Investment Companies Expert Panel

Highlights of the January 16, 2018 Meeting

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 meeting:

I. AICPA/Administrative:

1. The EP chair thanked outgoing members for their contributions to the AICPA EP and CPA profession over the past three years.

2. The Expert Panel (EP) May and September meetings and July and November 2017 calls highlights are being finalized.

3. The AICPA staff updated the EP on recent developments regarding the AICPA Asset Management Revenue Recognition Task force.

4. The AICPA staff and the EP members considered various AICPA Audit and Accounting Guide *Investment Companies* (the Guide) matters. In particular,

    a. The EP considered whether the auditor's report on internal control required by SEC under Form N-SAR should be updated to conform to the new reporting provisions prescribed by PCAOB Release No. 2017-001 (AS 3101, AS 3105, AS 1220, AS 1301, AS 2201, AS 2820, & AS 4105). The EP currently expressed a view that the report should not be updated but will continue to discuss as the EP members discuss within their firms.

    The EP also noted that Form N-SAR will be rescinded effective June 1, 2018, once Form N-CEN is effective.

    b. The EP also discussed potential enhancive update to the Guide on cryptocurrency. The EP will monitor AICPA developments on this topic and will revisit this topic during future EP calls.

II. Accounting/Reporting Issues:

1. The EP members discussed accounting methods for various loan fees that are received by BDCs or other types of funds with lending activities. Examples of types of loan fees received by BDCs include origination and upfront structuring fees, syndication fees, commitment fees, amendment or

restructuring fees and prepayment fees. An EP member inquired whether BDCs are adopting the new revenue recognition guidance in ASC 606, *Revenue from Contracts with Customers*, for these fees or applying FASB ASC 310-20 (formerly known as FAS 91) or other guidance. The EP members acknowledged certain diversity in practice in historic accounting for loan origination fees, yet, noted that certain BDCs and investment companies have been and are currently following guidance in FASB ASC 310-20, *Nonrefundable Fees and Other Costs*, and not necessarily revenue recognition guidance, if the activities are covered within FASB ASC 310-20. These entities have historically applied ASC 310-20 by analogy because ASC 946 is silent on the accounting for loan origination fees. The EP members discussed that financial instruments and other contractual rights or obligations within the scope of ASC 310 are specifically scoped out of ASC 606.

The EP will continue discussing this topic at the March EP conference call.

2. The Chicago Mercantile Exchange (CME) and LCH.Clearnet Limited (LCH) have amended their rulebooks to legally characterize variation margin payments for over-the-counter (OTC) derivatives they clear as settlements rather than collateral ("settled to market"). Some clearing members do not report the variation margin payments for each individual derivative contract, but on an aggregate basis. The EP discussed how nonregistered investment companies should present centrally cleared derivatives on the balance sheet and how the FASB ASC 820 fair value hierarchy disclosures required by ASC 820-10-50-2(a) and (b) may be affected. Additionally, the EP considered the effect, if any, on the ASC 815 derivative disclosures outlined by ASC 815-10-50-4A(a) and ASC 815-10-50-4B(c), which require derivative instruments to be presented as separate asset and liability values, segregated by type of contract (e.g. interest rate contracts, foreign exchange contracts, equity contracts, commodity contracts, credit contracts, etc.).

An EP member shared that historically, nonregistered investment companies presented the fair value of centrally cleared derivatives as a separate unit of account on the balance sheet, separate from the related variation margin payments. The variation margin payments have historically been presented as collateral on the balance sheet (i.e., balance sheet has been presented gross). However, due to the changes in the CME and LCH rulebooks, variation margin payments will be treated as legal settlement of open contracts between the clearing house and the clearing member. Investment companies should treat the fair value and related variation margin payments as a single unit of account and present the amounts net on the balance sheet when there is legal settlement between the fund and the clearing member, which is a legal determination that should be made by the fund.

With respect to the disclosures required under ASC 820 and ASC 815, the EP generally agreed that investment companies may analogize to the guidance in ASC 946-210-50-6(e) for futures contracts, consistent with the schedule of investments disclosures discussed in the November 2017 meeting, and show the cumulative appreciation/depreciation for open centrally cleared derivative contracts. One EP member acknowledged that for purposes of FASB ASC 820 and FASB ASC 815 disclosures, derivative assets and liabilities included in these disclosures are presented at fair value, as shown on the balance sheet, which under legal settlement would be zero or close to zero. For example, if a fund holds centrally cleared swaps with a gross unrealized depreciation of $675,000 and the fund has made margin payments to the counterparty in the same amount, the fair value of the centrally cleared swaps would be $0 on the balance sheet, as the swaps and related variation margin payment are viewed as a single unit of account. For the ASC 820 fair value hierarchy, the fund may elect to disclose the fair value of these centrally cleared swaps as an other financial instruments liability of $675,000 (i.e., gross fair value) or disclose the fair value as $0 (i.e. net presentation). For the ASC 815 asset/liability fair value disclosures, the fund may elect to disclose the gross value of the liability derivative (i.e. $675,000) or the net value which is presented on the balance sheet (i.e. $0). The EP members did not object to either presentation for ASC 820 or ASC 815 disclosures. One EP member noted it would be appropriate to consider materiality and also perform a qualitative and quantitative assessment.

3. The FASB issued ASU 2017-01, *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. Given the amendments to ASC 805, *Business Combinations,* the EP considered whether fund mergers would be considered business combinations or rather asset acquisitions and whether revisions to TQA 6910.33, "Certain

Financial Reporting, Disclosure, Regulatory, and Tax Considerations When Preparing Financial Statements of Investment Companies Involved in a Business Combination" are needed.

An EP member questioned if the acquisition of advisory contracts may support an argument that a business was acquired, as the advisory contracts may give the acquiring entity rights to processes and inputs. However, some EP members believe that the advisory contracts do not survive when funds merge, as new contracts are issued which might suggest a business was not acquired.

The EP will continue discussing this topic at the March EP conference call.

4. The FASB issued final guidance in ASU 2016-18, *Restricted Cash*, to clarify how entities should present restricted cash and restricted cash equivalents in the statement of cash flows. For public business entities, the ASU is effective for fiscal years beginning after December 15, 2017, and interim periods within those years. For all other entities, the ASU is effective for fiscal years beginning after December 15, 2018 and interim periods within fiscal years beginning after December 15, 2019. Early adoption is permitted.

The ASU requires entities to show the changes in the total of cash, cash equivalents, restricted cash and restricted cash equivalents in the statement of cash flows; however, the ASU does not define restricted cash.

Given this new guidance, the EP discussed how investment companies determine whether certain amounts included in "due from broker" or "deposits for derivatives/securities sold short" are considered restricted cash and should be reflected as restricted cash on the statement of cash flows upon adoption of the ASU. The EP members noted the importance of understanding legal arrangements to determine whether broker balances or deposits are considered restricted cash.

III. Audit and Attest Issues

1. Custody Rule:

a. The EP discussed the independent public accountant's responsibility under the attestation standards to test the completeness of the population of client accounts over which the RIA is considered to have custody when performing an independent verification of client funds and securities pursuant to Rule 206(4)-2(a)(4). Certain EP members expressed a view that testing completeness of the population of client accounts is a legal determination, rather than a requirement under the attestation standards, as clients typically instruct accountants as to which accounts are subject to the custody rule.

The EP will continue discussing this topic at the March EP conference call.

b. The EP also considered the independent public accountant's responsibility under the attestation standards with regard to previously issued surprise examination reports when an RIA is unable to comply with the SEC's no-action letter (NAL) on the use of standing letters of authorization. The NAL states that the SEC believes an adviser has custody of a client's assets if it has the power to dispose of the client's funds or securities for any purpose other than authorized trading. The NAL also states that a letter of instruction or other similar asset transfer authorization arrangement established by a client with a qualified custodian constitutes an arrangement under which an investment adviser has custody. The NAL provided detailed actions the adviser must take to comply with the relief. The EP members noted compliance with the custody rule is a legal determination.

The EP will continue discussing this topic at the March EP conference call.

IV. SEC Staff Update

Disclaimer

The following comments and observations were compiled by the AICPA Investment Companies Expert Panel and AICPA staff and are not authoritative positions or interpretations issued by the SEC or its staff. The comments and observations were not transcribed by the SEC or its staff and have not been considered or acted upon by the SEC or its staff. Accordingly, these comments and observations do not constitute a statement of the views of the SEC or its staff.

1. Agency Rule list:

The Fall 2017 SEC agency rule list includes, among others, forthcoming rules on ETFs, enhanced disclosure for separate accounts registered as UITs and offering variable annuities, auditor independence with respect to loans or debtor-creditor relationships, and investment company reporting modernization – option for website transmission of shareholder reports.

2. Initiatives in Investment Management (Investor Experience, Board Outreach, Valuation Guidance, and Cryptocurrency):

In her speech at the ICI Securities Law Developments Council on December 7, 2017, Dalia Blass, Director for the Division of Investment Management, highlighted the investor experience and board outreach as two current initiatives of the Division. Additionally, she commented that the Division of Investment Management anticipates working with the SEC's Office of the Chief Accountant to look at valuation. Specifically, they would focus on identifying recommendations for updates to staff guidance on valuation of securities and other assets held by registered investment companies.

She also mentioned cryptocurrency as a new innovation in the asset management space and noted several recent filings for registered funds that would hold cryptocurrency. Dalia Blass noted several concerns regarding these new types of products, including whether retail investors would have sufficient information about these products and fully understand their risks, how these funds would fit into existing regulatory framework, and which regulatory structures apply to the market for the underlying instrument.

The SEC staff shared relevant SEC staff speeches and publications on cryptocurrency or related virtual assets:

- SEC Chairman Jay Clayton Statement on Cryptocurrencies and Initial Coin Offerings (Dec. 11, 2017)
- SEC Division of Enforcement and SEC Office of Compliance Inspections and Examinations Statement on Potentially Unlawful Promotion of Initial Coin Offerings and Other Investments by Celebrities and Others (Nov. 1, 2017)
- Investor Alert: Public Companies Making ICO-Related Claims (Aug. 28, 2017)
- Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO (July 25, 2017)
- Investor Bulletin: Initial Coin Offerings (July 25, 2017)
- Investor Alert: Bitcoin and Other Virtual Currency-Related Investments (May 7, 2014)
- Investor Alert: Ponzi Schemes Using Virtual Currencies (July 23, 2013)

The staff highlighted that a legal and accounting framework exists and applies and that a holder, including an investment company, will need to consider the appropriate guidance based on the nature of its holdings. They discussed that there have been several registrants that want to invest in virtual assets and have attempted to register their products with the SEC. The staff discussed various concerns with virtual assets, including valuation (whether a fund's Board would have adequate information on daily basis to value the token, lack of depth in trading markets and volatile markets), custody (whether a fund that invests directly into virtual assets would be able to verify existence, including exclusive ownership, and concerns about software functionality) and price volatility for these investments. In light of these considerations, all registration statements for new funds that would hold virtual assets which would have gone automatically effective were withdrawn. Subsequent to the January Expert Panel meeting, on January 18th, the staff issued a letter to the ICI and SIFMA detailing their concerns around cryptocurrency-related holdings.

3. Staff Accounting Bulletin (SAB) No. 118:

On December 22, 2017, the SEC announced publication of staff guidance for publicly traded companies, auditors, and others to help ensure timely public disclosures of the accounting impacts of the Tax Cuts and Jobs Act (the Act) recently signed into law. Specifically, the staff of the Office of the Chief Accountant and the Division of Corporation Finance issued the following interpretations:

a. Staff Accounting Bulletin (SAB) No. 118 expresses views of the staff regarding the application of U.S. GAAP when preparing an initial accounting of the income tax effects of the Act.

b. Compliance and Disclosure Interpretation 110.02 expresses views of the staff regarding the applicability of Item 2.06 of Form 8-K with respect to reporting the impact of a change in tax rate or tax laws pursuant to the Act.

Under the staff guidance in SAB 118, companies may report provisional amounts in their financial statements based on reasonable estimates for items for which the accounting is incomplete. A company that cannot make a reasonable estimate for an income tax effect should not account for that effect until the first reporting period for which it can make such an estimate. Any provisional amounts recorded either initially or subsequent to the reporting period that includes the Act's enactment date may be subject to adjustment during a measurement period where an entity obtains, prepares, and analyzes the information needed to complete the accounting requirements under ASC 740 that should not exceed one year beyond the enactment date. The staff's guidance also describes supplemental disclosures about the material financial reporting effects of the Act for which the accounting under ASC 740 is incomplete.

Following issuance of SAB 118, the Division of Investment Management confirmed in Information Update 2017-07 (IM-INFO-2017-07) that investment companies can rely on SAB 118 guidance for purposes of calculating their daily NAV and reporting measurement period adjustments. The IM-INFO-2017-07 also noted that each registrant must disclose relevant information to investors to provide information about the material impacts of the Act to its calculation of NAV and material provisions for which the accounting is incomplete, if applicable. The disclosure about those impacts may be made in a press release, website disclosure, or some other reasonable manner.

The SEC staff further noted that FASB staff issued a Q&A indicating that the FASB staff would not object to private companies applying SAB 118 and that those private companies applying SAB 118 would be in compliance with GAAP. The Q&A also states that private companies applying SAB 118 should apply all relevant aspects of SAB 118 in its entirety including disclosures and such private companies should disclose their accounting policy of applying SAB 118 in accordance with ASC 235-10-50-1 through 50-3.

4. Frequently asked questions (FAQs) for Liquidity Rules

The staff of the Division of Investment Management has prepared responses to frequently asked question related to the investment company liquidity risk management program requirements.

Investment Companies Expert Panel

Highlights of the February 20, 2018 Panel call with the SEC staff for the Division of Investment Management

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:

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1. **Investment Company Reporting Modernization implementation discussion:**

   The SEC staff of the Division of Investment Management (SEC staff) is performing a targeted review to assess registrants' compliance with the S-X amendments in connection with the Investment Company Reporting Modernization final rule adopted in October 2016 and effective for periods ending after August 1, 2017. The SEC staff has observed variation in implementation for certain disclosure requirements within the following four thematic areas:

   a. ***Agreement of Article 12 Schedules to Balance Sheet (§210.12-12 – 12-14):***

      A note instruction to certain of the schedules in Article 12 requires that the total of certain columns agree with correlative amounts shown on the related balance sheet including the following generally:

      - For investments in securities and options, the total value on the schedules should agree with correlative amounts on the balance sheet.
      - For investments in derivatives, generally the total unrealized appreciation and depreciation on the schedules should agree with correlative amounts on the balance sheet.

- However, there is no such requirement for the schedule required by rule 12-13A Open futures contracts; although registrants may elect to do so.

A reconciliation demonstrating that agreement may assist a reader in understanding how the information in the schedules affects the NAV of a fund.

For example, rule 12-13C Open swap contracts, note instruction 7, states that the total of the upfront payments/receipts and the total of the unrealized appreciation/depreciation should agree with the total of correlative amount(s) shown on the related balance sheet. However, the total of different amounts for different types of swap contracts may appear in numerous line items on the balance sheet for amounts such as upfront premiums paid/received, variation margin for centrally cleared swaps, and unrealized appreciation/depreciation for non-exchange traded swaps.

The adopting release discussed an example of how registrants may accomplish the agreement required by Article 12 by outlining one commenter's suggestion that the appreciation/depreciation for non-exchange traded derivatives such as forward foreign currency contracts and swap contracts be disclosed in two separate columns or include subtotals, rather than in one column. However, the requirement suggested by the commenter was not adopted in order to allow flexibility in the manner in which registrants meet the requirement, acknowledging that an extra column may not be necessary to comply.

The SEC staff noted that there may be various ways to demonstrate agreement and meet the objective of informing investors about how the schedules relate to the balance sheet including subtotals, reconciliation, or other qualitative disclosures, etc.; further, the SEC staff acknowledged that, in some cases where few columns or line items are presented either in the schedules or the balance sheet, additional disclosure may not be necessary in order to demonstrate agreement. The SEC staff did not prescribe one method over another and intends to comment on financial statements where the agreement of the schedules required by Article 12 with the balance sheet is unclear.

b. Required disclosures for affiliate investments table (§210.12-14):

Q&A #5 of Regulation S-X section of the SEC staff Investment Company Reporting Modernization FAQs, released in July 2017, indicates that disclosures required by rule 12-14 of Regulation S-X regarding investments in and advances to affiliates may be presented in the schedule of investments (SOI) or in the notes to the financial statements. Rule 12-14 requires certain disclosures to be provided in the schedule of affiliated investments, including the categorization of investments by industry or geography, denoting restricted securities, securities valued using significant unobservable inputs, etc. The changes to rule 12-14 resulted in additional disclosure for affiliated investments.

The SEC staff observed that some registrants have not included information required by rule 12-14 if they have already provided such information in the SOI as required by rules 12-12 through 12-13D. The SEC staff observed that where a registrant's investments in affiliates are concentrated in an industry or geography, are restricted, or are valued using significant unobservable inputs, for example, it may be meaningful for investors to view that disclosure in aggregation on the affiliated investments schedule. Where there are a small number of affiliated holdings presented on a SOI with a small number of investments, for example, registrants may determine that such additional information may not be necessary to reasonably inform investors since it is easily identifiable on the SOI.

The SEC staff encourages registrants to evaluate facts and circumstances to determine whether that disclosure is meaningful to investors. The SEC staff intends to comment regarding how a registrant complied with the requirements of rule 12-14 if such

information is missing and it believes it may be helpful for a reader to better understand the context of the registrant's affiliated investments.

c. ***Variable rate securities (§210.12-12 fn. 4,12-12A fn. 3, 12-12B fn. 3, 12-14 fn. 3) and derivatives with reference assets as variable rate securities (§210.12-12B fn. 5, 12-13 fn. 3, 12-13C fn. 3)***

In accordance with the footnotes to certain schedules in Article 12, variable rate securities should include a description of the reference rate and spread and either the end of period interest rate or the end of period reference rate for each reference rate described in the schedule.

The SEC staff noted variation on how registrants provided disclosures on variable rate securities and highlighted certain effective disclosures:

i. Step coupon bonds and securities with caps/floors:

- Effective disclosures identified included the current rate and date through which it is effective, the date when the rate steps up or down, and what the rate would be at those dates.
- Effective disclosure may also include qualitative description of the direction and range of rates where a bond has multiple steps and a registrant has determined that disclosure of each step would not provide additional significant information to an investor about the return profile.
- The SEC staff observed that disclosure indicating whether the rate will step up or step down, may be an important indicator of a different return profile in contrast to just showing one rate and the maturity date when that rate will not be earned through maturity.
- Similarly, for securities with caps and floors, the SEC staff observed effective disclosure concerning the existence and description of a cap/floor, as well as, the amount of the cap/floor. Disclosure of such information regarding a cap/floor may be indicative of a different return profile.

ii. Asset-backed securities:

- Where the effective interest rate is constantly changing based on performance of underlying assets, the SEC staff observed an effective disclosure that included disclosure of the current rate and disclosure about how the investment works (e.g., how payments are made).

iii. Bank loans with multiple tranches and weighted average rates:

- Where there are investments with different tranches and rates but for an investment which is depicted as one unit of account, the SEC staff observed effective disclosure which included additional information about the various rates rather than including only a weighted average rate.

iv. Derivatives where the underlying asset is a variable rate security:

- The SEC staff observed effective disclosure which included a description sufficient for a user to understand the terms of the payments to be received and paid, for example, in the case of an interest rate swap, disclosure where both the reference rate and spread, and either the end of period rate or the end of period reference rate for each reference rate described was disclosed in a note to the schedule.

The SEC staff may comment where disclosures are unclear or insufficient for an investor to understand the investment in consideration of the overall portfolio.

d. ***Custom baskets disclosures (§210.12-13 and 12-13C*)**:

Q&A #2 and 3 of Regulation S-X section of the SEC staff Investment Company Reporting Modernization FAQs discuss certain questions around disclosure of custom baskets. During the February 2018 call, the SEC staff highlighted certain additional observations

concerning custom basket disclosure from discussions with registrants and from their review of registrants' financial statements.

The SEC staff discussed inquiries received:

- Specifically, regarding how registrants should treat notional values when custom baskets hold both long and short positions when determining whether a fund is required to disclose the components of the custom basket. Footnotes 3 in rules 12-13 and 12-13C states the following:

  > *If the reference instrument is an index or basket of investments, the components are not publicly available on a Web site as of the balance sheet date, and the notional amount of the option/swap contract does not exceed one percent of the net asset value of the registrant as of the close of the period, identify the index or basket. If the reference instrument is an index or basket of investments, the components are not publicly available on a Web site as of the balance sheet date, and the notional amount of the option/swap contract exceeds one percent of the net asset value of the registrant as of the close of the period provide a description of the index or custom basket and list separately: (i) The 50 largest components in the index or custom basket and (ii) any other components where the notional value for that components exceeds 1% of the notional value of the index or custom basket.*

  The SEC staff clarified that treating the notional values of the short positions of the custom basket in terms of their absolute values may be appropriate in order for a registrant to determine if the notional amount of the option/swap contract exceeds the threshold prescribed. The view that a fund should treat the notional values of short positions in terms of their absolute values when evaluating individual components to identify the top 50 largest components and any other components that exceed 1% of the notional value of the index or custom basket has already been expressed in Q&A #2 of Regulation S-X section of the SEC staff Investment Company Reporting Modernization FAQs.

The SEC staff shared additional financial statement review observations:

- Rule 12-13C, footnote 3, requires registrants to disclose the percentage value of the component when compared to the custom basket net assets:
  - While the SEC staff believes that the use of a component's "value" in the numerator is clear, they acknowledged there have been questions about what the "custom basket's net assets" (the denominator of the calculation) represents.
  - The SEC staff observed some registrants utilizing the value of the derivative as the denominator in the calculation.
  - The SEC staff observed some registrants disclosing the percentage value as a component of the fund's net assets, similar to the requirement in rule 12-12, footnote 5.
  - The SEC staff observed ineffective disclosure where a percentage is presented but it is unclear what the percentage represents.
  - Without further published guidance, the SEC staff intends to be flexible but may comment where disclosure is unclear or does not provide meaningful information.
- Rule 12-13C, footnote 3, requires registrants to disclose the 50 largest components and any other components where the notional value of the component exceeds 1% of the notional value of the basket.
  - The SEC staff observed disclosures where it is difficult for a reader to determine how the components of the basket that are disclosed relate to the derivative as a whole.

- The SEC staff observed effective disclosure where registrants are only providing the top 50 components and any component whose notional > 1% of the basket's notional and:
    - The registrant identified that the disclosure represented a subset of the basket (e.g., top 50 and > 1%) and not all of the contents of the basket were included; and/or,
    - Included a line item encompassing the totals of "other components" to agree to the total value of the swap.

