged determination would be based on facts and circumstances.

3. The EP continued discussing testing the completeness of population of accounts over which the registered investment adviser (RIA) is considered to have custody when performing a surprise examination and acknowledged it is a legal determination. The EP members agreed that the auditor carries a certain level of responsibility to understand the RIA’s process to identify and determine which accounts would be subject to the custody rule, and therefore included in the population.

4. With respect to auditing implications relating to cryptocurrencies, including testing of existence and valuation, the EP members shared that for operating companies while some believe cryptocurrency is an intangible asset (as acknowledged by certain non-investment company registrants from discussions with OCA), for the investment company industry, cryptocurrency may be considered “other investments” which are recognized at their transaction price in accordance with ASC 946-325-30-1 and subsequently measured at fair value in accordance with ASC 946-325-35-1. The EP plans to monitor activities of various organizations’ task forces on digital assets. Also see SEC Staff Update portion of these meeting highlights for additional information on this topic.

5. Custody rule and combined financial statements – For purposes of a registered investment adviser relying on the audited financial statement provision of the Custody Rule, Rule 206(4)-2(b)(4) specifies that the financial statements be prepared in accordance generally accepted accounting principles. The question has been raised regarding whether audited combined financial statements of multiple pooled investment vehicles (PIVs) may be used to satisfy the Custody Rule. ASC 810-10-55-1B states “There are circumstances, however, in which combined financial statements (as distinguished from consolidated financial statements) of commonly controlled entities are likely to be more meaningful than their separate financial statements. For example, combined financial statements would be useful if one individual owns a controlling financial interest in several entities that are related in their operations. Combined financial statements might also be used to present the financial position and results of operations of entities under common management.” As part of a single offering to investors, an adviser may set up separate legal entities for legal, tax, regulatory or other business reasons. Since these funds invest in identical investments, the adviser may determine that combined financial statements are more meaningful than the separate legal entities since they were formed in conjunction with each other. The EP members considered whether audited combined financial statements of multiple PIVs may be used to meet the requirements of the Custody Rule if they are prepared in accordance with generally accepted accounting principles. The EP noted that whether combined financial statements meet the requirements under the custody rule represents a legal determination that each investment adviser will have to make based on its particular fact pattern.

6. An EP member inquired whether, under the Custody Rule, a co-investment vehicle is considered a RIA’s client, and whether the RIA is deemed to have custody of the funds of a co-investment vehicle. Further, is a surprise examination under Rule 206(4)-2(a)(4) of the Investment Advisers Act of 1940 required for co-investment vehicles? In such cases, participation is at the discretion of the investor and invests directly into an intended investee. The RIA is merely acting as a facilitator for the co-investor and does not have authority to utilize the funds of the co-investor for any other purpose.

At the May EP meeting, EP members observed that definition of an advisory client is a legal determination. EP members have seen private equity funds that have audits of co-investment vehicles to satisfy the surprise examination requirement of the Custody
IV. SEC Staff Update

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1. Operations Related:
   a. Master/Feeder Presentation:

      The SEC staff reminded registrants about the requirements included in the 1998 “Dear CFO” letter and IM Guidance Update No. 2014-11, regarding the presentation for financial statements in a master-feeder structure:

      For an investment company registered under the Investment Company Act of 1940 (RICO) that is a feeder fund in a master-feeder structure, consolidated financial statements are generally the most meaningful presentation, provided that, among other things, the feeder fund attaches the financial statements of the master fund to the feeder fund’s financial statements.

      The SEC staff recently had discussions with a feeder fund which invested substantially all of its assets in an unaffiliated master fund. The master fund was a registrant under the Investment Company Act of 1940 (1940 Act), but not the Securities Act of 1933 (1933 Act). The feeder fund was registered under both the 1933 and 1940 Acts. Rather than attaching the master fund’s financial statements to the feeder fund’s financial statements, the feeder fund directed investors to the location of the master fund’s financial statements on the SEC website. The feeder fund did not attach the master fund’s financial statements due to concerns around certifying the affiliated master fund’s financial statements. The SEC staff noted that in order for the feeder fund’s financial statements to be complete, the master fund’s financial statements should be attached. The SEC staff also noted that when the master fund is unaffiliated, certain registrants believe it is important to include the certification of the master fund’s financial statements, signed by the certifying officer of the unaffiliated master fund. For example, the staff noted that they have observed in practice that certain feeder fund registrants have included a certification relating to the unaffiliated master fund’s financial statements in the feeder fund’s N-CSR filing.

   b. Accounting for digital assets:

      - The SEC staff shared that even though they are not seeing direct investments in digital assets, like cryptocurrencies, in registrants’ portfolios, certain registrants have indirect exposure, as they have invested in a grantor trust or a similar vehicle that holds within its portfolio bitcoin or other digital assets. The staff cautioned that registrants with indirect exposure should be monitoring these investments for significant events that may impact the value of their investments or may cause another recognition event in the registrant’s books and records.

      For example, the staff noted that in Q4 of 2017, the bitcoin network experienced multiple “hard forks.” The staff described a particular scenario where a registered fund invested in a grantor trust holding bitcoin, and the bitcoin network experienced a “hard fork.” On October 24, 2017, when bitcoin forked, the grantor trust was entitled to receive one bitcoin gold for each bitcoin it held (and retain its bitcoin). After the fork, the grantor trust had to determine how to account for the rights to bitcoin gold, including whether it should be recognized in the trust’s books and records, and if so, at what value. After the fork, the SEC staff observed that funds that invested in the grantor trust continued to fair value their investment in the grantor trust based off the traded value in the over-the-counter markets. On November 22, 2017, the grantor trust established a record date and declared a distribution as a result of the bitcoin gold fork. The grantor trust then distributed the rights to its bitcoin gold to an agent who ultimately obtained and sold the bitcoin gold, then made cash distributions to the trust’s investors. The staff observed that a fund registrant investing in this grantor trust did not reflect the distribution in its books and records as of the record date. The SEC staff shared that this registrant subsequently amended and restated its semi-annual financial statements to recognize the distribution related to the bitcoin gold fork on the record date.

      The SEC staff advises that registrants with indirect investments in cryptoassets must monitor significant events that may impact the fair value of its direct investments, and if direct investment vehicles declare distributions, the registrant should determine 1) whether a recognition event has happened, 2) what they received, and 3) its value.

      - The SEC staff has not received a consultation submittal from an investment company related to characterization of digital assets at this point, but noted that if an entity determines it is an investment company, the investment company-industry specialized accounting, including application of ASC 946 and the measurement of investments at fair value under ASC 820, would generally apply. The SEC staff and the EP both would generally expect that investment companies would consider digital assets to be “other
investments” which are recognized at their transaction price in accordance with ASC 946-325-30-1 and subsequently measured at fair value in accordance with ASC 946-325-35-1.

c. Other Filing Updates - the SEC staff informed that Investment Company Reporting Modernization Frequently Asked Questions (Compliance Dates and General Filing Obligations, FAQ 8) has been updated to indicate that a fund with a fiscal year falling on October 31 or November 30, 2018 (and its mid-year falling on April 30 or May 31, 2018) does not need to file the fund’s mid-year filing on Form N-SAR because reports on Form N-CEN, which is an annual report, will encompass the mid-year period ending on April 30 or May 31, 2018, and Form N-SAR will be rescinded on June 1, 2018. The fund is expected to file Form N-CEN for the fiscal year ended October 31 or November 30, 2018.

d. Use of Data - In her recent speech at 2018 ICI conference and Remarks at the PLI Investment Management Institute 2018, Dalia Blass, the Director of Division of Investment Management discussed use of data. In the first, Ms. Blass described the staff’s internal tool called MAGIC which is an acronym for Monitoring and Analytics GUI for Investment Companies.

Ms. Blass indicated “MAGIC allows us to pull together a number of data sets — including data from registrants and other sources — and look at it holistically. The tool combines performance, flow, holdings and other information and allows us to ask questions such as how does this fund’s portfolio compare to its strategy? Are its holdings aligned with its investment restrictions?”

The SEC staff noted that so far, the tool has been effective in assisting the SEC staff with their disclosure review process, making reviews more efficient and effective. It allows the SEC staff to quickly identify entities that may have exposure to certain assets (e.g., indirect exposure to digital assets), as well as allows the SEC staff to implement a risk-based approach for its reviews. It also provides the SEC staff with data on asset flow, holdings and other information and indicates how the fund’s portfolio compares to its investment strategy. The staff noted that MAGIC incorporates data that is publicly available, such as mutual funds’ data in the prospectus that is filed with the SEC in an XBRL format and will incorporate N-PORT data once available.

2. Policy Related:

a. Disclosure Effectiveness/Shareholder Experience - A comprehensive list of rulemakings the SEC staff is working on is included in the agency rule list published semi-annually by the Office of Information and Regulatory Affairs and the Office of Management and Budget. The Spring 2018 Agency Rule List has been posted. Among Chairman Clayton’s short-term agenda items are amendments to financial disclosures about acquired businesses, disclosure update and simplification, auditor independence with respect to loans or debtor-creditor relationships, exchange-traded funds, investment company reporting modernization - option for website transmission of shareholder reports, personalized investment advice standard of conduct, fund of funds arrangements, use of derivatives by registered investment companies and business development companies, and fund retail investor experience and disclosure request for comment.

b. Valuation Guidance - The SEC’s Office of the Chief Accountant and the Division of Investment Management are soliciting recommendations for updates to guidance in ASRs 113 and 118 on the valuation of portfolio securities and other assets held by registered investment companies, including auditing and governance considerations.

c. The SEC proposed a rule “Auditor Independence with Respect to Certain Loans of Debtor-Creditor Relationships” that would amend the SEC’s auditor independence rules, specifically related to rule 2-01(c)(1)(ii)(A), better known as “the loan provision.” The proposal outlines four amendments that would effectively identify those debtor-creditor relationships that could impair an auditor’s objectivity and impartiality, yet, would not include certain extended relationships that are unlikely to present threats to objectivity and impartiality. The amendments would primarily:

1. Focus the analysis solely on beneficial ownership;

2. Replace the existing 10 percent bright-line shareholder ownership test with a “significant influence” test;

3. Add a “known through reasonable inquiry” standard with respect to identifying beneficial owners of the audit client’s equity securities; and

4. Amend the definition of “audit client” for a fund under audit to exclude from the provision funds that otherwise would be considered “affiliates of the audit client”.

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Investment Companies Expert Panel
July 17, 2018 Conference Call

The Investment Companies Expert Panel serves the needs of AICPA members on financial and business reporting and audit and attest matters. The expert panel protects the public interest by bringing together knowledgeable parties in the investment companies industry to deliberate and come to agreement on key investment companies issues.

The following are brief highlights of the call:

I. AICPA/Administrative:
   2. The AICPA Product Development staff provided an update on status and timing of the 2018 AICPA Audit and Accounting Guide Investment Companies (the Guide).

II. Accounting/Reporting Issues:
   1. Bond Amortization – FASB ASU No. 2017-08, Receivables–Nonrefundable Fees and Other Costs (Subtopic 310-20), requires the premium on a purchased callable debt security be amortized to the call price on its earliest call date. One EP member suggested the EP consider the journal entries that will be made upon adoption of the standard, the effect on those journal entries on the components of capital, and the disclosures that would seem to be appropriate for an investment company under the ASU. The EP will continue discussing this at September EP meeting.

III. SEC Staff Update

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1. The SEC staff shared that to date, they received about 30 comment letters on the SEC proposed Rule “Auditor Independence with Respect to Certain Loans of Debtor-Creditor Relationships”.

2. The SEC staff discussed unitary fees, which are generally asset-based fees paid by a fund (such as managed funds, managed exchange-traded funds and common collective trust funds) to its investment advisor for the provision of investment advisory and other fund expenses (e.g. custody fees, administrative and accounting fees, shareholder services fees, etc.). Typically, a fund will not show the components of these other fund expenses separately on the income statement, as the fund is paying the unitary fee only, which the advisor will use to pay those expenses. However, the SEC staff reminded registrants that to the extent an investment adviser is unable to pay these fund expenses, there is a risk to the fund as the service providers could stop providing services the fund needs to continue operations and this risk could warrant disclosure to the investors. Further, if the fund, as opposed to the investment adviser, chooses to pay the service providers directly (for example, to avoid suspension of a service arrangement by the service provider), the related receivable from the adviser for reimbursement of these payments should be properly recorded by the fund, its collectability evaluated, and the receivable settled in a timely manner in order to avoid noncompliance with provisions of the Investment Company Act of 1940 concerning loans between affiliated parties.
3. The SEC is monitoring fund filings related to various items, such as material weaknesses or missing opinions. Additionally, the SEC is focused on monitoring funds with potential exposure to emerging risks (indirect or direct), such as digital assets and funds with exposure to Argentina, due to the recent local currency devaluation.
Investment Companies Entities Expert Panel
September 20, 2018 Meeting Highlights

The Investment Companies Expert Panel serves the needs of AICPA members on financial and business reporting and audit and attest matters. The expert panel protects the public interest by bringing together knowledgeable parties in the investment companies industry to deliberate and come to agreement on key investment companies issues.

The following are brief highlights of the call:

AICPA Investment Companies Expert Panel
Meeting Highlights
September 20, 2018

I. AICPA/Administrative:
   1. The Expert Panel (EP) March, May and July 2018 meeting highlights are available.
   2. AICPA Audit and Accounting Guide Investment Companies (the Guide) has been released.
   4. The AICPA staff discussed volunteer applications for 2019 AICPA volunteer year. The application process closes October 1, 2018.

II. Accounting/Reporting Issues:
   1. The EP discussed accounting for contingent common stock. A fund entered into an agreement with a public company for the purchase of restricted common stock, but the agreement had a provision that was contingent upon shareholder approval in conjunction with a pending merger. The fund could only purchase the shares of common stock if the shareholders of that company approved the pending merger. An EP member inquired whether the fund would meet the recognition guidance in FASB ASC 946-320-25-2 or FRR 404.04.a, which focus on an enforceable right to demand securities, and if the fund would record changes in the fair value of the public common stock to be received upon shareholder approval.

   ASC 946-320-25-2:
   A securities transaction outside conventional channels, such as through a private placement or by submitting shares in a tender offer, shall be recorded as of the date the investment company obtained a right to demand the securities purchased or to collect the proceeds of sale, and incurred an obligation to pay the price of the securities purchased or to deliver the securities sold, respectively. Determining the recording date may sometimes require an interpretation by legal counsel.

   FRR 404.04.a:
   Restricted securities should be included in the portfolio of a company and valued to determine current net asset value on the date that the investment company has an enforceable right to demand the securities
Where the investment company negotiates the acquisition of the restricted securities directly with the owner of the securities, there are three significant dates. The first occurs when the investment company and the seller orally agree upon the price and the amount of the securities (the "handshake date"). At this point, there would not seem to be any enforceable right of the investment company to demand the securities from the seller since, in most states, particularly those which have adopted the Uniform Commercial Code, there is no enforceable right unless there exists some writing "sufficient to indicate that a contract has been made for sale of a stated quantity of described securities at a defined or stated price" (Section 8-319(a) of the Uniform Commercial Code). If the terms of the oral understanding do not contemplate compliance with any condition by the seller, it is suggested that the investment company procure, from the seller, a signed memorandum setting forth the price and quantity of securities to be sold. Upon receipt of that memorandum, an enforceable right would be obtained. The securities should be valued as of that date.

In those situations where the oral understanding contemplates the execution of a formal contract of purchase and sale, no enforceable right exists until the time the formal contract is signed (the "contract date"). If the formal contract does not require compliance with any conditions by the seller, an enforceable right is then obtained, and the securities should be valued as of that date.

