



AICPA Investment Companies Expert Panel

Conference Call Highlights

May 19, 2020

I. AICPA/Administrative:

1. The Expert Panel (EP) chair updated the EP on the composition for the next volunteer year.
2. AICPA IC EP April EP meeting highlights are being finalized.
3. The EP and AICPA staff considered proposed changes for the 2020 AICPA Audit and Accounting Guide *Investment Companies* (the Guide).

II. Accounting/Reporting Issues:

1. An EP member received a question regarding how to account for securities with negative interest either because the security is issued with a negative interest rate or the security is a variable rate security whose interest rate flipped to a negative interest rate due to the current economic crisis. During the April 2020 meeting, the requestor referred the EP to its discussion on this topic from the March 2016 meetings and inquired if negative interest from securities could be accounted for as (1) a reduction of interest income, (2) an expense other than interest expense or (3) interest expense. The EP continued discussing this topic at the May 2020 meeting.

At the May 2020 EP meeting, the EP generally agreed that negative interest from securities could be accounted for as either a reduction of interest income previously generated by the security (option 1) or an expense other than interest expense (option 2). Generally, the EP members did not believe recording negative interest as interest expense was appropriate as the negative interest was not related to a fund's borrowings.

The EP members are aware of guidance from IAS 39 *Financial Instruments: Recognition and Measurement* and IAS 1 *Presentation of Financial Statements—Income and expenses arising on financial instruments with a negative yield—presentation in the statement of comprehensive income (Agenda Paper 4)*. That IFRS guidance from 2015 stated in part that “the expense arising on a financial asset because of a negative effective interest rate should not be presented as interest revenue, but in an appropriate expense classification” and also required the entity to disclose additional information about the expense, if relevant “to an understanding of the entity’s financial performance or to an understanding of this item.”

The EP also considered whether the answer be different if the entity’s entire portfolio of securities is

negative and there is no prior interest income. The EP members will revisit this topic at the next EP meeting and may consider seeking the SEC staff views.

2. The EP discussed [the SEC proposal related to fund valuation](#). For details of the proposal, refer to the SEC Staff Update section below.
3. The EP continued discussing COVID-19 related matters, including:
 - a. [TALF program](#) and a [new Q&A](#),
 - b. March 31, 2020 year-end reports and subsequent events disclosures, largely due to change in portfolio valuations,
 - c. if a registered investment adviser (RIA) participated in a Paycheck Protection Program and was a borrower, whether a RIA can account for the subsidy received as a government grant. The EP noted that if an RIA met certain facts and circumstances, it may use grant accounting and include disclosures. The EP also acknowledged the [SEC IM COVID-19 FAQ Question II.4](#) on this topic.
 - d. Registered fund of funds with March 31, 2020 year-end - discussion of potential COVID-19 timing delays of investee funds' financial information and the registered fund of funds ability to perform timely valuations.
4. The EP was informed of the adopted SEC rule [Amendments to Financial Disclosures about Acquired and Disposed Businesses](#) (for more information refer to the SEC Staff Update below).

III. Audit and Attest Issues

1. The EP considered potential changes (as a result of elimination of AU 324) to the illustrative report in paragraph 12.45 for the internal control report under the Custody Rule when an investment adviser or its related person maintains clients' funds or securities as a qualified custodian.

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. The staff of the Division of Investment Management (SEC IM staff) discussed the following upcoming meetings:
 - a. SEC Investor Advisory meeting on May 21, 2020, with focus on index fund and credit rating agency discussions.
 - b. SEC Asset Management Advisory Committee (AMAC) meeting on May 27, 2020, with focus on the work of different subcommittees under AMAC and COVID-19 impact to the asset management industry.
2. The SEC IM Chief Accountant's Office (CAO) is hiring for two open positions:
 - a. [Staff Accountant](#), in a permanent staff role, whose responsibilities include performing financial statement reviews and who will report to a CAO Branch Chief
 - b. [Assistant Chief Accountant](#), in a temporary professional accounting fellowship role, whose responsibilities include development of policy recommendations and interpretations and who will report to IM's Chief Accountant
3. The [Commission-wide COVID-19 efforts](#) include continuity of SEC operations in telework environment, monitoring markets and addressing market issues and risks, providing regulatory relief to registrants, as well as coordinating with other federal regulators and governmental authorities in the U.S. and globally.