Investment Companies Expert Panel

March 13, 2018 Conference Call

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:

I. Accounting/Reporting Issues:

1. The Expert Panel (EP) members discussed the SEC staff comments provided during the February EP conference call regarding implementation of Regulation S-X amendments.

2. The EP discussed the accounting treatment of investment research costs under the second Markets in Financial Instruments Directive (MiFID II) for U.S. entities. One of the directives under MiFID II is the unbundling of commissions into execution and research costs. Historically, investment research provided to the asset manager by a broker-dealer or a bank has not been a separately identifiable cost and has been bundled within trading commission rates.

   ASC 946-320-30-1 states, "An investment company shall initially measure its investments in debt and equity securities at their transaction price. The transaction price shall include commissions and other charges that are part of the purchase transaction." Accordingly, investment companies typically capitalized these commission transaction costs into the cost basis of the security purchased. One of the goals of MiFID II regulation is to provide greater transparency into execution and research costs. The firms may not be able to link research costs to transaction volume or transaction value.

   The EP considered whether research costs under MiFID II would qualify as direct incremental transaction costs that can be capitalized. When considering whether or not such costs can be capitalized an entity would need to consider if the research cost can be linked directly to a transaction. The EP members will discuss with asset managers to better understand current practice and what options for accounting treatment may be available. The EP will revisit at a future meeting.

3. During the May 2017 EP meeting, the EP noted that they believe investment companies may be impacted by guidance in FASB ASU 2016-13 *Financial Instruments: Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (CECL)* and have highlighted several broad areas for investment companies as potentially being affected by this ASU. One of the topics discussed at the July and November 2017 EP conference calls was beneficial interests accounted for under FASB ASC 325-40 and the related creation and release of an allowance account for all future expected credit losses. During the November 2017 EP conference call, the EP noted that generally an investment company would record interest income based on the interest method and would update the effective yield based on expectations of timing and the amount of cash flows to be collected.

   During the March 2018 EP conference call, the EP revisited this topic, as there has been discussion within the industry on the application of ASC 325-40 to beneficial instruments reported at fair value through net income. These discussions have focused on the impact of the application of ASC 325-40 to income statement geography (i.e., interest income vs. unrealized/realized gains and losses).

   ASC 325-40-15-7 indicates that beneficial interests classified as trading are within the scope of ASC 325-40 for purposes of income recognition:

   > "For income recognition purposes, beneficial interests classified as trading are included in the scope of this Subtopic because it is practice for certain industries (such as banks and investment companies) to report interest income as a separate item in their income statements, even though the investments are accounted for at fair value."

ASC 325-40-15-1 states:

> The guidance in this Subtopic applies to all entities.

There is no additional guidance in ASC 325-40 that is specific to securities that are recorded at fair value through net income. Previous guidance in ASC 325-40-35-2 had indicated that the same amount of interest income shall be recognized each period regardless of whether the beneficial interest is classified as held to maturity ("HTM"), available for sale ("AFS") or trading.

> "The method used for recognizing and measuring the amount of interest income on a beneficial interest shall not differ based on whether that beneficial interest is classified as held to maturity, available for sale, or trading debt security. The same amount of interest income shall be recognized each period regardless of whether the beneficial interest is classified as held to maturity, available for sale, or trading debt security."

However, that guidance has been superseded by ASU 2016-13. ASU 2016-13 added new guidance for how to account for changes in cash flows expected to be collected for HTM and AFS securities, but no additional guidance was added specifically for trading securities.

ASC 325-40-35-1 would appear to apply to trading securities (as well as HTM and AFS), it states:

> "The holder shall recognize accretable yield as interest income over the life of the beneficial interest using the effective yield method. The holder of a beneficial interest shall continue to update, over the life of the beneficial interest, the expectation of cash flows to be collected."

BC96 of ASU 2016-13 also appears to be relevant, it states:

> "The Board also acknowledges that practice related to interest income recognition on beneficial interests within the scope of Subtopic 325-40 will be different when the allowance for credit losses is present. When a beneficial interest within the scope of 325-40 has an allowance for credit losses, favorable or unfavorable changes in cash flows must first be considered as adjustments to the allowance for credit losses. Only the remaining portion of favorable or unfavorable changes in cash flows would be reflected in accretable yield."

The EP members discussed whether an investment company that holds a beneficial interest should maintain an allowance for credit losses for beneficial interests or should future cash flows be adjusted through interest income and/or unrealized/realized gains and losses. Specifically, the EP members discussed the following views:

View A – The entity should maintain an allowance for credit losses.

Proponents of View A believe that ASC 325-40 has and continues to be an integrated interest income and impairment model. The amount of interest income that a company records, and the degree to which the effective yield is updated on a prospective basis, depends first on whether or not an adjustment to the allowance for credit losses (either on a favorable or unfavorable basis) would be required. The model does not work unless a company is applying both the interest recognition and the impairment model.

Proponents of View A do not believe that the deletion of the guidance indicating interest income should be the same for available-for-sale, trading and held-to-maturity securities is determinative that the impairment model does not apply to instruments reported at fair value through net income. Interest income may be different between classes of securities because the impairment models for AFS and HTM are different. In addition, the bifurcation of derivatives from an AFS or HTM security would make interest income different from a trading instrument where such bifurcation is not required.

Some proponents of View A would require a security measured at fair value through net income subject to 325-40 to apply the AFS impairment model in ASC 326-30. Other proponents of View A would permit an accounting policy choice to apply either the AFS impairment model (ASC 326-30) or the HTM impairment model (ASC 326-20).

Proponents of View A note that an entity should also have a policy for charging off allowance balances against the amortized cost basis of the instrument.

Some proponents of View A believe that the allowance does not need to be separately included on the face of the balance sheet and that changes in the allowance do not need to be separately reported in the income statement as the instrument is carried at fair value with all changes recorded in net income. Other proponents of View A believe that the allowance should be separately reported in the financial statements consistent with how HTM or AFS allowances will be reported.

View B – The entity should not maintain an allowance for credit losses.

Proponents of View B believe that the computation of an allowance for credit losses is not required for instruments reported at fair value through net income, even for instruments subject to ASC 325-40. Under this approach, all changes in future estimated cash flows would result in prospective yield adjustments.

Some proponents on View B believe that, in situations involving a decline in cash flows that there should be some limitations on prospective yield adjustments. For example, some proponents of View B do not believe that the effective yield should be reduced below 0%.

Proponents of View B point to the lack of any discussion in ASC 325-40 about trading securities requiring an allowance as evidence that it is not required. Proponents of View B also note that ASC 325-40 directs companies to ASC 326-20 for HTM investments and ASC 326-30 for AFS investments to determine impairment. 326-20-15-3 states that the guidance in this subtopic does not apply to instruments reported at fair value through net income. Similarly 326-30-15-2 limits the applicability of that subtopic to instruments classified as available-for-sale.

Some proponents of View B point to the language in BC96

> "When a beneficial interest within the scope of 325-40 has an allowance for credit losses, favorable or unfavorable changes in cash flows must first be considered as adjustments to the allowance for credit losses."

which acknowledges that a beneficial interest may not have an allowance for credit losses as support for View B. They believe

that this language was not referring only to situations where an event that would have required the establishment of an allowance had not occurred.

Differences in views

At a high level (setting aside some specific issues if the available-for-sale impairment model as opposed to the held-to-maturity impairment model is applied), in a number of circumstances the differences in these views can be summarized as follows:

- Decline in cash flows:
  - Under View A, if a decline in cash flows would cause an impairment, yield would not be adjusted and instead, the company would record an allowance for credit losses.
  - Under View B, it would be treated as a prospective yield adjustment.
- Increase in cash flows – both View A and View B would have prospective yield adjustment.
- Increase in cash flows after there was a previous decline in cash flows:
  - Under View A, the increase in cash flows would result in the reversal of the allowance and only result in a yield adjustment after the allowance is reversed.
  - Under View B, the yield would adjust.

The EP members will consider Views A and B presented and will reconvene on this topic at a future meeting.

4. During the January 2018 meeting, the EP discussed the accounting for various loan fees that are received by BDCs or other types of funds with lending activities. Examples of these types of loan fees received by such entities include origination and upfront structuring fees, syndication fees, commitment fees, amendment or restructuring fees and prepayment fees. The EP discussed whether funds are adopting the new revenue recognition guidance in ASC 606 for these fees or whether they are applying ASC 310-20 by analogy or other guidance. The EP continued this discussion during the March EP conference call. EP members believe that these types of loan fees collected by BDCs or similar funds with lending activities are more associated with financial instruments and would generally fall outside of ASC 606; thus, ASC 310-20 would generally be more appropriate for these investment companies.

5. The SEC staff inquired whether the EP has been discussing accounting and presentation of EU tax reclaims or has formed any views given we are seeing some variance in practice. For more information, refer to the SEC Staff Update below.

6. The EP considered accounting for a business development company consolidating a wholly owned subsidiary. A BDC purchases 100% of a finance company that historically was not considered to be an investment company. After the acquisition, the operations of the finance company continue to be separate from the operations of the BDC. FASB ASC 946-810-45-2 states that consolidation by an investment company of an investee that is not an investment company is not appropriate. FASB ASC 946-10-25-1 states that 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. However, ASC 946-810-45-3 provides guidance for when an investment company should consolidate an operating company that is not an investment company, but provides services to the investment company, such as investment adviser or transfer agent services, and the purpose of the investment is to provide services to the investment company, rather than realize a gain on the sale of the investment. If the investment company holds a controlling financial interest in the operating company that provides services to the investment company, it should consolidate the entity rather than measuring the interest at fair value. Further, SEC IM Guidance Update 2014-11 states that a BDC should consolidate a wholly owned subsidiary when the design and purpose of the subsidiary is to act as an extension of the BDC's investment operations and to facilitate the execution of the BDC's investment strategy.

The EP noted the following questions would be relevant to the determination whether or not the BDC should consolidate the wholly owned finance company:

a. What is the purpose and design of the finance company?

b. Does the BDC have any other similar investments?

c. Is this investment in a finance company different from other BDC's investments? How?

d. Does the finance company appear to act as an extension of the BDC?

e. Does the finance company have employees?

f. Is the BDC a passive investor in the finance company?

g. Is the BDC investing in the finance company to get access to a portion of the loan market that the BDC hasn't traditionally had which gets integrated into the BDC's operations?

h. Is the finance company a regulated entity?

i. Who is going to manage the finance company?

j. Does the finance company have an independent board?

k. Is employee compensation for the finance company separate from employee compensation for the BDC?

l. Is there an exit plan for the BDC's investment in the finance company?

The EP members discussed that whether or not the BDC consolidated the wholly owned finance company would depend on the facts and circumstances. An important factor in reaching the conclusion would be the consideration of an exit strategy for the finance company.

7. The EP considered a question regarding nonregistered investment companies with ownership interests in the form of debt. FASB ASC 946-10-55-26 states "In addition, having significant ownership interests that are not considered equity interests in accordance with other Topics (for example, ownership interests in the form of debt) does not necessarily preclude an entity from being an investment company provided that the holders are exposed to variable returns from changes in the fair value of the underlying investments of the entity. The economic substance of the entity, rather than its legal form, should be evaluated to determine whether the entity has that characteristic of an investment company." As a result, certain entities (such as a CDO or CLO) with ownership interests in the legal form of debt may be considered to be investment companies.

The EP discussed the financial statement presentation impact on the schedule of investments and the financial highlights for these types of investment companies (nonregistered). The EP noted that although FASB ASU No. 2013-08 stated that having ownership interests of the investment company could be in the form of equity or debt, it did not consider implications for the schedule of investments and the financial highlights of ownership in the form of debt.

The entity would also consider how material debt holders are to the fund, and whether debt ownership and equity ownership should be treated as one or separate legal classes.

II. Audit and Attest Issues

1. During March EP conference call, the EP members shared that they continued discussions within their organizations regarding an independent public accountant's responsibility under the attestation standards to test the completeness of the population of client accounts over which the registered investment adviser (RIA) is considered to have custody when performing an independent verification (surprise exam) of client funds and securities under the Custody Rule. The EP members noted that whether a RIA is deemed to have custody of a client account under the custody rule is a legal determination. The EP members also noted that as part of the surprise exam, the accountant should understand the client's process and controls for determining which accounts they have custody of (including the clients' consultation with legal counsel, as applicable) and therefore which accounts are included in the population of accounts within the scope of the surprise exam. The EP will revisit this topic at its May meeting.

III. SEC Staff Update

Disclaimer

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1. The SEC staff discussed Custody Rule related matters pertaining to the SEC's no-action letter on the use of standing letters of authorization (NAL). The SEC staff acknowledged there have been questions about material non-compliance notification requirements and potential surprise exam opinion qualifications, for both historical surprise exams and prospective surprise exams as it relates to clients for which standing letters of authorization (SLOA) exist. The SEC staff indicated they did not originally anticipate a significant number of notifications or opinion qualifications as a result of the NAL. Ultimately, the determination of a material non-compliance or a qualification of the surprise exam opinion is up to the auditor's judgement. For material non-compliance notifications or qualifications of surprise exam opinions related to clients under SLOA, the SEC staff recommends using clear, standardized language either in the notification or in the qualified opinion, so that the source of the notification or qualification relating to SLOA specifically is evident.

2. The Internal Revenue Service Notice 2016-10 addresses the treatment of foreign withholding tax refunds received by U.S. regulated investment companies (RICs) due to recent court rulings that were favorable to RICs, where certain European countries have paid refunds (reclaims) of dividend withholding taxes previously withheld by these European countries. The Notice provides RICs with two alternative reporting methods under certain conditions: netting the reclaims against current foreign withholding tax or obtaining a closing agreement to estimate aggregate adjustments due (and pay a related closing fee).

The SEC staff discussed the accounting treatment and presentation of compliance fees paid to the IRS and professional fees paid to accountants and lawyers to assist funds in receiving these reclaims where the closing agreement path is selected. The SEC staff has seen diversity in practice in presentation of the professional fees and compliance fees on the income statement, as some funds net these fees against dividend income, while others treat these fees as operating expenses. The SEC staff noted that they have observed some cases where the fees are neither broken out separately on the income statement nor separately disclosed in the footnotes, which may be due to materiality.

The SEC staff acknowledged the variance in current practice, noting the conclusion may depend on facts and circumstances, and indicated that they may comment on the accounting framework utilized.

3. The SEC staff offered the following comments on crypto assets:

a. The SEC staff of Investment Management Division issued a letter to ICI and SIFMA on cryptocurrency and fund innovation. The letter identified some questions the Division had around existence, valuation, custody, liquidity and arbitrage for registered investment companies proposing to invest in crypto assets and related products. The SEC staff is focused on, among other things, the following accounting and auditing questions:

- Existence – How does an entity validate the existence of cryptocurrency? How are private keys stored and how is exclusive ownership or control of the keys validated?

- Valuation – How do funds approach valuation of cryptocurrency in accordance with ASC 820? The SEC staff is interested in how the principal or most advantageous market concepts are being applied, given there are many markets which may be volatile and fragmented, which includes how market selections are being made and how frequently they are being reassessed.

b. The SEC staff indicated that issues related to crypto assets are a focus of the Division and the SEC IM staff is working closely with the Division's Analytics Office to identify targeted areas of interest and certain funds for targeted reviews. The SEC staff performs targeted reviews of funds investing in Fintech instruments. Part of the focus of these reviews is on funds invested in instruments that would give exposure to crypto assets (e.g., grantor trusts or similar vehicles) and how the funds' accounting policies address significant events like forks or air drops. The SEC staff noted several factors to consider for investment companies invested in these instruments, including initial and subsequent fair value measurements in accordance with current fair value policies and procedures and whether operationally and legally the fund is positioned to receive such assets. The SEC staff also highlighted a focus on tax considerations and whether or not crypto assets would be considered non-qualifying assets under subchapter M.

Investment Companies Expert Panel

May 15, 2018 Meeting

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 meeting:

I. AICPA/Administrative:

1. The Expert Panel (EP) March 2018 call highlights are being finalized.
2. The EP members considered certain AICPA Audit and Accounting Guide *Investment Companies* (the Guide) matters.

II. Accounting/Reporting Issues:

1. One EP member inquired if there were any additional implementation issues relating to Investment Company Reporting Modernization. The EP was not aware of any new developments. EP members shared that certain registrants received financial statement review comments that were either exploratory in nature or related to reconciling financial statements to prospectus and overall consistency in filings and disclosures. Certain EP members shared that financial statement review comments they had observed were similar in nature to those shared by the SEC staff in the February 2018 EP meeting.
2. Interest paid to private equity funds – Private equity funds often have multiple closes of investors where the later subscribed investors may have to pay "interest" to the earlier subscribed investors. These amounts may be paid to investors outside the private equity fund or as an additional payment into the fund and allocated to the earlier subscribed investors. ASC 946-320-30-1 states "An investment company shall initially measure its investments in debt and equity securities at their transaction price. The transaction price shall include commissions and other charges that are part of the purchase transaction." The EP discussed that if the interest charge is paid by a fund of funds into an underlying private equity fund (and allocated specifically to earlier subscribed investors), a fund of funds that subscribes to a later close may record the "interest" paid as an adjustment to the cost basis of its investment, essentially paying a premium to NAV. One EP member noted that from an income tax perspective, this could be an interest expense. Certain EP members believed it was more appropriate to record the charge through the fund of fund's statement of operations as an unrealized loss.
3. Investment company determination for carried interest vehicle – Advisers of private equity funds often set up separate legal entities to invest as a limited partner in the private equity funds they manage. The adviser may also set up a separate legal entity for the benefit of its employees who are able to invest in the private equity fund and receive a portion of the carried interest. ASC 946-10-55-21 states "Having investors that are related parties of the parent or the investment manager does not necessarily preclude an entity from being an investment company. For example, an investment manager may form an investment company for its employees in conjunction with another investment company. Although the employees may be related parties of the investment manager, the investment company formed for its employees mirrors the business purpose and activities of the main investment company."

The EP members considered a scenario where an adviser gave its employees the ability to invest in a private equity fund, via an employee-only fund- that was also receiving a portion of the carried interest earned by the adviser. The majority of the earnings in the employee only fund were from its portion of carried interest, rather than from investing activities. The EP members discussed whether the separate legal entity that is held by employees may be considered an investment company or an extension of the adviser (i.e., an operating company). The EP members expressed a view that since the economics of the employee-only fund are more heavily skewed towards the carried interest it earns, it would appear this legal entity is acting as an extension of the adviser of private equity funds (i.e., an operating company), rather than as an investment company.

4. The EP considered basis of presentation and unit of account issues as it relates to special purpose vehicles (SPVs) and blockers (i.e., separate legal entities between the fund and the portfolio company). Blockers are usually created for the benefit of the investor and are often bundled with the underlying portfolio company upon exit of the investment.

In determining whether such entities are accounted for as an investment at fair value or consolidated by an investment company, the ownership (wholly owned versus multiple owners) and number of investments would be considered, among other factors, to determine if the entity is an investment or if it is an extension of the investment company.

III. Audit and Attest Issues

1. The EP discussed the auditor's report on mutual fund or separate account financial statements when reporting on numerous funds/subaccounts within one report (under the recently effective PCAOB AS 3101), specifically as it relates to all reporting entities and periods covered by each statement. Certain EP members noted they add a table between first and second paragraph of the report to identify numerous funds/subaccounts and periods for each, or add an appendix to the opinion.

2. The PCAOB standard on new audit report model states:

> "Because of the unique structure of investment companies, which typically includes common accounting, internal control, and oversight functions at the group level, the reproposed standard required that, for an investment company that is part of a group of investment companies[82], the auditor's statement regarding tenure will contain the year the auditor began serving consecutively as the auditor of any investment company in the group of investment companies."

[82]: "A group of investment companies, as defined by Section 12(d)(1)(G)(ii) of the Investment Company Act of 1940 ("Investment Company Act"), means any two or more registered investment companies that hold themselves out to investors as related companies for purposes of investment and investor services. For purposes of determining auditor tenure, any tenure with other entities that may be part of an investment company complex, such as investment advisers or private investment companies, is not included."

The EP discussed that generally, only registered investment companies would fall under the definition of "investment company group" in practice. The EP also considered how audit firms are thinking about the auditor tenure disclosures where the funds have been acquired and have either same or different auditors. The EP noted the importance of judgement and acknowledged determination would be based on facts and circumstances.

3. The EP continued discussing testing the completeness of population of accounts over which the registered investment adviser (RIA) is considered to have custody when performing a surprise examination and acknowledged it is a legal determination. The EP members agreed that the auditor carries a certain level of responsibility to understand the RIA's process to identify and determine which accounts would be subject to the custody rule, and therefore included in the population.

4. With respect to auditing implications relating to cryptocurrencies, including testing of existence and valuation, the EP members shared that for operating companies while some believe cryptocurrency is an intangible asset (as acknowledged by certain non-investment company registrants from discussions with OCA), for the investment company industry, cryptocurrency may be considered "other investments" which are recognized at their transaction price in accordance with ASC 946-325-30-1 and subsequently measured at fair value in accordance with ASC 946-325-35-1. The EP plans to monitor activities of various organizations' task forces on digital assets. Also see SEC Staff Update portion of these meeting highlights for additional information on this topic.

5. Custody rule and combined financial statements – For purposes of a registered investment adviser relying on the audited financial statement provision of the Custody Rule, Rule 206(4)-2(b)(4) specifies that the financial statements be prepared in accordance generally accepted accounting principles. The question has been raised regarding whether audited combined financial statements of multiple pooled investment vehicles (PIVs) may be used to satisfy the Custody Rule. ASC 810-10-55-1B states "There are circumstances, however, in which combined financial statements (as distinguished from consolidated financial statements) of commonly controlled entities are likely to be more meaningful than their separate financial statements. For example, combined financial statements would be useful if one individual owns a controlling financial interest in several entities that are related in their operations. Combined financial statements might also be used to present the financial position and results of operations of entities under common management." As part of a single offering to investors, an adviser may set up separate legal entities for legal, tax, regulatory or other business reasons. Since these funds invest in identical investments, the adviser may determine that combined financial statements are more meaningful than the separate legal entities since they were formed in conjunction with each other. The EP members considered whether audited combined financial statements of multiple PIVs may be used to meet the requirements of the Custody Rule if they are prepared in accordance with generally accepted accounting principles. The EP noted that whether combined financial statements meet the requirements under the custody rule represents a legal determination that each investment adviser will have to make based on its particular fact pattern.

6. An EP member inquired whether, under the Custody Rule, a co-investment vehicle is considered a RIA's client, and whether the RIA is deemed to have custody of the funds of a co-investment vehicle. Further, is a surprise examination under Rule 206(4)-2(a)(4) of the Investment Advisers Act of 1940 required for co-investment vehicles? In such cases, participation is at the discretion of the investor and invests directly into an intended investee. The RIA is merely acting as a facilitator for the co-investor and does not have authority to utilize the funds of the co-investor for any other purpose.