Where the formal contract requires compliance with stated conditions which the investment company believes should not be waived, no enforceable right is obtained until the stated conditions are satisfied. In that situation, the valuation date should be the date upon which the conditions are satisfied (the "closing date").

The EP members expressed a view that since the purchase of securities would only be recorded upon the shareholders approving the merger, prior to obtaining this shareholder approval, the fund’s right to demand securities [in accordance with aforementioned guidance] would not yet exist, and as such, only disclosure of the transaction would be appropriate. The EP members also discussed that entities should consider whether the contingency would be considered a derivative, similar to a contingent option.

2. The EP considered presentation of the financial statements for a fund’s investments in affiliated funds. A fund invests solely in funds managed by the same adviser. These underlying funds may have similar investing strategies and may be set up as different legal entities for either tax, regulatory or operational reasons. The EP considered whether the fund of funds can aggregate the underlying funds for purposes of applying the guidance in ASC 946-210-45-7 and make the presentation of the financial statements similar to a master-feeder presentation.

ASC 946-210-45-7:
The reporting fund may list the investee (portfolio) funds directly on the statement of assets and liabilities. Additional disclosures may be required for those funds that hold a mixture of investments in other investment companies and direct investments in securities. However, there is usually no need for a separate schedule of investments. Fund management shall consider if an investment in a single underlying fund is so significant to the fund of funds as to make the presentation of financial statements in a manner similar to a master-feeder fund more appropriate.

The EP discussed that a fund that invests solely in affiliated funds could aggregate these underlying funds for the purposes of applying the guidance in ASC 946-210-45-7 and make the presentation of the financial statements similar to a master-feeder presentation, as long as such presentation is more meaningful and useful to the user of financial statements. In determining if such presentation is meaningful to investors, consideration should be given as to whether the investment strategies of the underlying funds are similar, how the disclosure of positions would be affected if the financial statements of the affiliated funds were combined, and how the underlying affiliated funds are marketed (that is, are they bound together or held out as separate entities). The EP also discussed that consideration should be given to whether or not the combined underlying funds would be viewed as a single reporting entity. Further, the EP noted that the presentation would depend on specific facts and circumstances.

Lastly, for entities relying on the audit provision of the custody rule, consideration should also be given on whether or not such presentation would comply with the custody rule.

3. The EP considered accounting for transaction costs. A fund has agreed in principle to purchase bank debt from a third party. In finalizing the agreement to purchase the bank debt, the fund has incurred legal costs to review and finalize the terms of the purchase agreement. The EP members discussed whether this type of cost may be included in the purchase price in accordance with FASB ASC 946-320-30-1:

ASC 946-320-30-1:
An investment company shall initially measure its investments in debt and equity securities at their transaction price. The transaction price shall include commissions and other charges that are part of the purchase transaction.
EP members observed that there is mixed practice in the industry with respect to what constitutes “other charges that are part of the purchase transaction” in ASC 946-320-30-1. EP members noted that consideration should be given to whether or not these costs are direct and incremental to the investment due diligence process and/or if these costs would be incurred regardless of whether the transaction was executed or not. If such expenses were incurred solely to allow closing of the specific transaction, the expense should be included in the transaction price. However, if the expense would be incurred regardless of whether the transaction occurs, then the expense should be expensed as incurred.

4. The EP discussed implementation matters related to the SEC Disclosure Update and Simplification Rule issued in August 2018. Specifically, the EP discussed the amendments to Rule 6-09.3 of Regulation S-X, which has been amended to require investment companies to present distributions to shareholders in total, except for tax return of capital distributions, which should be disclosed separately. These amendments replace the requirement to state separately distributions to shareholders from (a) investment income-net; (b) realized gain from investment transactions-net; and (c) other sources.

**Update:** Subsequent to the September 2018 EP meeting, the EP held supplemental discussions about whether the prior year distribution amounts disclosed on the statement of changes in net assets (SOC) in the prior year could be retrospectively presented to conform to the current year presentation resulting from the amended Regulation S-X requirements.

The EP members expressed a view that investment companies should be able to conform the presentation of the prior year’s distribution amounts on the SOC to the current year’s presentation on the SOC, as long as they include a footnote in the financial statements indicating the reason for the changing the prior year’s SOC presentation and disclose the disaggregated distribution amounts from the prior year, so that the investors would still have the information available from the prior year’s SOC. The EP members also suggested including the prior year’s undistributed net investment income in the footnote, since it was technically required to be disclosed on the SOC in the prior year but is no longer required to be disclosed in the current year based on the Regulation S-X amendments. The EP members believe such presentation would be easier for investors to understand compared to disaggregating prior year distributions and aggregating current year distributions, excluding tax return of capital. See SEC Staff Update portion of these meeting highlights for the EP members discussion of this proposed presentation with the SEC staff.

5. The EP discussed example journal entries, financial statement presentation and footnote disclosures relating to the implementation of FASB ASU 2017-08, Receivables--Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities:

For public business entities, the amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted for all entities.

An entity should apply the amendments in this Update on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. Additionally, in the period of adoption, an entity should provide disclosures about a change in accounting principle as required by ASC 250.

**Example Security for a registered fund with a calendar year end (hypothetical amounts for illustrative purposes only)**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Par:</td>
<td>$10,000,000</td>
</tr>
<tr>
<td>Purchase Date:</td>
<td>01/01/2016</td>
</tr>
<tr>
<td>Original Cost:</td>
<td>$12,000,000</td>
</tr>
<tr>
<td>Maturity</td>
<td>12/31/2025 (previously amortized to this date – 10 years)</td>
</tr>
<tr>
<td>Earliest Call Date</td>
<td>12/31/2022 (now amortized to this date – 7 years)</td>
</tr>
<tr>
<td>Beginning of the period of adoption:</td>
<td>01/01/2019</td>
</tr>
<tr>
<td>Amortized cost as of 12/31/2018:</td>
<td>$11,400,000</td>
</tr>
<tr>
<td>Amortized cost as of 12/31/2018 (post-adoption):</td>
<td>$11,250,000</td>
</tr>
<tr>
<td>Amortized cost as of 06/30/2019, the first reporting date following adoption:</td>
<td>$11,220,000</td>
</tr>
<tr>
<td>Decrease in amortized cost as of 01/01/2019:</td>
<td>$150,000</td>
</tr>
</tbody>
</table>

**Journal Entries (for cumulative-effect adjustment) to be recorded as of the beginning of the period of adoption**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>DR: Unrealized (Asset account)</td>
<td>150,000</td>
</tr>
<tr>
<td>CR: Cost (Asset account)</td>
<td>150,000</td>
</tr>
<tr>
<td>DR: Distributable Earnings (Equity account)</td>
<td>150,000</td>
</tr>
<tr>
<td>CR: Unrealized App/Dep (Equity account)</td>
<td>150,000</td>
</tr>
</tbody>
</table>
Impact to financial statement line items for this one security position (as an example)

NOTE: Due to the SEC Disclosure Update and Simplification rule, the components of distributable earnings will no longer be shown on the statement of assets and liabilities.

Statement of Assets and Liabilities as of June 30, 2019

Investments, at fair value (cost $11,220,000) $13,000,000

NOTE: Cost as of the beginning of the period of adoption will be reduced for the cumulative-effect adjustment. No additional disclosure on the face of the Statement of Assets and Liabilities is required. The Notes to the Financial Statements will disclose the impact of the new accounting pronouncement. The cost basis on the initial statement of assets and liabilities following adoption is lower than cost immediately following adoption due to additional amortization from the beginning of the period of adoption through the reporting date.

Statement of Operations

NOTE: Due to the cumulative-effect adjustment as of the beginning of the period of adoption, a user will need to consider the amount disclosed in the Notes to the Financial Statements in order to be able to roll unrealized appreciation/depreciation from one period to the next. No additional disclosure on the face of the Statement of Operations is required. The Notes to the Financial Statements will disclose the impact of the new accounting pronouncement.

Notes to Financial Statements:

Newly adopted accounting pronouncement

In March 2017, the Financial Accounting Standards Board issued Accounting Standards Update No. 2017-08 ("ASU 2017-08"), “Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities.” ASU 2017-08 changed the amortization period for certain callable debt securities held at a premium. Specifically, it required the premium to be amortized to the earliest call date. The Fund has adopted and applied ASU 2017-08 on a modified retrospective basis through a cumulative-effect adjustment as of the beginning of the period of adoption. As a result of the adoption of ASU 2017-08, as of January 1, 2019, the amortized cost basis of investments was reduced by $150,000 and unrealized appreciation of investments was increased by $150,000. The adoption of ASU 2017-08 had no impact on beginning net assets, the current period results from operations, or any prior period information presented in the financial statements.

NOTE: Additional disclosures will be required if there are indirect effects of a change in accounting principle (e.g. fees or other expenses that are calculated based upon net investment income).

VI. Audit and Attest Issues:

1. The EP was updated on the AICPA efforts regarding applicability of FASB ASC 325-40 to investment companies (trading securities).

III. SEC Staff Update:

Disclaimer

The following comments and observations were compiled by the AICPA Investment Companies Expert Panel and AICPA staff and are not authoritative positions or interpretations issued by the SEC or its staff. The comments and observations were not transcribed by the SEC or its staff and have not been considered or acted upon by the SEC or its staff. Accordingly, these comments and observations do not constitute a statement of the views of the SEC or its staff.

1. The SEC’s Division of Investment Management Chief Accountant introduced two new Professional Accounting Fellows in its Chief Accountant’s Office.

2. The SEC staff highlighted the following matters for registered investment companies (RICs) and business development companies (BDCs) as a result of the SEC Disclosure Update and Simplification Release which was adopted on August 17, 2018. The amendments revise or eliminate certain disclosure requirements that have become redundant, duplicative, overlapping, outdated, or superseded:

   a. Distributable Earnings for Registered Investment Companies:
• Statement of Assets and Liabilities
  • Rule 6-04.17 of Regulation S-X has been amended to require presentation of the total, rather than the components, of distributable earnings on the balance sheet.

• Statement of Changes in Net Assets (SOC)
  • Rule 6-09.7 of Regulation S-X has been amended to delete the requirement for parenthetical disclosure of undistributed net investment income on the statement of changes in net assets on a book basis.
  • Rule 6-09.3 of Regulation S-X has been amended to require presentation of distributions to shareholders in total, except for tax return of capital distributions, which should be disclosed separately.

**UPDATE:** Subsequent to the September 2018 EP meeting, the SEC staff discussed with certain EP members that the above amendments to Regulation S-X requirements to show distributions to shareholders in total does not eliminate the requirement in ASC 946-205-45-4a, which states that for multiple class funds, dividends and distributions paid to shareholders for each class are required to be presented on the statement of changes in net assets or disclosed in the notes to financial statements.

• Financial Highlights
  • The SEC staff received comments on the proposed rule indicating that the per share distribution disclosure on the financial highlights is meaningful to investors and should not be changed to conform to the presentation on the SOC. Accordingly, no changes were made to the financial highlights; registrants should follow relevant instructions from Form N-1A or Form N-2.

• Disclosure
  • The SEC staff additionally noted that the changes above do not impact the U.S. GAAP requirements for tax basis disclosures in the footnotes, so registrants should continue to include those disclosures in the financial statements.

b. Consolidation
  • The SEC staff noted that the final rule also updated Rule 6-03(c)(1)(i) of Regulation S-X, in order to align with U.S. GAAP, to remove the rule which allowed for consolidation of the financial statements of RICs and BDCs only with the financial statements of subsidiaries which are investment companies themselves. The SEC staff reminded entities that this update also aligns with guidance in the Guide and with Investment Management Guidance Update No. 2014-11, Investment Company Consolidation.

c. BDC Specific Changes
  • Reconciliation of Changes in Stockholder’s Equity:
    • The SEC staff noted that the final rule amends interim financial statement requirements and will now require a reconciliation of changes in stockholders’ equity in the notes or as a separate statement, which will impact BDCs. This analysis should reconcile the beginning balance to the ending balance of each caption in stockholders’ equity for each period for which an income statement is required to be filed and comply with the remaining content requirements of Rule 3-04 of Regulation S-X. As a result, registrants will have to provide the reconciliation for both the year-to-date and quarterly periods and comparable periods in Form 10-Q but only for the year-to-date periods in registration statements.

**Update:** Subsequent to the September 2018 EP meeting, the Division of Corporation Finance issued a FAQ which addresses the effective date for the above requirement for interim financial statements. Refer to Disclosure Guidance from the Division of Corporation Finance of the Securities and Exchange Commission, Compliance and Disclosure Interpretations Section 105: Form 10-Q, new Question 105.09, issued September 25, 2018. This effective date guidance only applies to the above requirement for interim financial statements and does not apply to any Article 6 amendments.

d. Amendments to Regulation S-K:
  • Sale and Bid Prices:
The final rule eliminated the requirement in Item 201(a)(1) for detailed disclosure of sale or bid prices for most issuers whose equity is traded in an established public trading market and replaced it with disclosure of the trading symbol.

As described in footnote 410 of the final rule, “Form N-2, which is used for registration of closed-end management investment companies, includes disclosure requirements relating to sales prices and bid information that are similar to those in Item 201(a)(1) of Regulation S-K. Item 1, Instruction 1 and Item 8.5(b) of Form N-2. In addition to these requirements, Form N-2 requires disclosure of information relating to net asset value and discount or premium to net asset value. Item 8.5(b), Instructions 4 and 5 and Item 8.5(c) through (e) of Form N-2. Disclosure of sales prices and bid information is needed in registration statements on Form N-2 so that the required premium/discount disclosure can be fully understood. Accordingly, the Commission did not propose to change the requirements in Form N-2 relating to sales prices and bid information.”

e. Historical Presentation:

- The SEC staff noted that technically, the historical presentation of statement of changes in net assets (SOC) with respect to the distribution amounts paid to shareholders should remain consistent with the prior year. However, the EP inquired of the SEC staff’s view on the implementation matters discussed above in the EP section of the minutes with respect to presentation of prior year distribution amounts on the SOC. The staff did not object to the EP’s view and therefore would not object if investment companies conform the presentation of the prior year’s distribution amounts on the SOC to the current year’s presentation on the SOC, as long as they include a footnote on the SOC indicating the reason for the changing the prior year’s presentation and disclose the disaggregated distribution amounts from the prior year, so that the investors would still have the information available on the SOC. The staff also did not object to including the prior year’s undistributed net investment income in the footnote.

f. Effective Date:

- The EP and the SEC staff discussed the effective date of the Regulation S-X amendments.
- Update: Subsequent to the September 2018 EP meeting, the final rule was published in the Federal Register on October 4, 2018 and is effective November 5, 2018. The amendments to Regulation S-X are effective for reports filed on or after the effective date.

3. The SEC staff shared that Form 12b-25 “Notification for Late Filing” has not been updated for the RIC Modernization rule, which rescinded Form N-SAR. Consequently, Form 12b-25 does not include a checkbox for Form N-CEN (only N-SAR). Registrants should continue (for now) checking box “N-SAR” for late filings until Form 12b-25 is updated.

4. Change in auditor – the SEC staff reminded registrants that registrants should be including the predecessor auditor’s consent in their registration statement filings the first year a registration statement is filed after the change in auditors. Recently, the staff has observed that many registrants are not including the predecessor auditor’s consent in the first registration statement filing. The staff reaffirmed that their position, originally stated in the July 2005 EP minutes, has not changed. Registration statement filings should either contain or incorporate by reference the audit reports of a predecessor auditor for at least as long as financial statements audited by the predecessor firm are included in the annual report. Practically speaking, because the statement of changes includes two years, as long as the statement of changes audited by the predecessor firm is included in the annual report being included in the filing, the predecessor auditor’s report and consent should be incorporated/included in the filing.

