



AICPA Investment Companies Expert Panel

January 18-19, 2022, meeting highlights

I. Accounting/Reporting Issues:

1. The EP considered the accounting for pass-through entity taxes (PTETs) paid by funds taxed as partnerships. The 2017 federal Tax Cuts and Jobs Act imposed a \$10,000 annual limitation on the amount of state and local taxes (SALT) that individuals can deduct in computing federal income taxes (the “cap”). In response, a growing number of states enacted laws allowing certain entities taxed as partnerships to pay state taxes directly from the entity to the state, commonly known as PTETs. Electing to pay tax directly from the entity may allow the partnership to deduct the taxes paid on the partnership’s federal tax return. Since the entity pays the tax, it must consider ASC 740 to determine the appropriate accounting for these PTETs. Entities should attribute income taxes to either the entity or its owners based on how the tax laws and regulations of each jurisdiction attribute income taxes, rather than based on who pays the income taxes. One EP member noted that the examples within ASC 740-10-55-226 –228 are helpful in determining whether PTETs are entity level taxes (i.e., the debit would be to income tax expense), or taxes attributed to the owners of the entity (i.e., the debit would be to partners’ capital distributions). Each of the statutes in the 21+ states that have enacted these PTETs may contain different provisions, and therefore funds should evaluate each state law and the guidance in ASC 740 to determine the proper accounting treatment. The EP members also noted that they have seen questions related to this treatment, predominantly at the management company (adviser) level.
2. The EP members discussed the [Proposed ASU on Interim Reporting \(ASC 270\)](#) and the potential for scaled back disclosure for RIC semi-annual financial statements and BDC 10-Qs.
3. The EP members considered the financial statement impacts of swing pricing under the SEC’s December 15, 2021, proposal, [Money Market Fund Reforms](#). The EP members shared that they anticipate certain operational challenges in implementing the provisions of the proposal, when finalized, but not from a financial statement perspective.
4. The EP members offered their perspectives on Central Securities Depositories Regulation ("CSDR") settlement regime. The EP members discussed that facts and circumstances would determine whether the fund and its investors or the investment manager would bear the penalties for delayed settlements. Some EP members

observed that there were similarities to other transaction costs, and, as such, it could be appropriate to treat the amounts of penalties for delayed settlements as part of realized or unrealized gain/loss based on whether the entity holds a security. One EP member noted that for most US funds, the amounts may not be material. Certain funds may determine it is appropriate for the advisor to reimburse the fund for the penalties and upon review of legal documents with the executing broker, may also be entitled to reimbursement from the broker.

5. The EP members considered the financial statement presentation for a change in status from a non-investment company to an investment company. An entity that previously did not meet the characteristics of an investment company under ASC 946 plans to change its business purposes and activities to be consistent with those of an investment company. FASB ASC paragraph 946-10-25-3 states that an entity that subsequently becomes an investment company as a result of the reassessment of status shall account for the effect of the change as a cumulative-effect adjustment to net assets as of the date of change in status. For the statement of operations, it may be more meaningful to present separate columns for the periods of noninvestment company and investment company operations. If the entity had previously consolidated its portfolio companies prior to the change in status, no gain or loss would be recognized upon deconsolidation because the change in the basis of accounting for the portfolio companies as fair value investments would be captured in the cumulative-effect adjustment as of the date in change in status. As it relates to the internal rate of return (IRR), the EP members would expect the IRR calculation to begin from the date the entity has changed its status to an investment company.
6. The EP revisited its discussion from the November 2021 meeting of a scenario involving a private equity fund that acquires carbon credits that will be held at the fund level and the potential accounting for the carbon credits by the fund. During the January 2022 meeting, the EP members discussed a scenario where an investment company buys and holds carbon credits and then either sells or retires them. In this scenario, the EP members debated if the investment company that holds these carbon credits for capital appreciation may classify these credits as “other assets” or whether they should follow an intangible asset model.
7. The EP considered the presentation of IRR for periods of less than one year and whether the IRR should be “de-annualized” for short periods. The EP members acknowledged that GAAP does not appear to specifically address this scenario. Certain EP members stated that they would use the excel XIRR function without adjustment, acknowledging that the XIRR function produces an annualized calculation. Other members stated that they would use a deannualized IRR, as an annualized IRR for a short period could produce a distorted return (e.g., due to significant capital distributions or net income during the period). An EP member also pointed out that this would be consistent with GIPS guidance which states that IRR must not be annualized. Generally, the EP agreed that the IRR information presented should be useful and meaningful to investors and not misleading, and the best practice is to include disclosures that state how IRR is calculated and whether it is annualized or not.