At the May EP meeting, EP members observed that definition of an advisory client is a legal determination. EP members have seen private equity funds that have audits of co-investment vehicles to satisfy the surprise examination requirement of the Custody

Rule, even for those co-investment vehicles without management fees and carried interest.

IV. SEC Staff Update

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1. Operations Related:

a. Master/Feeder Presentation:

The SEC staff reminded registrants about the requirements included in the 1998 "Dear CFO" letter and IM Guidance Update No. 2014-11, regarding the presentation for financial statements in a master-feeder structure:

> For an investment company registered under the Investment Company Act of 1940 (RIC) that is a feeder fund in a master-feeder structure, unconsolidated financial presentation is generally the most meaningful presentation, provided that, among other things, the feeder fund attaches the financial statements of the master fund to the feeder fund's financial statements.

The SEC staff recently had discussions with a feeder fund which invested substantially all of its assets in an unaffiliated master fund. The master fund was a registrant under the Investment Company Act of 1940 (1940 Act), but not the Securities Act of 1933 (1933 Act). The feeder fund was registered under both the 1933 and 1940 Acts. Rather than attaching the master fund's financial statements to the feeder fund's financial statements, the feeder fund directed investors to the location of the master fund's financial statements on the SEC website. The feeder fund did not attach the master fund's financial statements due to concerns around certifying the unaffiliated master fund's financial statements. The SEC staff noted that in order for the feeder fund's financial statements to be complete, the master fund's financial statements should be attached. The SEC staff also noted that when the master fund is unaffiliated, certain registrants believe it is important to include the certification of the master fund's financial statements, signed by the certifying officer of the unaffiliated master fund. For example, the staff noted that they have observed in practice that certain feeder fund registrants have included a certification relating to the unaffiliated master fund's financial statements in the feeder fund's N-CSR filing.

b. Accounting for digital assets:

- The SEC staff shared that even though they are not seeing direct investments in digital assets, like cryptocurrencies, in registrants' portfolios, certain registrants have indirect exposure, as they have invested in a grantor trust or a similar vehicle that holds within its portfolio bitcoin or other digital assets. The staff cautioned that registrants with indirect exposure should be monitoring these investments for significant events that may impact the value of their investments or may cause another recognition event in the registrant's books and records.

For example, the staff noted that in Q4 of 2017, the bitcoin network experienced multiple "hard forks." The staff described a particular scenario where a registered fund invested in a grantor trust holding bitcoin, and the bitcoin network experienced a "hard fork." On October 24, 2017, when bitcoin forked, the grantor trust was entitled to receive one bitcoin gold for each bitcoin it held (and retain its bitcoin). After the fork, the grantor trust had to determine how to account for the rights to bitcoin gold, including whether it should be recognized in the trust's books and records, and if so, at what value. After the fork, the SEC staff observed that funds that invested in the grantor trust continued to fair value their investment in the grantor trust based off the traded value in the over-the-counter markets. On November 22, 2017, the grantor trust established a record date and declared a distribution as a result of the bitcoin gold fork. The grantor trust then distributed the rights to its bitcoin gold to an agent who ultimately obtained and sold the bitcoin gold, then made cash distributions to the trust's investors. The staff observed that a fund registrant investing in this grantor trust did not reflect the distribution in its books and records as of the record date. The SEC staff shared that this registrant subsequently amended and restated its semi-annual financial statements to recognize the distribution related to the bitcoin gold fork on the record date.

The SEC staff advises that registrants with indirect investments in cryptoassets must monitor significant events that may impact the fair value of its direct investments, and if direct investment vehicles declare distributions, the registrant should determine 1) whether a recognition event has happened, 2) what they received, and 3) its value.

- The SEC staff has not received a consultation submittal from an investment company related to characterization of digital assets at this point, but noted that if an entity determines it is an investment company, the investment company-industry specialized accounting, including application of ASC 946 and the measurement of investments at fair value under ASC 820, would generally apply. The SEC staff and the EP both would generally expect that investment companies would consider digital assets to be "other

investments" which are recognized at their transaction price in accordance with ASC 946-325-30-1 and subsequently measured at fair value in accordance with ASC 946-325-35-1.

c. Other Filing Updates - the SEC staff informed that Investment Company Reporting Modernization Frequently Asked Questions (Compliance Dates and General Filing Obligations, FAQ 8) has been updated to indicate that a fund with a fiscal year falling on October 31 or November 30, 2018 (and its mid-year falling on April 30 or May 31, 2018) does not need to file the fund's mid-year filing on Form N-SAR because reports on Form N-CEN, which is an annual report, will encompass the mid-year period ending on April 30 or May 31, 2018, and Form N-SAR will be rescinded on June 1, 2018. The fund is expected to file Form N-CEN for the fiscal year ended October 31 or November 30, 2018.

d. Use of Data - In her recent speech at 2018 ICI conference and Remarks at the PLI Investment Management Institute 2018, Dalia Blass, the Director of Division of Investment Management discussed use of data. In the first, Ms. Blass described the staff's internal tool called MAGIC which is an acronym for Monitoring and Analytics GUI for Investment Companies.

   Ms. Blass indicated "MAGIC allows us to pull together a number of data sets – including data from registrants and other sources – and look at it holistically. The tool combines performance, flow, holdings and other information and allows us to ask questions such as how does this fund's portfolio compare to its strategy? Are its holdings aligned with its investment restrictions?"

   The SEC staff noted that so far, the tool has been effective in assisting the SEC staff with their disclosure review process, making reviews more efficient and effective. It allows the SEC staff to quickly identify entities that may have exposure to certain assets (e.g., indirect exposure to digital assets), as well as allows the SEC staff to implement a risk-based approach for its reviews. It also provides the SEC staff with data on asset flow, holdings and other information and indicates how the fund's portfolio compares to its investment strategy. The staff noted that MAGIC incorporates data that is publicly available, such as mutual funds' data in the prospectus that is filed with the SEC in an XBRL format and will incorporate N-PORT data once available.

2. Policy Related:

a. Disclosure Effectiveness/Shareholder Experience - A comprehensive list of rulemakings the SEC staff is working on is included in the agency rule list published semi-annually by the Office of Information and Regulatory Affairs and the Office of Management and Budget. The Spring 2018 Agency Rule List has been posted. Among Chairman Clayton's short-term agenda items are amendments to financial disclosures about acquired businesses, disclosure update and simplification, auditor independence with respect to loans or debtor-creditor relationships, exchange-traded funds, investment company reporting modernization - option for website transmission of shareholder reports, personalized investment advice standard of conduct, fund of funds arrangements, use of derivatives by registered investment companies and business development companies, and fund retail investor experience and disclosure request for comment.

b. Valuation Guidance - The SEC's Office of the Chief Accountant and the Division of Investment Management are soliciting recommendations for updates to guidance in ASRs 113 and 118 on the valuation of portfolio securities and other assets held by registered investment companies, including auditing and governance considerations.

c. The SEC proposed a rule "Auditor Independence with Respect to Certain Loans of Debtor-Creditor Relationships" that would amend the SEC's auditor independence rules, specifically related to rule 2-01(c)(1)(ii)(A), better known as "the loan provision." The proposal outlines four amendments that would effectively identify those debtor-creditor relationships that could impair an auditor's objectivity and impartiality, yet, would not include certain extended relationships that are unlikely to present threats to objectivity and impartiality. The amendments would primarily:

   1. Focus the analysis solely on beneficial ownership;
   2. Replace the existing 10 percent bright-line shareholder ownership test with a "significant influence" test;
   3. Add a "known through reasonable inquiry" standard with respect to identifying beneficial owners of the audit client's equity securities; and
   4. Amend the definition of "audit client" for a fund under audit to exclude from the provision funds that otherwise would be considered "affiliates of the audit client".

Investment Companies Expert Panel

July 17, 2018 Conference Call

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:

I. AICPA/Administrative:

1. The Expert Panel (EP) March 2018 call and May 2018 meeting highlights are being finalized. The EP also considered EP-developed nonauthoritative guidance that should be retained on the EP webpage on aicpa.org.
2. The AICPA Product Development staff provided an update on status and timing of the 2018 AICPA Audit and Accounting Guide *Investment Companies* (the Guide).

II. Accounting/Reporting Issues:

1. Bond Amortization – FASB ASU No. 2017-08, *Receivables–Nonrefundable Fees and Other Costs (Subtopic 310-20)*, requires the premium on a purchased callable debt security be amortized to the call price on its earliest call date. One EP member suggested the EP consider the journal entries that will be made upon adoption of the standard, the effect on those journal entries on the components of capital, and the disclosures that would seem to be appropriate for an investment company under the ASU. The EP will continue discussing this at September EP meeting.

III. SEC Staff Update

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1. The SEC staff shared that to date, they received about 30 comment letters on the SEC proposed Rule "Auditor Independence with Respect to Certain Loans of Debtor-Creditor Relationships".
2. The SEC staff discussed unitary fees, which are generally asset-based fees paid by a fund (such as managed funds, managed exchange-traded funds and common collective trust funds) to its investment advisor for the provision of investment advisory and other fund expenses (e.g. custody fees, administrative and accounting fees, shareholder services fees, etc.). Typically, a fund will not show the components of these other fund expenses separately on the income statement, as the fund is paying the unitary fee only, which the advisor will use to pay those expenses. However, the SEC staff reminded registrants that to the extent an investment adviser is unable to pay these fund expenses, there is a risk to the fund as the service providers could stop providing services the fund needs to continue operations and this risk could warrant disclosure to the investors. Further, if the fund, as opposed to the investment adviser, chooses to pay the service providers directly (for example, to avoid suspension of a service arrangement by the service provider), the related receivable from the adviser for reimbursement of these payments should be properly recorded by the fund, its collectability evaluated, and the receivable settled in a timely manner in order to avoid noncompliance with provisions of the Investment Company Act of 1940 concerning loans between affiliated parties.

3. The SEC is monitoring fund filings related to various items, such as material weaknesses or missing opinions. Additionally, the SEC is focused on monitoring funds with potential exposure to emerging risks (indirect or direct), such as digital assets and funds with exposure to Argentina, due to the recent local currency devaluation.

Investment Companies Entities Expert Panel

September 20, 2018 Meeting 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 of the call:

AICPA Investment Companies Expert Panel

Meeting Highlights

September 20, 2018

I. AICPA/Administrative:

1. The Expert Panel (EP) March, May and July 2018 meeting highlights are available.
2. AICPA Audit and Accounting Guide *Investment Companies* (the Guide) has been released.
3. The EP considered dates for 2019 meetings.
4. The AICPA staff discussed volunteer applications for 2019 AICPA volunteer year. The application process closes October 1, 2018.

II. Accounting/Reporting Issues:

1. The EP discussed accounting for contingent common stock. A fund entered into an agreement with a public company for the purchase of restricted common stock, but the agreement had a provision that was contingent upon shareholder approval in conjunction with a pending merger. The fund could only purchase the shares of common stock if the shareholders of that company approved the pending merger. An EP member inquired whether the fund would meet the recognition guidance in FASB ASC 946-320-25-2 or FRR 404.04.a, which focus on an enforceable right to demand securities, and if the fund would record changes in the fair value of the public common stock to be received upon shareholder approval.

ASC 946-320-25-2:

A securities transaction outside conventional channels, such as through a private placement or by submitting shares in a tender offer, shall be recorded as of the date the investment company obtained a right to demand the securities purchased or to collect the proceeds of sale, and incurred an obligation to pay the price of the securities purchased or to deliver the securities sold, respectively. Determining the recording date may sometimes require an interpretation by legal counsel.

FRR 404.04.a:

Restricted securities should be included in the portfolio of a company and valued to determine current net asset value on the date that the investment company has an enforceable right to demand the securities

from the seller.

Where the investment company negotiates the acquisition of the restricted securities directly with the owner of the securities, there are three significant dates. The first occurs when the investment company and the seller orally agree upon the price and the amount of the securities (the "handshake date"). At this point, there would not seem to be any enforceable right of the investment company to demand the securities from the seller since, in most states, particularly those which have adopted the Uniform Commercial Code, there is no enforceable right unless there exists some writing "sufficient to indicate that a contract has been made for sale of a stated quantity of described securities at a defined or stated price" (Section 8-319(a) of the Uniform Commercial Code). If the terms of the oral understanding do not contemplate compliance with any condition by the seller, it is suggested that the investment company procure, from the seller, a signed memorandum setting forth the price and quantity of securities to be sold. Upon receipt of that memorandum, an enforceable right would be obtained. The securities should be valued as of that date.

In those situations where the oral understanding contemplates the execution of a formal contract of purchase and sale, no enforceable right exists until the time the formal contract is signed (the "contract date"). If the formal contract does not require compliance with any conditions by the seller, an enforceable right is then obtained, and the securities should be valued as of that date.

Where the formal contract requires compliance with stated conditions which the investment company believes should not be waived, no enforceable right is obtained until the stated conditions are satisfied. In that situation, the valuation date should be the date upon which the conditions are satisfied (the "closing date").

The EP members expressed a view that since the purchase of securities would only be recorded upon the shareholders approving the merger, prior to obtaining this shareholder approval, the fund's right to demand securities [in accordance with aforementioned guidance] would not yet exist, and as such, only disclosure of the transaction would be appropriate. The EP members also discussed that entities should consider whether the contingency would be considered a derivative, similar to a contingent option.

2. The EP considered presentation of the financial statements for a fund's investments in affiliated funds. A fund invests solely in funds managed by the same adviser. These underlying funds may have similar investing strategies and may be set up as different legal entities for either tax, regulatory or operational reasons. The EP considered whether the fund of funds can aggregate the underlying funds for purposes of applying the guidance in ASC 946-210-45-7 and make the presentation of the financial statements similar to a master-feeder presentation.

ASC 946-210-45-7:

The reporting fund may list the investee (portfolio) funds directly on the statement of assets and liabilities. Additional disclosures may be required for those funds that hold a mixture of investments in other investment companies and direct investments in securities. However, there is usually no need for a separate schedule of investments. Fund management shall consider if an investment in a single underlying fund is so significant to the fund of funds as to make the presentation of financial statements in a manner similar to a master-feeder fund more appropriate.

The EP discussed that a fund that invests solely in affiliated funds could aggregate these underlying funds for the purposes of applying the guidance in ASC 946-210-45-7 and make the presentation of the financial statements similar to a master-feeder presentation, as long as such presentation is more meaningful and useful to the user of financial statements. In determining if such presentation is meaningful to investors, consideration should be given as to whether the investment strategies of the underlying funds are similar, how the disclosure of positions would be affected if the financial statements of the affiliated funds were combined, and how the underlying affiliated funds are marketed (that is, are they bound together or held out as separate entities). The EP also discussed that consideration should be given to whether or not the combined underlying funds would be viewed as a single reporting entity. Further, the EP noted that the presentation would depend on specific facts and circumstances.

Lastly, for entities relying on the audit provision of the custody rule, consideration should also be given on whether or not such presentation would comply with the custody rule.

3. The EP considered accounting for transaction costs. A fund has agreed in principle to purchase bank debt from a third party. In finalizing the agreement to purchase the bank debt, the fund has incurred legal costs to review and finalize the terms of the purchase agreement. The EP members discussed whether this type of cost may be included in the purchase price in accordance with FASB ASC 946-320-30-1:

ASC 946-320-30-1:

An investment company shall initially measure its investments in debt and equity securities at their transaction price. The transaction price shall include commissions and other charges that are part of the purchase transaction.

EP members observed that there is mixed practice in the industry with respect to what constitutes "other charges that are part of the purchase transaction" in ASC 946-320-30-1. EP members noted that consideration should be given to whether or not these costs are direct and incremental to the investment due diligence process and/or if these costs would be incurred regardless of whether the transaction was executed or not. If such expenses were incurred solely to allow closing of the specific transaction, the expense should be included in the transaction price. However, if the expense would be incurred regardless of whether the transaction occurs, then the expense should be expensed as incurred.

4. The EP discussed implementation matters related to the SEC Disclosure Update and Simplification Rule issued in August 2018. Specifically, the EP discussed the amendments to Rule 6-09.3 of Regulation S-X, which has been amended to require investment companies to present distributions to shareholders in total, except for tax return of capital distributions, which should be disclosed separately. These amendments replace the requirement to state separately distributions to shareholders from (a) investment income-net; (b) realized gain from investment transactions-net; and (c) other sources.

Update: Subsequent to the September 2018 EP meeting, the EP held supplemental discussions about whether the prior year distribution amounts disclosed on the statement of changes in net assets (SOC) in the prior year could be retrospectively presented to conform to the current year presentation resulting from the amended Regulation S-X requirements.

The EP members expressed a view that investment companies should be able to conform the presentation of the prior year's distribution amounts on the SOC to the current year's presentation on the SOC, as long as they include a footnote in the financial statements indicating the reason for the changing the prior year's SOC presentation and disclose the disaggregated distribution amounts from the prior year, so that the investors would still have the information available from the prior year's SOC. The EP members also suggested including the prior year's undistributed net investment income in the footnote, since it was technically required to be disclosed on the SOC in the prior year but is no longer required to be disclosed in the current year based on the Regulation S-X amendments. The EP members believe such presentation would be easier for investors to understand compared to disaggregating prior year distributions and aggregating current year distributions, excluding tax return of capital. See SEC Staff Update portion of these meeting highlights for the EP members discussion of this proposed presentation with the SEC staff.

5. The EP discussed example journal entries, financial statement presentation and footnote disclosures relating to the implementation of FASB ASU 2017-08, *Receivables–Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities*):

For public business entities, the amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted for all entities.

An entity should apply the amendments in this Update on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. Additionally, in the period of adoption, an entity should provide disclosures about a change in accounting principle as required by ASC 250.

Example Security for a registered fund with a calendar year end (hypothetical amounts for illustrative purposes only)

Par:	$10,000,000
Purchase Date:	01/01/2016
Original Cost:	$12,000,000
Maturity	12/31/2025 (previously amortized to this date – 10 years)
Earliest Call Date	12/31/2022 (now amortized to this date – 7 years)
Beginning of the period of adoption:	01/01/2019
Amortized cost as of 12/31/2018:	$11,400,000
Amortized cost as of 12/31/2018 (post-adoption):	$11,250,000
Amortized cost as of 06/30/2019, the first reporting date following adoption:	$11,220,000
Decrease in amortized cost as of 01/01/2019:	$150,000

Journal Entries (for cumulative-effect adjustment) to be recorded as of the beginning of the period of adoption

DR: Unrealized (Asset account)	150,000	
CR: Cost (Asset account)	150,000	
DR: Distributable Earnings (Equity account)		150,000
CR: Unrealized App/Dep (Equity account)		150,000

Impact to financial statement line items for this one security position (as an example)

NOTE: *Due to the SEC Disclosure Update and Simplification rule, the components of distributable earnings will no longer be shown on the statement of assets and liabilities.*

Statement of Assets and Liabilities as of June 30, 2019

Investments, at fair value (cost $11,220,000) $13,000,000

NOTE: Cost as of the beginning of the period of adoption will be reduced for the cumulative-effect adjustment. No additional disclosure on the face of the Statement of Assets and Liabilities is required. The Notes to the Financial Statements will disclose the impact of the new accounting pronouncement. The cost basis on the initial statement of assets and liabilities following adoption is lower than cost immediately following adoption due to additional amortization from the beginning of the period of adoption through the reporting date.

Statement of Operations

NOTE: Due to the cumulative-effect adjustment as of the beginning of the period of adoption, a user will need to consider the amount disclosed in the Notes to the Financial Statements in order to be able to roll unrealized appreciation/depreciation from one period to the next. No additional disclosure on the face of the Statement of Operations is required. The Notes to the Financial Statements will disclose the impact of the new accounting pronouncement.

Notes to Financial Statements:

Newly adopted accounting pronouncement

In March 2017, the Financial Accounting Standards Board issued Accounting Standards Update No. 2017-08 ("ASU 2017-08"), "Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities." ASU 2017-08 changed the amortization period for certain callable debt securities held at a premium. Specifically, it required the premium to be amortized to the earliest call date. The Fund has adopted and applied ASU 2017-08 on a modified retrospective basis through a cumulative-effect adjustment as of the beginning of the period of adoption. As a result of the adoption of ASU 2017-08, as of January 1, 2019, the amortized cost basis of investments was reduced by $150,000 and unrealized appreciation of investments was increased by $150,000. The adoption of ASU 2017-08 had no impact on beginning net assets, the current period results from operations, or any prior period information presented in the financial statements.

NOTE: Additional disclosures will be required if there are indirect effects of a change in accounting principle (e.g. fees or other expenses that are calculated based upon net investment income).

6. The EP was updated on the AICPA efforts regarding applicability of FASB ASC 325-40 to investment companies (trading securities).

III. Audit and Attest Issues:

1. The EP was updated on the AICPA and CAQ efforts 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 standard. The EP is monitoring this effort and will be updated on new developments in the future.
2. The EP members discussed Rule 206(4)-2(a)(6)(ii)(A) of the Custody rule and whether they have seen in practice registered investment advisers (RIAs) obtain an internal control report for periods less than a full year (e.g., nine months ending September of each year). The EP expressed a view that generally, there should be "no gaps" in the coverage contained in internal control reports.
3. The EP discussed sampling considerations as it relates to testing zero and closed accounts for surprise examinations, specifically, whether the SEC staff would expect a separate sample for zero and closed accounts or if these accounts can be incorporated into one population. The EP noted that such determination should be based on relevant attestation standards.

IV. SEC Staff Update:

Disclaimer

The following comments and observations were compiled by the AICPA Investment Companies Expert Panel and AICPA staff and are not authoritative positions or interpretations issued by the SEC or its staff. The comments and observations were not transcribed by the SEC or its staff and have not been considered or acted upon by the SEC or its staff. Accordingly, these comments and observations do not constitute a statement of the views of the SEC or its staff.

1. The SEC's Division of Investment Management Chief Accountant introduced two new Professional Accounting Fellows in its Chief Accountant's Office.
2. The SEC staff highlighted the following matters for registered investment companies (RICs) and business development companies (BDCs) as a result of the SEC Disclosure Update and Simplification Release which was adopted on August 17, 2018. The amendments revise or eliminate certain disclosure requirements that have become redundant, duplicative, overlapping, outdated, or superseded:
    a. Distributable Earnings for Registered Investment Companies:

- Statement of Assets and Liabilities
  - Rule 6-04.17 of Regulation S-X has been amended to require presentation of the total, rather than the components, of distributable earnings on the balance sheet.
- Statement of Changes in Net Assets (SOC)
  - Rule 6-09.7 of Regulation S-X has been amended to delete the requirement for parenthetical disclosure of undistributed net investment income on the statement of changes in net assets on a book basis.
  - Rule 6-09.3 of Regulation S-X has been amended to require presentation of distributions to shareholders in total, except for tax return of capital distributions, which should be disclosed separately.