5. The SEC staff covered certain relevant points from recent Statement Regarding Staff Views by Chairman Clayton, including that “all staff statements are nonbinding and create no enforceable legal rights or obligations of the Commission or other parties” and among other SEC divisions and office, the Division of Investment Management “will continue to review whether prior staff statements and staff documents should be modified, rescinded or supplemented in light of market or other developments”.

6. The SEC staff is evaluating comments received on the SEC proposed Rule “Auditor Independence with Respect to Certain Loans of Debtor-Creditor Relationships”.

7. Section 19(a) of the Investment Company Act of 1940 (“1940 Act”) generally prohibits management investment companies from making a distribution from any source other than the fund’s net investment income, unless that payment is accompanied by a written statement that adequately discloses the source or sources of the payment. The SEC staff reminded entities that IRS Forms, specifically IRS Form 1099, would not satisfy the requirement under Rule 19a-1 for a written statement to accompany dividend payments due to the timing of the notification,
as a Section 19(a) notice should be sent contemporaneously with the distribution. Additionally, as Form 1099 is designed with the IRS tax regulations in mind, it may not contemplate the notification requirements included in Section 19(a). The SEC staff also stated that they have previously communicated that the Section 19(a) rules are based on “good accounting practice.” The SEC staff’s view is that this means accounting based on U.S. GAAP, but its prime focus is on egregious violations of the rule. The SEC staff would not object if either U.S. GAAP or tax basis is used, as long as the basis is applied consistently. This is consistent with views expressed historically by the staff and stated within the April 17, 2008 EP minutes.

8. In his Remarks before AICPA National Conference on Banks & Saving Institutions, Chief Accountant Wesley Bricker covered, among other topics:
   a. Digital assets:
      • a reminder to understand the technology used and utilized, and act appropriately within existing laws and regulations as they relate to books and records, internal accounting control, internal controls over financial reporting, and custody;
      • provided five illustrative examples, including those on books and records, fair value measurements and related parties, and audit committee considerations.
   b. Implementation of new auditor reporting model and an invitation to registrants, audit committees and auditors to share their experience with the SEC and PCAOB regarding implementation of critical audit matters.
The Investment Companies Expert Panel serves the needs of AICPA members on financial and business reporting and audit and attest matters. The expert panel protects the public interest by bringing together knowledgeable parties in the investment companies industry to deliberate and come to agreement on key investment companies issues.

The following are brief highlights:

I. AICPA/Administrative:

1. The Expert Panel (EP) September 2018 meeting highlights are available.

2. The EP staff noted timing for first review of proposed conforming changes to the AICPA Audit and Accounting Guide Investment Companies (the Guide).

II. Accounting/Reporting Issues:

1. The EP considered financial statement presentation for partially failing deposit securities. An EP member presented a scenario where an ETF issued creation units in-kind (deposit securities) to an Authorized Participant (AP) in exchange for contributed securities but certain securities were not received by the ETF (classified as failing deposit securities) and cash collateral has been deposited by the Authorized Participant (AP) on behalf of the ETF, but was not yet deployed to cover the failing deposit securities. The EP discussed the financial statement implications of such transactions.

ETF issuers use creation units for new share issuance through broker-dealers. They also have relationships with broker-dealer trading desks, which act as APs. For creation units in-kind, the AP delivers cash collateral on behalf of the ETF for the deposit securities not yet received (classified as failing deposit securities). If and when the ETF decides to close out the trade and use the collateral to purchase the undelivered deposit securities, the AP will be liable for (1) the costs incurred by the ETF in connection with any such purchases and (2) any shortfall between the cost of the purchased deposit securities and the value of the cash collateral.

The AP has an obligation to the ETF to fulfill its obligation of funding the creation of the new ETF shares. The ETF has fulfilled its legal obligation by issuing shares to the AP and recognized the shares issued to the AP on its books and records. Lastly, both the ETF and the AP have access to the cash collateral at the custodian; however, the other party must be notified and proper proof of delivery/non-delivery of assets is verified by the custodian prior to cash movement; indicating that neither party has control over the collateral.

The EP members discussed the financial statement presentation of the deposit securities not yet received. The EP members discussed whether a right to offset exists. Per ASC 210-20-45-1 states,

“A right of setoff exists when all of the following conditions are met:

   a. Each of two parties owes the other determinable amounts.
   b. The reporting party has the right to set off the amount owed with the amount owed by the other party.
   c. The reporting party intends to set off.
   d. The right of setoff is enforceable at law.”

The EP members considered whether the collateral belonged to the ETF or not. The EP members discussed the considerations should be given to whether the contributing party fulfilled its obligation, which would be a legal determination. Generally, the EP members discussed the collateral would not belong to the ETF, until such time the ETF decided to forgo delivery of the shares, which is also a legal determination.
2. The EP continued discussing applicability of FASB ASC 326 (CECL) to investment companies holding beneficial interests within the scope of ASC 325-40 in light of the November 1, 2018 TRG meeting. At that meeting, FASB staff noted that financial assets measured at fair value through net income are not in the scope of ASC 326-20. Accordingly, entities would not have an allowance for credit losses for beneficial interests classified as trading within the scope of ASC 325-40. The staff further noted that the entities would need to use reasonable judgement in determining the amount of accretable yield for beneficial interests classified as trading. The EP members generally agreed that both Views A and B discussed on the March 2018 EP conference call contained reasonable judgements.

3. The EP considered several implementation issues related to the adoption of ASU 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement for nonpublic investment companies:

a. ASC 820-10-50-2(bbb)(2)(ii) does not require nonpublic entities to provide the information described in (bbb)(2)(i), which requires public entities to disclose the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements; however, nonpublic entities are required to provide quantitative information about the significant unobservable inputs used in the fair value measurement in accordance with (bbb)(2). An EP member expressed the view that the ASU dictates what public companies are required to disclose; however, the ASU offers more flexibility for nonpublic entities. The EP members discussed how non-public entities could meet the quantitative information requirement about significant unobservable inputs. The EP expressed a view that a nonpublic investment company may meet the quantitative information requirement for significant unobservable inputs by providing the range of such inputs, but unlike a public company, the nonpublic investment company is not explicitly required to provide the weighted average of such inputs. Certain EP members felt that under certain circumstances, nonpublic entities could continue to disclose quantitative information as they historically have disclosed (i.e., range and weighted average of significant unobservable inputs) while in other circumstances, nonpublic entities may only elect to disclose either a range of significant unobservable inputs or the weighted average of significant unobservable inputs. The EP further noted that an entity would need to ensure their quantitative disclosure is still meaningful to investors.

b. ASC 820-10-50-2G states that in lieu of the Level 3 rollforward, nonpublic entities should disclose separately changes during the period which are attributable to purchases, issues and transfers into/out of Level 3 of the fair value hierarchy. The EP members discussed whether nonpublic entities are required to disclose Level 3 purchases, issues, and transfers by class. The EP members also discussed whether nonpublic entities disclose Level 3 purchases, issues and transfers of derivatives on a gross or net basis.

The EP members generally expressed a view that nonpublic entities are required to disclose Level 3 purchases, issues, and transfers by class.

4. The EP discussed the recently issued Working Draft of the AICPA Accounting and Valuation Guide Valuation of Portfolio Company Investments of Venture Capital and Private Equity Funds and Other Investment Companies. The EP members found the illustrative examples provided in the guide to be helpful for discussions with those in the industry.

5. The EP members considered several implementation questions related to the amendments to Article 6 of Regulation S-X. Please see SEC Staff Update section for more information.

III. Audit and Attest Issues:

1. Form N-CEN requires a registrant to include in their annual Form N-CEN filing the independent accountant’s report on internal control. Per Form N-CEN, “The accountant’s report shall be based on the review, study and evaluation of the accounting system, internal accounting controls, and procedures for safeguarding securities made during the audit of the financial statements for the reporting period. The report should disclose any material weaknesses in: (a) the accounting system; (b) system of internal accounting control; or (c) procedures for safeguarding securities which exist as of the end of the Registrant’s fiscal year.”

The EP members discussed the PCAOB standards used for the report required by Form N-CEN. The EP members noted that the report for the purposes of Form N-CEN is on the company’s internal control over financial reporting.

2. Critical audit matters (CAMs) will be applicable to business development companies (BDCs). The EP discussed implementation matters related to CAMs and will continue discussing this topic as needed.

3. Upon liquidation of pooled investment vehicles, Rule 206(4)-2(b)(4)(iii) requires a registered investment adviser to distribute audited GAAP financial statements to limited partners (or members or other beneficial owners) promptly after the completion of such audit. The EP members discussed a scenario where the fund was liquidated by selling the partners’ interest rather than the underlying investments of the fund. The EP members agreed that ultimately this is a legal determination and entities should confer with their legal counsel and or chief compliance officer.

4. The EP considered modifications to the illustrative independent accountant’s report, which is issued on the annual study and evaluation of a transfer agent’s internal controls, as required to be filed with the SEC pursuant to Rule 17Ad-13 of the 1934 Act (par. 12.47 of the 2018 Guide).

The EP members will continue discussing proposed modifications to the report at the following meeting.
IV. SEC Staff Update:

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1. Policy update:

   a. The SEC Office of Information and Regulatory Affairs and the Office of Management and Budget issue a semi-annual comprehensive list of rulemakings the SEC staff is working on. The Fall 2018 Agency Rule List includes, among others, offering reform for BDCs, auditor independence with respect to loans or debtor-creditor relationships, exchange-traded funds, modernization of investment company reporting disclosure, and use of derivatives by registered investment companies and business development companies.

   b. The SEC staff is considering recommendations for updating the Commission’s existing valuation guidance for management and Boards of registered investment companies to reflect the evolving markets and existing accounting and auditing standards.

   c. The SEC staff also mentioned that amendments to the Custody Rule for Investment Companies and Investment Advisers are on the SEC’s long-term agenda.

   d. The SEC staff informed the EP about the recently launched Strategic Hub for Innovation and Financial Technology (FinHub). It will serve as a resource on any of the SEC’s FinTech-related issues and initiatives, including digital assets, distributed ledger technology, artificial intelligence and machine learning, among others, and also as a portal to the industry, where constituents can submit inquiries.

2. The SEC amended Regulation S-X through the adoption of its Disclosure Update and Simplification final rule. See the September 2018 EP minutes for the impact of the amendments to regulated investment companies as well as the SEC staff’s views on conforming historical presentation to the current year’s presentation for the comparative statement of changes in net assets.

   The SEC staff commented on the following implementation questions related to the amendments to Article 6 of Regulation S-X presented by EP members:

   a. Is it acceptable to not disclose the GAAP character of prior year distributions on the statement of changes in net assets or in the notes to the financial statements? The tax character of prior year distributions are disclosed in the notes to the financial statements.

   b. Is it acceptable to not disclose the prior year GAAP-basis undistributed net investment income on the statement of changes in net assets?

   **Staff View:** With respect to questions (a) and (b), the SEC staff did not express a view but noted that the rule amends Regulation S-X prospectively and does not require retrospective application. The prior year financial statements were completed under the pre-existing rules and if a fund is going to change historical presentation in future reports, the staff recommends registrants consult with their auditor.

   c. For comparative balance sheets of a BDC, is it acceptable to collapse prior year components of equity to conform to current year Regulation S-X requirements and footnote the amount to explain why the presentation changed and disclose the prior year amounts in a footnote to the balance sheet? Such presentation would be consistent with what was discussed in September 2018 SEC Staff Update for statement of changes in net assets.

   **Staff View:** The SEC staff would not object if a BDC conforms the presentation of the prior year’s components of equity on the SAL to the current year’s presentation on the SAL, as long as they include a footnote on the SAL indicating the reason for the change in presentation and the amounts, so that the investors would still have the information available on the SAL. The staff would also not object if the historical presentation remained the same and was inconsistent with the current year presentation.

   d. How should distributions be presented in the financial highlights per share section now that net investment income (NII) and realized distributions are combined on the statement of changes in net assets? Form N-1A/N-2 instructions say that distributions from NII, net capital gains and return of capital should all be stated separately.

   However, ASC 946-205-50-7(e) states that “Distributions to shareholders shall be disclosed as a single line item except that tax return of capital distributions shall be disclosed separately. Details of distributions shall conform to those shown in the statement of changes in net assets.” How should registrants interpret these seemingly contradictory requirements?

   **Staff View:** The SEC staff does not believe the requirements are in conflict with one another, but rather views the Form N-1A/N-2 requirements as incremental to those required by GAAP. As the financial highlight requirements in the Forms have not changed, the SEC staff would not expect to see a change in a registrant’s presentation of its financial highlights.
3. The SEC staff shared recently issued no-action letters\(^1\) providing relief to issuers of certain non-variable insurance products under Regulation S-X §3-13 to file its audited financial statements prepared in accordance with statutory accounting principles in place of financial statements prepared in accordance with U.S. generally accepted accounting principles in registration statements submitted under the Securities Act of 1933 on Form S-1 for certain insurance contracts.

4. The SEC staff would like to remind registrants to be cognizant of the form questions and requirements in completing their Form N-CEN filings. The SEC staff has observed responses to form N-CEN that may contain errors such as (1) certain ETF registrants answering that they don’t rely on exemptive orders; (2) certain registrants reporting that they have no investment adviser; (3) certain registrants indicating that they are not utilizing any pricing services (which may be an appropriate response in some circumstances). IM’s Analytics Office and OCIE, if appropriate, may contact registrants in connection with these or other errors identified in those filings to date.

5. Subsequent to the November EP meeting, on November 14, 2018, the Division of Investment Management updated Investment Company Reporting Modernization Frequently Asked Questions (FAQs). Included in the updated FAQs are staff responses to questions concerning Compliance Dates and General Filing Obligations, Form N-Port, Regulation S-X (including requirements associated with custom basket disclosures), and Form N-CEN.

\(^1\) Allianz Life Insurance Company of North America, September 28, 2018  
Athene Annuity and Life Company, September 28, 2018  
Great West Life & Annuity Insurance Company, September 28, 2018  
Midland National Life Insurance Company, September 28, 2018
The Investment Companies Expert Panel serves the needs of AICPA members on financial and business reporting and audit and attest matters. The expert panel protects the public interest by bringing together knowledgeable parties in the investment companies industry to deliberate and come to agreement on key investment companies issues.

The following are brief highlights:

I. AICPA/Administrative:
   1. The Expert Panel (EP) November 2018 meeting highlights are being finalized.
   2. The EP and AICPA staff discussed the timing of interim review of proposed conforming changes to and referencing PCAOB in the AICPA Audit and Accounting Guide Investment Companies (the Guide).

II. Accounting/Reporting Issues:
   1. The EP discussed a situation where a business development company (BDC) that previously was taxed as a regulated investment company (RIC) no longer met the diversification tests under the Internal Revenue Code. As a result, upon the loss of its RIC status, the BDC elected to be taxed as a real estate investment trust (REIT). The BDC will continue to be regulated as a BDC under the Investment Company Act of 1940. The EP considered whether as a REIT, the BDC meets the definition of an investment company under FASB ASC 946.

   The EP recognized that even though FASB ASC 946-10-15-3 specifically notes that “The guidance in this Topic does not apply to real estate investment trusts”, FASB ASC 946-10-15-4 recognizes “an entity regulated under the Investment Company Act of 1940 is an investment company under this Topic.” Further, FASB ASC 946-10-25-1 states

   The initial determination of whether an entity is an investment company within the scope of this Topic shall be made upon formation of the entity. An entity shall reassess whether it meets (or does not meet) the assessment of investment company status in paragraphs 946-10-15-4 through 15-9 only if there is a subsequent change in the purpose and design of the entity or if the entity is no longer regulated under the Investment Company Act of 1940.

