



AICPA Investment Companies Expert Panel Meeting Highlights

March 17, 2020

I. Accounting/Reporting Issues:

1. The Expert Panel (EP) members considered potential implications of the coronavirus outbreak (COVID-19), including fair value considerations, financial statement disclosures and going concern considerations.

Fair value considerations

The EP members discussed various observations/questions that have come up in the industry with respect to valuation in light of the COVID-19 crisis. EP members discussed whether a decrease in market activity signals an illiquid or inactive market which may cause a change in valuation methodology. Preparers should consider the guidance in FASB ASC 820-10-35 about measuring fair value when the volume or level of activity for an asset or a liability has significantly decreased (paragraphs 54C through 54H) and the guidance about identifying transactions that are not orderly (paragraphs 54I through 54J).

The EP emphasized that if a market becomes less active (and, as such, there are fewer observable transactions) and time has passed from the last transaction date to the measurement date, those transactions should still be considered when determining fair value. However, adjustments may be needed from the last transaction price to reflect changes in market conditions.

The EP members also discussed that there is a possibility that financial instruments that historically have used level 2 inputs may soon use significant level 3 inputs due to the lack of observable inputs. Additionally, the EP members discussed what funds should do if trading is halted or certain markets are closed on March 31. One EP member shared that certain funds are discussing this item more broadly and are considering looking at the last traded price as well as information from other markets and inputs. The EP members also discussed that funds should assess the availability and reliability of information for valuing its investments. For example, funds may consider if pricing vendors can provide pricing information and if so, the reliability of such information. Similarly, funds should consider if they will be able to receive timely information from portfolio companies or financial statements from investee funds. In addition to these considerations, the EP members also discussed considerations for valuation models. Some EP members suggested that perhaps using market inputs in private investments may require additional analysis, given the recent market volatility.

Subsequent event disclosures

The EP discussed whether any members had observed funds including disclosures in their subsequent event footnotes related to COVID-19. Per FASB ASC 855-10-25-1, an entity shall recognize in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements.

Per FASB ASC 855-10-50-2, some non-recognized subsequent events may be of such a nature that they must be disclosed to keep the financial statements from being misleading.

Many EP members shared that they had seen funds include general disclosures about the COVID-19's effect on the global economy and related market volatility. If subsequent events arising after the balance sheet date materially impacted a fund's financial condition, management should consider quantifying any material impact in the fund's subsequent event disclosures, if possible. If not possible, management should consider disclosing that the events arising subsequent to the balance sheet date may result in a material impact to

the fund's financial condition and that an estimate of the impact cannot yet be determined. However, the EP members acknowledged the environment was changing from day to day and funds should consider current conditions when determining the precision of their subsequent event disclosures.

The EP members also discussed other factors a fund may consider when evaluating its subsequent event disclosure, including, but not limited to:

- Portfolio composition and whether there is a concentration in an affected industry or geographic region
- Material decreases in net assets
- Significant redemption requests from investors and liquidity of the fund
- Financing agreements or debt covenants are significantly impacted/breached
- See other considerations below

Going concern considerations

FASB ASC 205-40, *Presentation of Financial Statements — Going Concern*, requires management to evaluate an entity's ability to continue as a going concern within one year after the date the financial statements are issued (or available to be issued, when applicable). Substantial doubt about a fund's ability to continue as a going concern exists when conditions and events, considered in the aggregate, indicate that it is probable that the fund will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued (or within one year after the date that the financial statements are available to be issued when applicable). Disclosures in the notes to the financial statements are required if management concludes that substantial doubt exists or that its plans alleviate that substantial doubt.

One EP member expressed that highly leveraged funds may not continue as going concerns if their portfolios become highly illiquid and they are no longer able to meet their current and future obligations for up to one year after the date the financial statements are issued (or available to be issued, when applicable). Another EP member shared that some funds are beginning to see either (1) significant redemptions or (2) their debt covenants are triggered and require investments in the fund's portfolio to be liquidated in order to meet their obligations.

2. The EP members discussed start date for financial highlights for a registered fund that commenced operations prior to the effective date of the registration statement. Form N-1A states, "Present the information in comparative columnar form for each of the last 5 [10 in Form N-2] fiscal years of the Fund (or for such shorter period as the Fund has been in operation), but only for periods subsequent to the effective date of the Fund's registration statement." There is also a [no-action letter](#) that suggests it could be appropriate to use commencement of operations if that date follows the effective date of the fund's registration statement. One EP member inquired whether the EP has seen situations where it was appropriate to use the date the fund commenced operations if it is prior to the effective date of the fund's registration statement; specifically, for a business development company (BDC) or a private fund that goes public.

The EP members observed that financial highlights would typically be presented for periods after the effective date of the registration statement, which is in line with instructions to Form N-1A or Form N-2. The EP members discussed that if a registrant prefers to show fund performance prior to effective date, they should engage in discussions with the SEC staff.