8. The EP discussed the impact on a RIC's ASC 740 analysis for EU tax reclaims when a RIC, for tax purposes, believes that foreign taxes paid are "reasonably certain" to be refunded and therefore does not pass through the foreign tax credit to its shareholders.

The EP members discussed that for the purposes of FASB ASC 740 analysis, if a RIC is reasonably certain that it will receive a refund of foreign taxes paid, it would likely be appropriate to book a receivable under the more likely than not criteria in ASC 740.

II. 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. SEC's leadership personnel changes:
 - a. Commissioner Elad L. Roisman has departed the Commission this month,
 - b. Haoxiang Zhu was appointed Director of Division of Trading and Markets.
 - c. William Birdthistle was named Director of Division of Investment Management.
2. Statements and speeches:
 - a. [Statement on OCA's Continued Focus on High Quality Financial Reporting in a Complex Environment](#) Paul Munter, December 6, 2021
 - b. [SEC Staff Statement on LIBOR Transition—Key Considerations for Market Participants](#) December 7, 2021
 - c. The [Fall 2021 Agency Rule List](#) was released. The fall 2021 rules agenda has over 50 items, including:
 - Amendments to Form PF,
 - Updates to Rules Related to Private Fund Advisers,
 - Money Market Fund Reforms,
 - Amendments to Fund Names Rule,
 - Rules Related to Investment Companies and Investment Advisers to Address Matters Relating to Environmental, Social and Governance Factors,
 - Open-End Fund Liquidity and Dilution Management,
 - Tailored Shareholder Reports, Treatment of Annual Prospectus Updates for Existing Investors, and Improved Fee and Risk Disclosure for Mutual Funds and ETFs; Fee Information in Investment Company Ads
3. The SEC staff offered the following registration statement and financial statement review comments:
 - a. The SEC staff has seen an increase in new funds with strategies to invest in real estate and direct lending products, often through a subsidiary. The staff reminded registrants that the legal analysis to determine whether leverage at

the subsidiary should be attributed to the asset coverage ratio of a closed end fund or BDC under Section 18 of the 1940 Act is separate from the accounting analysis to determine whether the subsidiary should be consolidated, in accordance with US GAAP. As a result, there may be scenarios where a subsidiary is not consolidated under ASC 810, but under Section 18 of the 1940 Act, the leverage of the unconsolidated subsidiary would be included in the asset coverage calculation of the registrant. The SEC stated that they noted the issue during the recent initial registration statement reviews of certain closed-end funds with real estate exposure. Registrants are encouraged to discuss consolidation and implications of Section 18 with fund counsel.

- b. Transmittal dates - The SEC staff reminded registrants that Rule 30e-1 under the Investment Company Act of 1940 (“the Act”), *Reports to stockholders of management companies*, 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. Rule 30b2-1 of the Act, *Filing of reports to stockholders*, provides that investment companies file with the Commission a report on N-CSR no later than ten days after the transmission to stockholders of any report that is required to be transmitted to stockholders under 30e-1. The staff highlighted that Rule 0-2 of the Act allows filings with the Commission which are due on Saturday, Sunday, or holidays be filed with the Commission the first business day following; however, as Rule 30e-1 is not a filing with the Commission, but rather a transmission requirement to stockholders, the provisions of Rule 0-2 do not apply, and accordingly, for purposes of complying with Rule 30e-1, if the 60th day falls on a weekend or holiday, the transmittal deadline should not be extended to the next business day. The staff further noted the Form N-CSR is required to be filed 10 days after the report is transmitted to shareholders. The staff illustrated an example: Funds with fiscal years ended March 31, 2021, were required to transmit the shareholder report to shareholders by May 30, 2021. While this date fell on a Sunday, as Rule 0-2 does not apply, the fund would have been required to transmit the shareholder reports no later than May 30, 2021. The Form N-CSR filing date is 10 days after the transmission to stockholders date, in this example May 30, 2021, so June 9, 2021. However, had June 9, 2021 been a Saturday, Sunday, or holiday, under Rule 0-2, the Fund would have been permitted to file the shareholder report with the Commission on the following business day. If a registered investment company is unable to file all or any portion of a Form N-CSR within the prescribed time period, Form 12b-25 is required to be filed with the SEC within one business day after the due date of the report, disclosing the reasons for the delay.
- c. Rule 3-11 of Regulation S-X discusses financial statements of an inactive registrant. An inactive entity must meet all of the following conditions:
 - Gross receipts from all sources for the fiscal year are not in excess of \$100,000;

- The registrant has not purchased or sold any of its own stock, granted options therefor, or levied assessments upon outstanding stock,
- Expenditures for all purposes for the fiscal year are not in excess of \$100,000;
- No material change in the business has occurred during the fiscal year, including any bankruptcy, reorganization, readjustment or succession or any material acquisition or disposition of plants, mines, mining equipment, mine rights or leases; and
- No exchange upon which the shares are listed, or governmental authority having jurisdiction, requires the furnishing to it or the publication of audited financial statements.