   The EP members discussed that even though this BDC elected to be taxed as a REIT for tax purposes only, the purpose and design of the entity has not changed, and the BDC continues to be regulated under the Investment Company Act of 1940. Therefore, this BDC would meet the definition of an investment company under FASB ASC 946.
2. The EP started discussing the following implementation issues relating to premium amortization of convertible debt (FASB ASU No. 2017-08, Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20)):
   a. Would an entity need to reassess whether or not instruments held in its portfolio fall within the scope of the ASU at a later date? The EP considered the following scenario;
      • An entity purchased a security at $104 and the first call price is $107. At the date of purchase, the security is not in scope of the ASU. At the next call date, the call price is now $102 and the amortized cost is $103. Is the instrument now in scope of the ASU? The EP considered instruments with multiple call dates, which could be out of scope in one reporting period and in scope in another reporting period.
   b. When calculating the cumulative effect adjustment at the adopting date, would financial instruments within the scope need to be amortized since the purchase date or on a prospective basis? The EP members generally believed the adjustment would be calculated from the purchase date. This view point is consistent with the modified retrospective application required by the standard.

The EP will revisit these issues in the future.

3. Certain funds classify cash pledged as collateral to cover margin requirements in the “due from broker” line item. FASB ASU 2016-18, Statement of Cash Flows (Topic 320), does not define the terms “restricted cash” and “restricted cash equivalents.” An EP member inquired whether expert panel members would object if an investment company didn’t consider collateral recorded within due from broker balances to be ‘restricted cash’ if it had not historically considered these to be restricted cash. BC9 of ASU No. 2016-18 stated that “the Task Force’s intent is not to change practice for what an entity reports as restricted cash or restricted cash equivalents.” Certain EP members expressed a view that such amounts may be considered restricted cash and included in the cash flow statement as such and that the intent of BC9 was to suggest that entities may continue reporting restricted cash as they historically have (i.e., in “due from broker” line item on the balance sheet), as the ASU also calls for a reconciliation of the totals in the statement of cash flows to the related captions in the balance sheet. To the extent that an item was considered to be restricted cash prior to the ASU (regardless of which financial statement line item it was presented in), an entity would include such item in cash and cash equivalents and restricted cash and cash equivalents on the cash flow statement. An entity that historically did not have a policy to determine restricted cash because it was not impactful to the financial statements should consider implementing a policy upon adoption of the standard. [updated December 2019]

4. The EP members discussed the presentation of centrally cleared derivatives on the schedule of investments (SOI) and balance sheet. An EP member inquired whether expert panel members would object to investment companies analogizing to the presentation of futures, where cumulative unrealized appreciation/depreciation is disclosed on the SOI, but variation margin receivable/payable is disclosed on the balance sheet. EP members discussed that they have seen diversity in practice but would not object to analogizing to futures presentation on the SOI for other centrally cleared derivatives. The balance sheet would reflect the rights and obligations of the fund.

5. EP members discussed the distributable earnings caption on the balance sheet, particularly since unrealized appreciation/depreciation is not distributable. One EP member stated that if the fund liquidated at the balance sheet date, unrealized would be distributable. Other EP members agreed that “distributable earnings (loss)” or “distributable earnings (deficit)” is the appropriate caption. Another EP member suggested the caption “total accumulated earnings,” to address the fact that unrealized is not distributable.

III. Audit and Attest Issues:

1. The EP members will review proposed modifications to “Reports on Processing of Transactions by a Transfer Agent” subsection of chapter 12 of the Guide and provide feedback to the AICPA staff by the end of January.

2. During the November 2018 EP meeting, the EP members discussed whether the report required by Form N-CEN should be based on PCAOB attestation standards (AT 101 and AT 601) or PCAOB auditing standards. The EP members noted that the report for the purposes of Form N-CEN is on the company’s internal control over financial reporting and expressed a view that the report should be performed under PCAOB auditing standards rather than attestation standards.

   The EP members revisited this topic and discussed that the report is a byproduct of the audit and would not be considered a separate engagement.

3. The EP discussed recently issued PCAOB standards:
   a. Auditing Accounting Estimates, Including Fair Value Measurements and amendments to PCAOB auditing standards.
   b. Amendments to Auditing Standards for Auditor’s Use of the Work of Specialists

The EP discussed guidance in Appendix 1, par. AS 2501.A4 of Auditing Accounting Estimates regarding reliability of pricing information provided by the pricing services.
The Investment Companies Expert Panel serves the needs of AICPA members on financial and business reporting and audit and attest matters. The expert panel protects the public interest by bringing together knowledgeable parties in the investment companies industry to deliberate and come to agreement on key investment companies issues.

The following are brief highlights of the call:

**AICPA Investment Companies Expert Panel**

**Conference Call Highlights**

**March 12, 2019**

1. **AICPA/Administrative:**
   1. The Expert Panel (EP) January 2019 conference call highlights have been finalized.
   2. The AICPA staff described progress made on initial review of proposed conforming changes to the AICPA Audit and Accounting Guide Investment Companies (the Guide).

2. **Accounting/Reporting Issues:**
   - The EP considered how funds that have adopted a liquidation basis of accounting should account for the accrual of estimated disposal costs for investments (e.g., commissions) still held as of the balance sheet date (i.e., what account is debited). FASB ASC 205-30-25-6 and 25-7 states that “An entity shall accrue estimated costs to dispose of assets or other items that it expects to sell in liquidation and present those costs in the aggregate separately from those assets or items. An entity shall accrue costs and income that it expects to incur or earn (for example, payroll costs or income from preexisting orders that the entity expects to fulfill during liquidation) through the end of its liquidation if and when it has a reasonable basis for estimation.”
   
   The EP generally agreed that estimated disposal costs on investments should be accrued and recorded separately on the balance sheet, in accordance with paragraphs 6-7 of FASB ASC 205-30-25. The EP members also discussed whether estimated disposal costs should be recorded as a debit to cost or expenses or be recorded as a reduction in the net realizable value of the related investment through a debit to change in unrealized gain/loss (income statement), with disclosure in the notes to the financial statements about the estimated disposal costs. The EP members generally believe that consistent with the concepts in FASB ASC 946, the estimated disposal costs should be accounted for in change in unrealized gain/loss (and ultimately realized gain/loss) on the statement of operations, and not as an expense.

   1. An investment adviser of a private equity (PE) fund may set up a separate co-investment vehicle for investing in a specific portfolio company. Due to the limitations of the size of the capital commitments of the PE fund, investors in the PE fund are often given the opportunity to separately invest in the portfolio company (either directly into the portfolio company or through the co-investment vehicle). The portfolio company is held by both the PE fund and the co-investment vehicle. The co-investment vehicle may meet the definition of an investment company based upon FASB ASC 946-10-55-15, which states “An investment company with a single investment also may be formed (for legal, regulatory, tax, or other business reasons) in conjunction with another investment company that holds multiple investments (for example, a master-feeder structure or blocker fund). Investment companies formed in conjunction with each other are not required to be formed at the same time. Holding a single investment for that reason does not necessarily preclude an entity from being an investment company.” While the PE fund has audited financial statements, the co-investment vehicle may not have separate audited financial statements.

   The EP discussed whether a fund investing in both the unaffiliated PE fund and the unaffiliated co-investment vehicle can use the practical expedient for valuation of the co-investment vehicle, and if so, to what extent can the audited financial statements of the PE fund be used for the valuation of the co-investment vehicle if the co-investment vehicle does not have separate audited financial statements.
The EP members agreed that a fund investing in an unaffiliated co-investment vehicle that does not have separate audited financial statements can use the practical expedient to value its investment in the co-investment vehicle if the co-investment vehicle meets both of the criteria in FASB ASC 820-10-15-4 (i.e., (a) the co-investment vehicle does not have a readily determinable fair value and (b) the co-investment vehicle is an investment company within the scope of Topic 946 or the co-investment vehicle is a real estate fund for which it is industry practice to measure investment assets at fair value on a recurring basis and to issue financial statements that are consistent with the measurement principles in Topic 946).

Generally, the EP members believe that the audited financial statements of the unaffiliated PE Fund, which include a valuation of the co-investment vehicle, cannot be used as a sole source to validate the valuation of the unaffiliated co-investment vehicle, as there are various factors to be considered. For example, the materiality level for the co-investment vehicle may be different from the PE fund’s materiality levels or it may hold different investments or securities in the portfolio company. The auditor of the investor fund would consider the materiality, as well as the process and controls, in evaluating whether the net asset value of the co-investment vehicle has been calculated consistent with FASB ASC 946.

2. The FASB issued ASU 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business, which changes the definition of a business to assist entities with evaluating when a set of transferred assets and activities is a business. The guidance requires an entity to evaluate if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or a group of similar identifiable assets; if so, the set of transferred assets and activities is not a business.


3. The EP members considered if a fund that is organized as a partnership with defined classes within the partnership agreement should follow the guidance in FASB ASC 946-235-50-2(d), which requires investment companies to disclose for each class capital share transactions in the notes to the financial statements (if not disclosed separately in the statement of changes in net assets), even though the fund is not a unitized fund with shares. The EP members generally noted that if a fund is organized as a partnership and the partnership agreement clearly defines classes with different terms/economics (such as, liquidity, minimum subscription amount, management fees, among others), the fund should follow the guidance in FASB ASC 946-235-50-2(d) and disclose capital share transactions separately for each class.

III. SEC Staff Update: Disclaimer

The following comments and observations were compiled by the AICPA Investment Companies Expert Panel and AICPA staff and are not authoritative positions or interpretations issued by the SEC or its staff. The comments and observations were not transcribed by the SEC or its staff. Accordingly, these comments and observations do not constitute a statement of the views of the SEC or its staff.

1. Financial Statement Comments In accordance with Section 408(c) of the Sarbanes-Oxley Act, the SEC staff reviews the financial statements of issuers, including registered investment companies, at least once every three years. During the recent government shutdown, certain designated SEC staff performed only “excepted” functions in accordance with their Operations Plan Under a Lapse in Appropriations and Government Shutdown; normal operations resumed in February and the SEC staff shared the following recent financial statement review comments:

a. “Return of capital” policy disclosure – FASB ASC 235-10-50-1 states, in part, that “a description of all significant accounting policies of the entity shall be included as an integral part of the financial statements”. When a registrant has a significant investment in a Master Limited Partnership or a REIT and receives distributions from those investments, an investment company may estimate the portion of the distribution that could be characterized as a return of capital. The SEC staff would expect to see disclosures about the investment company’s accounting policy for return of capital distributions.

b. “Fund of fund” disclosures – registrants should include disclosures about the underlying fund structure when there is a significant investment in an underlying fund. Additionally, registrants should include information about where investors can obtain the financial statements for an underlying fund that represents a significant portion of the registrant’s portfolio. The SEC staff referred to the November 1997 Dear CFO letter which indicates that when a fund of funds has a significant amount of its portfolio invested in a single underlying fund or owns a controlling interest in an underlying fund, the fund of funds should consider providing additional financial information to shareholders. The SEC staff also reminded that pursuant to FASB ASC 946-210-45-7, if an investment in a single underlying fund is so significant to the fund of funds, the fund’s management shall consider whether the presentation of financial statements in a manner similar to a master-feeder fund is more appropriate.

c. Consistency of information presented to investors – the SEC staff may review registrants’ websites for consistency with a registrant’s filings with the Commission. Recent reviews noted fund websites which presented expense ratios that appeared inconsistent with expense ratios included in financial statements and registration statements. SEC staff further noted fund websites that provided no explanation for the difference. The SEC staff reminded registrants to consider the consistency and presentation of information provided to investors.

2. Other Comments The SEC staff also shared other relevant points of outreach:

a. Internet optionality for certain reports of registered investment companies – the recently adopted rule 30e-3 under the Investment Company Act of 1940 will allow certain registered investment companies to transmit shareholder reports by making such reports accessible at a website address specified in a notice to investors. The SEC has also adopted amendments to rule 498 under the
Form N-PORT: The SEC staff discussed the Amendments to the Timing Requirements for Filing Reports on Form N-PORT. These amendments do not affect the amount or timing of the information that will be made available to the public and the current compliance dates for N-PORT did not change.

<table>
<thead>
<tr>
<th>Form N-PORT</th>
<th>Compliance Date for Filing Reports on EDGAR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large Fund Groups</td>
<td>April 1, 2019</td>
</tr>
<tr>
<td>Smaller Fund Groups</td>
<td>April 1, 2020</td>
</tr>
</tbody>
</table>

The Commission amended rule 30b1-9 to require reports on Form N-PORT for each month in a fiscal quarter to be filed with the Commission no later than 60 days after the end of each month. The amended rule 30b1-9 requires that funds, no later than 30 days after the end of each month, maintain in their records the information that is required to be included in Form N-PORT. The following chart shows the filing dates for larger funds groups’ first reports on Form N-PORT:

<table>
<thead>
<tr>
<th>Fiscal Quarter End</th>
<th>First Report on Form N-PORT must be filed on EDGAR by:</th>
<th>Required Monthly Data</th>
</tr>
</thead>
<tbody>
<tr>
<td>March 31, 2019</td>
<td>May 30, 2019</td>
<td>March 2019</td>
</tr>
<tr>
<td>April 30, 2019</td>
<td>July 1, 2019</td>
<td>March, April 2019</td>
</tr>
<tr>
<td>May 31, 2019</td>
<td>July 30, 2019</td>
<td>March, April, May 2019</td>
</tr>
</tbody>
</table>

The SEC staff also discussed the following implementation question related to the interim final rule:

1. For larger fund groups, the compliance date is 4/1/19. For funds with a fiscal quarter ending on 1/31/19 where the 60th day after the end of the fiscal quarter is on 4/1/19 or funds with a fiscal quarter ending on 2/28/19 where the 60th day after the end of the fiscal quarter is on 4/29/19, would these funds need to file their first Form N-PORT filings with the SEC on 4/1/19 or 4/29/19, as applicable?

The SEC staff noted that while funds with these quarter ends would be required to maintain their monthly N-PORT filings in their internal records, the funds will not have to file their Form N-PORTs with the SEC for these quarters and referenced the chart above for compliance dates. The first N-PORT filing date is for funds with a fiscal quarter-end of 3/31/19 where N-PORT filings must be made for quarters ending March 2019 by 5/30/19.

4. PCAOB Standards: The SEC staff explained the process for the Commission’s upcoming vote on the adoption of two new PCAOB standards:
   a. Auditing Accounting Estimates, Including Fair Value Measurements and amendments to PCAOB auditing standards.
   b. Amendments to Auditing Standards for Auditor’s Use of the Work of Specialists.

5. Madison No-Action Letter: The SEC staff discussed the recent Madison Capital Funding LLC, December 20, 2018, no-action letter, specifically items 6 and 7 regarding developing and implementing controls and control attestation (written internal control report). In response to an EP question, the SEC staff noted that the asset verification requirement in item 7 relates to the Control Attestation (internal control report), not a separate requirement to perform asset verification. The SEC staff separately noted that the determination of whether a surprise examination must also be performed is not within the scope of this letter. The SEC staff is encouraging registrants to reach out with specific questions about

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1 Large Fund Groups - funds that together with other investment companies in the same “group of related investment companies” have net assets of $1 billion or more as of the end of the most recent fiscal year of the fund. Smaller Fund Groups - funds that together with other investment companies in the same “group of related investment companies” have net assets of less than $1 billion as of the end of the most recent fiscal year of the fund,

2 [footnote 52] Because 60 days after the fund’s April 30, 2019 fiscal quarter end falls on a Saturday (June 29, 2019), the report on Form N-PORT must be filed with the Commission no later than July 1, 2019 (the next business day). See General Instruction A to Form N-PORT (“If the due date falls on a weekend or holiday, the filing deadline will be the next business day.”). In order to make General Instruction A clearer for registrants, we are moving the due date instruction to the end of the paragraph. See amended General Instruction A to Form N-PORT.
application of the letter’s conditions, including those in items 6 and 7, as necessary, and as specific facts and circumstances, including those concerning the nature of the registered investment company, differ from those described in the letter.

