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 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 if an investment company 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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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

I. 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).

II. 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 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. 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
Securities Act of 1933 and fund registration forms to require that during a certain transition period funds that choose to implement the new delivery method for shareholder reports provide prominent disclosures in prospectuses and certain other shareholder documents that will notify investors of the upcoming change in transmission format for a period of two years. As part of SOX reviews, the staff may inquire as a form of outreach if they do not see such disclosures being made.

b. Form N-CEN data review – The SEC staff review Form N-CEN filings and evaluate answers to variety of questions. These reviews may result in registrants hearing directly from the Division of Investment Management’s Analytics Office to ensure data validity and data consistency.

The SEC staff is also monitoring and evaluating the consistency of certain disclosures made in Form N-CEN with disclosures made in the financial statements and related filings to inform their reviews of either financial statements or reviewable filings – e.g., 1) legal proceedings; 2) NAV errors and material weaknesses; 3) errors and omission insurance policy; 4) changes in accounting principles and practices.

3. 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-PORT1</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 not later than 60 days after the end of that fiscal quarter (as opposed to filing each monthly report no later than 30 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 2</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          | ($109 – $104) |
|--------------------------------------------------|------------|-------------|
| Amortized cost at 31 Dec 2030 (realized loss of $2 if called) | $106       | $104        | (no realized loss if called) |
| Amortization 2031–2050 (if not called)          | $6*        | $4          | ($104 – $100) |
| **Total**                                        | $9         | $9          | ($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***

### Fact Pattern

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</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 its 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 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.

The SEC Staff continues to encourage registrants, service providers and auditors to reach out to the Staff if there are any questions regarding a comment issued or a particular matter. Additionally, the SEC Staff encourages fund accountants or administrators to be included on calls with the registrants when discussing comments related to a fund’s financial statements, if any.

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 confidentiality/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 confidentiality/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.
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:
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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.
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.
**Other IM Related Updates**

- **LIBOR** – the SEC staff highlighted portions of the [SEC Staff Statement on LIBOR Transition](https://www.sec.gov) 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 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:

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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 disposal 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.
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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(1) 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 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:
   a. [Modernizing our Regulatory Framework: Focus on Authority, Expertise and Long-Term Investor Interests](#) by Chairman Clayton, November 14, 2019
   b. [Keynote Address - ALI CLE 2019 Conference on Life Insurance Company Products](#) by Dalia Blass, Director, Division of Investment Management, November 7, 2019
   c. [What You Don’t Know Can Hurt You](#) by Stephanie Avakian, Co-Director, Division of Enforcement, November 5, 2019
   d. [Fiscal Year 2019 Agency Financial Report](#)

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.