

Investment Companies Expert Panel

January 15, 2019

Conference call 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:

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 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. However, 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.
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 EP 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.

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