6. IDC No-Action Letter On February 28, 2019, the Division of Investment Management issued a letter to the Independent Directors Council that provides assurance that the staff would not recommend enforcement action to the Commission for certain violations of Sections 12(b), 15(c) or 32(a) of the Investment Company Act of 1940 (the “Act”) or Rules 12b-1 or 15a-4(b)(2) under the Act, which require a registered fund’s board to approve certain items while physically in person. The letter addresses situations where directors cannot meet in person due to unforeseen or emergency circumstances, or where directors previously fully discussed and considered all material aspects of the proposed matters at an in-person meeting but did not vote on the matter during that meeting.

7. OCIE Priorities The SEC Office of Compliance Inspections and Examinations announced its 2019 examination priorities. Perennial risk areas and products and services include matters of importance to retail investors, including seniors and those saving for retirement; compliance and risk in registrants responsible for critical market infrastructure; select areas and programs of FINRA and MSRB; digital assets; cybersecurity; and Anti-Money Laundering.

8. Share Class Initiative The SEC’s Share Class Selection Disclosure Initiative, initially announced in February 2018, resulted in settling charges against 79 investment advisers who will return more than $125 million to clients, mostly retail investors.

9. Staff Changes Brent J. Fields has been named Associate Director of Disclosure Review and Accounting in the SEC’s Division of Investment Management, replacing Barry Miller.

IV. Audit and Attest Issues:

1. The EP was updated on the current status of proposed modifications to “Reports on Processing of Transactions by a Transfer Agent” subsection of chapter 12 of the Guide.

2. The EP members considered whether the Guide should include illustrative audit report for business development companies (BDCs) and separate report issued on senior securities table for BDCs and closed-end funds.
AICPA Investment Companies Expert Panel  
Meeting Highlights  
May 14, 2019  

I. AICPA/Administrative:  
2. The EP offered feedback on certain items relating to conforming changes’ review for the AICPA Audit and Accounting Guide Investment Companies (the Guide).  
3. The EP considered providing industry perspective input for potential comment letter for the recent SEC proposal Amendments to Financial Disclosures about Acquired and Disposed Businesses 

II. Accounting/Reporting Issues:  
1. The EP members discussed the following implementation issues for ASU 2017-08, Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities. The ASU is applicable to securities with explicit, non-contingent call features callable at fixed prices on preset dates and shortens the amortization period to the earliest call date. Specifically, the ASU amends 310-20-35-33 to state “to the extent that the amortized cost basis of an individual callable debt security exceeds the amount repayable by the issuer at the earliest call date, the excess (that is, the premium) shall be amortized to the earliest call date...” If call option is not exercised after earliest call date, the effective yield is reset using payment terms of the debt security (i.e., to next call date/price or to maturity, as applicable). The ASU does not change the accounting for securities purchased at a discount; discounts will continue to be amortized to the maturity date. The following document includes illustrative examples discussed by the EP members.
### Example Calculation

**ASU 2017-08**

<table>
<thead>
<tr>
<th>Fact Pattern</th>
<th>Prior GAAP</th>
<th>ASU 2017-08</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amortized cost basis at purchase (31 Dec 2020)</td>
<td>$109</td>
<td></td>
</tr>
<tr>
<td>Amount repayable at first call date (31 Dec 2030)</td>
<td>$104</td>
<td></td>
</tr>
<tr>
<td>Par amount at maturity (31 Dec 2050)</td>
<td>$100</td>
<td></td>
</tr>
</tbody>
</table>

| Amortization 2021–2030                                  | $3*        | $5          |
| (realized loss of $2 if called)                        |            | ($109 – $104) |
| Amortized cost at 31 Dec 2030                          | $106       | $104        |
| (if not called)                                        | ($104 – $100) |
| Amortization 2031–2050                                  | $6*        | $4          |
| (if not called)                                        |            | ($104 – $100) |
| Total                                                  | $9         | $9          |
|                                                        | ($109 – $100) | ($109 – $100) |

* Generally results in lower interest income earlier, but no loss if called

* The $3 and $6 is calculated using a straight line method for simplicity.
## Calculating the Cumulative-Effect Adjustment upon Adoption

*ASU 2017-08*

<table>
<thead>
<tr>
<th>Fact Pattern</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchase price (1 Jan 2018)</td>
<td>$110</td>
</tr>
<tr>
<td>Amount repayable at first call date (30 Nov 2018)</td>
<td>$105</td>
</tr>
<tr>
<td>Amortized cost per financial statements (31 Dec 2018)</td>
<td>$107</td>
</tr>
<tr>
<td>Amount repayable at second call date (31 Dec 2019)</td>
<td>$102</td>
</tr>
</tbody>
</table>

### Option 1

Determine what amortized cost would be as if the fund, since the purchase date, applied the guidance in ASU 2017-08 and amortized to the earliest call date.

In the example, if the fund had applied the new guidance on the purchase date on 1/1/18, the fund would have amortized to $105 by 11/30/18 (1st call date).

After 11/30/18, the fund would have started amortizing so the fund could be at $102 on 12/31/19 (2nd call date).

Assume this would have resulted in amortized cost of $104 on 12/31/18. The cumulative-effect adjustment to cost under Option 1 is $3 (to get from $107 to $104).

### Option 2

Disregard the 1st call date, as it was prior to the fund’s adoption of ASU 2017-08.

Determine what amortized cost would be if the fund had been amortizing since purchase to the first call date after adoption (in this case, to the 2nd call of $102 at 12/31/19).

Assume this would have resulted in amortized cost of $106 on 12/31/18. The cumulative effect adjustment to cost under Option 2 would be $1 (to get from $107 to $106).

### Options 1 and 2 are acceptable methods of calculating the cumulative-effect adjustment to amortized cost

* Date of adoption for this example is the fiscal year ended December 31, 2019.
Select Implementation Questions
ASU 2017-08

• Should entities re-assess whether an instrument falls into the scope of the standard at later call dates?
  • Yes, there should be a continual reassessment.

<table>
<thead>
<tr>
<th>Fact Pattern</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchase price (1 Jan 2020)</td>
<td>$105</td>
</tr>
<tr>
<td>Amount repayable at first call date (31 Dec 2020)</td>
<td>$107</td>
</tr>
<tr>
<td>Amortized cost at 31 Dec 2020</td>
<td>$104</td>
</tr>
<tr>
<td>Amount repayable at second call date (31 Dec 2021)</td>
<td>$102</td>
</tr>
</tbody>
</table>

• At 1/1/20, debt security is not in scope of standard – amortize premium of $5 to maturity (par value is $100)
• At 12/31/20, amortized cost is now $104, and debt security is not called. Next call date is 12/31/21 at $102
• Debt security is now in scope, and entity should amortize the debt security from current amortized cost of $104 to the next call price of $102 at 12/31/21
Select Implementation Questions
ASU 2017-08

• Are debt securities that are callable at fixed prices “on or after” or “on and after” pre-set dates in scope of ASU 2017-08?
  • Yes, such securities are equivalent to securities callable on pre-set dates for purposes of ASU 2017-08.
  • This scenario is common for municipal bond securities.

• Are debt securities which are callable at any time with a 30-day notice period in scope of ASU 2017-08?
  • No, because there is no pre-set call date and price.
  • The Basis for Conclusions within the ASU indicates that the FASB did not intend for securities that are immediately prepayable to be in scope.
2. An EP member inquired about best practice financial statement presentation for income statement items for entities that invest in mineral and royalty interests in producing oil and gas properties. These entities incur depletion expenses on the properties they hold and receive income from the underlying interests in these properties.

The EP members discussed that first, the entity should determine whether it meets the definition of an investment company under FASB ASC 946. The EP also discussed that presentation on the income statement may depend on the composition of the portfolio (e.g., does the entity have a direct investment in oil and gas properties or is it invested in a portfolio that invests in oil/gas properties). The EP members discussed whether the fund should record depletion expense related to the oil/gas properties as a direct expense to the income statement or an offset to the cost, which would flow through the unrealized/realized gains(losses). Certain EP members believed that the depletion expense was an attribute of the investment and would be accounted for as an offset to cost; while others believed it was more transparent to present the depletion expense gross as an expense on the income statement.

3. The EP members discussed whether a fund of funds (FOF) could change between using net asset value (NAV) as a practical expedient to using a true fair value measurement in accordance with the fair valuation principles in ASC 820, when it is not probable of selling a portion of an investment in an underlying fund at an amount different from NAV/share. The EP noted the guidance in ASC 820-10-35-61:

A reporting entity shall decide on an investment-by-investment basis whether to apply the practical expedient in paragraph 820-10-35-59 and shall apply that practical expedient consistently to the fair value measurement of the reporting entity’s entire position in a particular investment, unless it is probable at the measurement date that the reporting entity will sell a portion of an investment at an amount different from net asset value per share (or its equivalent) as described in the following paragraph. In those situations, the reporting entity shall account for the portion of the investment that is being sold in accordance with this Topic (that is, the reporting entity shall not apply the guidance in paragraph 820-10-35-59).

The EP expressed a view that a FOF could change valuation from NAV practical expedient to a true fair value measurement, as the change would result in a measurement that is equally or more representative of fair value. The EP also discussed whether such change would be considered a change in estimate or a change in accounting principle under FASB ASC 250, Accounting Changes and Error Corrections.

4. The EP discussed the following scenario. Near the end of a private equity (PE) fund’s life, the general partner may have an obligation to return previously received carried interest (a clawback) but may not have the financial resources to pay that obligation. In the discussion of accounting for clawbacks, AICPA TQA 6910.29 states that “it may not be appropriate to reflect a negative general partner capital balance (and a corresponding increase to limited partner capital balances) if the general partner does not have the financial resources to make good on its obligation”.

The EP discussed whether:

- In situations in which the PE fund determines it inappropriate to reflect a negative general partner capital balance, should a liability be recorded for the clawback obligation to the limited partners? The EP members believed in most situations the clawback is the general partner’s obligation, not the fund’s, and as such, the fund would not record a liability. The EP members also discussed if the fund should assess the general partner’s ability to pay the clawback, including whether or not the general partner’s capital balance should be brought up to zero with a corresponding reduction of the limited partner balances.
• Should the general partner’s inability to return the clawback to the fund be considered in assessing substantial doubt about the PE’s fund ability to continue as a going concern in applying FASB ASC 205-40, *Going Concern*? The EP members believed this would be a factor in the going concern analysis for the fund in assessing the general partner’s overall financial viability and ability to continue providing advisory services.

III. SEC Staff Update: Disclaimer

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1. Division of Investment Management Update: New staff appointments and newly announced Smaller Fund Outreach Effort
2. Commission Update:
   - The SEC staff highlighted Chairman Clayton’s Testimony before the Financial Services and General Government Subcommittee of the U.S. Senate Committee on Appropriations.
   - The SEC recently hired a Chief Risk Officer, whose office will focus on identifying uses and potential exposure of data.
   - The SEC staff discussed Remarks before the 2019 Baruch College Financial Reporting Conference: Aiming toward the future by Wesley Bricker, SEC Chief Accountant.
3. Staff Guidance: The SEC staff reminded the EP about fall 2018 Statement Regarding Staff Views by Chairman Clayton, including that “all staff statements are nonbinding and create no enforceable legal rights or obligations of the Commission or other parties” and among other SEC divisions and offices, the Division of Investment Management “will continue to review whether prior staff statements and staff documents should be modified, rescinded or supplemented in light of market or other developments”. The SEC staff encouraged registrants and their auditors to engage in dialogue with the staff regarding any guidance that they believe may need to be rescinded or updated.
4. Surprise Examinations: In response to a question from an EP member regarding timing of a surprise examination pursuant to SEC Rule 17f-2, the SEC staff noted no changes to, or new interpretations of, the rule. The SEC staff encouraged audit firms reach out to a SEC disclosure accountant regarding further questions.
5. Policy Matters:
   a. Proposed rule Securities Offering Reform for Closed-End Investment Companies.
   b. The SEC staff informed the EP about SEC proposed amendments to the accelerated filer and large accelerated filer definitions.
   c. The SEC staff discussed proposed amendments to Regulation S-X with respect to financial disclosures of acquired and disposed businesses. In the release, the Commission proposes impacts to registered investment companies, including BDCs, as follows:
      - Creating a new, two-part significant subsidiary test specifically for investment companies which also eliminates the asset test. The proposed 1-02(w)(2) significance tests include two tests, an investment test and a two-part income test, as follows:
        i. **Investment Test:** A subsidiary is considered significant if the value of the registrant’s and its other subsidiaries’ investment in and advances to the tested subsidiary exceeds 10% of the value of the total investments of the registrant and its subsidiaries consolidated as of the end of the most recently completed fiscal year; or
        ii. **Income Test:** A subsidiary will be deemed significant under the income test if the sum of a subsidiary’s investment-related income (interest, dividends, other income, realized and unrealized gains and losses) is greater than either (1) 80% of the registrant’s net increase or decrease in net assets resulting from operations (or net
income equivalent) by itself or (2) 10% of the net increase or decrease in net assets resulting from operations and the investment test for investment companies yields a result of greater than 5% (“alternate income test”). The proposed rule also includes guidance as to when to utilize a five year absolute value average.

- Amending Form N-14 and creating a new rule 6-11 to govern the financial reporting requirements for acquisitions involving investment companies that would:
  i. Require certain financial information for investment company acquisitions of other investment companies, including private funds and separate accounts if they meet certain significance thresholds. The financial information of the acquired funds would include one year of audited financial statements prepared in accordance with U.S. GAAP, except for the schedule of investments (or equivalent schedule) prepared in accordance with the provisions of Article 12 of Regulation S-X.
  ii. Eliminate certain pro forma financial information requirements and instead require supplemental information about newly, combined entities that would include: (1) a pro forma fee table, setting forth the post-transaction fee structure of the combined entity; (2) if the transaction will result in a material change in the acquired fund’s investment portfolio due to investment restrictions, a schedule of investments of the acquired fund modified to show the effects of such change and accompanied by narrative disclosure describing the change; and (3) narrative disclosure about material differences in accounting policies of the acquired fund when compared to the newly combined entity.

- SEC staff discussed the adoption of a final rule to implement the FAST Act mandate to modernize and simplify disclosure.

6. Operational Matters:
   a. Reviews – The SEC staff described the financial statement review and comment process. As required by the Sarbanes-Oxley Act, all public companies, including registered investment companies, are subject to the financial statement review process at least once every three years (SOX Review). In addition to the SOX Reviews, the SEC staff may also perform targeted in-depth reviews of certain types of investment companies. The SEC staff reviews not only financial statements but also accounting information included in other filings with the SEC, such as merger filings to ensure consistency and compliance with securities laws. The SEC staff will also review website disclosures. The SEC staff generally provides financial statement review comments verbally, and registrants are generally required to provide written responses within 30 days. In certain circumstances, comments may be given to the registrant in a written letter. Lack of comments does not mean that financial statement reviews have not been performed. Certain investment companies may have been reviewed but the reviewer does not have comments.
   b. The SEC staff provided the following perspectives on financial statement review comments:
      • Audited Annual Financial Statement Requirement: In a SOX review, SEC staff identified a fund that did not file its annual audited financial statements on Form N-CSR. The registrant explained that the fund was acquired post fiscal year end but before the date the report was to be transmitted to shareholders. The registrant took the position, under Rule 30e-1, that there were no stockholders of record on transmission date as the fund was acquired prior to that date. Thus, the registrant did not prepare annual financial statements, obtain an audit, or as a result, file financial statements on form N-CSR. The SEC staff disagreed with this conclusion.
      • Similar situations have arisen in the past, in which no-action relief was provided which allowed for a registrant to notify investors at the time the share confirmation related to the reorganization was sent to shareholders, that the shareholders could request a copy of the annual report at no charge, but the registrant would not have to transmit the annual report to all shareholders. The registrant still prepared their financial statements, obtained an audit, and filed those audited financial statements with the Commission.
• Financial Statements contained in a Registration Statement: The Staff discussed a fact pattern involving an initial registration statement of a fund that contained financial statements, which included a seed balance sheet audit where the date of the audited financial statements contained in the initial registration statement would become stale (e.g. 16 months) shortly after the expected filing of the fund’s annual report and prior to the next annual prospectus update. The Staff noted the requirements of Section 10(a)(3) of the 1933 Act which requires when a prospectus is used more than nine months after the effective date of the registration statement, the information contained therein shall be as of a date not more than sixteen months prior to such use. The Staff reminds stakeholders to consider the dating requirements in connection with an initial registration statement with advice of the adviser, counsel, and auditors.