4. Emerging markets:
 - a. [Joint Statement on Emerging Markets](#): the joint statement by the SEC and PCAOB covering key matters related to emerging market investments, including challenges related to audits, financial reporting, and related disclosure.
 - b. Following that, the Chairman announced the [SEC Staff to Host July 9 Roundtable on Emerging Markets](#) to hear the views of investors, other market participants, regulators, and industry experts on the risks of investing in emerging markets, including China. The roundtable will focus on discussing risks associated with investments in emerging markets, including quality of financial information, risk disclosures, auditor oversight of member firms, and will explore potential steps to mitigate risks.
5. [SEC proposal Good Faith Determinations of Fair Value](#): The Commission voted to propose a new rule providing a framework for fair value practices of investment funds (“funds” includes registered investment companies, business development companies, and unit investment trusts). Proposed new rule 2a-5 under the Investment Company Act of 1940 (the “Act”) would
 - provide requirements for determination of fair value of the fund’s investments in good faith and would permit boards to assign the determination of fair value to an adviser to the fund, subject to board oversight and certain other conditions;
 - define “readily available market quotations” for purposes of the Act; and
 - rescind previously issued guidance (including ASRs 113 and 118) on the role of the board of directors in determining fair value and the accounting and auditing of investments funds.

The public comment period for this proposal will remain open until July 21, 2020.

6. [BDC/CEF Offering Reform](#): The Commission voted to adopt final rules related to offering reform for BDCs and CEFs, substantially as was originally proposed in May 2019. Expansion of offering reform to BDCs and CEFs was mandated by Congress in the Small Business Credit Availability Act and the Economic Growth, Regulatory Relief, and Consumer Protection Act to allow for a more streamlined registration, offering, and investor communications process. Some key highlights of the final rule are as follows:
 - *Shelf Offering Process and New Short-Form Registration Statement*
 - *Ability to Qualify for Well-Known Seasoned Issuer (WKSI) Status*
 - *Immediate or Automatic Effectiveness of Certain Filings*
 - *Communications and Prospectus Delivery Reforms*
 - *New Method for Interval Funds and Certain Exchange-Traded Products to Pay Registration Fees*
 - *Periodic Reporting Requirements*
 - *Incorporation by Reference Changes*
 - *Structured Data Requirements*

In response to a question from an EP member about the effect of offering reform on the inclusion of auditor consents, the SEC IM staff confirmed that the placement of an auditor’s consent may have changed in certain instances for certain offering types as a result of this rule adoption. For example, a BDC with automatic shelf registration who newly qualifies for and elects WKSI status will now have the update to their shelf registration automatically effected by the filing of their annual report on Form 10-K. This update of the shelf registration ensures compliance under the Securities Act of 1933 Section 10(a)(3). This automatic update to the shelf registration, or “10(a)(3) update”, occurs with the filing of the Form 10-K because the registration statement forward incorporates the financial information filed. Once filed, this annual report on Form 10-K updates the registration statement and an auditor’s consent is required for use of their report in the forward incorporated registration statement. The Staff noted that, in these circumstances, the auditor’s consent can be included as an exhibit to the Form 10-K, which allows such a BDC to meet their Section 10(a)(3) and 439 obligations.

Fund management, legal counsel, and auditors should continue to work together to ensure registration

statements contain updated information, as applicable, and contain appropriate auditor consents. The SEC IM staff is happy to consult on related questions in advance of relevant filings.

7. The [IM COVID-19 Response FAQ page](#) organizes responses to questions about funds and advisers affected by COVID-19 for ease of reference. The SEC IM staff highlighted the following FAQs:
 - a. Modified custody rule-related [FAQ Question VI.9](#) to include fund of funds, pools investing in fund of funds, and top tier funds investing in one or more fund of fund.
 - b. New [Question I.2](#) which directs institutional investment managers that file Form 13F on how to contact the staff if it has questions or concerns related to impacts of COVID-19 on its operations or compliance.
 - c. New [Question II.4](#) on regulatory reporting obligations under the Investment Advisers Act of 1940 if a registered investment adviser has or will receive a paycheck protection program loan.