The SEC staff objected to the use of unaudited financial statements in reliance of Rule 3-11 of one business development company (BDC) that had not commenced investment operations, yet, actively sought and closed on capital commitments in excess of \$100,000 and incurred offering/organization costs in excess of \$100,000. It was the staff's view that the activities of this registrant did not meet the requirements or the spirit of Rule 3-11.

d. Mergers and NAST analysis:

- The staff shared that the guidance in [North American Security Trust no-action letter \(pub. avail. Aug. 5, 1994\) \(also known as NAST\)](#) continues to be important in determining the accounting survivor in mergers (most recently discussed at the July 2021 meeting). The staff noted that in determining the accounting survivor, the entity should consider all facts and circumstances, including portfolio composition, portfolio management, asset size, fee ratios and expense structure.
- The SEC staff revisited a topic most recently discussed in the May 2021 SEC Staff Update regarding accounting for fund mergers. The SEC staff noted that they have not objected to the application of AICPA TQA 6910.33 in open end fund mergers. However, when accounting for the merger of two BDCs, registrants should follow FASB ASC 805-50 around accounting for asset acquisitions. Registrants should apply judgment when accounting for the merger of 2 closed-end funds based on the facts and circumstances of the fund merger. Some factors to consider when determining whether ASC 805-50 or the AICPA TQA is appropriate are portfolio composition and fund structures (e.g., exchange traded or transacting at NAV as interval or tender offer funds). The staff recognized there may be situations where a closed-end fund may find it challenging to determine the appropriate accounting model and encouraged registrants and their auditors to consult with the staff.

4. In the May 2012 EP meeting, the SEC staff discussed that separate financial statements of a significant subsidiary that are reported with a registered fund under Rule 3-09 of Regulation S-X should be prepared in accordance with Regulation S-X and include a full schedule of investments. With respect to private funds acquired or

to be acquired, Rule 6-11 permits the acquired private funds to provide financial statements prepared in accordance with U.S. GAAP and schedules that comply with S-X Article 12. In response to an EP member's question as to whether this permission for acquired private funds in Rule 6-11 applies to the separate financial statements of private entities required under Rule 3-09, the SEC staff indicated that it does not. Registrants should continue to apply Rule 3-09 reporting requirements when applicable, which requires preparing financial statements in accordance with Regulation S-X in their entirety.

5. Policy updates:

- a. In December 2020, the Commission proposed rule and form amendments designed to improve the resilience and transparency of money market funds. These amendments are designed to address concerns about money market fund stability, which was highlighted by the liquidity events in March 2020 and the funds' susceptibility to heavy redemptions in times of stress. The proposed amendments would revise existing money market fund requirements by:
 - Increasing minimum daily liquid asset requirements from 10% to 25% and increasing weekly liquid asset requirements from 30% to 50% to provide a more substantial buffer in the event of rapid redemptions;
 - Removing the ability of money market funds to impose liquidity fees and redemption gates when they fall below certain liquidity thresholds, which would eliminate an incentive for preemptive redemptions;
 - Requiring institutional prime and institutional tax-exempt money market funds to implement swing pricing so that redeeming investors bear the liquidity costs of their redemptions;
 - Requiring stable NAV funds to convert to a floating share price if future market conditions result in negative fund yields; and
 - Enhancing certain reporting requirements to improve the Commission's ability to monitor and analyze money market fund data.
- b. The SEC staff reminded registrants of the upcoming compliance dates for recently issued rules:
 - a. Use of Derivatives by Registered Investment Companies and Business Development Companies – August 19, 2022.
 - b. Good Faith Determinations of Fair Value – September 8, 2022 (18 months after the effective date of the rule, which was March 8, 2021) Acknowledging that compliance dates do not coincide with period reporting dates, registrants' filings after the compliance date should include required disclosures.

6. Enforcement cases:

- a. Independence violation – [a public accounting firm provided non-audit services for its audit client on a contingent fee basis](#).
- b. Advisory compliance program
 - The SEC [charged private equity fund adviser with fee and expense disclosure failures](#)
 - maintaining best compliance program and provide information to investors

- c. Conflict of interest - a registered investment adviser (RIA) and its related party broker-dealer received compensation from the clients' investments into mutual funds with 12b-1 fees without disclosing a conflict of interest.