• Negative Fee Funds: Recently a fund launched with a negative fee. This fund has not filed financial statements to date, thus, the staff is still considering the applicable accounting treatment of adviser payments (reimbursements) that are greater than the fund’s expenses accrued, and the Staff encourages registrants and auditors to do the same when these types of payments arise. The staff has previously issued guidance around affiliate payments in staff accounting bulletin 5.T and the 1994 Dear CFO letter.

• Fund of Private Equity Funds/Fund of Venture Capital Funds: The Staff discussed a recent observation from the review of a fund of private equity funds which had a strategy that includes the purchase and sale of underlying private equity funds over the life of the top tier fund. While many funds of private equity funds utilize NAV as a practical expedient to fair value, the Staff reminds stakeholders to evaluate the requirements of ASC 820-10-35-62 for fund of private equity funds that intend to sell private equity fund interests on private secondary markets.
  • ASC 820-10-35-62 highlights: A reporting entity is not permitted to estimate the fair value of an investment (or a portion of the investment) within the scope of paragraphs 820-10-15-4 through 15-5 using the net asset value per share of the investment (or its equivalent) as a practical expedient if, as of the reporting entity’s measurement date, it is probable that the reporting entity will sell the investment for an amount different from net asset value per share (or its equivalent).

7. Data Analytics:
   a. The SEC Staff discussed recent observations from form N-CEN filings and informed the EP that the SEC has started receiving data on from N-PORT for larger entities.

8. Digital Assets Update:
   a. The SEC staff informed the EP about How We Howey, a speech at Securities Enforcement Forum by Commissioner Hester M. Peirce, delivered May 9, 2019.
   b. SEC is seeking feedback on Division of Investment Management staff letter to Investment Adviser Association regarding non-DVP custodial practices and digital assets.
   c. The SEC staff informed the Expert Panel about the FinTech Forum to be held at the SEC on May 31, 2019. The forum focused on distributed ledger technology and digital assets and a replay can be found here.

IV. Audit and Attest Issues:
1. The EP was updated on the status of proposed modifications to “Reports on Processing of Transactions by a Transfer Agent” subsection of chapter 12 of the Guide.
2. During the March EP conference call, the SEC staff discussed the recent Madison Capital Funding LLC, December 20, 2018, no-action letter, specifically items 6 and 7 regarding developing and implementing controls and control attestation (written internal control report). In response to an EP question, the SEC staff noted that the asset verification requirement in item 7 relates to the Control Attestation (internal control report), not a separate requirement to perform asset verification. During May EP meeting, the EP considered whether to undertake an EP project to draft a new attestation report. The EP decided not to pursue this effort currently but may consider it in the future.
3. The EP members discussed comments on the following draft illustrative audit reports for potential inclusion into the Guide:
   a. Business Development Companies (BDCs)
b. Separate reports issued on senior securities table for BDCs and closed-end funds.

4. The EP discussed the following questions presented by one EP member:
   a. Regarding whether the Guide should provide guidance to auditors to consider
certainty/non-disclosure agreements in determining whether to disclose the investees 
name in their auditor’s report. The EP noted that the standards do not contemplate
confidence/non-disclosure agreements; as such, the Guide also does not contemplate such
agreements. Accordingly, any removal or non-disclosure of required investee names would be
considered a departure from U.S. GAAP.
   b. The EP does not plan to change the guidance in Chapters 7 and 12 of the Guide at this time.
AICPA Investment Companies Expert Panel Conference Call Highlights
July 16, 2019

I. AICPA/Administrative:
   1. The Expert Panel (EP) May 2019 meeting highlights are being finalized.
   2. The EP considered several items for the AICPA Audit and Accounting Guide Investment Companies (the Guide).

II. Accounting/Reporting Issues:
   1. The EP discussed the following scenario. A fund was formed with no plan of liquidation specified in its governing documents at inception. Several years later, the fund modified its governing documents to establish a limited life of five years from the date of the modification. The fund continued its operations for the next four years and in year 5, began the liquidation process and started selling its investments in an orderly manner. The EP discussed whether the fund should apply the liquidation basis of accounting and if so, when. ASC 205-30-25-1 states that an entity shall prepare financial statements in accordance with the requirements of this Subtopic when liquidation is imminent unless the liquidation follows a plan for liquidation that was specified in the entity’s governing documents at the entity’s inception.

   The EP expressed a view that since the modification of the fund’s documents created a change in the purpose and design of the entity and the fund is following a liquidation plan specified in its revised governing documents, the liquidation basis of accounting would not apply to the fund’s financial statements in year 5 (when the fund began the liquidation process and selling its investments at fair value).

III. Audit and Attest Issues:
   1. The EP members considered EP members’ feedback received to date and determined immediate next steps relating to the following draft illustrative audit reports:
      a. Business Development Companies (BDCs)
      b. Separate reports issued on senior securities table for BDCs and closed-end funds.

IV. SEC Staff Update:
Disclaimer

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Division of Investment Management Update:

1. SEC personnel news:
   a. Division of Investment Management’s Chief Accountant’s Office is seeking candidates for a 2019 Professional Accounting Fellow Position.
   b. Allison Herren Lee was sworn into office as an SEC Commissioner earlier this July.
   c. Following the departure of Wes Bricker, Sagar Teotia has been named the SEC’s Chief Accountant.

2. PCAOB-related:
   a. The SEC issued a Statement on Commencement of Appointment Process for the 2019-2024 PCAOB Board Seat. This board seat is for a non-CPA.
   b. SEC recently adopted these two PCAOB standards:
      - Amendments to Auditing Standards for Auditor's Use of the Work of Specialists
      - Auditing Accounting Estimates, Including Fair Value Measurements, and Amendments to PCAOB Auditing Standards
   c. Earlier this year, the PCAOB held webinars on implementing critical audit matters (CAM) requirements.
   d. The PCAOB staff issued several publications:
      - Overview of Staff Guidance on Audit Committee Communications Related to Independence (May 31, 2019)
      - Rule 3526(b) Communications with Audit Committees Concerning Independence (May 31, 2019)
      - Implementation of Critical Audit Matters: A Deeper Dive on the Communication of CAMs (May 22, 2019)

3. The SEC adopted amendments to the auditor independence rules relating to the analysis that must be conducted to determine whether an auditor is independent when the auditor has a lending relationship with certain shareholders of an audit client. These amendments will become effective 90 days after they are published in the Federal Register.

4. Five federal financial regulatory agencies (Federal Reserve Board, the Commodity Futures Trading Commission, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Securities and Exchange Commission) adopted a final rule to exclude community banks from the Volcker Rule, consistent with the Economic Growth, Regulatory Relief, and Consumer Protection Act. The Volcker Rule generally restricts banking entities from engaging in proprietary trading and from owning, sponsoring, or having certain relationships with hedge funds or private equity funds. Under the final rule, community banks with $10 billion or less in total consolidated assets and total trading assets and liabilities of 5 percent or less of total consolidated assets are excluded from the Volcker Rule. The final rule also permits a hedge fund or private equity fund, under certain circumstances, to share the same name or a variation of the same name with an
investment adviser as long as the adviser is not an insured depository institution, a company that controls an insured depository institution, or a bank holding company.

5. Recent no-action letters:

The staff issued a no-action letter, **Staff Letter No-Action relief under Sections 5(b), 13(a)(1) and 34(b) of the Investment Company Act of 1940** where the staff would not recommend enforcement action to the Commission under Sections 13(a)(1) or 34(b) of the 1940 Act against an index-based fund that exceeds the limits for a diversified company, as defined in Section 5(b)(1) of the 1940 Act. The basis for relief considered a number of items, as discussed in the no-action letter.

6. Policy Matters:

Consistent with 2018 **Statement Regarding Staff Views** by Chairman Clayton, the staff noted that the Division of Investment Management continues to review “whether prior staff statements and staff documents should be modified, rescinded or supplemented in light of market or other developments”. As part of their review, the SEC staff may consider prior meeting highlights to determine if any previously issued guidance or past communication of a staff position has been superseded by more current guidance or rule.

7. Operational Matters:

   a. The staff highlighted that they are performing an analysis of financial statement review correspondence, including evaluating the comments provided to and responses received from registrants.

   b. The SEC staff provided the following perspectives on financial statement review comments:

      • The staff provided comments on a related party transaction in connection with Fair Fund payments. A Fair Fund is a fund established by the SEC to distribute disgorgements (returns of wrongful profits) and penalties (fines) to defrauded investors. Meaning, if a fund is harmed and it gets money back, the money is distributed to the fund from the Fair Fund. The staff discussed a fund that had an agreement with an affiliate of the adviser to handle the administration of the distribution of the fair fund payments. The adviser affiliate would collect a percentage of any fair fund payments received by the fund. The staff reminded registrants to consider disclosure requirements of ASC 850 for related party transactions and Regulation S-X 6-07. The extent and nature of the disclosure may depend upon specific facts and circumstances.

8. Enforcement update:

   June 2019 – a private fund manager in the mortgage-backed securities space has agreed to pay a $5 million penalty to settle charges stemming from compliance deficiencies that contributed to the firm’s failure to ensure that certain securities in its flagship fund were valued properly.
AICPA Investment Companies Expert Panel  
Meeting Highlights  
September 17, 2019

I. AICPA/Administrative:
   1. The Expert Panel (EP) July 2019 call highlights are being finalized.

II. Accounting/Reporting Issues:
   1. The EP discussed the potential impact of Indian Surcharge (capital gain) Tax on accrued income taxes for investment companies under GAAP. The August 24, 2019, press release “Government withdraws enhanced surcharge on tax payable on transfer of certain assets” by India’s Commissioner of Income Tax states, in part:
      
      “the enhanced surcharge shall be withdrawn on tax payable at special rate by both domestic as well as foreign investors on long-term & short-term capital gains arising from the transfer of equity share in a company or unit of an equity oriented fund/business trust which are liable for securities transaction tax and also on tax payable at special rate under section 115AD by the FPI on the capital gains arising from the transfer of derivatives. However, the tax payable at normal rate on the business income arising from the transfer of derivatives to a person other than FPI shall be liable for the enhanced surcharge.”

   The EP members noted that the press release by itself would not constitute sufficient evidence to withdraw a surcharge related to capital assets, until enacted into law. As such, many entities are not currently adjusting their tax accruals for the surcharge withdrawal.

   Representatives of the ICI later joined the EP meeting to share their efforts in pursuing the Indian government to take further legislative action.

   Subsequent to the September 2019 EP meeting, the Indian government issued an ordinance to amend the Indian Surcharge Tax to provide that the enhanced surcharge does not apply to capital gains from a sale of securities or derivatives in an investment company. An entity should consider its facts and circumstances to determine whether the ordinance would be considered enacted law.

   2. An EP member inquired what asset managers and investment companies are doing with the cessation and transition away from London Interbank Offer Rate (LIBOR) and what challenges and related
disclosures, if any, may be expected for the 2019 year-end. While the discontinuation of LIBOR is not effective until 2021, the EP members acknowledged the importance of analyzing existing contracts for entities investing in instruments referencing LIBOR as these instruments’ liquidity, functioning and value may be affected. The EP also noted the SEC Staff Statement on LIBOR Transition (including SEC Investment Management Division’s specific industry guidance) and recent FASB proposal on reference rate reform. The FASB proposed providing temporary optional expedients and exceptions to the US GAAP guidance on contract modifications and hedge accounting in light of the expected market transition from LIBOR and other reference interest rates to alternatives, such as Secured Overnight Financing Rate (SOFR). Under the proposal, an entity could choose not to apply certain modification accounting requirements in US GAAP to contracts affected by what the proposal calls reference rate reform, if certain criteria are met. An entity that made this election would present and account for a modified contract as a continuation of the existing contract. Any contemporaneous changes to other terms (i.e., those that don’t directly replace or have the potential to replace a reference rate) that change, or have the potential to change, the amount and timing of contractual cash flows must be related to the replacement of the reference rate.

The transition to new reference interest rates will require countless contracts (e.g., derivative contracts, variable rate debt agreements) to be modified. The proposal is intended to mitigate the effect of this transition on financial reporting.

3. At the December 2012 and March 2017 EP meetings, the EP noted that for private equity funds, industry practice is generally to defer placement agent fees and charge them to capital when called. The fund may have a negative capital balance if placement fees are greater than seed capital. In certain circumstances, the placement fees may be payable upon the initial capital call and are not refundable; however, in other circumstances, the placement fees may be refundable if subsequent capital calls are not received by the fund. An EP member inquired as to how placement fees should be deferred or amortized when capital is called over time (i.e., pro-rata as each capital commitment is called or entire amount upon receipt of the first capital commitment called). Guidance considered:

- ASC 946-20-25-5 states “Offering costs of closed-end funds and investment partnerships should be charged to paid-in capital upon sale of the shares or units.”
- ASC 946-20-25-6 states, “Offering costs of open-end investment companies and of closed-end funds with a continuous offering period shall be recognized as a deferred charge.”
- ASC 946-20-35-5 states that “offering costs recognized as a deferred charge under ASC 946-20-25-6 shall be amortized to expense over 12 months on a straight-line basis when operations begin.”
- TQA 6910.24 states “Some investment partnerships may offer their interests at a single point in time and require new investors to commit to providing capital contributions over a period of time. As interests are not available for purchase over a continuous period, such investment partnerships would not be deemed to have a continuous offering period.”
- Paragraph 8.31 of the Guide states “Some closed-end funds and business development companies offer stock through shelf registration statements. According to Q&A section 4110.10, "Costs Incurred in Shelf Registration," legal and other fees incurred for a stock issue under a shelf registration should be capitalized as a prepaid expense. When securities are taken off the shelf and sold, a portion of the costs attributable to the securities sold should be charged against paid-in-capital. Any subsequent costs incurred to keep the filing "alive" should be charged to expense as incurred. If the filing is withdrawn, the related capitalized costs should be charged to expense.
- SAB Topic 5.A, Expenses of Offering (ASC 340-10-S99-1) states “Specific incremental costs directly attributable to a proposed or actual offering of securities may properly be deferred and charged against the gross proceeds of the offering.”
The EP noted that each circumstance may be unique, and an entity would need to consider the above guidance in its analysis.

4. A fund may have an arrangement with its adviser to waive management fees to the extent that placement fees are paid by the fund. In certain master feeder structures, the placement fees may be paid by the master fund since the management fees that are subject to waiver are also paid by the master fund. However, the placement fees are directly attributable to the capital raised by the feeder fund (and indirectly attributable to the feeder fund’s capital contribution into the master fund). The EP members discussed the following two views:

   o View A – The placement fees should be accounted for at the feeder fund. The placement fees are directly attributable to each specific investor’s capital contribution into the feeder fund.

   o View B – The placement fees should be accounted for at the master fund. The placement fees are indirectly attributable to the feeder fund’s capital contribution into the master fund and are offset against the management fees incurred by the master fund. The placement fees would then be allocated to the extent attributable to the feeder fund. The feeder fund would account for the placement fees as a component of income and expenses allocated from the master fund, similar to an incentive allocation accounted for at the master fund. ASC 946-205-50-17 states “If, in a master-feeder structure, an incentive is levied as an allocation at the master level, the feeder shall present its share of the incentive allocation as a separate line item in the statement of operations.”