3. FASB ASC 946-210-50 requires investment partnerships that are exempt from SEC registration to include a condensed schedule of investments (CSOI) at the close of the most recent period, which discloses each investment (including short sales) constituting 5% or greater of net assets. The EP discussed a scenario where a recently launched, committed capital private-equity fund has purchased the fund's initial investments using a line of credit or other form of temporary leverage, but has not yet called capital from investors. The line of credit will be paid off using the initial capital calls. One EP member inquired as to how the fund should determine which investments are greater than 5% of net assets, since the equity is nominal and all of the fund's investments may be greater than 5% of net assets. They inquired if the fund could consider this temporary leverage as capital and use that amount as the denominator for the purposes of determining which investments represent 5% or greater of net assets.

The EP members noted that the GAAP requirement is to disclose investments that are greater than 5% of net assets and any departure from this requirement is a departure from GAAP that would need to be evaluated for materiality.

4. The FASB recently issued FASB ASU 2020-04, *Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting*, which provides entities temporary optional expedients and exceptions to the guidance in US GAAP on contract modifications and hedge accounting to ease the financial reporting burdens related to the expected market transition from the London Interbank Offered Rate (LIBOR) and other interbank offered rates to alternative reference rates.

The EP members discussed certain swap contracts that currently reference the federal funds rate but will be moving to Secured Overnight Financing Rate (SOFR) in order to create market liquidity for SOFR. An EP member inquired whether moving from one base rate, which will still be in existence (e.g. federal funds rate) to another base rate (e.g. SOFR) would be within scope of the ASU, and could therefore, be accounted for as a continuation of a contract, rather than a contract modification. The EP members believed, that unless a reference rate is expected to be discontinued (as described in FASB ASC 848-10-15-4), the transition from one existing rate to another existing rate would not be within the scope of the ASU, as the federal funds rate is not expected to be discontinued. Specifically, FASB ASC 848-10-15-3 states, "the guidance in this Topic, if elected by an entity, shall apply to contracts or other transactions that reference the London Interbank Offered Rate (LIBOR) or a reference rate that is expected to be discontinued as a result of reference rate reform."

II. Audit and Attest Issues

1. The EP considered feedback received on the illustrative draft audit opinion for BDCs. The EP will resume its discussion at the next conference call.

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 staff of the SEC Office of the Chief Accountant for the Division of Investment Management (the SEC IM staff or IM staff) joined the call to discuss the following:

1. COVID-19:

- a. Starting March 10, 2020, most SEC staff began transitioning to full telework posture and the Commission remains fully operational. The SEC IM staff stand ready to support stakeholders, answer questions, and to provide further relief to market participants, as necessary and appropriate, and to make themselves available for consultations with registrants. Simultaneously, the IM staff continue rule-making efforts, enforcement work, as well as financial statement reviews.
- b. The IM staff reminded registrants to consider whether impact of coronavirus disease 2019 (COVID-19) triggers subsequent event disclosures under FASB ASC Topic 855.
- c. **COVID-19 Related Relief:**

To date, the Commission issued [two orders](#) for relief related to the Investment Advisers Act and the Investment Company Act for funds and investment advisers whose operations may be affected by COVID-19 emergency:

- The Division recognizes that some investment companies may face challenges in transmitting annual and semi-annual reports, timely filing Forms N-CEN and N-PORT and delivering updated prospectuses to existing shareholders as a result of the COVID-19 emergency. The Division recognizes that similar challenges may also be experienced in preparing and filing amendments to Forms ADV and Form PF in a timely manner. As such, the Commission's orders conditionally exempt registered funds and advisers from certain filing and transmittal requirements.
- The Division previously issued a [staff statement](#) taking a no-action position with respect to investment companies' in-person board voting requirements as a result of the COVID-19 emergency. Since issuing that staff statement, the Division has received feedback from industry participants that boards of directors would appreciate the greater certainty of an exemption, rather than a staff no-action statement, and the Commission order includes a conditional exemption with respect to investment companies' in-person board voting requirements.
- Further, as a result of declines in asset values, the Division also recognizes that some registered closed-end funds and business development companies ("BDC") may need to call or redeem securities in order to maintain asset coverage ratios in compliance with the Investment Company Act and the terms of the security or other instrument pursuant to which the securities were issued. Ordinarily, these funds would be required to provide the Commission with 30 days prior notice of the call or redemption, however, the Commission's order notes that such prior notice is not necessary under the conditions described in the order.
- **Update:** on March 25, 2020, the SEC has extended regulatory relief previously provided to funds and investment advisers whose operations may be affected by COVID-19. The Commission issued orders (<https://www.sec.gov/rules/other/2020/ia-5469.pdf> and <https://www.sec.gov/rules/other/2020/ic-33824.pdf>) that would provide certain investment funds and investment advisers with additional time with respect to holding in-person board meetings and meeting certain filing and delivery requirements, as applicable. These Orders supersede and extend the filing periods covered by the Commission's Original Orders of March 13, 2020, described above. Among other conditions, entities must notify the Division staff and/or investors, as applicable, of the intent to rely on the relief, but generally no longer need to describe why they are relying on the order or estimate a date by which the required action will occur. The time periods for relief are described in the Orders. The Commission may provide extensions to the time period for the relief, with any additional conditions it deems appropriate, or provide additional relief as circumstances warrant. Firms and financial professionals are encouraged to contact SEC staff with questions or matters of particular concern.

