



## AICPA Investment Companies Expert Panel

### January 19 and 27, 2021 meeting highlights

#### I. AICPA/Administrative:

1. AICPA Investment Companies Expert Panel (EP) November meetings highlights have been posted.
2. The AICPA staff reminded the EP of the timing for the 2021 AICPA Audit and Accounting Guide *Investment Companies* (the guide) review.

#### II. Accounting/Reporting Issues:

1. In November 2020, the President issued an Executive Order that prohibits “any transaction in publicly traded securities, or any securities that are derivative of or are designed to provide investment exposure to such securities, of any Communist Chinese military company.” A current listing of those securities, as of the date of the meeting, can be found [here](#). The order was effective January 11, 2021 and resulted in the NYSE delisting the stocks/ADRs of China Mobile, China Telecom and China Unicom. The Expert Panel members anticipate that funds would assess the significance of such holdings to their financial statements to determine if risk disclosures or subsequent event disclosures are needed for financial statements.
2. The EP members noted no new developments relative to accounting for and disclosure of European withholding tax reclaims. Potentially impacted funds are continuing to assess whether receivables for reclaims should be recorded under ASC 740. EP members have seen diversity in practice based on each specific fund or fund group’s facts and circumstances.
3. The EP revisited a topic on accounting for securities received in a spinoff and stock rights. GAAP includes explicit guidance for securities received via spinoffs (paragraphs 2 and 3 of FASB ASC 946-320-30) and stock rights (FASB ASC 946-320-35-8), which requires an allocation of cost from existing shares to new shares for investment companies. To the extent such transactions are deemed taxable, GAAP treatment will likely differ from tax treatment, which generally assigns full cost to the new security equal to its market value and recognizes non-cash dividend income that is distributable to taxable shareholders.  
The EP member inquired whether the funds that receive securities in taxable spinoff and taxable stock rights typically would apply GAAP or tax accounting for daily NAV accounting purposes. EP members acknowledged that recording a taxable spinoff transaction using the cost allocation method under GAAP as opposed to recording dividend income under tax accounting would result in a difference between book and tax basis. Therefore, some funds may choose to follow the tax treatment for book purposes if the amounts are not material. The EP members also noted that if material, the fund would track the difference between GAAP and tax accounting and make

a financial statement adjustment at the reporting date; however, the EP members were not aware of predetermined quantitative thresholds that may trigger such adjustment.

4. The EP members further considered the nature of SPAC PIPE commitments (previously discussed at the November 2020 meeting) and acknowledged that the entity may need to make an assessment whether a SPAC PIPE commitment meets the definition of a financial instrument, or a derivative, or other investment under GAAP. The EP members expressed a view that a SPAC PIPE commitment would be recognized when it is legally binding, which is a legal determination, and initially recorded and subsequently measured at fair value. The EP members also discussed whether contractual equity commitments typically may be considered as a single unit of account in combination with the corresponding equity security.

The EP members also considered whether there could be a point where it is appropriate for a fund investing in a PIPE commitment to fund a SPAC to record a gross asset and gross liability prior to closing date.

For example, if the fund entered into the PIPE commitment on 8/1/20, all contingencies were resolved on 9/28/20 and funding occurred on the closing date of 10/1/20, would it be appropriate for the fund to record a gross asset (dr. investment) and liability (cr. payable for investment purchased) on its balance sheet on any date prior to the closing date. Alternatively, would the fund continue to follow a derivative accounting model or a model similar to derivative accounting (if the PIPE commitment is not a derivative) until the closing date, and as such, not record a gross asset and liability prior to the closing? Some EP members expressed a view that the fund would not record a gross asset and a gross liability on any date prior to the closing date; rather, the net fair value of the PIPE commitment would be recorded. Other EP members believed that it could be appropriate to gross up the investment in the PIPE and the corresponding liability to fund the PIPE at the point that the contingency is resolved, as the fund has an obligation to fund the investment at that point.

The EP also considered two alternatives regarding whether the commitment and equity security are one unit of account:

- If they are considered one unit of account, there could be a view that there is only one trade date on 8/1/20 (the date that the fund made the binding commitment to the PIPE) and therefore, no balance sheet gross up would be recorded prior to the closing date. Once the PIPE is funded, the unrealized gain/loss on the commitment would carry over into the investment.
- If the commitment and the equity security are considered two separate financial instruments (that is, two units of account), one may argue that a realization event occurs upon acquisition of the equity shares.

The EP discussed the merits of each view and will continue discussion at a future meeting.