  UPDATE: Subsequent to the September 2018 EP meeting, the SEC staff discussed with certain EP members that the above amendments to Regulation S-X requirements to show distributions to shareholders in total does not eliminate the requirement in ASC 946-205-45-4a, which states that for multiple class funds, dividends and distributions paid to shareholders for each class are required to be presented on the statement of changes in net assets or disclosed in the notes to financial statements.
- Financial Highlights
  - The SEC staff received comments on the proposed rule indicating that the per share distribution disclosure on the financial highlights is meaningful to investors and should not be changed to conform to the presentation on the SOC. Accordingly, no changes were made to the financial highlights; registrants should follow relevant instructions from Form N-1A or Form N-2.
- Disclosure
  - The SEC staff additionally noted that the changes above do not impact the U.S. GAAP requirements for tax basis disclosures in the footnotes, so registrants should continue to include those disclosures in the financial statements.

b. Consolidation

- The SEC staff noted that the final rule also updated Rule 6-03(c)(1)(i) of Regulation S-X, in order to align with U.S. GAAP, to remove the rule which allowed for consolidation of the financial statements of RICs and BDCs only with the financial statements of subsidiaries which are investment companies themselves. The SEC staff reminded entities that this update also aligns with guidance in the Guide and with Investment Management Guidance Update No. 2014-11, *Investment Company Consolidation*.

c. BDC Specific Changes

- Reconciliation of Changes in Stockholder's Equity:
  - The SEC staff noted that the final rule amends interim financial statement requirements and will now require a reconciliation of changes in stockholders' equity in the notes or as a separate statement, which will impact BDCs. This analysis should reconcile the beginning balance to the ending balance of each caption in stockholders' equity for each period for which an income statement is required to be filed and comply with the remaining content requirements of Rule 3-04 of Regulation S-X. As a result, registrants will have to provide the reconciliation for both the year-to-date and quarterly periods and comparable periods in Form 10-Q but only for the year-to-date periods in registration statements.

  Update: Subsequent to the September 2018 EP meeting, the Division of Corporation Finance issued a FAQ which addresses the effective date for the above requirement for interim financial statements. Refer to Disclosure Guidance from the Division of Corporation Finance of the Securities and Exchange Commission, Compliance and Disclosure Interpretations Section 105: Form 10-Q, new Question 105.09, issued September 25, 2018. This effective date guidance only applies to the above requirement for interim financial statements and does not apply to any Article 6 amendments.

d. Amendments to Regulation S-K:

- Sale and Bid Prices:

- The final rule eliminated the requirement in Item 201(a)(1) for detailed disclosure of sale or bid prices for most issuers whose equity is traded in an established public trading market and replaced it with disclosure of the trading symbol.
- As described in footnote 410 of the final rule, "Form N-2, which is used for registration of closed-end management investment companies, includes disclosure requirements relating to sales prices and bid information that are similar to those in Item 201(a)(1) of Regulation S-K. Item 1, Instruction 1 and Item 8.5(b) of Form N-2. In addition to these requirements, Form N-2 requires disclosure of information relating to net asset value and discount or premium to net asset value. Item 8.5(b), Instructions 4 and 5 and Item 8.5(c) through (e) of Form N-2. Disclosure of sales prices and bid information is needed in registration statements on Form N-2 so that the required premium/discount disclosure can be fully understood. Accordingly, the Commission did not propose to change the requirements in Form N-2 relating to sales prices and bid information."

e. Historical Presentation:

- The SEC staff noted that technically, the historical presentation of statement of changes in net assets (SOC) with respect to the distribution amounts paid to shareholders should remain consistent with the prior year. However, the EP inquired of the SEC staff's view on the implementation matters discussed above in the EP section of the minutes with respect to presentation of prior year distribution amounts on the SOC. The staff did not object to the EP's view and therefore would not object if investment companies conform the presentation of the prior year's distribution amounts on the SOC to the current year's presentation on the SOC, as long as they include a footnote on the SOC indicating the reason for the changing the prior year's presentation and disclose the disaggregated distribution amounts from the prior year, so that the investors would still have the information available on the SOC. The staff also did not object to including the prior year's undistributed net investment income in the footnote.

f. Effective Date:

- The EP and the SEC staff discussed the effective date of the Regulation S-X amendments.
- **Update**: Subsequent to the September 2018 EP meeting, the final rule was published in the Federal Register on October 4, 2018 and is effective November 5, 2018. The amendments to Regulation S-X are effective for reports filed on or after the effective date.

3. The SEC staff shared that Form 12b-25 "Notification for Late Filing" has not been updated for the RIC Modernization rule, which rescinded Form N-SAR. Consequently, Form 12b-25 does not include a checkbox for Form N-CEN (only N-SAR). Registrants should continue (for now) checking box "N-SAR" for late filings until Form 12b-25 is updated.

4. Change in auditor – the SEC staff reminded registrants that registrants should be including the predecessor auditor's consent in their registration statement filings the first year a registration statement is filed after the change in auditors. Recently, the staff has observed that many registrants are not including the predecessor auditor's consent in the first registration statement filing. The staff reaffirmed that their position, originally stated in the July 2005 EP minutes, has not changed. Registration statement filings should either contain or incorporate by reference the audit reports of a predecessor auditor for at least as long as financial statements audited by the predecessor firm are included in the annual report. Practically speaking, because the statement of changes includes two years, as long as the statement of changes audited by the predecessor firm is included in the annual report being included in the filing, the predecessor auditor's report and consent should be incorporated/included in the filing.

5. The SEC staff covered certain relevant points from recent 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 office, 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".

6. The SEC staff is evaluating comments received on the SEC proposed Rule "Auditor Independence with Respect to Certain Loans of Debtor-Creditor Relationships".

7. Section 19(a) of the Investment Company Act of 1940 ("1940 Act") generally prohibits management investment companies from making a distribution from any source other than the fund's net investment income, unless that payment is accompanied by a written statement that adequately discloses the source or sources of the payment. The SEC staff reminded entities that IRS Forms, specifically IRS Form 1099, would not satisfy the requirement under Rule 19a-1 for a written statement to accompany dividend payments due to the timing of the notification,

as a Section 19(a) notice should be sent contemporaneously with the distribution. Additionally, as Form 1099 is designed with the IRS tax regulations in mind, it may not contemplate the notification requirements included in Section 19(a). The SEC staff also stated that they have previously communicated that the Section 19(a) rules are based on "good accounting practice." The SEC staff's view is that this means accounting based on U.S. GAAP, but its prime focus is on egregious violations of the rule. The SEC staff would not object if either U.S. GAAP or tax basis is used, as long as the basis is applied consistently. This is consistent with views expressed historically by the staff and stated within the April 17, 2008 EP minutes.

8. In his Remarks before AICPA National Conference on Banks & Saving Institutions, Chief Accountant Wesley Bricker covered, among other topics:

a. Digital assets:

- a reminder to understand the technology used and utilized, and act appropriately within existing laws and regulations as they relate to books and records, internal accounting control, internal controls over financial reporting, and custody;
- provided five illustrative examples, including those on books and records, fair value measurements and related parties, and audit committee considerations.

b. Implementation of new auditor reporting model and an invitation to registrants, audit committees and auditors to share their experience with the SEC and PCAOB regarding implementation of critical audit matters.

Investment Companies Expert Panel

November 2018 Meeting 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) September 2018 meeting highlights are available.
2. The EP staff noted timing for first review of proposed conforming changes to the AICPA Audit and Accounting Guide *Investment Companies* (the Guide).

II. Accounting/Reporting Issues:

1. The EP considered financial statement presentation for partially failing deposit securities. An EP member presented a scenario where an ETF issued creation units in-kind (deposit securities) to an Authorized Participant (AP) in exchange for contributed securities but certain securities were not received by the ETF (classified as failing deposit securities) and cash collateral has been deposited by the Authorized Participant (AP) on behalf of the ETF, but was not yet deployed to cover the failing deposit securities. The EP discussed the financial statement implications of such transactions.

   ETF issuers use creation units for new share issuance through broker-dealers. They also have relationships with broker-dealer trading desks, which act as APs. For creation units in-kind, the AP delivers cash collateral on behalf of the ETF for the deposit securities not yet received (classified as failing deposit securities). If and when the ETF decides to close out the trade and use the collateral to purchase the undelivered deposit securities, the AP will be liable for (1) the costs incurred by the ETF in connection with any such purchases and (2) any shortfall between the cost of the purchased deposit securities and the value of the cash collateral.

   The AP has an obligation to the ETF to fulfill its obligation of funding the creation of the new ETF shares. The ETF has fulfilled its legal obligation by issuing shares to the AP and recognized the shares issued to the AP on its books and records. Lastly, both the ETF and the AP have access to the cash collateral at the custodian; however, the other party must be notified and proper proof of delivery/non-delivery of assets is verified by the custodian prior to cash movement; indicating that neither party has control over the collateral.

   The EP members discussed the financial statement presentation of the deposit securities not yet received. The EP members discussed whether a right to offset exists. Per ASC 210-20-45-1 states,

   > "A right of setoff exists when all of the following conditions are met:
   >
   > a. Each of two parties owes the other determinable amounts.
   > b. The reporting party has the right to set off the amount owed with the amount owed by the other party.
   > c. The reporting party intends to set off.
   > d. The right of setoff is enforceable at law."

   The EP members considered whether the collateral belonged to the ETF or not. The EP members discussed the considerations should be given to whether the contributing party fulfilled its obligation, which would be a legal determination. Generally, the EP members discussed the collateral would not belong to the ETF, until such time the ETF decided to forgo delivery of the shares, which is also a legal determination.

2. The EP continued discussing applicability of FASB ASC 326 (CECL) to investment companies holding beneficial interests within the scope of ASC 325-40 in light of the November 1, 2018 TRG meeting. At that meeting, FASB staff noted that financial assets measured at fair value through net income are not in the scope of ASC 326-20. Accordingly, entities would not have an allowance for credit losses for beneficial interests classified as trading within the scope of ASC 325-40. The staff further noted that the entities would need to use reasonable judgement in determining the amount of accretable yield for beneficial interests classified as trading. The EP members generally agreed that both Views A and B discussed on the March 2018 EP conference call contained reasonable judgements.

3. The EP considered several implementation issues related to the adoption of ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement* for nonpublic investment companies:

   a. ASC 820-10-50-2(bbb)(2)(ii) does not require nonpublic entities to provide the information described in (bbb)(2)(i), which requires public entities to disclose the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements; however, nonpublic entities are required to provide quantitative information about the significant unobservable inputs used in the fair value measurement in accordance with (bbb)(2). An EP member expressed the view that the ASU dictates what public companies are required to disclose; however, the ASU offers more flexibility for nonpublicnon-public entities. The EP members discussed how non-public entities could meet the quantitative information requirement about significant unobservable inputs. The EP expressed a view that a nonpublic investment company may meet the quantitative information requirement for significant unobservable inputs by providing the range of such inputs, but unlike a public company, the nonpublic investment company is not explicitly required to provide the weighted average of such inputs. Certain EP members felt that under certain circumstances, nonpublic entities could continue to disclose quantitative information as they historically have disclosed (i.e., range and weighted average of significant unobservable inputs) while in other circumstances, nonpublic entities may only elect to disclose either a range of significant unobservable inputs or the weighted average of significant unobservable inputs. The EP further noted that an entity would need to ensure their quantitative disclosure is still meaningful to investors.

   b. ASC 820-10-50-2G states that in lieu of the Level 3 rollforward, nonpublic entities should disclose separately changes during the period which are attributable to purchases, issues and transfers into/out of Level 3 of the fair value hierarchy. The EP members discussed whether nonpublic entities are required to disclose Level 3 purchases, issues, and transfers by class. The EP members also discussed whether nonpublic entities disclose Level 3 purchases, issues and transfers of derivatives on a gross or net basis.

   The EP members generally expressed a view that nonpublic entities are required to disclose Level 3 purchases, issues, and transfers by class.

4. The EP discussed the recently issued Working Draft of the AICPA Accounting and Valuation Guide *Valuation of Portfolio Company Investments of Venture Capital and Private Equity Funds and Other Investment Companies*. The EP members found the illustrative examples provided in the guide to be helpful for discussions with those in the industry.

5. The EP members considered several implementation questions related to the amendments to Article 6 of Regulation S-X. Please see SEC Staff Update section for more information.

III. Audit and Attest Issues:

1. Form N-CEN requires a registrant to include in their annual Form N-CEN filing the independent accountant's report on internal control. Per Form N-CEN, *"The accountant's report shall be based on the review, study and evaluation of the accounting system, internal accounting controls, and procedures for safeguarding securities made during the audit of the financial statements for the reporting period. The report should disclose any material weaknesses in: (a) the accounting system; (b) system of internal accounting control; or (c) procedures for safeguarding securities which exist as of the end of the Registrant's fiscal year."*

The EP members discussed the PCAOB standards used for the report required by Form N-CEN. The EP members noted that the report for the purposes of Form N-CEN is on the company's internal control over financial reporting.

2. Critical audit matters (CAMs) will be applicable to business development companies (BDCs). The EP discussed implementation matters related to CAMs and will continue discussing this topic as needed.

3. Upon liquidation of pooled investment vehicles, Rule 206(4)-2(b)(4)(iii) requires a registered investment adviser to distribute audited GAAP financial statements to limited partners (or members or other beneficial owners) promptly after the completion of such audit. The EP members discussed a scenario where the fund was liquidated by selling the partners' interest rather than the underlying investments of the fund. The EP members agreed that ultimately this is a legal determination and entities should confer with their legal counsel and or chief compliance officer.

4. The EP considered modifications to the illustrative independent accountant's report, which is issued on the annual study and evaluation of a transfer agent's internal controls, as required to be filed with the SEC pursuant to Rule 17Ad-13 of the 1934 Act (par. 12.47 of the 2018 Guide).

   The EP members will continue discussing proposed modifications to the report at the following meeting.

IV. SEC Staff Update:

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1. Policy update:

   a. The SEC Office of Information and Regulatory Affairs and the Office of Management and Budget issue a semi-annual comprehensive list of rulemakings the SEC staff is working on. The Fall 2018 Agency Rule List includes, among others, offering reform for BDCs, auditor independence with respect to loans or debtor-creditor relationships, exchange-traded funds, modernization of investment company reporting disclosure, and use of derivatives by registered investment companies and business development companies.

   b. The SEC staff is considering recommendations for updating the Commission's existing valuation guidance for management and Boards of registered investment companies to reflect the evolving markets and existing accounting and auditing standards.

   c. The SEC staff also mentioned that amendments to the Custody Rule for Investment Companies and Investment Advisers are on the SEC's long-term agenda.

   d. The SEC staff informed the EP about the recently launched Strategic Hub for Innovation and Financial Technology (FinHub). It will serve as a resource on any of the SEC's FinTech-related issues and initiatives, including digital assets, distributed ledger technology, artificial intelligence and machine learning, among others, and also as a portal to the industry, where constituents can submit inquiries.

2. The SEC amended Regulation S-X through the adoption of its Disclosure Update and Simplification final rule. See the September 2018 EP minutes for the impact of the amendments to regulated investment companies as well as the SEC staff's views on conforming historical presentation to the current year's presentation for the comparative statement of changes in net assets.

   The SEC staff commented on the following implementation questions related to the amendments to Article 6 of Regulation S-X presented by EP members:

   a. Is it acceptable to not disclose the GAAP character of prior year distributions on the statement of changes in net assets or in the notes to the financial statements? The tax character of prior year distributions are disclosed in the notes to the financial statements.

   b. Is it acceptable to not disclose the prior year GAAP-basis undistributed net investment income on the statement of changes in net assets?

   Staff View: With respect to questions (a) and (b), the SEC staff did not express a view but noted that the rule amends Regulation S-X prospectively and does not require retrospective application. The prior year financial statements were completed under the pre-existing rules and if a fund is going to change historical presentation in future reports, the staff recommends registrants consult with their auditor.

   c. For comparative balance sheets of a BDC, is it acceptable to collapse prior year components of equity to conform to current year Regulation S-X requirements and footnote the amount to explain why the presentation changed and disclose the prior year amounts in a footnote to the balance sheet? Such presentation would be consistent with what was discussed in September 2018 SEC Staff Update for statement of changes in net assets.

   Staff View: The SEC staff would not object if a BDC conforms the presentation of the prior year's components of equity on the SAL to the current year's presentation on the SAL, as long as they include a footnote on the SAL indicating the reason for the change in presentation and the amounts, so that the investors would still have the information available on the SAL. The staff would also not object if the historical presentation remained the same and was inconsistent with the current year presentation.

   d. How should distributions be presented in the financial highlights per share section now that net investment income (NII) and realized distributions are combined on the statement of changes in net assets? Form N-1A/N-2 instructions say that distributions from NII, net capital gains and return of capital should all be stated separately.

   However, ASC 946-205-50-7(e) states that "Distributions to shareholders shall be disclosed as a single line item except that tax return of capital distributions shall be disclosed separately. Details of distributions shall conform to those shown in the statement of changes in net assets." How should registrants interpret these seemingly contradictory requirements?

   Staff View: The SEC staff does not believe the requirements are in conflict with one another, but rather views the Form N-1A/N-2 requirements as incremental to those required by GAAP. As the financial highlight requirements in the Forms have not changed, the SEC staff would not expect to see a change in a registrant's presentation of its financial highlights.

3. The SEC staff shared recently issued no-action letters[1] providing relief to issuers of certain non-variable insurance products under Regulation S-X §3-13 to file its audited financial statements prepared in accordance with statutory accounting principles in place of financial statements prepared in accordance with U.S. generally accepted accounting principles in registration statements submitted under the Securities Act of 1933 on Form S-1 for certain insurance contracts.

4. The SEC staff would like to remind registrants to be cognizant of the form questions and requirements in completing their Form N-CEN filings. The SEC staff has observed responses to form N-CEN that may contain errors such as (1) certain ETF registrants answering that they don't rely on exemptive orders; (2) certain registrants reporting that they have no investment adviser; (3) certain registrants indicating that they are not utilizing any pricing services (which may be an appropriate response in some circumstances). IM's Analytics Office and OCIE, if appropriate, may contact registrants in connection with these or other errors identified in those filings to date.

5. Subsequent to the November EP meeting, on November 14, 2018, the Division of Investment Management updated Investment Company Reporting Modernization Frequently Asked Questions (FAQs). Included in the updated FAQs are staff responses to questions concerning Compliance Dates and General Filing Obligations, Form N-Port, Regulation S-X (including requirements associated with custom basket disclosures), and Form N-CEN.

[1] Allianz Life Insurance Company of North America, September 28, 2018
Athene Annuity and Life Company, September 28, 2018
Great West Life & Annuity Insurance Company, September 28, 2018
Midland National Life Insurance Company, September 28, 2018

Financial Reporting Center

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 EP members would object to investment companies analogizing to the presentation of futures, where cumulative unrealized appreciation/depreciation is disclosed on the SOI, but variation margin receivable/payable is disclosed on the balance sheet. EP members discussed that they have seen diversity in practice but would not object to analogizing to futures presentation on the SOI for other centrally cleared derivatives. The balance sheet would reflect the rights and obligations of the fund.

5. EP members discussed the distributable earnings caption on the balance sheet, particularly since unrealized appreciation/depreciation is not distributable. One EP member stated that if the fund liquidated at the balance sheet date, unrealized would be distributable. Other EP members agreed that "distributable earnings (loss)" or "distributable earnings (deficit)" is the appropriate caption. Another EP member suggested the caption "total accumulated earnings," to address the fact that unrealized is not distributable.

III. Audit and Attest Issues:

1. The EP members will review proposed modifications to "Reports on Processing of Transactions by a Transfer Agent" subsection of chapter 12 of the Guide and provide feedback to the AICPA staff by the end of January.

2. During the November 2018 EP meeting, the EP members discussed whether the report required by Form N-CEN should be based on PCAOB attestation standards (AT 101 and AT 601) or PCAOB auditing standards. The EP members noted that the report for the purposes of Form N-CEN is on the company's internal control over financial reporting and expressed a view that the report should be performed under PCAOB auditing standards rather than attestation standards.

    The EP members revisited this topic and discussed that the report is a byproduct of the audit and would not be considered a separate engagement.

3. The EP discussed recently issued PCAOB standards:
    a. Auditing Accounting Estimates, Including Fair Value Measurements and amendments to PCAOB auditing standards.
    b. Amendments to Auditing Standards for Auditor's Use of the Work of Specialists

    The EP discussed guidance in Appendix 1, par. AS 2501.A4 of Auditing Accounting Estimates regarding reliability of pricing information provided by the pricing services.

Investment Companies Entities Expert Panel

March 12, 2019

Conference Call

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 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.

Given the amendments to FASB ASC 805, *Business Combinations*, the EP is currently exploring potential revisions to Chapter 8 of the Guide, paragraphs 8.37 to 8.48 and Appendix E, "Illustrative Financial Statement Presentation for Tax-Free Business Combinations of Investment Companies," and TQA 6910.33, "Certain Financial Reporting, Disclosure, Regulatory, and Tax Considerations When Preparing Financial Statements of Investment Companies Involved in a Business Combination".

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.

Form N-PORT[1]	Compliance Date for Filing Reports on EDGAR
Large Fund Groups	April 1, 2019
Smaller Fund Groups	April 1, 2020

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:

Fiscal Quarter End	First Report on Form N-PORT must be filed on EDGAR by:	Required Monthly Data
March 31, 2019	May 30, 2019	March 2019
April 30, 2019	July 1, 2019 [2]	March, April 2019
May 31, 2019	July 30, 2019	March, April, May 2019

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 shown 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:

1. The Expert Panel (EP) March 2019 conference call highlights are being finalized.
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

Fact Pattern	
Amortized cost basis at purchase (31 Dec 2020)	$109
Amount repayable at first call date (31 Dec 2030)	$104
Par amount at maturity (31 Dec 2050)	$100

	Prior GAAP	ASU 2017-08
Amortization 2021–2030	$3*	$5 ($109 – $104)
Amortized cost at 31 Dec 2030	$106 (realized loss of $2 if called)	$104 (no realized loss if called)
Amortization 2031–2050 (if not called)	$6*	$4 ($104 – $100)
Total	$9 ($109 – $100)	$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	
Purchase price (1 Jan 2018)	$110
Amount repayable at first call date (30 Nov 2018)	$105
Amortized cost per financial statements (31 Dec 2018)	$107
Amount repayable at second call date (31 Dec 2019)	$102

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.