With all of these actions, a fund or adviser must meet certain conditions described in the orders, including for example, notification requirements to the Division through various email addresses, publication on its website that the fund or advisers intent to rely on the position, including documentation of the reasons why, and publishing certain other available information on its website in certain cases as relevant.

The IM staff noted that they consider the current conditions to require the Staff to take an iterative approach, as the markets and conditions continue to evolve, and they may consider additional relief, as necessary.

- d. The EP inquired whether the SEC is considering providing relief from the 120 days requirement for distribution of pooled investment vehicle's financial statement where relying on the audit exemption under the SEC Rule 206(4)-2(b)(4) (Custody Rule). The IM staff reminded the EP about SEC staff [FAQs on Custody Rule](#), and specifically, Question VI.9:

Q: If a pooled investment vehicle is subject to an annual audit and its adviser is relying on the "audit provision" under rule 206(4)-2(b)(4), would the adviser be in violation of the rule if the pooled vehicle fails to distribute its audited financial statements within 120 days after the end of its fiscal year?

A: The Division would not recommend enforcement action for a violation of rule 206(4)-2 against an adviser that is relying on rule 206(4)-2(b)(4) and that reasonably believed that the pool's audited financial statements would be distributed within the 120-day deadline, but failed to have them distributed in time under certain unforeseeable circumstances. (Modified March 5, 2010.)

The IM staff noted that the FAQ does not include specific conditions, but had heard good practices from RIAs who intended to document the reasons for such delay in distribution and the process undergone, as well as, intention to notify the staff consistent with the conditions of the formal relief. The IM staff again noted that they consider the current conditions to require the Staff to take an iterative approach, as the markets and conditions continue to evolve, and they may consider additional relief, as necessary.

2. On March 2, 2020, the Commission issued a [request for public comment](#) on its current requirements that intend to restrict the use of potentially misleading fund names. Fund names can have a significant impact on an investment decision, and the request seeks feedback on whether the current requirements are effective and whether there are alternatives that the Commission should consider.
3. On March 13, 2020, the staff issued [IM Information Update 2020-02](#) which provides a list of modified or withdrawn no-action letters and staff statements. The IM staff continues evaluating previously issued staff letters and views and plans to update the list periodically and make it easily accessible to stakeholders.
4. Latest rule making:

a. [Accelerated and Large Accelerated Filer Amendments Adoption:](#)

On March 12, 2020, the Commission adopted amendments to the accelerated and large accelerated filer definitions in Exchange Act Rule 12b-2 which:

- Exclude from the definitions an issuer that is eligible to be a smaller reporting company (“SRC”) and that had annual revenues of less than \$100 million in the most recent fiscal year for which audited financial statements are available;
- Exclude BDCs from the definitions in analogous circumstances. Because BDCs are not eligible to be SRCs, the amendments provide a definition of “revenue” which excludes a BDC that:
 - (1) has a public float of \$75 million or more, but less than \$700 million; and
 - (2) has investment income of less than \$100 million.
- Increase the transition thresholds for accelerated and large accelerated filers becoming non-accelerated filers from \$50 million to \$60 million, and for exiting large accelerated filer status from \$500 million to \$560 million. Further, the amendments add a revenue test to the transition thresholds for exiting from both accelerated and large accelerated filer status; and
- Adds check boxes on cover pages of Form 10-K, 20-F, and 40-F to indicate whether an auditor attestation is included in the filing.

As a result of the amendments, certain low-revenue issuers will remain obligated, among other things, to establish and maintain ICFR and have management assess the effectiveness of ICFR, but they will not be required to have their management assessment attested to, and reported on, by an independent auditor.

b. [Investor Disclosure Improvements for Variable Annuities and Variable Life Insurance Contracts:](#)

On March 11, 2020, the Commission adopted amendments to simplify and streamline disclosures about variable annuities and variable life insurance contracts, specifically amendments to Forms N-3, N-4, and N-6—the registration forms for variable contracts—that are intended to improve the content, format, and presentation of information to investors, as well as, a new rule which:

- Permits prospectus delivery obligations under the Securities Act for a variable contract to be satisfied by providing a summary prospectus to investors and making the statutory prospectus available online;
- Permits variable contracts to make the prospectuses for underlying mutual fund investment options, and other documents relating to those mutual funds, available online; and
- Provides the Commission’s position to issuers of some variable contracts that are discontinued by July 1, 2020 to not have to update the variable contracts’ registration statements or provide updated prospectuses to existing investors.

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