The EP also considered whether these PIPE commitments should be included on the schedule of investments or disclosed in the notes to financial statements. One EP member suggested considering the SEC staff views on disclosing loan commitments from the January 2006 EP meeting highlights SEC Staff Update.

5. During the November EP meeting, the EP members considered a scenario in which an externally managed BDC (the “Company”) entered into an agreement and plan of merger to acquire another BDC (“the Target”), where the merger transaction was effected through an exchange of shares, and is accounted for as an asset acquisition. The fair values of the net assets to be acquired will

exceed the purchase consideration (that is, a bargain purchase). In accordance with FASB ASC 805-50-30-3, the cost of the asset acquisition shall be allocated to the acquired net assets based on their relative fair values and shall not give rise to goodwill. The application of this guidance to a bargain purchase scenario would result in the shortfall of the purchase consideration being allocated as a reduction to the carrying amounts of the acquired assets. Because the majority of the assets acquired are comprised of the investment portfolio (loans) of the Target, which is measured at fair value, the purchase price allocation would result in a reduction to the cost basis of the acquired portfolio and give rise to the recognition of an unrealized gain. The EP also discussed potential considerations for interest accretion and will continue its discussion at the next EP meeting.

### 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.**

The SEC Chief Accountant and Assistant Chief Accountants and Branch Chiefs joined the EP meeting to share the following observations and updates.

1. The SEC staff discussed the transition of leadership roles within the SEC.
2. Recent speeches and statements by the SEC Commissioners and staff:
  - a. [December 1, 2020, AMAC committee meeting and related draft observations](#)
  - b. [November 19, 2020, Putting Principles into Practice, the SEC from 2017-2020 Remarks to the Economic Club of New York by Chairman Clayton](#)
  - c. November 17, 2020, [Chairman Clayton testified before the U.S. Senate Committee on Banking, Housing, and Urban Affairs on the Oversight of the SEC](#)
  - d. [November 19, 2020, The Role of the CCO – Empowered, Senior and With Authority by Peter Driscoll](#)
  - e. [December 23, 2020, Staff Statement on the President’s Working Group Report on Money Market Funds by Dalia Blass](#)
3. [IM-INFO-2020-06](#) regarding IM staff withdrawal of staff letters related to exchange-traded funds
4. December 22, 2020, J.P. Morgan Investment Management Inc., et al.; [Notice of Application to use an amended liquidity program](#) and related [final approval](#)
5. PCAOB related activities and speeches:
  - a. [Staff Observations and Reminders during the COVID-19 Pandemic](#)
  - b. [January 15, 2021, The Future of Audit Oversight by J. Robert Brown Jr., Board Member](#)
  - c. [The PCAOB’s Auditing Accounting Estimates, Including Fair Value Measurements standard](#) became effective for audits of financial statements for fiscal years ending on or after December 15, 2020
6. The [Fall 2020 Agency Rule list](#) has been posted and includes, among others, the following:

- a. Investment Company Shareholder Report and Modernization of Certain Investment Company Disclosure
  - b. Enhanced Listing Standards for Access to Audit Work Papers; Access to Audit Work Papers and Co-Audit Standards
  - c. Other items on the [long term agenda](#) include Amendments to the Custody Rules for Investment Advisers, Amendments to the Custody Rules for Investment Companies, Amendments to Rule 17a-7 Under the Investment Company Act, Request for Comment on Fund Names, Money Market Fund Reforms and Exchange-Traded Products.
7. The Commission adopted a new rule providing a framework for fund valuation practices. [New rule 2a-5 under the Investment Company Act](#) establishes requirements for determining fair value in good faith for purposes of the Act. The rule will permit boards, subject to board oversight and certain other conditions, to designate certain parties to perform the fair value determinations. The rule also defines when market quotations are “readily available” for purposes of the Act, the threshold for determining whether a fund must fair value a security. The Commission also adopted new rule 31a-4, which provides the recordkeeping requirements associated with fair value determinations. Additionally, the Commission is rescinding previously issued guidance on related issues, including the role of the board of directors in determining fair value and the accounting and auditing of fund investments. Both rules are effective March 8, 2021 with a required compliance date of September 8, 2022. The SEC staff has encouraged registrants to reach out with any inquiries related to adoption of these rule and also offered the following observations in response to questions from EP members:
- From an accounting perspective, the release acknowledges the applicability of FASB ASC Topic 820 to fair value determinations to registered investment companies and business development companies...
  - Early adoption is allowed as long as the rule is adopted in its entirety.
  - The new rules are under the Investment Company Act of 1940, therefore, while the rule includes procedures that the Staff believe are best practice, they are not required to be applied by non-registered investment companies.
8. Emerging markets recent developments:
- a. [ADI 2020-11 Registered Funds’ Risk Disclosure Regarding Investments in Emerging Markets](#)
  - b. On December 18, 2020, President Trump signed into law the Holding Foreign Companies Accountable Act, which amends the Sarbanes-Oxley Act 2002 and requires the SEC to take actions to increase oversight of Chinese companies listed on US stock exchanges.
  - c. On November 12, 2020, President Trump issued Executive Order 13959, [Addressing the Threat From Securities Investments That Finance Communist Chinese Military Companies](#), which restricted U.S. investors from transacting in certain securities in China.
  - d. [NYSE recent activities regarding delisting certain Chinese stocks](#)
  - e. [The SEC Division of Examination Risk Alert “Executive Order on Securities Investments that Finance Communist Chinese Military Companies”](#)
9. Digital assets related activities:

- a. Many have reported that the spike in the price of bitcoin renewed investors' interest in digital assets, including interest in investor exposure through exchange traded products. The SEC staff noted very limited exposure by RICs through investment in digital asset futures and other exchange traded products (such as GBTC) but not through direct investments in digital assets. The SEC IM staff encouraged registrants that are interested in gaining any exposure in digital assets or related instruments to consult with them about their interest and intent before filing a registration statement.
- b. The staff of the Division of Investment Management issued a [Staff Statement](#) in response to Wyoming Division of Banking's [no-action letter](#) "NAL on Custody of Digital Assets and Qualified Custodian Status" to Two Ocean, a wealth management firm hoping to offer custodial services for digital assets and become a qualified custodian under the Investment Advisers Act of 1940. In the statement, the SEC staff noted that they are not bound by the Wyoming Division of Banking's determination and encouraged interested parties to engage with the SEC staff directly on the application of the Custody Rule to digital assets, including with respect to the definition of qualified custodian under the rule. The Staff Statement also include a request for comment related to the topic of qualified custodians.
- c. The staff of the Division of Trading and Markets issued a [statement and request for comment regarding the custody of digital asset securities by broker-dealers](#) in order to encourage innovation around the application of Securities Exchange Act Rule 15c3-3 to digital assets.
- d. The Office of the Comptroller of the Currency (OCC) recently announced [conditional approval of the conversion of Anchorage Trust Company](#), a South Dakota chartered trust company, to become Anchorage Digital Bank, National Association, with the intention to custody digital assets.

**10. Enforcement case update:**

- a. [ICE Data Pricing & Reference Data LLC](#)
- b. [Cheesecake factory COVID-19 related enforcement action](#)

- 11.** At the recent AICPA Conference on Current SEC & PCAOB Developments, the staff from the Division of Corporation Finance (CF) addressed transition matters relating to the SEC's amendments to financial disclosures about acquired and disposed businesses. For purposes of S-X Rules 3-09 and 4-08(g), the CF staff expressed a view that in a Form 10-K filed after the compliance date of the rule, a registrant is required to recompute the prior-year significance of its equity method investees using the amended income test. The EP members inquired whether the IM staff apply the guidance similarly for IM registrants, that is, for purposes of S-X Rules 3-09 and 4-08(g), whether BDCs would recompute the prior year significance of unconsolidated subsidiaries using the amended investment and income tests in new rule 1-02(w)(2).

Consider the following example: In a BDC's 2019 10-K, the BDC's investment in Investee A was significant and tripped the income test at 12%. In accordance with S-X Rule 4-08(g), the BDC included summarized financial information for Investee A in its 2019 audited financial statements for each year presented. For purposes of its 10-K filing for its 12/31/20 year-end, the BDC elects voluntary early compliance with the amended rules.

Using the amended significance tests, assume that Investee A would not trip the thresholds for 4-08(g) in 2020 using the amended tests. Also, in recomputing significance for Investee A for 2019 and 2018 using the amended income and investment tests in S-X Rule 1-02(w)(2), Investee A would not trip 4-08(g). Question: Could the BDC exclude summarized financial information for Investee A from its 2020 10-K for all years presented?

Answer: Yes, if the amended significance tests in 1-02(w)(2) were computed by the BDC and Investee A does not trip the thresholds for 4-08(g) in any of the years presented in the 2020 10-K, the registrant would not need to provide the summarized financial information required of by 4-08(g) in the registrant's 2020 10-K for Investee A.

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