Fact Pattern	
Purchase price (1 Jan 2020)	$105
Amount repayable at first call date (31 Dec 2020)	$107
Amortized cost at 31 Dec 2020	$104
Amount repayable at second call date (31 Dec 2021)	$102

- 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 a subsidiary's 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.

d. 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.

AICPA Investment Companies Expert Panel Conference Call Highlights
July 16, 2019

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:

Disclaimer

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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.

AICPA Investment Companies Expert Panel
Meeting Highlights
September 17, 2019

I. AICPA/Administrative:

1. The Expert Panel (EP) July 2019 call highlights are being finalized.
2. The 2019 AICPA Audit and Accounting Guide *Investment Companies* (the Guide) will be available in e-book and print edition in October 2019.

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:

- 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.
- 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:

- 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 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.

   <u>AICPA Accounting and Valuation Guide:</u>

   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×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 or use 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:

   > 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.

   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(l) 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.

AICPA Investment Companies Expert Panel

Conference Call highlights

January 21, 2020

I. AICPA/Administrative:

1. The Expert Panel (EP) November 2019 meeting highlights for administrative and restricted cash items have been posted; remaining portion is being finalized. January 2019 meeting highlights have been updated for restricted cash agenda item.
2. Illustrative draft audit opinion for business development companies (BDCs) is being reviewed by regulators.
3. The EP considered the AICPA Audit and Accounting Guide *Investment Companies* (the Guide) matters for 2020 conforming changes cycle.

II. Accounting/Reporting Issues:

1. The EP discussed whether the EP members plan to comment on the SEC proposed rule regarding use of derivatives by registered investment companies and business development companies, including on potential implications for calculating and auditing the asset coverage ratio.

III. SEC Staff Update:

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1. Commission Update:
   - The SEC staff highlighted several projects from the Chairman Clayton's Testimony on "Oversight of the Securities and Exchange Commission" Before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, December 10, 2019
   - SEC Agency Rule List for Fall 2019 included, among others, proposed rules on amendments to auditor independence rules, derivatives, custody rules for investment advisers, investment company summary shareholders report and update to marketing rules

for investment advisers; final stage rules included but not limited to, exchanges-traded funds, enhanced disclosures for separate accounts, and offering reform for BDCs.

- The SEC staff noted continuous Commission's focus on independence as evidenced in
  - Statement in Connection with the 2019 AICPA Conference on Current SEC and PCAOB Developments by Sagar Teotia, Chief Accountant
  - Remarks before the 2019 AICPA Conference on Current SEC and PCAOB Developments by Vassilios Karapanos, Associate Chief Accountant, Office of the Chief Accountant, in particular on coordination between audit committees, audit firms, and management to ensure compliance with auditor independence rule
  - Statement on Role of Audit Committees in Financial Reporting and Key Reminders Regarding Oversight Responsibilities by Chairman Jay Clayton, Sagar Teotia, Chief Accountant, William Hinman, Director, Division of Corporation Finance, in particular on the shared responsibility for compliance with auditor independence rules of the audit firm, the issuer, and its audit committee

2. Division of Investment Management Update:

- Keynote Address — 2019 ICI Securities Law Developments Conference by Dalia Blass, Director, Division of Investment Management, December 3, 2019
- Remarks to the Greater Cincinnati Mutual Fund Association by Alison Staloch, Chief Accountant, Division of Investment Management, December 3, 2019
- The Commission formed a new advisory panel Asset Management Advisory Committee (AMAC) to provide diverse views from retail and institutional investors, large and small funds, and other industry participants.

3. Financial Statement Review:

The SEC staff provided the following financial statement review comments:

- *Sub-advisory fees and consistency between annual report and prospectus* – The SEC staff noted that certain funds describe relationships with sub-advisers in their registration statements (Item 19 of N-1A) and the disclosure will often include amounts paid by the fund or adviser to a sub-adviser. The SEC staff has seen instances where the sub-advisory arrangement is not described in the notes to the financial statements, where facts and circumstances might warrant such disclosure, or is significantly inconsistent with the description in the prospectus. The SEC Staff reminds registrants that significant elements of the arrangement may warrant disclosure in the notes to the financial statements, depending on facts and circumstances.
- *Schedule of investments (SOI) holdings depiction for international funds* – The SEC staff noted instances where an international fund's SOI categorized investments by country but did not include indications of industry concentration when it appears such concentration was present in the portfolio. The SEC staff reminded the registrants of the following relevant guidance:
  - FASB ASC 825-10-50 regarding concentration of credit risk, and
  - Paragraph 7.28 of the guide that refers to FASB ASC 825-10-50 regarding significant concertation of credit risk, and "for example, an international fund that categorizes its investments by industry or geographic region should also report a summary of its investments by country, if such concentration is significant."

  The SEC staff encouraged all registrants to evaluate their disclosures particularly if a related SOI shows a significant concentration in a single country but does not include information to evaluate the concentration in particular industries, or vice-versa in situations where an international fund has categorized investments by industry yet there is significant concentration in a single country.

4. IM 2019 Dear CFO Letter:

Consistent with Chairman Clayton's Statement regarding SEC Staff Views made on September 13, 2018, the IM staff reviewed prior guidance and staff statements, including eight Dear CFO letters

(issued between 1994 and 2001) covering over 50 different topics, for continued relevance. The IM staff issued a new Dear CFO Letter from the Division of Investment Management on November 22, 2019, which rescinds, modifies, and supplements prior positions, as well as introduces a new position. The letter, among other things, includes rationale for why certain positions were rescinded and how certain positions were modified. It also creates an identifier for each position and an Accounting Matters Bibliography, accumulating all existing and current Dear CFO Letter positions in one place.

IM will continue to review whether additional positions, or further rescissions or modifications to prior positions, are necessary. While the IM Division has engaged in an initial review of prior Staff statements to identify positions that require modification, rescission, or supplementation as a result of market, regulatory, or other developments, the IM staff recognizes there may be additional questions from the industry in the future that may require further updates and encourages registrants and other stakeholders to engage as those questions arise.

5. Policy Initiatives:

The following proposed rules are currently open for comment:

- Use of Derivatives by Registered Investment Companies and Business Development Companies; Required Due Diligence by Broker-Dealers and Registered Investment Advisers Regarding Retail Customers' Transactions in Certain Leveraged/Inverse Investment Vehicles (comment period closes March 24, 2020)
- Amendments to Rule 2-01, Qualifications of Accountants (comment period closes March 16, 2020)

6. OCIE Update:

The Office of Compliance Inspections and Examinations issued its OCIE 2020 Examinations Priorities.

AICPA Investment Companies Expert Panel
Meeting Highlights
March 17, 2020

I. Accounting/Reporting Issues:

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

Fair value considerations

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

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

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

Subsequent event disclosures

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

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

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

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

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

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

Going concern considerations

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

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

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

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

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

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

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

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

II. Audit and Attest Issues

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

III. SEC Staff Update:

Disclaimer

The following comments and observations were compiled by the AICPA Investment Companies Expert Panel and AICPA staff and are not authoritative positions or interpretations issued by the SEC or its staff. The comments and observations were not transcribed by the SEC or its staff and have not been considered or acted upon by the SEC or its staff. Accordingly, these comments and observations do not constitute a statement of the views of the SEC or its staff.

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

1. COVID-19:
   a. Starting March 10, 2020, most SEC staff began transitioning to full telework posture and the Commission remains fully operational. The SEC IM staff stand ready to support stakeholders, answer questions, and to provide further relief to market participants, as necessary and appropriate, and to make themselves available for consultations with registrants. Simultaneously, the IM staff continue rule-making efforts, enforcement work, as well as financial statement reviews.
   b. The IM staff reminded registrants to consider whether impact of coronavirus disease 2019 (COVID-19) triggers subsequent event disclosures under FASB ASC Topic 855.
   c. **COVID-19 Related Relief:**
      To date, the Commission issued two orders for relief related to the Investment Advisers Act and the Investment Company Act for funds and investment advisers whose operations may be affected by COVID-19 emergency:
      - The Division recognizes that some investment companies may face challenges in transmitting annual and semi-annual reports, timely filing Forms N-CEN and N-PORT and delivering updated prospectuses to existing shareholders as a result of the COVID-19 emergency. The Division recognizes that similar challenges may also be experienced in preparing and filing amendments to Forms ADV and Form PF in a timely manner. As such, the Commission's orders conditionally exempt registered funds and advisers from certain filing and transmittal requirements.
      - The Division previously issued a staff statement taking a no-action position with respect to investment companies' in-person board voting requirements as a result of the COVID-19 emergency. Since issuing that staff statement, the Division has received feedback from industry participants that boards of directors would appreciate the greater certainty of an exemption, rather than a staff no-action statement, and the Commission order includes a conditional exemption with respect to investment companies' in-person board voting requirements.
      - Further, as a result of declines in asset values, the Division also recognizes that some registered closed-end funds and business development companies ("BDC") may need to call or redeem securities in order to maintain asset coverage ratios in compliance with the Investment Company Act and the terms of the security or other instrument pursuant to which the securities were issued. Ordinarily, these funds would be required to provide the Commission with 30 days prior notice of the call or redemption, however, the Commission's order notes that such prior notice is not necessary under the conditions described in the order.
      - **Update:** on March 25, 2020, the SEC has extended regulatory relief previously provided to funds and investment advisers whose operations may be affected by COVID-19. The Commission issued orders (https://www.sec.gov/rules/other/2020/ia-5469.pdf and https://www.sec.gov/rules/other/2020/ic-33824.pdf) that would provide certain investment funds and investment advisers with additional time with respect to holding in-person board meetings and meeting certain filing and delivery requirements, as applicable. These Orders supersede and extend the filing periods covered by the Commission's Original Orders of March 13, 2020, described above. Among other conditions, entities must notify the Division staff and/or investors, as applicable, of the intent to rely on the relief, but generally no longer need to describe why they are relying on the order or estimate a date by which the required action will occur. The time periods for relief are described in the Orders. The Commission may provide extensions to the time period for the relief, with any additional conditions it deems appropriate, or provide additional relief as circumstances warrant. Firms and financial professionals are encouraged to contact SEC staff with questions or matters of particular concern.

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

      The IM staff noted that they consider the current conditions to require the Staff to take an iterative approach, as the markets and conditions continue to evolve, and they may consider additional relief, as necessary.
   d. The EP inquired whether the SEC is considering providing relief from the 120 days requirement for distribution of pooled investment vehicle's financial statement where relying on the audit exemption under the SEC Rule 206(4)-2(b)(4) (Custody Rule). The IM staff reminded the EP about SEC staff FAQs on Custody Rule, and specifically, Question VI.9:

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

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

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

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

   a. **Accelerated and Large Accelerated Filer Amendments Adoption:**

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

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

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

   b. **Investor Disclosure Improvements for Variable Annuities and Variable Life Insurance Contracts:**

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

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

AICPA Investment Companies Expert Panel

Conference Call Highlights

April 17, 2020

I. Accounting/Reporting Issues:

1. On March 31, 2020, the Bank of England Prudential Regulation Authority requested that large UK banks cancel payments of all outstanding 2019 dividends and suspend payments of dividends through the end of 2020. As a result, on March 31, 2020, several UK banks canceled dividends with ex-dividend dates prior to March 31, 2020 and payment dates subsequent to March 31.

   The EP discussed how a fund that has a significant investment in a company that has canceled dividends with an ex-date prior to year-end would account for dividends that were cancelled either on the year-end date (e.g. March 31) or post-year-end (e.g. February 29) in its annual financial statements. According to FASB ASC 946-320-25-4, investment companies record dividend income on the ex-dividend date, not on the declaration, record, or payable date, because on the ex-dividend date the quoted market price of listed securities and other market-traded securities tends to be affected by the exclusion of the dividend declared.

   For funds with a February year-end, the EP members believed this announcement would be treated as a non-recognized (Type II) subsequent event that would warrant disclosure in the notes to the financial statements. However, for funds with a March year-end, a fund would have to consider whether the information was known or knowable as of the year-end date, and whether the financial statements should be updated to recognize this event. The EP members considered guidance in FASB ASC 820-10-35-41C(b), which discusses how a quoted market price in an active market does not represent fair value at the measurement date if significant events, such as an announcement, take place after the close of the market but before the end of the measurement date. Certain EP members expressed a view that funds would most likely need to reverse the dividend income and related receivable. Funds would also need to consider whether any adjustments will be needed to the valuation of investments in these banks.

2. An EP member shared that the FASB staff recently received a technical inquiry regarding situations in which a lender had provided a loan payment holiday to assist borrowers impacted by COVID-19. The inquiry did not relate to troubled debt restructurings. The staff discussed the following two alternative accounting treatments and determined that both were acceptable:

i. Adjust the effective interest rate and continue to record interest income during the payment holiday;

ii. Cease recording interest income during the holiday and resume afterward.

The Expert Panel observed that a fund should perform an analysis to assess the underlying investment and that the accounting treatment would depend on the particular facts and circumstances for the investment. For example, a fund would consider if the payment holiday represents a change in effective interest rate because there is an expectation that the company will be able to make payments in the future or if the payment holiday is indicative of a collectability issue and it's doubtful that the company will be able to make interest payments going forward.

3. In light of the current market conditions, certain funds have been repurchasing their public debt at values below their redemption amounts. At the September 2017 meeting, the EP discussed the classification of any gains/losses that arise from a fund's extinguishment of debt and generally agreed that such amount should be accounted for as a separate line item on the income statement outside of net investment income. At the April 2020 meeting, an EP member inquired what would be considered the appropriate timing of recognition of that gain/loss.

Paragraph 1(a) of FASB ASC 405-20-40 notes that a debtor shall derecognize a liability if and only if it has been extinguished. A liability has been extinguished when the debtor pays the creditor and is relieved of its obligation for the liability. Per FASB ASC 405-20-40-1(a)(4), one way a liability can be extinguished is through the reacquisition by the debtor of its outstanding debt securities whether the securities are cancelled or held as so-called treasury bonds. The EP expressed a view that it is a legal determination. If a fund repurchases its outstanding public debt, it would record the extinguishment of that debt at the point in time when the obligor is legally relieved of its obligation (i.e., the settlement date).

4. The Federal Reserve has established the Money Market Mutual Fund Liquidity Facility (MMLF), whereby the Federal Reserve Bank of Boston will make loans available to eligible financial institutions to purchase securities from money market funds. An EP member inquired what disclosures, if any, a money market mutual fund would need to consider if it decides to participate in the MMLF to address liquidity issues (to meet demands for redemptions) or to avoid "breaking the buck".

Certain EP members expressed a view that there may be nothing specific to disclose as the sale of the securities would be similar to any other sale, but acknowledged that each fund participating in the MMLF would need to undergo legal analysis to determine whether a sale under the program can be categorized as an "arm's-length" transaction. Another EP member observed that as the sale of the securities under the MMLF program is contemplated at the amortized cost, one may question whether an amortized cost is representative of fair value and whether additional disclosures may be warranted.

5. The EP continued sharing other observations seen in practice regarding the implications of the COVID-19 outbreak:

a. Fair Value:

- Estimating fair value requires significant judgment in normal circumstances. However, in the current environment characterized by market volatility and uncertain outlook, applying judgement in determining fair value will be even more challenging. Both the AICPA and the International Private Equity and Venture Capital Valuation ("IPEV") recently issued valuation related articles on COVID-19. The AICPA article and IPEV article provide reminders of FASB ASC 820 principles and are intended to serve as reminder and assist practitioners and others with applying FASB ASC 820 guidance during COVID-19 crisis.

- The EP discussed a situation where an investment company that uses net asset value as a practical expedient to value its investment in an underlying fund may not have current

information from the underlying fund available at the balance sheet date due to COVID-19 related business interruptions. The EP noted that an investment company would use the most recent underlying fund information available and estimate the change in the net asset value of the underlying fund through the balance sheet date in accordance with FASB ASC 820-10-35-60. An investment company would need to use judgement in determining adjustments needed to arrive at the net asset value of the underlying fund as of the balance sheet date.

b. Subsequent events disclosures:

- At the March 2020 Expert Panel conference call, the EP discussed how subsequent events arising after the balance sheet date that materially impact a fund's financial condition would be disclosed. As the COVID-19 outbreak continues, the EP members acknowledged there may be more information available now [in April 2020] that may assist an investment company in expanding qualitative and quantitative subsequent events disclosures.

c. An EP member shared that COVID-19-related staffing issues at printing facilities may cause potential delays in printing financial statements and prospectuses.

6. An EP member received a question regarding how to account for securities with negative interest either because the security is issued with a negative interest rate or the security is a variable rate security whose interest rated flipped to a negative interest rate due to the current economic crisis. The requestor referred the EP to its discussion on this topic from the March 2016 meetings and inquired if negative interest from securities could be accounted for as (1) a reduction of interest income previously generated by the security [prior to the current situation causing negative interest], (2) an expense other than interest expense or (3) interest expense.

The EP will continue discussing this topic at the May 2020 meeting.

7. The EP considered a situation where a private equity fund is set up only for insurance companies that prefer to invest largely in debt rather than equity for statutory reasons (for example, 90 percent of the investment will be in debt and 10 percent in equity). All investors would invest pro-rata and have the same 90/10 debt to equity split for their investment for the life of their investment in the fund. The debt will pay contractual interest rate of 5 percent to investors and the investors would receive their P&L allocation on the equity portion of their investment based on a standard waterfall agreement. The EP discussed how this fund should calculate its internal rate of return (IRR), when the investors are invested mostly in the fund's debt vs. equity. The EP expressed a view that for this fact pattern, for the purposes of the IRR calculation, debt and equity may be considered as a single investor class in applying FASB ASC 946-205-50-23. The EP members noted that IRR may be more meaningful for users of financial statements in these circumstances, when debt and equity are treated as a single investor class because they are investing in both the debt and equity on an equal, pro-rata basis.

II. Audit and Attest Issues

1. The EP resumed its discussion of feedback received from regulators on the illustrative draft audit opinion for business development companies.

III. AICPA/Administrative:

1. AICPA IC EP March meeting highlights are available here.

IV. SEC Staff Update

Disclaimer

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1. The staff of the Division of Investment Management (SEC IM staff) stated that the Commission remains fully operational during the Coronavirus (COVID-19) pandemic and, beyond health and safety, is focused on maintaining continuity of Commission operations, monitoring market functions and system risks, providing prompt, targeted regulatory relief and guidance to stakeholders, and working with other financial regulators, as needed, to coordinate efforts. The SEC IM staff has received many questions from registrants and continues both financial statement reviews and rulemaking efforts, though the Commission has stated on the public webpage discussing the SEC's COVID-19 Response under section titled "Effect on Comment Periods for Certain Pending Actions" that they understand challenges associated with COVID-19 may impair stakeholder's ability to meet current comment periods and will not take final action on several proposals before May 1, 2020 including:
    a. Amendments to Rule 2-01, Qualifications of Accountants;
    b. Amending the "Accredited Investor" Definition;
    c. Use of Derivatives by Registered Investment Companies and Business Development Companies.
2. The SEC IM staff created an IM COVID-19 Response FAQ, where they have organized responses to questions about funds and advisers affected by COVID-19 for ease of reference. These responses represent the views of the staff of the Division, however they reference both staff actions and Commission actions, as well as contact information for both specific and general questions.

    a. Investment Adviser-related highlights:
        - New and updated Custody Rule FAQs regarding:
            1. inadvertent receipt of client securities when an adviser's personnel may be unable to access mail or deliveries (new Question II.1);
            2. inability to complete surprise examination (new Question IV.7); and
            3. custody of certain privately issued securities that are evidenced by physical certificates (new Question VII.4).
        - Existing Custody Rule FAQs regarding:
            1. inability of a pooled investment vehicle to distribute its audited financial statements within 120 days after its fiscal year – the IM staff referenced existing Question VI.9 from the Custody Rule FAQs (for more detail, refer to the SEC Staff Update from the March 2020 EP meeting highlights) on the COVID-19 landing page.
        - The EP inquired whether (i) Fund of Funds and (ii) Funds that invest in Fund of Funds would be afforded similar relief to that given in existing Question VI.9 with respect to meeting the 180 day and 260 deadline, respectively, given for stand-alone funds in FAQ VI.9, i.e. "The Division would not recommend enforcement action for a violation of rule 206(4)-2 against an adviser that is relying on rule 206(4)-2(b)(4) and that reasonably believed that the pool's audited financial statements would be distributed within the 120-day deadline, but failed to have them distributed in time under certain unforeseeable circumstances." Subsequent to the meeting, the SEC IM staff directed the EP to Custody Rule FAQ Question VI.9 which was modified on April 27, 2020 to address this question.
        - The SEC IM staff also noted that, as stated in March 20, 2020 OCIE Statement on Operations and Exams – Health, Safety, Investor Protection and Continued Operations are our Priorities, "reliance on regulatory relief will not be a risk factor utilized in determining whether OCIE commences an examination."

b. Investment Company-related highlights:

- The IM staff noted there are several Commission and Staff action items listed on IM's page related to investment companies that have been released over the past month, including actions related to in-person board meetings, inter-fund lending, affiliate transactions, and certain filing requirements.
- The IM staff highlighted an IM staff statement reminding investment company issuers of their obligations under section 10(a)(3) of the Securities Act of 1933 to update the information in their prospectuses, including the required underlying certified financial statements. The statement also reminds investment companies of their information delivery obligations for sales of fund shares to new investors and encourages investment companies to communicate with investors about their delivery preferences. The SEC IM staff highlighted certain specific delivery obligations for existing vs. new investors.
- The Commission announced temporary, conditional relief for BDCs that allows additional flexibility in certain requirements to make additional investments in small and mid-sized businesses, including those impacted by COVID-19, subject to certain protection conditions. The relief focuses on two areas:
  (1) issuance of senior securities and asset coverage, and
  (2) expanded relief for BDCs with existing co-investment orders.
- The relief in both areas is intended to allow for BDCs to continue to facilitate providing capital to small and mid-sized businesses in light of the current market environment. Absent these exemptions, they may be unable to do so, either because the BDC cannot satisfy their asset coverage requirements due to temporary mark-downs in the value of their investments or from the prohibition of certain affiliated funds from participating in additional follow-on investments.

(1) The first area of relief for BDCs relates to the issuance of senior securities and calculation of an *Adjusted Asset Coverage Ratio*, as described in the Order. During the exemption period, a BDC may issue or sell a senior security that represents an indebtedness or that is a stock (together, the "covered senior securities"), if certain provisions are met.