8. The SEC IM staff shared the following recent financial statement and registration statement reviews:
 - a. Investments in restricted securities per Schedule 12-12 of Regulation S-X:
Footnote 8 to Schedule 12-12 highlights the information required to be presented for restricted securities, including the cost of such securities and acquisition date. Many registrants structure this information in an organized format, incorporated into the Schedule of Investments (“SOI”) or as a separate table. During financial statements reviews of certain registered funds of hedge funds and funds of private equity funds, the SEC IM staff identified the following:

1. Several funds did not include the acquisition date of restricted securities held. The SEC IM staff commented to such registrants.

Several funds included the cost of restricted securities held in a footnote as block text, distinguished only by commas, and separate and apart from the other investment-related information on the SOI. For example, the portfolio of restricted securities on the SOI includes a footnote which states, ‘the cost of the restricted securities are: x million, x million, x million, x million, etc.’ with no direct linkages to the individual restricted securities for which the cost relates. This presentation may make it difficult for investors to identify the cost of each restricted security without significant effort and high likelihood of confusion or misidentification.

The SEC IM staff have observed effective disclosure where the cost component is included within the SOI or relevant information is presented in an organized table and commented to registrants where disclosure was unclear.

- b. Investments in and advances to affiliates – Schedule 12-14 of Regulation S-X:

- Recent updates to Footnote 1 to Schedule 12-14 as a result of the ETF rule adoption have clarified its intent. The footnote now indicates that if during the period there has been any increase or decrease in the amount of investment in and advance to any affiliate, a registrant should state in a footnote (or if there have been changes to numerous affiliates, in a supplementary schedule) a rollforward of such changes, including the (1) name of each issuer and title of issue or nature of indebtedness; (2) balance at beginning of period; (3) gross additions; (4) gross reductions; (5) balance at close of period as shown in Column F. Column F refers to the value of each item at the close of period, as updated with the adoption of ETF rule. Previously this footnote required the balance at the close of the period as shown in Column E, which referred to amounts of dividends and income rather than value. This correction clarifies that the

roll forward table required by Footnote 1 to Schedule 12-14 should be based upon value.

The SEC IM staff have identified certain funds that have continued to provide this information based upon share amounts and have commented to registrants.

c. Collectability of Interest Income:

In recent reviews of the financial statements of some BDCs, the SEC IM staff identified potential concerns for certain investments with a reported fair value of zero that simultaneously continued to accrue PIK interest income. The SEC IM Staff reminds registrants to consider collectability of income as discussed in FASB ASC 946-320-05-8 and industry guidance within the AICPA Audit and Accounting Guide *Investment Companies* (2019) in paragraphs 2.126 and 2.130.

d. Form N-PORT, Item C.8:

The SEC IM staff noted certain funds for which its investments' fair value measurement levels in Form N-PORT did not match those included in financial statements for the same period, and the discrepancy was due to error. Item C.8 requires registrant to indicate the level within the fair value hierarchy "in which the fair value measurements fall pursuant to U.S. Generally Accepted Accounting Principles (ASC 820, Fair Value Measurement)". The SEC IM staff emphasized that data contained in Form N-PORT needs to be consistent with a registrant's other filings containing the same information.

9. Enforcement update:

The SEC IM staff highlighted a [recent enforcement case](#) against a registered investment adviser that caused the overvaluation of smaller-sized bond positions known as "odd lots" purchased by one of its funds, resulting in the overstating of the fund's net asset value.

10. Rulemaking Update: Following the EP Meeting, on May 21, 2020, the SEC adopted [Amendments to Financial Disclosures about Acquired and Disposed Businesses](#), which included new rules and form amendments to improve for investors the financial information about acquired and disposed of businesses. While the rule makes a number of changes in these areas affecting operating companies, the adopted rule does impact areas specific to investment companies highlighted below:

- Amends the definition of "significant subsidiary" to provide a definition that is specifically tailored for investment companies and business development companies and
- Adds new Rule 6-11 and amend Form N-14 to cover financial reporting for fund acquisitions by investment companies and business development companies.

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