The EP expressed a view that the in order to determine how the placement fees should be accounted for an entity should look at the legal agreements and understand which entity is legally obligated to pay the fee.

5. The EP members discussed that they have not observed any funds expecting to have significant or material allowances upon adoption of FASB ASU 2016-13, Financial Instruments: Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (CECL). Generally, receivables not accounted for at fair value would be within scope of the standard. The EP members discussed per FASB ASC 326-20-30-5A, there is an ability for an entity to make an accounting policy election not to book an allowance on interest receivable, if the entity writes off the uncollectible accrued interest receivable in a timely manner; however, the EP members noted that “timely” was not defined by the FASB. Please refer to March 2018 and November 2018 EP minutes for additional discussions of the impact on CECL on investment companies.

6. The EP members discussed whether participation in related cryptocurrency activities (i.e. crypto mining activities) disqualify an entity from classification as an investment company within the scope of Topic 946 Financial Services – Investment Companies. ASC 946-10-55-3 states that to be an investment company, an entity shall possess the fundamental characteristics in paragraph 946-10-15-6, which states:

   o An investment company has the following fundamental characteristics:

     ▪ It is an entity that does both of the following:

       • Obtains funds from one or more investors and provides the investor(s) with investment management services

       • Commits to its investor(s) that its business purpose and only substantive activities are investing the funds solely for returns from capital appreciation, investment income, or both.

     ▪ The entity or its affiliates do not obtain or have the objective of obtaining returns or benefits from an investee or its affiliates that are not normally attributable to ownership interests or that are other than capital appreciation or investment income.
ASC 946-10-55-4 further states that an investment company should have no substantive activities other than its investing activities and should not have significant assets or liabilities other than those relating to its investing activities, subject to certain exceptions outlined in ASC 946-10-55-5:

“An investment company may provide investing-related services (for example, investment advisory or transfer agent services) to other entities, directly or indirectly through an investment in an entity that provides those services, as long as those services are not substantive. However, an investment company may provide substantive investing-related services, directly or indirectly through an investment in an entity that provides those services, if the substantive services are provided to the investment company only.”

The EP expressed a view that generally cryptocurrency mining would be inconsistent with substantive activities of an investment company (that is, investing activities or investing-related activities described above), as it would include setting up computers, running programs, etc. However, some EP members noted that an entity which invests in cryptocurrency and is mining cryptocurrency may analogize to loan origination activity in a fund that trades loans. AICPA TQA 6910.36 states that when determining whether loan origination is a substantive activity when assessing whether an entity is an investment company, “the entity should consider its design, business purpose (see FASB ASC 946-10-55-4 through 946-10-55-7), and the reason for performing the activities (see FASB ASC 946-10-55-10), including how the entity is marketed and presented to current and potential investors. If an entity believes it is an investment company under FASB ASC 946, the entity’s design, business purpose, and how it holds itself out to investors should be consistent with those of an investment company.

The EP members discussed that while one may analogize mining activities with loan origination, if mining constitutes a substantive part of investment company’s activity, it may disqualify an entity from being an investment company.

The EP members also discussed whether an entity that validates cryptocurrency may still be considered an investment company. The EP members discussed that an entity that engages in validating cryptocurrency solely to validate the cryptocurrency it holds, may still qualify as an investment company. However, if an entity was validating cryptocurrency on behalf of others, then it may not qualify as an investment company.

7. The EP commenced discussion on potential accounting, auditing and regulatory considerations regarding Overstock.com declaring a dividend on its shares that is payable in digital shares.

III. SEC Staff Update:

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Division of Investment Management Update:

- Operations Related:
  - Program Update
    - Update on Comment Compilation Project and Thematic Comments: The SEC staff highlighted that during fiscal year ended September 30, 2019, the SEC staff has completed 4,600 Sarbanes-Oxley reviews of financial statements of regulated
investment companies, and also reviewed 800 registration statements. Additionally, the SEC staff has compiled comments issued to registrants from such reviews to identify what themes are emerging and to consider whether any guidance is necessary.

The SEC staff also continues to encourage registrants to dialogue with the staff, including the assigned accountant, Branch Chief, or Chief Accountant, directly if there are any questions regarding a comment issued and before filing a response letter.

Financial Statement Review Comments:

- **N-CEN Change in Auditor** – Item B.17.f of Form N-CEN requires registrant to disclose whether the auditor has changed since the last filing. The registrant can have multiple series audited by different auditors. Some registrants have only marked item B.17.f if all auditors have changed since prior filing. The SEC staff reminded registrants with multiple series and multiple auditors that if a particular series changed an auditor, such change should be noted.

- **Expense Limitation Issue** – The staff highlighted a potential situation where a registered investment adviser (RIA) enters into an expense limitation agreement, whereby the RIA would reimburse the fund for expenses incurred in excess of the maximum limit permitted by the agreement. If the maximum limit was met and a receivable was recorded, the collectability of the receivable should be evaluated. The staff described situations where an RIA was unable to reimburse a fund, and the fund administrator determined that the due from adviser amounts were deemed uncollectable and were written off. Subsequently, the board determined to liquidate the fund. The staff reminded relevant stakeholders to continue to evaluate the collectability of any amounts receivable on a fund’s balance sheet including consideration of the payment terms specified in the advisory agreement.

- **NAV Errors Reminder** – Item B.22 of Form N-CEN requires an open-end investment company to disclose payments made to shareholders as a result of NAV errors. The SEC staff reminded registrants that to the extent the subsequent payment is made by an affiliate, the fund should consider whether the disclosure requirements of FASB ASC Topics 850-10 and 946-20 apply.

Policy Related:

- **Relief Requests and Consultation – Year in Review**
  The SEC staff noted that all relief requests are based on specific facts and circumstances and are evaluated on a case by case basis. The SEC staff are open to hearing registrants’ positions and recommend that their auditors are part of the registrant’s relief request.

- **3-09/4-08(g) Fact Patterns:**
  - Rules 3-09 and 4-08(g) of Regulation S-X prescribe the reporting requirements for separate financial statements or summarized financial information is required for subsidiaries not consolidated and 50 percent of less owned persons (“the subsidiaries”), if these subsidiaries meet certain significance thresholds in the significant subsidiary conditions set forth in Rule 1-02(w) or Regulation S-X.
  - The SEC staff noted that the majority of these types of relief requests relate to anomalous differences that cause the “income test” to be triggered. For example, when an investment is sold or completely written off for tax purposes, a registrant may recognize a large realized gain or loss for the period.
  - One request related to a situation where the “asset test” was triggered, but neither the investment test nor the income test were triggered. In lieu of providing a full set of audited financial statements of the investment that triggered the test as required under Rule 3-09, the registrant provided Rule 4-
08(g) information (that is, disclosure of a summarized balance sheet and income statement in the notes to the financial statements).

- The SEC staff stated that they generally do not grant relief for investments that trigger the “investment test” as they believe it is the most relevant test for investment companies because it provides investors with an understanding of an investment’s significance compared to that of the registrant’s overall portfolio.

• Insurance Product Relief continues – The SEC staff discussed the application of Rule 3-13 of Regulation S-X that states, “the Commission may, upon the informal written request of the registrant, and where consistent with the protection of investors, permit the omission of one or more of the financial statements required, or the filing in substitution therefor of appropriate statements of comparable character” to insurance company sponsors of non-variable insurance products. Seven no-action letters have been issued on this topic to date granting relief to use financial statements prepared in accordance with statutory accounting principles in lieu of financial statements prepared under U.S. GAAP in registration statements filed under the Securities Act of 1933 on Form S-1. When considering relief, the SEC staff considered, among other matters, 1) whether statutory financial statements would allow an investor/contract holder the ability to determine if the insurance company sponsor could pay its claims and meet its contractual obligation; 2) whether the reporting entity would not otherwise prepare US. GAAP financial statements which includes assessment of preparation of a U.S. GAAP financial reporting package, in order to provide relief consistent with the exemption provided for variable insurance products filed on N-Forms; and 3) the ability for insurance companies to perform ongoing monitoring of significant changes to principles prescribed or permitted for financial statements prepared in accordance with Statutory accounting principles.

• Financial statement Printing/Filing Timelines – The SEC staff reminded members that when a registered investment company changes its fiscal year-end to a new date that is one month later than its current fiscal year-end or semi-annual period-end (i.e., seven months later than its current fiscal year-end), the fund can request relief from the timing and transmittal requirements of Rule 30e-1 under the Investment Company Act of 1940 (“the Act”), Reports to stockholders of management companies, which provides that the shareholder report must be transmitted to shareholders within 60 days after the close of the period for which such report is being made and Rule 30b2-1 of the Act, Filing of reports to stockholders, which provides that investment companies file a report on N-CSR not later than ten days after the transmission to stockholders of any report that is required to be transmitted to stockholders under 30e-1. Specifically, when a registrant’s fiscal year-end is changed by one or seven month(s), a registrant, upon showing good cause pursuant to Rule 30e-1(e) under the Act, may request relief to include financial statements for both the annual (12 months) and stub (one month audited in fiscal year-end changes by one month or one month unaudited if the fiscal year-end changes by seven months) periods in one combined set of financial statements (with separate columns covering each period), as long as the combined report is distributed to the fund’s shareholders within 75 days following the original fiscal year-end.

• Independence Consultations – the SEC staff noted consultations conducted with Commission’s OCA on the loan provision, partner rotation, non-audit services and independence requirement for compliance with the Custody Rule. Registrants and accounting firms are encouraged to contact the SEC staff in the Division of Investment Management and the independence group in the Commission’s Office of the Chief Accountant on independence-related matters.
o Other IM Related Updates
  ▪ LIBOR – the SEC staff highlighted portions of the SEC Staff Statement on LIBOR Transition related to investment companies and advisers. The SEC staff noted that disclosures should be tailored to potential impact that the discontinuation of the LIBOR would have on liquidity and value of the holdings of investment companies and to make clear to investors which investments are affected and what percentage of portfolio may be impacted.
  ▪ No-Action Letter – Golub – the SEC staff highlighted a letter that states it would not recommend enforcement action under Section 205 of the Investment Advisers Act of 1940 (“Advisers Act”) against Golub Capital Investment Corporation (“GCIC”), GC Advisors LLC (“GC Advisors”) or Golub Capital BDC, Inc. (“GBDC”), if GCIC were to treat the proposed merger of GCIC into GBDC (the “Merger”) as a realization event for purposes of calculating GCIC’s “realized capital gains” under Section 205(b)(3) of the Advisers Act, and pay certain capital gains performance fees to GC Advisors.
  ▪ ADI on Risk Disclosures – ADI 2019-08 Improving Principal Risks Disclosure noted that some risk disclosures provided by certain funds are lengthy and difficult for investors to understand, and offered several approaches that may improve principal risks disclosures for investors.
  ▪ Question on Leases Standard and Senior Securities Table – The EP members inquired the SEC staff’s views regarding the impact of ASC 842, Leases, on the asset coverage calculation for business development companies (BDCs). For BDCs that enter into leases exceeding 12 months (e.g., certain internally managed BDCs), the new leases standard requires lessees to gross up their balance sheet for leases and requires them to include an asset and liability. For BDCs, the standard is effective for annual periods beginning after December 15, 2018 and interim periods within those years. In response to the EP’s inquiry, the SEC staff stated they would generally not view the lease liability as a security or a senior security, dependent upon specific facts and circumstances. Further, the SEC staff would consider lease terms in determining whether the asset be excluded from the asset coverage calculation. The SEC staff reminded registrants that the determination of whether a financial instrument or transaction represents a senior security should be discussed with relevant parties, including fund counsel.

• Statements/Speeches
  ▪ Chief Accountant Sagar Teotia Remarks before the AICPA National Conference on Banks & Savings Institutions, September 9, 2019
  ▪ Chairman Clayton Remarks to the Economic Club of New York, September 9, 2019
  ▪ Commissioners’ Testimony before the U.S. House of Representatives Committee on Financial Services Oversight of the Securities and Exchange Commission: Wall Street’s Cop on the Beat September 24, 2019

IV. Audit and Attest Issues:

1. Cayman Islands Data Protection Law (“DPL”) goes into effect September 30th, 2019. The law applies to personal data accessed by “data controllers” or “data processors”. In an investment fund complex the “data controller” would be the fund entity and, in some cases, the investment managers, whereas the “data processor” would be, for example, the auditor. The “data controller” is responsible for complying with the DPL. One of the principles in the DPL states that personal data shall not be transferred outside the Cayman Islands unless an adequate level of protection for the rights and freedoms of data subjects is ensured. The EP member inquired how investment managers are thinking about this law relative to their auditors and what they are looking to see from auditors, if anything. The EP members have not been focusing on this item and will consider revisiting this topic at a future meeting.
2. An EP member shared that some investment management firms have requested that auditors add into their engagement letter that the audit firms will perform criminal background check, fingerprinting, credit checks, and drug testing for anyone providing audit services, regardless of whether that person will set foot on the investment management firm’s presence.

The EP members noted that generally the terms and scope of services provided by the audit firms would be based on the applicable professional standards. The EP expressed a view that the procedures outlined above likely would be outside of the audit firms’ own procedures and, therefore, excluded from the audit firm’s standard engagement letter.

3. The EP members have been updated on the status of draft illustrative audit reports for business development companies (BDCs) for potential inclusions into the Guide.

The EP members also discussed which PCAOB reporting standards, AS 3315, Reporting on Condensed Financial Statements and Selected Financial Data, or AS 2701, Auditing Supplemental Information Accompanying Audited Financial Statements, are applicable to separate reports issued over the Senior Securities tables. Form N-2 requires the following information for each class of senior securities: (1) Year, (2) Total Amount Outstanding Exclusive of Treasury Securities, (3) Asset Coverage Per Unit, (4) Involuntary Liquidating Preference Per Unit, and (5) Average Market Value Per Unit (Exclude Bank Loans).

In order to apply AS 3315, the information needs to be derived from audited financial statements (as defined in AS 3315.09); whereas, in order to apply AS 2701, the information can either be required by a regulatory authority or be derived from the company’s accounting books and records (as defined in AS 2701.A2).

**AS 3315.09:** An auditor may be engaged to report on selected financial data that are included in a client-prepared document that contains audited financial statements (or, with respect to a public entity, that incorporates such statements by reference to information filed with a regulatory agency). Selected financial data are not a required part of the basic financial statements, and the entity's management is responsible for determining the specific selected financial data to be presented. If the auditor is engaged to report on the selected financial data, his report should be limited to data that are derived from audited financial statements (which may include data that are calculated from amounts presented in the financial statements, such as working capital). If the selected financial data that management presents include both data derived from audited financial statements and other information (such as number of employees or square footage of facilities), the auditor's report should specifically identify the data on which he is reporting. The report should indicate (a) that the auditor has audited and expressed an opinion on the complete financial statements, (b) the type of opinion expressed, and (c) whether, in the auditor's opinion, the information set forth in the selected financial data is fairly stated in all material respects in relation to the complete financial statements from which it has been derived. If the selected financial data for any of the years presented are derived from financial statements that were audited by another independent auditor, the report on the selected financial data should state that fact, and the auditor should not express an opinion on that data.

**AS 2701.A2 Supplemental Information** - Refers to the following information when it accompanies audited financial statements:

a. Supporting schedules that brokers and dealers are required to file pursuant to Rule 17a-5 under the Securities Exchange Act of 1934;

b. Supplemental information (i) required to be presented pursuant to the rules and regulations of a regulatory authority and (ii) covered by an independent public accountant's report on that information in relation to financial statements that are audited in accordance with PCAOB standards; or
c. Information that is (i) ancillary to the audited financial statements, (ii) derived from the company's accounting books and records, and (iii) covered by an independent public accountant's report on that information in relation to the financial statements that are audited in accordance with PCAOB standards.