- The EP and the SEC IM staff further discussed the adjusted asset coverage calculation included in the relief, noting it included an example where the BDC had a statutorily determined limitation of 150% and its asset coverage calculation did not fall below that limitation, but still determined to utilize the relief. The EP and SEC IM staff discussed an additional scenario where a BDCs asset coverage calculation at the calculation date fell below the limitation:

  Example *Adjusted Asset Coverage Ratio* Calculation:

  For example, a BDC has a 190% asset coverage ratio on December 31, 2019. Its asset coverage ratio declines to 130% in April on the date of calculation due to a 25% decline in asset values, not using the Adjusted Portfolio Value, and 190% if it calculated the ratio using the Adjusted Portfolio Value (without the 25% decline in asset values). This BDC, if electing the relief and complying with the Order, would have an Adjusted Asset Coverage Ratio of 175% (190% minus 15% (25% of the difference between 190% and 130%)). As a result, the BDC would comply with the statutory asset coverage limit of 150% and be able to issue an additional 25% in leverage before reaching its statutory limit.
  NOTE: The above example demonstrates a scenario where a BDCs asset coverage has fallen below its statutory limit of 150% and holds all other variables, such as investment purchases and sales, consistent since December 31, 2019. Other facts and circumstances could exist. Like the example in the Order, this example assumes the BDC has met the other conditions necessary to utilize the relief.

(2) The second focus area of the relief provided to BDCs expands on current BDC co-investment orders and allows for BDCs to co-invest with certain affiliated private funds that did not participate in the original investment, to participate in the follow-on investments.

(3) Lastly, the EP inquired whether an accounting firm may serve as an "independent evaluator" as described in the provision for the Board approval for each issuance of senior securities. The SEC IM staff noted that service providers like accounting firms might be hired by a BDC to provide such a service, and the staff would expect an accounting firm to perform an analysis of their independence for that BDC, including if they had an audit relationship with the BDC or affiliate. The staff are as always available for consultation on specific fact patterns.

3. The Commission also voted to adopt final rules related to offering reform for BDCs and CEFs, substantially as was originally proposed in May 2019. Expansion of offering reform to BDCs and CEFs was mandated by Congress in the Small Business Credit Availability Act and the Economic Growth, Regulatory Relief, and Consumer Protection Act to allow for a more streamlined registration, offering, and investor communications process.

Some key highlights of the final rule are as follows:

- *Shelf Offering Process and New Short-Form Registration Statement*
- *Ability to Qualify for Well-Known Seasoned Issuer (WKSI) Status*
- *Immediate or Automatic Effectiveness of Certain Filings*
- *Communications and Prospectus Delivery Reforms*
- *New Method for Interval Funds and Certain Exchange-Traded Products to Pay Registration Fees*
- *Periodic Reporting Requirements*
- *Incorporation by Reference Changes*
- *Structured Data Requirements*

At a high-level, the reforms essentially allow for certain eligible funds to engage in the same registration processes that have been available to operating companies since 2005 and also included changes to supplement the specific amendments mandated by Congress to align the immediately effective or automatically effective offering process long available to other types of investment funds with the eligible funds. Lastly, the reforms also include certain disclosure requirements and new structured data requirements that will make it easier for investors and others to analyze BDC and fund data.

The rule and form amendments will become effective on August 1, 2020, with the exception of the amendments related to registration fee payments by interval funds and certain exchange-traded products, which will become effective on August 1, 2021.

In addition, the Commission is adopting compliance dates for specific requirements under the amendments to provide a transition period after the effective date of the final rule, which are described in detail here.

AICPA Investment Companies Expert Panel

Conference Call Highlights

May 19, 2020

I. AICPA/Administrative:

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

II. Accounting/Reporting Issues:

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

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

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

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

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

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

III. Audit and Attest Issues

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

IV. SEC Staff Update

Disclaimer

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

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

    The public comment period for this proposal will remain open until July 21, 2020.
6. BDC/CEF Offering Reform: The Commission voted to adopt final rules related to offering reform for BDCs and CEFs, substantially as was originally proposed in May 2019. Expansion of offering reform to BDCs and CEFs was mandated by Congress in the Small Business Credit Availability Act and the Economic Growth, Regulatory Relief, and Consumer Protection Act to allow for a more streamlined registration, offering, and investor communications process. Some key highlights of the final rule are as follows:
    - *Shelf Offering Process and New Short-Form Registration Statement*
    - *Ability to Qualify for Well-Known Seasoned Issuer (WKSI) Status*
    - *Immediate or Automatic Effectiveness of Certain Filings*
    - *Communications and Prospectus Delivery Reforms*
    - *New Method for Interval Funds and Certain Exchange-Traded Products to Pay Registration Fees*
    - *Periodic Reporting Requirements*
    - *Incorporation by Reference Changes*
    - *Structured Data Requirements*

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

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

7. The IM COVID-19 Response FAQ page organizes responses to questions about funds and advisers affected by COVID-19 for ease of reference. The SEC IM staff highlighted the following FAQs:

a. Modified custody rule-related FAQ Question VI.9 to include fund of funds, pools investing in fund of funds, and top tier funds investing in one or more fund of fund.
b. New Question I.2 which directs institutional investment managers that file Form 13F on how to contact the staff if it has questions or concerns related to impacts of COVID-19 on its operations or compliance.
c. New Question II.4 on regulatory reporting obligations under the Investment Advisers Act of 1940 if a registered investment adviser has or will receive a paycheck protection program loan.

8. The SEC IM staff shared the following recent financial statement and registration statement reviews:

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

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

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

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

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

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

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

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

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

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

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

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

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

AICPA Investment Companies Expert Panel
Meeting Highlights
July 21, 2020

I. AICPA/Administrative:

1. AICPA Investment Companies Expert Panel (EP) May meeting highlights are being finalized.

II. Accounting/Reporting Issues:

1. The EP was made aware of the potential EITF agenda request topic re: Application of FASB ASC Topic 820, Fair Value Measurement, when valuing a security subject to an underwriter lockup agreement.

2. The EP members shared that at this time they are not aware of any new accounting, reporting, or valuation challenges related to COVID-19 matters. The EP members are only aware of a handful of investment companies that have taken advantage of SEC provided COVID-19 relief (see SEC Staff Update portion of the March 2020 AICPA IC EP meeting highlights for more information on relief offered).

3. At the April 2020 EP meeting, the EP discussed how a lender should account for loan payment holidays to assist borrowers impacted by COVID-19. Business development companies (BDCs) and other investment company lenders are also making modifications to other terms of the loans in addition to loan payment holidays (e.g., changing interest rates or maturity dates).
   At the July 2020 EP meeting, the EP discussed loan modifications for BDCs. Specifically, an EP member asked the EP to share observations in practice and whether BDCs are applying loan modification guidance (that is, FASB ASC 310-20) by analogy, absent investment company-specific guidance.
   The EP members noted that generally, a BDC should establish a policy on when a loan modification results in a realization event that it applies consistently and continuously. One EP member noted that if that policy is to analogize to guidance in FASB ASC 310-20, the BDC should consider other guidance in that Topic as well.
   Another EP member observed that there may be more modifications of loan agreements in the future due to transitioning from LIBOR to another alternative reference rate.

4. The EP shared themes from comment letters submitted on the SEC proposed rule Good Faith Determinations of Fair Value.

5. The AICPA Audit and Accounting Guide *Investment Companies* in par. 2.120 indicates that an investment company should classify paydown gain and losses on mortgage-backed and asset-backed securities (MBS and ABS) as an adjustment to interest income. The EP considered whether similar logic applies to paydowns relating to loans that are not in the form of MBS or ABS. The EP will resume this discussion at a future meeting.

III. SEC Staff Update

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1. The Commission remains fully operational in current telework environment due to COVID-19 and continues to monitor markets and address market issues and risks, provide regulatory relief and guidance to registrants, coordinate with other federal regulators and maintain its enforcement and investor protection efforts.

2. The SEC staff discussed Asset Management Advisory Committee (AMAC) activities, including 2 recent meetings:

    a. May 27, 2020, meeting on
        - ESG
        - Private investments
        - Impact of COVID-19
    b. July 16, 2020, meeting on
        - improving diversity and inclusion in the asset management industry and
        - data privacy and technology's impact on investment advice

3. The SEC staff provided an update on emerging markets initiatives:

    a. April 21, 2020 Joint Statement on Emerging Markets by the SEC Chairman, Division Directors, and PCAOB Chairman covering key matters related to emerging market investments, including challenges related to audits, financial reporting, and related disclosure;

    b. May 4, 2020 Statement Announcing SEC Staff Roundtable on Emerging Markets by Chairman Jay Clayton;

    c. July 9, 2020, SEC Staff Roundtable on Emerging Markets included four panels:
        - **Investments in Emerging Markets by U.S. Retail Investors**
        - **Limitations on Inspection and Enforcement in Emerging Markets; Auditors' Global Oversight of Member Firms in Emerging Markets**
        - **Disclosure and Reporting Considerations with Respect to Investments in Emerging Markets**
        - **Improving Emerging Market Investing for US Retail Investors and Markets**

4. The SEC staff highlighted recent testimony and other speeches:

a. June 23, 2020 Statement on the Continued Importance of High-Quality Financial Reporting for Investors in Light of COVID-19 by Sagar Teotia, Chief Accountant
b. June 24, 2020 Statement on Commencement of Appointment Process for the 2020-2025 PCAOB Board Seat by Sagar Teotia, Chief Accountant
c. July 14, 2020, Remarks to the Financial Stability Oversight Council by Chairman Jay Clayton
d. July 7, 2020 Keynote Speech at the Society for Corporate Governance National Conference by Commissioner Elad L. Roisman
e. June 25, 2020, Testimony before the Investor Protection, Entrepreneurship, and Capital Markets Subcommittee, U.S. House Committee on Financial Services by Chairman Jay Clayton on the SEC's response to the impact of COVID-19 and fiscal year 2021 budget request
f. Following the EP meeting, Division of Investment Management Director Dalia Blass published remarks from PLI's Investment Management Institute highlighting the Division's accomplishments and upcoming agenda

5. Rulemaking:

a. July 6, 2020 Amendments to Procedures With Respect to Applications Under the Investment Company Act of 1940
b. July 10, 2020 Reporting Threshold for Institutional Investment Managers – a proposed amendment to Form 13F reports by institutional investment managers
c. Adoption of Securities Offering Reform for Closed-End Investment Companies

6. Policy initiatives:

a. SEC has a dedicated COVID 19 response page and the Division of Investment Management has a dedicated COVID-19 Response FAQ page.
b. June 26, 2020 joint statement An Update on the Commission's Targeted Regulatory Relief to Assist Market Participants Affected by COVID-19 and Ensure the Orderly Function of our Markets

7. The SEC staff noted that the SEC Spring 2020 regulatory agenda has been updated and currently includes the following IM-related items:

a. Proposed rule stage:
- Amendments to the Custody Rules for Investment Advisers
- Investment Company Summary Shareholder Report and Modernization of Certain Investment Company Disclosure
- Amendments to Rule 17a-7 Under the Investment Company Act
- Amendments to Form PF
- Investment Company Fair Value (proposed April 21st)
- Amendments to Form 13F Filer Threshold (proposed July 10th)

b. Final rule stage:
- Use of Derivatives by Registered Investment Companies and Business Development Companies
- Fund of Funds Arrangements

- Amendments to Certain Provisions of the Auditor Independence Rules
- Amending the "Accredited Investor" Definition
- Amendments to Financial Disclosures About Acquired Businesses (adopted May 20th)
- Amendments to Procedures for Applications Under the Investment Company Act (adopted July 6th)

8. The SEC staff noted that comment periods have closed and comments filed are available for proposals on Auditor Independence and Good Fair Determinations of Fair Value.

9. On May 20, 2020, the SEC adopted Amendments to Financial Disclosures about Acquired and Disposed Businesses. The rule is effective on January 1, 2021. To date, the SEC staff received a handful of questions, including some on supplemental financial information. The SEC staff reminded that while voluntary early adoption of the rule is permitted in advance of the effective date, registrants who early adopt must apply the final amendments in their entirety. The SEC staff encouraged registrants to reach out with questions on particular facts and circumstances.

10. Operations related: Financial statement reviews comments

1. Presentation of recoupments of previously waived fees on the statement of operations:

a. The SEC staff highlighted previously issued guidance, see Dear CFO position 1995-09 and ADI 2019-09, which indicates that for fee table presentation in the registration statement, recoupments should be presented in gross expenses either in a separate line item or in other expenses.
b. For financial statement purposes on the statement of operations, certain registrants include recoupments in gross expenses, while others include them below gross expenses and above net expenses, which is the same section in which fee waivers are presented. The EP members inquired whether the staff would object to the presentation of recoupments in either of these manners.
c. The SEC staff noted that management, in consultation with the fund's auditors, should evaluate the placement of recoupments in a manner that reflects what management believes is best disclosure for shareholders, and that the SEC Staff would not object to either presentation for typical recoupment agreements at this time, absent unique facts or circumstances.

2. As noted in item #9 above, if registrants choose to early adopt the new rules within Amendments to Financial Disclosures about Acquired and Disposed Businesses, registrants are required to adopt all provisions of the rule, including the supplemental financial information. The SEC staff highlighted a best practice is to disclose that the fund has early adopted the rule within the Form N-14 filing or in the cover letter. Lastly, the SEC staff emphasized that pro-forma financial statements should be included if a registrant does not early adopt the rule.

3. In a SOX review, the SEC staff identified a fund that had recorded and expensed fees through the fund that related to services performed by the Chief Compliance Officer (CCO); however, the fund's advisory agreement specified that the adviser was responsible for paying the CCO fees. The fund was reimbursed for all years impacted in accordance with the fund's NAV error policies. The SEC staff reminded registrants of the importance of evaluating whether expense accruals match the terms and conditions of the agreements entered into by the fund, particularly

when new agreements are entered into that may conflict with the language in previous agreements.

4. The SEC staff reminded registrants that LIBOR transition may impact registrants in variety of ways, not just with respect to fund investments. The SEC staff offered an observation from one review of a registration statement where a BDC had an incentive fee hurdle rate based on LIBOR and included disclosure around the adviser's ability to move from LIBOR to SOFR. The SEC staff explained that funds may have non-investment related agreements that reference LIBOR and, to the extent that exposure is known and material, registrants are encouraged to include disclosures describing the exposure. The SEC staff also reminded registrants to review the June 2019 staff statement on LIBOR transition.

5. Form N-PORT Item C.7. a. "Liquidity classification information" requires disclosure of the liquidity classification(s) for each portfolio investment among the four categories as specified in SEC Rule 22e-4 and the percentage amount attributable to each classification. Liquidity classifications are:

i. Highly Liquid Investments
ii. Moderately Liquid Investments
iii. Less Liquid Investments
iv. Illiquid Investments

The SEC staff reminded registrants that for a fund with multiple liquidity classifications, a percentage amount attributed to each classification should be indicated, and that the percentages included should total 100%. The SEC staff emphasized the importance of the accuracy and consistency of all data contained in such reports to analyses performed by the Commission.

11. Recent OCIE Risk Alerts:

a. Risk Alert: Observations from Examinations of Investment Advisers Managing Private Funds June 23, 2020
b. Risk Alert: Cybersecurity: Ransomware Alert July 10, 2020

AICPA Investment Companies Expert Panel
Meeting highlights
September 15, 2020
September 30, 2020

I. AICPA/Administrative:

1. AICPA Investment Companies Expert Panel (EP) July meetings highlights are available here.
2. The EP was updated on the availability of the 2020 AICPA Audit and Accounting Guide *Investment Companies* (the guide). The EP also considered potential 2021 guide updates.

II. Accounting/Reporting Issues:

1. FASB projects updates:

a. The FASB added a project to its technical agenda on how underwriting restrictions on the sale of equity securities should be considered when measuring fair value under FASB ASC Topic 820, *Fair Value Measurement*. The FASB also added a project to its research agenda to evaluate the effects of other types of sale restrictions on fair value measurements.

b. At the August 19, 2020 meeting, the Board discussed a clarification related to Subtopic 310-20, *Receivables—Nonrefundable Fees and Other Costs* as part of Codification Improvements for premium amortization on purchased callable debt securities. The Board affirmed its prior decision that an entity should reevaluate whether a callable debt security is within the scope of paragraph 310-20-35-33 for each reporting period, consistent with its intent when it issued Accounting Standards Update No. 2017-08, *Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities.*

Subsequent to the September 2020 EP meeting, the FASB issued Accounting Standards Update (ASU) No. 2020-08, *Codification Improvements to Subtopic 310-20, Receivables—Nonrefundable Fees and Other Costs,* which amended Subtopic 310-20.

2. The EP revisited a previously discussed topic on whether an investment company, including a business development company (BDC), could have other comprehensive income (OCI). For example, the EP discussed a scenario where a BDC issues variable rate debt and then enters into an interest rate swap to hedge changes in interest rates. The EP reaffirmed that the EP views from the March 2016 meeting still apply:

ASU 2016-01 *Financial Instruments—Overall (Subtopic 825-10)* amended FASB ASC 220-10-45-10A to require the change in fair value caused by a change in

instrument-specific credit risk (own credit risk) to be presented separately in other comprehensive income (OCI) for financial liabilities measured using the fair value option in ASC 825. An EP member questioned if an investment company that elected the fair value option for its debt, would be required to present the change in fair value caused by instrument specific credit risk in OCI.
EP members indicated that neither FASB ASC Topic 946 nor Article 6 of Regulation S-X currently provide any guidance for/require presentation of OCI. An EP member noted that investment companies are not excluded from presenting OCI.

The EP members also observed that while nothing prohibits an investment company, including a BDC, from having OCI, it would be unusual for an investment company to have OCI in practice based on the activities of investment companies.

3. The EP revisited its discussion on potential differences between the published NAV of a mutual fund as of its fiscal year end and the NAV reported in the mutual fund's audited financial statements from the EP May 2020 meeting. Sometimes open-ended mutual funds have differences between their published NAV and the NAV reported in their financial statements. In some cases (e.g. the occurrence of a NAV error), the fund may determine it necessary to reprocess its redemptions and subscriptions impacted by the adjusted NAV. The EP continued discussing situations in which an investment company invests in an open-end mutual fund for which the published NAV differs from the NAV reported in its financial statements and whether the fund should adjust its price of the investee fund to match the NAV in the audited financial statements.
The EP observed that FASB ASC 820-10-35-41C(b) states:

> A reporting entity shall not make an adjustment to a Level 1 input except in the following circumstances:
>
> …b. When a quoted price in an active market does not represent fair value at the measurement date. That might be the case if, for example, significant events (such as transactions in a principal-to-principal market, trades in a brokered market, or announcements) take place after the close of a market but before the measurement date. A reporting entity shall establish and consistently apply a policy for identifying those events that might affect fair value measurements. However, if the quoted price is adjusted for new information, the adjustment results in a fair value measurement categorized within a lower level of the fair value hierarchy.

The EP members discussed various scenarios, including reprocessing of transactions and timing differences. The EP acknowledged that facts and circumstances may vary. While it may depend on specific facts and circumstances, certain EP members expressed a view that an investment company that invests in an open-end mutual fund for which there is a difference between published NAV and financial statement NAV, may not need to go back and adjust the price of the investee fund to match the NAV in the audited financial statements as long as the original reported NAV is a published price that is determined to be a Level 1 price.

4. At the April 2020 EP meeting, the EP discussed a situation in which a private equity fund is set up for investors that prefer to invest largely in debt rather than equity for statutory or other reasons (for example, 90 percent of the investment will be in debt and 10 percent in equity and all investors would invest pro-rata and have the same 90/10 debt to equity split for their investment for the life of their investment in the fund). Certain EP members expressed a view that for this fact pattern, the debt and equity may be considered a single investor class in presenting the fund's internal rate of return (IRR).

   At the September 2020 meeting, the EP considered how the entities should value its debt and equity interest in the private equity fund, specifically, whether the debt and equity interests are a single unit of account and whether both the debt and equity interests can be valued using NAV as a practical expedient. Some EP members agreed that the investment described above [that consists of pro-rata debt and equity interests] may be considered a single unit of account and can be valued using NAV as a practical expedient in accordance with FASB ASC 820-10-15-4, as long as the investment does not have a readily determinable fair value and is an investment in an entity that meets the characteristics of the investment company within FASB Topic 946.

5. The EP discussed the SEC's proposing rule and form amendments that would modernize the disclosure framework for open-end management investment companies.

6. The EP considered accounting for cash compensation related to discount rate transition. Clearing organizations are expected to change the rate used for discounting and determining the PAI/PAA on certain cleared derivative instruments. The change in discount rate will result in a revaluation of the cleared derivative which, in turn, will trigger a variation margin payment. To compensate the party required to make (or entitled to receive) this variation margin payment, there will also be a one-time compensating payment made to the party required to make the additional variation margin payment (or by the party entitled to receive the additional variation margin payment). The EP discussed the treatment of the cash compensation.

   The EP members discussed a view that technically this cash payment represents compensation for a change in the value of the variation margin account, and therefore, should merely offset the change in the value of that account. Further, for many investment companies these amounts are not likely to be significant, so based on materiality and to avoid operational complexity, there may be diversity in practice in how funds account for this cash compensation.

7. The French and other European Union Tax Authorities have recently informed certain funds about potential refunds of previously paid European dividend withholding taxes. Many funds have not recorded reclaims receivable for these amounts in the past, due to uncertainty around whether they would receive them.

   The EP previously discussed potential accounting implications for these situations in May 2013, when "EP member expressed a view that when viewed as a fund's income tax, the technical answer would be to follow ASC 740 guidance on refunds, which essentially would

result in a receivable for the refund if it is "more likely than not" (MLTN) that the tax position would be sustainable and then identifying the greatest amount of refund that is more likely than not to be received. One EP member noted that when funds pass-through the foreign tax credit to the shareholders, it may be possible to take a view that these potential refunds of tax are not the fund's income tax. Some expressed a view that they prefer the gain contingency accounting which is a more conservative approach and easier to apply, for example, in situations, where refunds are not material to the fund complex, and nothing is booked until actual receipt of cash refund. It was noted that this is likely not the technically correct approach."

At the September 2020 meeting, certain EP members acknowledged that significant judgement is involved in recognizing these amounts as an asset. While certain RICs may, based on their specific facts and circumstances, elect to account for these European Union tax reclaims differently, the EP reaffirmed its views from May 2013. The EP members further noted that when received and recorded, these refunds would follow the character of the original withholding.

III. SEC Staff Update

Disclaimer

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1. The SEC staff provided an update on emerging markets initiatives:
    a. SEC Chairman Jay Clayton, SEC Division of Corporation Finance Director William Hinman, SEC Division of Investment Management Director Dalia Blass, SEC Division of Trading and Markets Director Brett Redfearn, SEC Office of International Affairs Director Raquel Fox, and SEC Chief Accountant Sagar Teotia, Statement on SEC Response to the Report of the President's Working Group on Financial Markets (8/10/2020)
    b. President's Working Group on Financial Markets: Report on Protecting United States Investors from Significant Risks from Chinese Companies (7/24/2020)
2. The SEC staff highlighted July 28, 2020, Dalia Blass, Director, Division of Investment Management Speech: PLI Investment Management Institute
3. The Commission remains fully operational in current telework environment due to COVID-19 and continues to maintain its enforcement and investor protection efforts.
4. Rulemaking:
    a. The SEC issued a final rule "Amending the "Accredited Investor" Definition", which, among other things, expands eligibility to participate in private capital markets to qualified natural persons. The final amendment identified holders in good standing of the Series 7, Series 65, and Series 82 licenses as qualifying natural persons and also provided that "the Commission may designate qualifying professional certifications, designations, and other credentials by order, with such designation to be based upon

consideration of all the facts pertaining to a particular certification, designation, or credential."

b. The SEC proposed to "Improve the Retail Investor Experience through Modernized Fund Shareholder Reports and Disclosures", including rule and form amendments that would modernize the disclosure framework for open-end management investment companies, including ETFs. The framework proposal would feature:
   - A summary shareholder report that would highlight key information that is particularly important for retail investors to assess and monitor their fund investments,
   - An alternative way to keep shareholders informed about their fund investment and fund updates, instead of delivering prospectus updates to existing shareholders, and
   - Amendments to the scope of Rule 30e-3 to exclude open-end funds. Instead, under this proposal, an investor will receive the summary shareholder report in the mail unless the investor opts into electronic delivery.

   The SEC also proposed amendments to:
   - Prospectus disclosure requirements for open-end funds to provide greater clarity and more consistent information about fees, expenses and principal risks, and
   - Advertising rules for all RICs and BDCs to promote more transparent and balanced statements about investment costs.

c. The SEC staff discussed recently adopted Securities Offering Reform for Closed-End Investment Companies as the staff have started to see registration statements for closed-end funds applying the status afforded under the new rule. The staff highlighted reminders including changes to annual reports, the addition of management's discussion of fund performance, changes to senior securities tables, and disclosure of certain strategy and risk items in the annual report for funds relying on Rule 8b-16(b) of the 1940 Act to not amend their registration statement every year.

d. The SEC staff is actively working through comment letters received on the Investment Company Fair Value proposal and shared several common themes from the comment letters, including regarding the definition of a "readily available market quotation", the prompt reporting requirement and certain documentation requirements, among others.

5. The SEC staff shared one financial statement comment regarding appropriateness of categorization of certain expenses as extraordinary expense. FASB ASU 2015-01 eliminated the concept of extraordinary items from US GAAP, but the instructions for the operating expense table for investment company registration statements in Item 3(c((ii) of Form N-1A retained that concept using the exact same definition from US GAAP. The SEC staff offered several examples where a registrant classified certain fees, for example, audit fees, proxy fees, or professional fees in connection with filing foreign tax reclaims, as extraordinary. Since these fees occurred for more than one year or would be expected to occur in future periods, the staff questioned their extraordinary categorization and reminded registrants that an item or transaction would need to be both unusual in nature and infrequent in occurrence to potentially qualify as "extraordinary." The SEC staff acknowledged that compliance with expense limitation agreements is a separate legal determination. The SEC staff also encouraged advisers and fund administrators in consultation with the fund's auditor to evaluate the classification of extraordinary expenses.
6. Lastly, the SEC staff shared the following OCIE risk alerts:
   a. "Select COVID-19 Compliance Risks and Considerations for Broker-Dealers and Investment Advisers"

b. "Examination Initiative: LIBOR Transition Preparedness"

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AICPA Investment Companies Expert Panel
Meeting highlights
November 16, 17, 23 2020

I. AICPA/Administrative:

1. AICPA Investment Companies Expert Panel (EP) September meetings highlights have been posted.
2. The text of the EP's Custody Rule FAQ discussion with the SEC staff from 2010 now also appears in the same pdf as the archived 2003-2010 EP meeting highlights)
3. The EP members considered the AICPA Audit and Accounting Guide *Investment Companies* (the guide) matters, including reaffirming EP prior views that the PCAOB content in the guide remains relevant to the users of the guide. The EP also considered a potential conforming change to Exhibit 5-4 of the guide, which contains illustrative financial statements for a feeder fund.

II. Accounting/Reporting Issues:

1. FASB projects updates:

a. The FASB added an agenda item to its technical agenda on how underwriting restrictions on the sale of equity securities should be considered when measuring fair value under FASB ASC Topic 820, *Fair Value Measurement*. The FASB also added a project to its research agenda to evaluate the effects of other types of sale restrictions on fair value measurements.

b. The FASB issued Accounting Standards Update (ASU) No. 2020-08, *Codification Improvements to Subtopic 310-20, Receivables—Nonrefundable Fees and Other Costs,* which amended Subtopic 310-20. The EP members discussed that under the amended guidance, an entity should reevaluate whether a callable debt security is within the scope of Paragraph 310-20-35-33 for each reporting period.

2. The EP considered a scenario in which an externally managed BDC (the "Company") entered into an agreement and plan of merger to acquire another BDC ("the Target"), where the merger transaction was effected through an exchange of shares, and is accounted for as an asset acquisition. The fair values of the net assets to be acquired will exceed the purchase consideration (that is, a bargain purchase). In accordance with FASB ASC 805-50-30-3, the cost of the asset acquisition shall be allocated to the acquired net assets based on their relative fair values and shall not give rise to goodwill. The application of this guidance to a bargain purchase scenario would result in the shortfall of the purchase consideration being allocated as a reduction to the carrying amounts of the acquired assets. Because the majority of the assets acquired are comprised of the investment portfolio (loans) of the Target, which is measured at fair value, the purchase price allocation would result in a reduction to the cost

basis of the acquired portfolio and give rise to the recognition of an immediate gain. Members also discussed that the BDC may not be able to recognize incentive fee on the accretion of the discount, specifically in a situation where the BDC acquired an affiliated BDC. This could result in the BDC's investment advisor collecting the incentive fee twice. The EP will continue its discussion at the next EP meeting.

3. The EP members resumed its discussion regarding potential refunds of previously paid European dividend withholding taxes topic from the September 2020 EP meeting. During November 2020 meeting, the EP members acknowledged that the timing of recognition of contingent fees due to third parties in connection with collecting European tax reclaims would likely coincide with the related asset recognition. Please refer to the SEC Staff Update section of these highlights for more discussion.
4. The EP members discussed that a Financial Transactions Tax (FTT) of 0.20% was recently adopted in Spain and will be applicable as of January 16, 2021. The FTT will apply to acquisitions of shares of Spanish companies with a market capitalization over €1,000 million, trading on the Spanish market, or on a regulated market of another EU Member State, or on an equivalent third-country market. The tax base is determined by the consideration in return for the transaction excluding transaction fees, commissions, or any other expense linked to the transaction. The Spanish FTT will be assessed by an investment services company acquiring Spanish shares on its own behalf, as an FTT taxpayer, irrespective of its residence. The EP discussed that the FTT can be included in the transaction price (i.e., capitalized into cost basis) in accordance with FASB ASC 946-320-30-1.
5. The EP discussed the recognition criteria for PIPEs (Private Investments in a Public Entity) offered through special purpose acquisition companies (SPACs). In 2020, the financial markets have seen an increase in SPAC initial public offering (IPO) activity. With these transactions, SPACs raise capital through an IPO whereby the SPAC shell company becomes a listed entity. After the IPO, the SPACs generally have, on average, between 18 to 24 months to find a merger target to effect a reverse merger IPO whereby the merger target is the surviving public company. SPACs often offer interests in a specified merger target through PIPE commitments whereby the investing entity enters into a commitment to buy shares of the merger target company. This commitment is subject to various contingencies, such as obtaining a sufficient level of capital raise & shareholder approval of the merger. The EP expressed a view that these commitments should be recognized when the commitment is legally binding, which is a legal determination. A binding commitment is deemed to meet the definition of a financial instrument as specified in the ASC Master Glossary.

   Upon meeting this definition, the commitment will be recognized as a financial instrument (e.g., contingent forward purchase commitment or other investment) and will be initially recognized at and subsequently marked to fair value. The EP members acknowledged that while the merger transaction may be subject to contingencies, this does not preclude the PIPE commitment from being legally binding. The contingencies could, however, impact the fair value of the instrument. Contractual equity commitments typically may be considered as a single unit of account in combination with the underlying equity security. Certain EP members expressed a view that upon issuance of the PIPE equity security, there may be a basis for the fair value from the commitment instrument to be carried over to the newly issued security resulting in an unrealized gain or loss on the position.

6. An EP member inquired whether EP members have experience with active non-transparent ETFs. At this time, the EP members shared that they were only aware that these are emerging types of ETFs.
7. A registered fund has an investment in direct real estate properties (either directly or through a wholly owned, consolidated REIT subsidiary). The EP members were asked how, if at all, purchases and sales of real estate property and the balance of real estate would impact the portfolio turnover ratio. The EP members generally agreed that the portfolio turnover calculation [in forms N-1A and N-2] focuses on securities only, so from legal perspective, non-securities should be excluded from the portfolio turnover calculation. Certain EP members acknowledged that supplemental disclosure of portfolio turnover that includes non-securities may be appropriate, especially to the extent a fund engages in real estate (and potentially, also in digital assets that are not securities) transactions and incurs transaction costs.

III. SEC Staff Update

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1. The SEC staff highlighted recent Asset Management Advisory Committee (AMAC) November 5, 2020 meeting, which focused on the Committee's preliminary recommendations for COVID-19 related operational issues, including electronic delivery, remote work, e-authorization, and dematerialization of physical securities.
2. Recent speeches by the SEC Commissioners and staff:
    a. By Chairman Jay Clayton:
        - An Update on FY 2020 Results – Remarks at SEC Speaks by Chairman Jay Clayton, Oct. 8, 2020
        - Testimony on "Oversight of the Securities and Exchange Commission" by Chairman Jay Clayton, Nov. 17, 2020
        - Putting Principles into Practice, the SEC from 2017-2020 Remarks to the Economic Club of New York, Nov. 19, 2020
    b. Playing the Long Game: The Intersection of Climate Change Risk and Financial Regulation by Commissioner Allison Herren Lee, Nov. 5, 2020
    c. When the Nail Fails – Remarks before the National Society of Compliance Professionals by Commissioner Hester M. Peirce, Oct. 19, 2020
    d. By Dalia Blass, Director, Division of Investment Management:
        - Keynote Address: ALI CLE 2020 Conference on Life Insurance Company Products, Nov. 10, 2020
        - Keynote Address: Regulating with our Eyes on the Future, Sept. 24, 2020
    e. The SEC staff also noted the following statements by SEC commissioners and staff related to issuing final rules:
        - Auditor independence (October 16, 2020):

1. Promoting an Effective Auditor Independence Framework by Chairman Jay Clayton
2. Who Watches the Watchers?* Joint Statement on Auditor Independence Amendments by Commissioner Allison Herren Lee and Commissioner Caroline A. Crenshaw

- Funds' Use of Derivatives (October 28, 2020):
  1. Modernizing the Regulatory Framework for Funds' Use of Derivatives by Chairman Jay Clayton
  2. Opening Statement on Use of Derivatives by Registered Investment Companies and Business Development Companies by Commissioner Hester M. Peirce
  3. Statement on Regulation of Funds' Use of Derivatives by Commissioner Elad L. Roisman
  4. Statement on the Final Rule on Funds' Use of Derivatives by Commissioner Allison Herren Lee
  5. Statement on Funds' Use of Derivatives by Commissioner Caroline A. Crenshaw
  6. Joint Statement Regarding Complex Financial Products and Retail Investors by Chairman Jay Clayton; Dalia Blass, Director, Division of Investment Management; William Hinman, Director, Division of Corporation Finance; Brett Redfearn, Director, Division of Trading and Markets

3. The SEC Chief Accountant's Office of the Division of Investment Management issued a letter directed to the Chief Financial Officer of the Division's registrants and other relevant parties (Dear CFO letter) to assist investment company registrants and their independent public accountants in addressing certain accounting matters. These positions can be found in the Accounting Matters Bibliography. The letter rescinds 1 position, modifies 2 positions and includes 3 new positions:

- Rescinding **DCFO 1998-01** Average Commission Rate Disclosure
- Modifying **DCFO 1998-04** Change in Independent Public Accountants
- Modifying **DCFO 2001-02** Senior Securities Table Disclosure
- Adding **DCFO 2020-01** Determining Commencement of Operations Date
- Adding **DCFO 2020-02** Business Development Companies –Financial Statements in Initial Registration Statements
- Adding **DCFO 2020-03** Combined Financial Statements for Compliance with Advisers Act Rule 206(4)-2

a. DCFO 2001-02 on senior securities table disclosure was recently modified. While Footnote 5 to 2001-02 indicates that the financial highlights can be presented either as a separate schedule or within the notes to the financial statements, the first bullet point indicates that since the financial highlights are **specifically covered by the audit opinion**, the senior securities table information also would be covered.
In response to EP member question, the SEC staff shared that the update was not intended to change their original position and reaffirmed that a BDC that includes the financial highlights in the notes to the audited financial statements would satisfy the

audit requirement for the senior securities table if the financial highlights are not specifically referenced directly in the audit opinion but they are included in the notes to the financial statements, which are covered by the audit opinion.

b. With respect to DCFO 2020-03, the SEC staff noted that the position lays out a framework of considerations for assessing the appropriateness of using combined financial statements for purposes of the audit exception in the Custody Rule. The staff noted that the bulleted items outlined in the position are not structured as a checklist nor a list of exclusive, mandated conditions, but rather, a non-exclusive list of factors that RIAs should consider when determining if combined financial statements are appropriate. . The staff recognizes there are multiple scenarios where combined financial statements may be appropriate to satisfy the intentions of the Custody Rule's audit exception.

The SEC IM staff continue to consider whether additional positions should be rescinded, modified, or supplemented or if there are new positions that should be shared. The SEC IM staff encourage stakeholders to engage directly on any questions raised by the changes or if they believe there are other Staff positions that merit reevaluation.

4. Rulemaking

a. Fund of Funds Arrangements
b. Qualifications of Accountants (auditor independence)
c. Use of Derivatives by Registered Investment Companies and Business Development Companies

5. The SEC staff sought EP members' feedback regarding types of disclosures they may be seeing for loan modifications, payment holidays, and forbearance agreements.

6. The SEC staff offered the following comments in connection with recent financial statement and registration statement reviews or consultations with registrants:

a. The SEC staff have had discussions with registrants that have either reported or anticipate material refunds of previously paid European dividend withholding taxes, as well as related IRS compliance fees, and professional fees. In these conversations, these registrants have shared that they are accounting for the reclaims under FASB ASC Topic 740 and the IRS compliance fee as contra-income versus expense. The Staff understands that registrants may have to make significant judgments and estimates for the many different components of the reclaims and would generally not object to well-reasoned judgements as long as the judgments reflect all known facts at the time of determination. The Staff will continue to monitor financial statement disclosures around reclaims and welcomes consultations from registrants.

b. Forms N-CEN and N-PORT:

- The SEC staff observed inconsistencies between information reported on Forms N-CEN and N-PORT and noted that inconsistencies may result in IM's Analytics Office's review. One example noted in connection with review of registrant's Form N-CEN relates to the methodology used to calculate the registrant's monthly average value of securities on loan (question C.6) and monthly average net assets (Question C.19). Average value of securities on loan is intended to inform investors of the potential risks related to securities

lending activity. The Staff reminded registrants that while the Staff has not prescribed methodologies for this metric, they should use calculation methodologies that result in a reasonable representation of the activity during the year and that are consistent across filings.

7. OCIE alerts:
   - **Observations from OCIE's Examinations of Investment Advisers: Supervision, Compliance and Multiple Branch Offices**
     November 9, 2020
   - **Risk Alert: Cybersecurity: Safeguarding Client Accounts against Credential Compromise**
     September 15, 2020
8. The SEC's Division of Enforcement issued its annual report for fiscal year 2020
9. Subsequent to the November EP meeting, the Commission voted to adopt a new rule providing a framework for fund valuation practices. New rule 2a-5 under the Investment Company Act ("the Act") establishes requirements for determining fair value in good faith for purposes of the Act. The rule will permit boards, subject to board oversight and certain other conditions, to designate certain parties to perform the fair value determinations. The rule also defines when market quotations are "readily available" for purposes of the Act, the threshold for determining whether a fund board, or its designee, must "fair value a security in good faith" as defined by the Act. The Commission also adopted new rule 31a-4, which provides the recordkeeping requirements associated with fair value determinations. Additionally, the Commission is rescinding previously issued guidance on related issues, including the role of the board of directors in determining fair value and the accounting and auditing of fund investments.
   The rule as adopted can be viewed here: https://www.sec.gov/rules/final/2020/ic-34128.pdf
   A press release with more detail can be viewed here: https://www.sec.gov/news/press-release/2020-302

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AICPA Investment Companies Expert Panel

January 19 and 27, 2021 meeting highlights

I. AICPA/Administrative:

1. AICPA Investment Companies Expert Panel (EP) November meetings highlights have been posted.
2. The AICPA staff reminded the EP of the timing for the 2021 AICPA Audit and Accounting Guide *Investment Companies* (the guide) review.

II. Accounting/Reporting Issues:

1. In November 2020, the President issued an Executive Order that prohibits "any transaction in publicly traded securities, or any securities that are derivative of or are designed to provide investment exposure to such securities, of any Communist Chinese military company." A current listing of those securities, as of the date of the meeting, can be found here. The order was effective January 11, 2021 and resulted in the NYSE delisting the stocks/ADRs of China Mobile, China Telecom and China Unicom. The Expert Panel members anticipate that funds would assess the significance of such holdings to their financial statements to determine if risk disclosures or subsequent event disclosures are needed for financial statements.
2. The EP members noted no new developments relative to accounting for and disclosure of European withholding tax reclaims. Potentially impacted funds are continuing to assess whether receivables for reclaims should be recorded under ASC 740. EP members have seen diversity in practice based on each specific fund or fund group's facts and circumstances.
3. The EP revisited a topic on accounting for securities received in a spinoff and stock rights. GAAP includes explicit guidance for securities received via spinoffs (paragraphs 2 and 3 of FASB ASC 946-320-30) and stock rights (FASB ASC 946-320-35-8), which requires an allocation of cost from existing shares to new shares for investment companies. To the extent such transactions are deemed taxable, GAAP treatment will likely differ from tax treatment, which generally assigns full cost to the new security equal to its market value and recognizes non-cash dividend income that is distributable to taxable shareholders.
   The EP member inquired whether the funds that receive securities in taxable spinoff and taxable stock rights typically would apply GAAP or tax accounting for daily NAV accounting purposes. EP members acknowledged that recording a taxable spinoff transaction using the cost allocation method under GAAP as opposed to recording dividend income under tax accounting would result in a difference between book and tax basis. Therefore, some funds may choose to follow the tax treatment for book purposes if the amounts are not material. The EP members also noted that if material, the fund would track the difference between GAAP and tax accounting and make

a financial statement adjustment at the reporting date; however, the EP members were not aware of predetermined quantitative thresholds that may trigger such adjustment.

4. The EP members further considered the nature of SPAC PIPE commitments (previously discussed at the November 2020 meeting) and acknowledged that the entity may need to make an assessment whether a SPAC PIPE commitment meets the definition of a financial instrument, or a derivative, or other investment under GAAP. The EP members expressed a view that a SPAC PIPE commitment would be recognized when it is legally binding, which is a legal determination, and initially recorded and subsequently measured at fair value. The EP members also discussed whether contractual equity commitments typically may be considered as a single unit of account in combination with the corresponding equity security.

The EP members also considered whether there could be a point where it is appropriate for a fund investing in a PIPE commitment to fund a SPAC to record a gross asset and gross liability prior to closing date.

For example, if the fund entered into the PIPE commitment on 8/1/20, all contingencies were resolved on 9/28/20 and funding occurred on the closing date of 10/1/20, would it be appropriate for the fund to record a gross asset (dr. investment) and liability (cr. payable for investment purchased) on its balance sheet on any date prior to the closing date. Alternatively, would the fund continue to follow a derivative accounting model or a model similar to derivative accounting (if the PIPE commitment is not a derivative) until the closing date, and as such, not record a gross asset and liability prior to the closing? Some EP members expressed a view that the fund would not record a gross asset and a gross liability on any date prior to the closing date; rather, the net fair value of the PIPE commitment would be recorded. Other EP members believed that it could be appropriate to gross up the investment in the PIPE and the corresponding liability to fund the PIPE at the point that the contingency is resolved, as the fund has an obligation to fund the investment at that point.

The EP also considered two alternatives regarding whether the commitment and equity security are one unit of account:

- If they are considered one unit of account, there could be a view that there is only one trade date on 8/1/20 (the date that the fund made the binding commitment to the PIPE) and therefore, no balance sheet gross up would be recorded prior to the closing date. Once the PIPE is funded, the unrealized gain/loss on the commitment would carry over into the investment.
- If the commitment and the equity security are considered two separate financial instruments (that is, two units of account), one may argue that a realization event occurs upon acquisition of the equity shares.

The EP discussed the merits of each view and will continue discussion at a future meeting.

The EP also considered whether these PIPE commitments should be included on the schedule of investments or disclosed in the notes to financial statements. One EP member suggested considering the SEC staff views on disclosing loan commitments from the January 2006 EP meeting highlights SEC Staff Update.

5. During the November EP meeting, the EP members considered a scenario in which an externally managed BDC (the "Company") entered into an agreement and plan of merger to acquire another BDC ("the Target"), where the merger transaction was effected through an exchange of shares, and is accounted for as an asset acquisition. The fair values of the net assets to be acquired will

exceed the purchase consideration (that is, a bargain purchase). In accordance with FASB ASC 805-50-30-3, the cost of the asset acquisition shall be allocated to the acquired net assets based on their relative fair values and shall not give rise to goodwill. The application of this guidance to a bargain purchase scenario would result in the shortfall of the purchase consideration being allocated as a reduction to the carrying amounts of the acquired assets. Because the majority of the assets acquired are comprised of the investment portfolio (loans) of the Target, which is measured at fair value, the purchase price allocation would result in a reduction to the cost basis of the acquired portfolio and give rise to the recognition of an unrealized gain.
The EP also discussed potential considerations for interest accretion and will continue its discussion at the next EP meeting.

III. SEC Staff Update

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The SEC Chief Accountant and Assistant Chief Accountants and Branch Chiefs joined the EP meeting to share the following observations and updates.