The EP members determined that whether AS 3315 or AS 2701 applies to reports on senior securities information would depend on the facts and circumstances and professional judgement.

4. The ICI staff joined the EP meeting telephonically to discuss any updates on the ICI’s letter to the PCAOB regarding referencing periods within the auditors’ report for investment company complexes that include multiple funds which commenced operations on different dates, in light of the new auditor reporting model under the PCAOB standards. The ICI letter previously recommended auditors go back to preceding practice to include language such as “periods therein” in the audit opinion and would not include all various period end dates for multiple funds in the investment company complex in the audit opinion.

The ICI staff had a consultation with the PCAOB staff in August 2019, where the PCAOB staff indicated that the relief requested would be a change to the current PCAOB standards and therefore, could not provide requested relief. Two alternatives were offered:

1. If another page in a shareholder report book listed all funds, financial statements and periods covered in financial statements, then audit report could reference that page in the shareholder report book.

2. Include an appendix or footnote to auditor’s report that lists the financial statements and periods covered for each financial statement and fund at the end of report or in smaller font.
AICPA Investment Companies Expert Panel

Meeting Highlights

November 19, 2019

I. **AICPA/Administrative:**
   1. The Expert Panel (EP) September 2019 meeting highlights are being finalized.
   2. The EP discussed the AICPA Audit and Accounting Guide *Investment Companies* (the Guide) matters, including potential updates for 2020 Guide, and reaffirmed that the PCAOB content in the Guide remains relevant to its users.

II. **Accounting/Reporting Issues:**
   1. Underwriter’s lock-ups – The EP member discussed fair value measurements of securities with a contractual restriction through an underwriter agreement and inquired whether the restriction is a characteristic of the security or a characteristic of the entity holding the security. The EP previously discussed accounting for discounts on securities subject to underwriter lock-up agreement in May 2014.

In light of recently issued AICPA Accounting and Valuation Guide: *Valuation of Portfolio Company Investments of Venture Capital and Private Equity Funds and Other Investment Companies* (accounting and valuation guide), the EP revisited this topic. Specifically, paragraphs 11-12 of chapter 13 of accounting and valuation guide (see below) points to a restriction being security-specific.

**AICPA Accounting and Valuation Guide:**

13.11 When the underlying security is traded in an active market but there is a legal or contractual restriction that is deemed a characteristic of the shares and not of the holder, an adjustment to the \( P \times Q \) fair value estimate may be necessary. Such a restriction would prevent the fund from accessing the public market and, therefore, the principal market would be a transfer of the interest to another market participant who typically would also be subject to the restriction. FASB ASC 820-10-55-52 provides an example of the effect on a fair value measurement of a restriction on sale, considering the following situation:
A reporting entity holds an equity instrument (a financial asset) for which sale is legally or contractually restricted for a specified period. (For example, such a restriction could limit sale to qualifying investors, as may be the case in accordance with Rule 144 or similar rules of the Securities and Exchange Commission [SEC].) The restriction is a characteristic of the instrument and, therefore, would be transferred to market participants.

In situations in which the fund holds restricted shares (whether due to a legal or regulatory restriction on the sale of shares, a contractual restriction on the fund through an underwriter agreement, an additional regulatory restriction due to the status of the fund as an affiliate, or some other form of restriction), the fund is prohibited from selling shares through the public markets for a given period of time. When evaluating an assumed transfer of such a position, if any buyer of the position would be subject to the same restrictions, either via direct transfer of the restriction (for legal or regulatory restrictions) or because the counterparty would require that the buyer accept the same restrictions (for contractual restrictions), the task force believes that it would likely be appropriate to consider the restriction to be a characteristic of the asset irrespective of the form of the restriction.

13.12 Fundamentally, the assumptions that a market participant would take into account drive the determination of fair value. A restriction under the SEC's Rule 144A or an underwriter's lock-up that effectively prevents the sale of the securities is considered a characteristic of the asset because the hypothetical transaction could only take place if the restriction or lock-up accompanies the shares when they are sold to a market participant. Thus, the restriction or lock-up would be considered in valuing the asset. Such market participants typically would not pay the full traded price for locked up shares and, therefore, an adjustment typically would be necessary. When there is a restriction on the shares that would be transferred to market participants, FASB ASC 820-10-55-52 indicates the following:

In that case, the fair value of the instrument would be measured on the basis of the quoted price for an otherwise identical unrestricted equity instrument of the same issuer that trades in a public market, adjusted to reflect the effect of the restriction. The adjustment would reflect the amount market participants would demand because of the risk relating to the inability to access a public market for the instrument for the specified period. The adjustment will vary depending on all of the following:

a. The nature and duration of the restriction
b. The extent to which buyers are limited by the restriction (for example, there might be a large number of qualifying investors)
c. Qualitative and quantitative factors specific to both the instrument and the issuer.

**FASB ASC 820-10 states:**

35-2B A fair value measurement is for a particular asset or liability. Therefore, when measuring fair value a reporting entity shall take into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Such characteristics include, for example, the following:

a. The condition and location of the asset

b. Restrictions, if any, on the sale or use of the asset.

35-2C The effect on the measurement arising from a particular characteristic will differ depending on how that characteristic would be taken into account by market participants. Paragraph 820-10-55-51 illustrates a restriction’s effect on fair value measurement.

55-51 The effect on a fair value measurement arising from a restriction on the sale or use of an asset by a reporting entity will differ depending on whether the restriction would be taken into account by market participants when pricing the asset. Cases A and B illustrate the effect of
restrictions when measuring the fair value of an asset.

Case A: Restriction on the Sale of an Equity Instrument

55-52 A reporting entity holds an equity instrument (a financial asset) for which sale is legally or contractually restricted for a specified period. (For example, such a restriction could limit sale to qualifying investors, as may be the case in accordance with Rule 144 or similar rules of the Securities and Exchange Commission [SEC].) The restriction is a characteristic of the instrument and, therefore, would be transferred to market participants. In that case, the fair value of the instrument would be measured on the basis of the quoted price for an otherwise identical unrestricted equity instrument of the same issuer that trades in a public market, adjusted to reflect the effect of the restriction. The adjustment would reflect the amount market participants would demand because of the risk relating to the inability to access a public market for the instrument for the specified period. The adjustment will vary depending on all of the following:

a. The nature and duration of the restriction
b. The extent to which buyers are limited by the restriction (for example, there might be a large number of qualifying investors)
c. Qualitative and quantitative factors specific to both the instrument and the issuer.

The EP members discussed whether the restriction was a characteristic of the security or a characteristic of the holder of the asset. Generally, the EP members have observed that there is diversity in practice. The EP may revisit this topic in the future.

2. Restricted cash – The EP continued discussions from the January 2018 and January 2019 conference calls regarding the application of ASU No. 2016-18, Restricted Cash, and the presentation of cash and collateral amounts held with the broker. At the November 2019 meeting, the EP expressed a view that for purposes of preparing the statement of cash flows, an entity should have an accounting policy that determines what is “restricted cash” and “restricted cash equivalents”. Such policy should consider cash and collateral amounts held with the broker and be consistently followed.

For reference, the definitions of “cash” and “cash equivalents” in FASB’s Master Glossary are as follows:

**Cash**

Consistent with common usage, cash includes not only currency on hand but demand deposits with banks or other financial institutions. Cash also includes other kinds of accounts that have the general characteristics of demand deposits in that the customer may deposit additional funds at any time and also effectively may withdraw funds at any time without prior notice or penalty. All charges and credits to those accounts are cash receipts or payments to both the entity owning the account and the bank holding it. For example, a bank's granting of a loan by crediting the proceeds to a customer's demand deposit account is a cash payment by the bank and a cash receipt of the customer when the entry is made.

**Cash equivalents**

Cash equivalents are short-term, highly liquid investments that have both of the following characteristics:

a. Readily convertible to known amounts of cash
b. So near their maturity that they present insignificant risk of changes in value because of changes in interest rates.

Generally, only investments with original maturities of three months or less qualify under that definition. Original maturity means original maturity to the entity holding the investment. For
example, both a three-month U.S. Treasury bill and a three-year U.S. Treasury note purchased three months from maturity qualify as cash equivalents. However, a Treasury note purchased three years ago does not become a cash equivalent when its remaining maturity is three months. Examples of items commonly considered to be cash equivalents are Treasury bills, commercial paper, money market funds, and federal funds sold (for an entity with banking operations).

3. **Definition of an “Other” Investment** - Investment companies must fair value their investments. Some are traditional, but some might be best described as “other investments”. FASB ASC 946-325-35-1 states that an investment company shall subsequently measure its other investments at fair value.

The EP considered whether litigation rights that may be bought directly or received by virtue of holding equity constitute an “other investment,” and, therefore should be accounted for under FASB ASC 946 or if these litigation rights should be accounted for as a gain contingency under FASB ASC 450. The EP will revisit this topic at a future meeting.

4. **Presentation of affiliate reimbursements and the associated losses** - GAAP requires that funds have a special break-out on the statement of operations relating to reimbursements for trade errors/investment restriction violations.

FASB ASC 946-20-45-1 states:

> Payments made by affiliates for the two reasons in paragraph 946-20-05-2 shall be combined and reported as a separate line item entitled net increase from payments by affiliates and net gains (losses) realized on the disposition of investments in violation of restrictions in the statement of operations as part of net realized and unrealized gains (losses) from investments and foreign currency. That separate line item would comprise amounts related to all of the following:

a. Voluntary reimbursements by the affiliate for investment transaction losses

b. Realized and unrealized losses on investments not meeting the investment guidelines of the fund

c. Reimbursements from the affiliate for losses on investments not meeting the investment guidelines of the fund

d. Realized and unrealized gains on investments not meeting the investment guidelines of the fund.

As further discussed in FASB ASC 946-20-50-2, the amounts and circumstances of payments by affiliates to reimburse the fund for losses on investment transactions should be described in the notes to the financial statements. The gains and losses on investments not meeting investment guidelines of the fund should also be disclosed in the notes to the financial statements.

FASB ASC 946-20-45-1 seems to indicate that the amounts in (b) and (c) above would be shown combined on the same line item. Potentially, that could result in the presentation of a line item containing a net amount of zero.

The EP considered whether such presentation was the intention of the FASB. The EP members acknowledged that even though the combination of the four items in (a) – (d) may result in the presentation of a line item containing a net amount of zero, the amounts and circumstances of payments by affiliates to reimburse the fund for losses on investment transactions would be described in the notes to the financial statements. Further, the EP members discussed that Rule 6-03(l) of Regulation S-X requires amounts involving directors, officers, and affiliates to be separately set forth except as otherwise specifically permitted under a particular caption. Also, such payments would be considered a related party transaction, and FASB ASC 850, *Related Party Disclosures*, requires disclosure of material related party transactions.
5. **Initial financial statements** – After the seed financial statements of a new regulated investment company (RIC) are produced, preparers of the first full set of financial statements produced afterward often have a decision to make as to whether to start the statement of operations from the date of organization (which could actually be a long time before), the last twelve months (if it is has existed for that long before shares have been sold), or from the date of the latest seed financial statements. A [no-action letter](https://www.sec.gov/comments/200135/200135-1.txt) dated October 30, 2002, permitted Lindbergh Funds to calculate its standardized average annual total return from the date that the Fund commenced investment operations. The EP members noted that in practice they generally see the first full set of financial statements prepared from the commencement of operations’ date, which is generally viewed as the earlier of (1) the date on which the fund received external capital or (2) the date on which the fund started investing in accordance with its investment objectives.

6. The EP considered whether investment company receivables, which are carried at net realizable value in accordance with FASB ASC 946-310-45-1, are within the scope of FASB ASU 2016-13, *Financial Instruments: Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* (CECL) which, in accordance with FASB ASC 326-20-15-2a, applies to financial assets measured at amortized cost basis. The EP understands that FASB staff members have informally expressed a view that investment company receivables carried at net realizable value are likely within the scope of CECL standard.

III. **SEC Staff Update:**

**Disclaimer**

The following comments and observations were compiled by the AICPA Investment Companies Expert Panel and AICPA staff and are not authoritative positions or interpretations issued by the SEC or its staff. The comments and observations were not transcribed by the SEC or its staff and have not been considered or acted upon by the SEC or its staff. Accordingly, these comments and observations do not constitute a statement of the views of the SEC or its staff.

1. **Statements/Speeches/Reports:**
   c. [What You Don’t Know Can Hurt You](https://www.sec.gov/news/speech/what-you-dont-know-can-hurt-you) by Stephanie Avakian, Co-Director, Division of Enforcement, November 5, 2019

2. **Division of Investment Management Update:**
   a. **Financial Statement Reviews:**
      Fiscal year 2020 Sarbanes-Oxley (“SOX”) review cycle started and the SEC staff discussed the following themes identified in initial SOX reviews:
      - Fund service providers:
        The SEC staff discussed the continuing trend of outsourcing/co-sourcing in the investment management industry and the resulting challenges that require oversight, for example potential conflicts of interest, auditor independence impacts, or issues at a service provider that affect multiple, unrelated fund groups. Various data sets or reports derived from Form N-CEN are used by the SEC staff to obtain information regarding the evolution of fund service providers and its impacts.
        - Change in auditor: Form N-CEN provides the SEC staff with information regarding a change in auditor. This can be useful to the SEC staff, for example, in reviewing whether consents of the predecessor auditor are appropriately provided in subsequent period filings. There is continued divergence from the requirements and the SEC staff remind registrants about their ongoing obligation to include a consent in the filing
made in the year following the registrant’s change in accountant. Please refer to the 
September 2018 EP meeting highlights for additional discussion related to changes in 
auditor. Also refer to the Division of Investment Management’s Accounting Matters 
Bibliography, topic 1998-04.
- For registrants that have already filed but did not include the consent of the 
predecessor audit firm, the SEC staff noted that certain registrants have indicated they 
may attach the prior auditor’s consent via post-effective amendment (485(b)) or a 
POS-EX filing.

- Principal risks:
The SEC staff highlighted recent comments related to principal risk disclosures for certain 
fund investments and remind registrants to consider the adequacy of related risk disclosures 
as exposure to these types of investments may result in a heightened risk profile. See also 
September 2019 EP meeting highlights for discussion of related ADI 2019-08.
  - Covenant-lite loans: Certain funds invest in loans with fewer covenants than typical 
(often referred to as “covenant-lite loans”), which may result in fewer restrictions on 
the borrower and fewer protections for the lender.
  - Unitranche loans: Certain funds invest in unitranche loans, which may have a 
structure such that a senior debt position is made subordinate to other lenders through 
contractual arrangements with other lenders, often referred to as the “last-out” portion 
of a unitranche loan, which may result in positions which are contractually 
subordinated in liquidation through contractual agreements with other lenders.

b. Accounting and Disclosure Information (ADI):
- ADI 2019-09 - Performance and Fee Issues focused on encouraging funds to closely review 
their performance and fee disclosures prior to providing them to investors, flag certain disclosure 
issues the staff has observed, and inform the public about how the SEC uses collected 
information.

3. OCIE Update:
On November 7, 2019, the Office of Compliance Inspections and Examinations published Risk 
Alert: Top Compliance Topics Observed in Examinations of Investment Companies and 
Observations from Money Market Fund and Target Date Fund Initiatives.

4. Enforcement Update:
On Nov. 6, 2019, The Securities and Exchange Commission’s Division of Enforcement issued the Division of 
Enforcement 2019 annual report. The report details the division’s efforts and initiatives on behalf of 
investors, highlights several significant actions, and presents the activities of the division from both a qualitative 
and quantitative perspective.