1. The SEC staff discussed the transition of leadership roles within the SEC.
2. Recent speeches and statements by the SEC Commissioners and staff:
    a. December 1, 2020, AMAC committee meeting and related draft observations
    b. November 19, 2020, Putting Principles into Practice, the SEC from 2017-2020 Remarks to the Economic Club of New York by Chairman Clayton
    c. November 17, 2020, Chairman Clayton testified before the U.S. Senate Committee on Banking, Housing, and Urban Affairs on the Oversight of the SEC
    d. November 19, 2020, The Role of the CCO – Empowered, Senior and With Authority by Peter Driscoll
    e. December 23, 2020, Staff Statement on the President's Working Group Report on Money Market Funds by Dalia Blass
3. IM-INFO-2020-06 regarding IM staff withdrawal of staff letters related to exchange-traded funds
4. December 22, 2020, J.P. Morgan Investment Management Inc., et al.; Notice of Application to use an amended liquidity program and related final approval
5. PCAOB related activities and speeches:
    a. Staff Observations and Reminders during the COVID-19 Pandemic
    b. January 15, 2021, The Future of Audit Oversight by J. Robert Brown Jr., Board Member
    c. The PCAOB's *Auditing Accounting Estimates, Including Fair Value Measurements* standard became effective for audits of financial statements for fiscal years ending on or after December 15, 2020
6. The Fall 2020 Agency Rule list has been posted and includes, among others, the following:

a. Investment Company Shareholder Report and Modernization of Certain Investment Company Disclosure
b. Enhanced Listing Standards for Access to Audit Work Papers; Access to Audit Work Papers and Co-Audit Standards
c. Other items on the long term agenda include Amendments to the Custody Rules for Investment Advisers, Amendments to the Custody Rules for Investment Companies, Amendments to Rule 17a-7 Under the Investment Company Act, Request for Comment on Fund Names, Money Market Fund Reforms and Exchange-Traded Products.

7. The Commission adopted a new rule providing a framework for fund valuation practices. New rule 2a-5 under the Investment Company Act establishes requirements for determining fair value in good faith for purposes of the Act. The rule will permit boards, subject to board oversight and certain other conditions, to designate certain parties to perform the fair value determinations. The rule also defines when market quotations are "readily available" for purposes of the Act, the threshold for determining whether a fund must fair value a security. The Commission also adopted new rule 31a-4, which provides the recordkeeping requirements associated with fair value determinations.
Additionally, the Commission is rescinding previously issued guidance on related issues, including the role of the board of directors in determining fair value and the accounting and auditing of fund investments. Both rules are effective March 8, 2021 with a required compliance date of September 8, 2022. The SEC staff has encouraged registrants to reach out with any inquiries related to adoption of these rule and also offered the following observations in response to questions from EP members:

- From an accounting perspective, the release acknowledges the applicability of FASB ASC Topic 820 to fair value determinations to registered investment companies and business development companies...
- Early adoption is allowed as long as the rule is adopted in its entirety.
- The new rules are under the Investment Company Act of 1940, therefore, while the rule includes procedures that the Staff believe are best practice, they are not required to be applied by non-registered investment companies.

8. Emerging markets recent developments:

a. ADI 2020-11 Registered Funds' Risk Disclosure Regarding Investments in Emerging Markets
b. On December 18, 2020, President Trump signed into law the Holding Foreign Companies Accountable Act, which amends the Sarbanes-Oxley Act 2002 and requires the SEC to take actions to increase oversight of Chinese companies listed on US stock exchanges.
c. On November 12, 2020, President Trump issued Executive Order 13959, Addressing the Threat From Securities Investments That Finance Communist Chinese Military Companies, which restricted U.S. investors from transacting in certain securities in China.
d. NYSE recent activities regarding delisting certain Chinese stocks
e. The SEC Division of Examination Risk Alert "Executive Order on Securities Investments that Finance Communist Chinese Military Companies"

9. Digital assets related activities:

a. Many have reported that the spike in the price of bitcoin renewed investors' interest in digital assets, including interest in investor exposure through exchange traded products. The SEC staff noted very limited exposure by RICs through investment in digital asset futures and other exchange traded products (such as GBTC) but not through direct investments in digital assets. The SEC IM staff encouraged registrants that are interested in gaining any exposure in digital assets or related instruments to consult with them about their interest and intent before filing a registration statement.

b. The staff of the Division of Investment Management issued a Staff Statement in response to Wyoming Division of Banking's no-action letter "NAL on Custody of Digital Assets and Qualified Custodian Status" to Two Ocean, a wealth management firm hoping to offer custodial services for digital assets and become a qualified custodian under the Investment Advisers Act of 1940. In the statement, the SEC staff noted that they are not bound by the Wyoming Division of Banking's determination and encouraged interested parties to engage with the SEC staff directly on the application of the Custody Rule to digital assets, including with respect to the definition of qualified custodian under the rule. The Staff Statement also include a request for comment related to the topic of qualified custodians.

c. The staff of the Division of Trading and Markets issued a statement and request for comment regarding the custody of digital asset securities by broker-dealers in order to encourage innovation around the application of Securities Exchange Act Rule 15c3-3 to digital assets.

d. The Office of the Comptroller of the Currency (OCC) recently announced conditional approval of the conversion of Anchorage Trust Company, a South Dakota chartered trust company, to become Anchorage Digital Bank, National Association, with the intention to custody digital assets.

10. Enforcement case update:

a. ICE Data Pricing & Reference Data LLC

b. Cheesecake factory COVID-19 related enforcement action

11. At the recent AICPA Conference on Current SEC & PCAOB Developments, the staff from the Division of Corporation Finance (CF) addressed transition matters relating to the SEC's amendments to financial disclosures about acquired and disposed businesses. For purposes of S-X Rules 3-09 and 4-08(g), the CF staff expressed a view that in a Form 10-K filed after the compliance date of the rule, a registrant is required to recompute the prior-year significance of its equity method investees using the amended income test. The EP members inquired whether the IM staff apply the guidance similarly for IM registrants, that is, for purposes of S-X Rules 3-09 and 4-08(g), whether BDCs would recompute the prior year significance of unconsolidated subsidiaries using the amended investment and income tests in new rule 1-02(w)(2).

Consider the following example: In a BDC's 2019 10-K, the BDC's investment in Investee A was significant and tripped the income test at 12%. In accordance with S-X Rule 4-08(g), the BDC included summarized financial information for Investee A in its 2019 audited financial statements for each year presented. For purposes of its 10-K filing for its 12/31/20 year-end, the BDC elects voluntary early compliance with the amended rules.

Using the amended significance tests, assume that Investee A would not trip the thresholds for 4-08(g) in 2020 using the amended tests. Also, in recomputing significance for Investee A for 2019 and 2018 using the amended income and investment tests in S-X Rule 1-02(w)(2), Investee A would not trip 4-08(g). Question: Could the BDC exclude summarized financial information for Investee A from its 2020 10-K for all years presented?

Answer: Yes, if the amended significance tests in 1-02(w)(2) were computed by the BDC and Investee A does not trip the thresholds for 4-08(g) in any of the years presented in the 2020 10-K, the registrant would not need to provide the summarized financial information required of by 4-08(g) in the registrant's 2020 10-K for Investee A.

Financial Reporting Center

AICPA Investment Companies Expert Panel

Meeting highlights

March 22-23, 2021

I. AICPA/Administrative:

1. AICPA Investment Companies Expert Panel (EP) January meetings highlights are available here.
2. The AICPA new volunteer year will start late May 2021. The AICPA staff and EP chair discussed 2021 volunteer year EP composition and sought EP members' assistance with recruiting potential EP members.
3. The AICPA staff and the EP have explored an idea of potential AICPA Investment Companies conference.
4. The AICPA staff offered timing for the conforming changes review for the 2021 AICPA Audit and Accounting Guide *Investment Companies* (the guide).

II. Accounting/Reporting Issues:

1. The EP considered a scenario where a private equity fund (PE fund) has guaranteed the debt of a portfolio company (a noninvestment company) which the PE fund holds a controlling financial interest in but is not consolidated by the PE fund. FASB ASC 460-10-25-1(f) provides a scope exception to the recognition provisions of Topic 460 for a guarantee issued either between parents and their subsidiaries or between companies under common control. The EP member inquired whether the PE fund is required to recognize the guarantee under ASC Topic 460, or, alternatively, if the PE fund should consider the guarantee in determining the fair value of the portfolio company (would a market participant consider the existence of the guarantee in a transaction). Some EP members observed that in this scenario, as the PE fund holds a controlling financial interest in a portfolio company (a noninvestment company) that the PE fund has not consolidated, such a relationship maybe viewed as akin to a relationship between a parent and a subsidiary, and thus, would qualify for a scope exception. Regardless, EP members observed that the PE fund could consider the impact of the guarantee in determining the fair value.
2. The EP members shared experiences about funds that issue a combination of debt and equity interests to investors or debt with equity-like features. The EP members discussed the presentation of financial highlights in these funds. Per FASB ASC 946-205-50, only equity class shares would be required for disclosure. However, some EP members noted that a fund may choose to present supplemental disclosures combining the debt and equity elements for ratio calculation. Please also refer to April 2020 meeting highlights. The EP will revisit this topic at the May 2021 meeting.

3. The Expert Panel members shared recent experience with special purpose acquisition companies (SPACs). Please refer to prior meeting highlights from November 16, 17, 23, 2020 and January 19 and 21, 2021.

III. SEC Staff Update

Disclaimer

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The SEC Chief Accountant and Assistant Chief Accountants and Branch Chiefs for the Division of Investment Management joined the EP meeting to share the following observations and updates.

1. Money Market Funds (MMFs) reform: the SEC requests comments on potential reform measures to improve the resilience of money market funds as highlighted in a report of the President's Working Group on Financial Markets issued in December 2020.
2. Recent speeches and letters by the SEC Commissioners and staff:
    a. By Commissioner Hester M. Peirce:
        - Small World, March 1, 2021
        - Atomic Trading, Feb. 22, 2021
    b. Division of Corporation Finance (CF) Sample Letter to Companies Regarding Securities Offerings During Times of Extreme Price Volatility
    c. Acting Chair Allison Herren Lee's Every Vote Counts: The Importance of Fund Voting and Disclosure. March 17, 2021
    d. Remarks made at the March 19, 2021, Asset Management Advisory Committee (AMAC) meeting, focusing on promoting diverse actions among registrants in the asset management industry, including manager selection; including demographics on Form ADV; actions related to "pay to play" rule; and facilitating remediation for discriminatory business practices
3. Environmental, social, and governance (ESG) related:
    a. New landing page to bring together agency information on ESG, including
        - Creation of a new Task Force within Division of Enforcement to identify ESG misconduct-related matters
        - Investor bulletin related to ESG funds
        - Request for comments related to climate disclosures from Acting Chair Lee. Recent speech by commissioner Roisman included additional questions
    b. Remarks at Asset Management Advisory Committee Meeting by Commissioner Peirce
    c. The IFRS Foundation has published a Consultation Paper to assess demand for global sustainability standards.
4. SPACs and private investments in public entity (PIPEs)
    a. The SEC IM staff noted considerable amount of market activity, 25 % of IPOs in 2020 were SPACs. These issuers are generally regulated by the SEC Division of

CorpFin and should consider CF Disclosure Guidance: Topic No. 11 issued December 22, 2020.

b. Celebrity Involvement with SPACs – Investor Alert
c. The SEC noted limited exposure of SPAC in investment management space and highlighted relevant disclosures regarding restrictions of shares held (they may have different rights and lockup period), consistency between information included in Form N-PORT and financial statements, disclosures on commitments (e.g. PIPE funding) and related party considerations (e.g. funds sponsors could be sponsors of SPACs).

5. Emerging markets update:
   a. ADI 2020-11 Registered Funds' Risk Disclosure Regarding Investments in Emerging Markets
   b. The SEC announced the adoption of interim final amendments to implement the congressionally mandated Holding Foreign Companies Accountable Act's submission and disclosure requirements. The interim final amendments will apply to registrants that the Commission identifies as having filed an annual report with an audit report issued by a registered public accounting firm that is located in a foreign jurisdiction and that the PCAOB is unable to inspect or investigate completely because of a position taken by an authority in that jurisdiction.

6. Investment Company Shareholder Report and Modernization of Certain Investment Company Disclosure – comment period ended in January 2021. The SEC staff shared an overview of the comment letters received on the proposed rule.

7. Final rule Good Faith Determinations of Fair Value:
   a. The staff of the Division of Investment Management has issued the following responses to questions related to the adoption of rules 2a-5 and 31a-4 under the Investment Company Act of 1940 (the Act):
      - Regarding withdrawing certain past guidance, including ASR 118. The SEC staff would not object if an independent public accountant chooses to stop looking to the auditing guidance contained in ASR 118 and instead determines the appropriate audit approach (sampling) by following only the relevant PCAOB auditing standards any time after March 8, 2021, the effective date of the release.
      - Regarding interaction of Rule 2a-5 definition of "readily available market quotations" with other rules under the Act, including rule 17a-7. While the Commission provided an eighteen-month transition period beginning on the effective date of rule 2a-5 (March 8, 2021) until its compliance date (Sept. 8, 2022) for rule 2a-5, funds may choose to begin complying with rule 2a-5 at any time after the new rule's effective date. However, funds would not be required to comply with rule 2a-5, including its definition of "readily available market quotations," until rule 2a-5's compliance date. This new definition applies in all contexts under the Act, including to determine whether a security may be cross-traded under rule 17a-7, and not just to valuation matters subject to rule 2a-5. Nevertheless, if a fund chooses to comply with rule 2a-5 before its compliance date, the staff would not object if the fund does not apply rule 2a-5's definition of readily available market quotations to

its cross-trading practices under rule 17a-7 until the Sept. 8, 2022 compliance date.

b. The SEC staff also shared the following remarks and observations:
   - The board should have a process in place to fair value the fund's investments when price quotations are not reliable and therefore, not readily available. Rule 2a-5 has not made changes to FASB ASC 820 nor prescribed any incremental guidance.
   - The final rule requires the boards apply an appropriate (consistent with FASB ASC 820) methodology to determine fair value and have it applied in a consistent manner. This requirement is not intended to limit the boards, yet, it would prevent "cherry picking" to achieve a more favorable outcome without justification.
   - The rule is within the Investment Company Act of 1940. Therefore, if there are differences in determining fair value for different funds under the same board, the board would need to explain why these differences are justifiable, supportable, and documented. One example of justifiable differences could be funds that have merged over time that use different pricing conventions (mid vs bid pricing). The SEC staff encourage registrants to reach out with specific facts should they have questions.
   - Regarding the final rules prompt reporting requirement and the interaction with the internal controls over financial reporting on Form N-CEN, the staff was asked whether a material valuation matter would always result in a material weakness in financial reporting. The staff believes there is likely an overlap but recognize that this determination will be on a situational basis. The specific facts and circumstances of each reporting matter will have to be individually evaluated in determining whether a material weakness exists.
   - The SEC staff received a question whether the final rule applies to private funds and their advisers. The final rule is within the Investment Company Act of 1940, so it applies to registered investment companies and business development companies regulated under the Act. However, to the extent a registered investment adviser (RIA) has both private and public funds under management, RIAs should consider their fiduciary responsibility over funds under management as many of the provisions of the rule would be prudent considerations for private fund managers to consider in their policies and procedures over fair value.
   - In response to an EP member's question, the SEC staff noted that the SEC issued an order approving Infinity Q Diversified Alpha Fund's request under Section 22(e) of the Investment Company Act to temporarily suspend redemptions in the fund and referred members to such order for further information.

8. Division of Examinations Update:

a. "Continued Focus on Digital Asset Securities" risk alert highlights risks identified from recent examinations of investment advisers managing digital assets securities, either directly or indirectly. The alert identifies focus of future examinations of investment advisers on compliance with portfolio management, books and records, custody, disclosure, pricing, valuation and registration. For broker-dealers, the

exams will focus on safekeeping of customer funds, registration, AML program, offering, outside business activities and disclosure of conflicts of interest. For national exchanges, the exams will focus on exchange's registration to facilitate electronic trading of digital asset securities.

b. The SEC Division of Examinations has issued "2021 Examination Priorities" with greater focus on climate related risk, implementation of Regulation Best Interest by brokers and registered investment advisers, and on FinTech, including digital assets.

9. Division of Enforcement Update: SEC charged a ratings agency with disclosure and internal controls failures.

AICPA

Financial Reporting Center

AICPA Investment Companies Expert Panel

Meeting highlights

May 17-18, 2021

I. AICPA/Administrative:

1. The AICPA Investment Companies Expert Panel (EP) March meetings highlights are being finalized.
2. The EP and staff considered timing and format of the potential AICPA Investment Companies conference.
3. The EP considered timing of final review and reviewer's comments for the 2021 AICPA Audit and Accounting Guide *Investment Companies* (the guide).

II. Accounting/Reporting Issues:

1. The EP discussed their observations on increased or enhanced disclosures by funds about the discontinuation of LIBOR. The EP members noted that the SEC Staff Statement on LIBOR Transition addresses risk disclosure considerations relating to LIBOR discontinuation. Some EP members observed that funds have included general disclosures about the discontinuation of LIBOR, while other EP members observed that some funds have taken the view that there has not been enough actual movement from LIBOR yet to warrant a change. An EP member brought up the application of the relief guidance from FASB Accounting Standards Update No. 2020-04 which permits certain changes resulting from LIBOR transition to be treated as a continuation of an existing contract rather than as a contract modification or extinguishment. The EP members also discussed whether there were uncertainties relating to valuation relating from LIBOR discontinuation that would require disclosure.
2. The EP continued its discussion of whether there are any circumstances in which gross presentation of the PIPE commitments would be acceptable. Please refer to prior meeting highlights from November 2020 and January 2021 for more information and EP views expressed during those discussions.
   At the May 2021 meeting, the EP discussed that some funds may record PIPE commitments gross for operational purposes. One member observed that all facts and circumstances should be considered. The EP generally noted that the funds should present PIPE commitments on a net fair value basis for financial reporting purposes. Some members expressed a view that it may be reasonable to present a gross asset

and liability for the brief period between resolution of all contingencies and receipt of the underlying SPAC shares.

3. The EP members considered how to fair value digital assets on continuously open exchanges in context of the SEC Rule 2a-5 and monitoring aftermarket events. The EP will continue conversations on this topic at future meetings.
4. The EP members considered how an entity with investments in digital assets would account for significant events, like air drops and hard forks, where it receives additional or new digital assets. Please also refer to the SEC Staff Update portions of March and May 2018 meetings for previous discussions related to air drops and hard forks. The EP will continue discussing this topic at future meeting.
5. The EP members discussed whether it would be acceptable to apply the SEC staff guidance from the March 2005 minutes [which allowing the presentation of a range of maturities and coupon rates of U.S. government and Agency securities in a full schedule of investments] to any other types of securities in a condensed schedule of investments for investments that exceed 5% of a private fund's net assets. Some EP members expressed a view that it may under certain circumstances be acceptable to group other assets, such as those issued by non-U.S. governments. The EP will continue discussing this topic at a future meeting.
6. The EP considered a scenario where a master fund issues both debt and equity interests to a single feeder fund. The feeder fund determined to use the master-feeder reporting model and does not consolidate the master fund. The EP discussed whether the feeder fund may present interest income on the debt securities it holds in the master fund and the interest recognized by the master fund as part of the gain/loss from investment in the master fund, similar to a fund of funds presentation, rather than interest expense allocated from the master fund or if these amounts should be eliminated. The EP members noted this is not likely a common scenario and no prescribed model exists.

III. SEC Staff Update

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1. The SEC staff discussed recent SEC leadership appointments.
2. Recent speeches and statements by the SEC Commissioners and staff:
    a. May 6, 2021, Chair Gary Gensler Testimony Before the House Committee on Financial Services
    b. April 30, 2021, Chair Gary Gensler Prepared Remarks at SEC Small Business Capital Formation Advisory Committee Meeting
    c. April 28, 2021, Commissioner Hester M. Peirce Werewolves of Change: Remarks before the ISDA Derivatives Trading Forum on Regulatory Change
    d. April 12, 2021, Commissioner Hester M. Peirce Statement on the Staff ESG Risk Alert

3. April 15, 2021, IM staff statements:
    a. IM Staff Releases an Analysis of Prime Money Market Funds at the Onset of the Pandemic (PDF)
    b. Division of Investment Management Staff Statement Regarding Termination Notice for Exemptive Relief and Withdrawal of Staff Letters Related to COVID-19 Response
4. May 11, 2021 Staff Statement on Funds Registered Under the Investment Company Act Investing in the Bitcoin Futures Market
5. SPACs:
    a. April 12, 2021 Staff Statement on Accounting and Reporting Considerations for Warrants Issued by Special Purpose Acquisition Companies ("SPACs") by John Coates, Acting Director, Division of Corporation Finance and Paul Munter, Acting Chief Accountant
    b. April 8, 2021SPACs, IPOs and Liability Risk under the Securities Laws by John Coates, Acting Director, Division of Corporation Finance
    c. March 31, 2021 Staff Statement on Select Issues Pertaining to Special Purpose Acquisition Companies by Division of Corporation Finance
    d. March 31, 2021 Financial Reporting and Auditing Considerations of Companies Merging with SPACs by Paul Munter, Acting Chief Accountant
6. Holding Foreign Companies Accountable Act Disclosure and related PCAOB proposed rule
7. Latest "Dear CFO Letter" March 30, 2021 - the Chief Accountant's Office of the Division of Investment Management issued a letter directed to the Chief Financial Officer of the Division's registrants and other relevant parties to assist investment company registrants and their independent public accountants in addressing certain accounting matters. The SEC staff has withdrawn 3 positions, modified 5 positions and included 1 new position:
    a. Withdrawn 1994-02 Valuation of Certain Portfolio Investments
    b. Withdrawn 1997-03 Designation of Segregated Assets
    c. Withdrawn 1998-07 Financial Data Schedules
    d. Modified 1995-11 Pro Forma Fee Tables and Capitalization Tables
    e. Modified 1997-01 Foreign Pricing Considerations
    f. Modified 1997-06 Closed-End Fund Expense Ratios – Dividend Payments
    g. Modified 2001-06 Filings Pursuant to Rule 488 of the Securities Act of 1933
    h. Modified 2020-03 Combined Financial Statements for Compliance with Advisers Act Rule 206(4)-2
    i. Added 2021-01 Insurance Products Transitioning to SAP from GAAP per Provision or Request
2. The SEC staff offered the following financial statement review comments:
    a. The SEC staff noted that certain funds are excluding total realized gain/loss from their 17a-7 quantitative disclosures. The SEC staff reminded that for related party transactions under section 17a-7 of the Investment Company Act of 1940, disclosure requirements under FASB ASC 850 apply. The SEC staff most recently discussed this topic at the January 2016 EP meeting, including sharing examples of qualitative and quantitative disclosures that

registrants used in filings in accordance with FASB ASC 850 guidance, such as:

- Qualitative – disclosures on fund's general program, including existence and nature of transaction of related party and review those transactions for compliance with the rule
- Quantitative – aggregate purchase and sales or realized gain/loss by fund.

The staff will issue comments for related party transactions lacking relevant disclosures unless immaterial.

3. As registered investment companies and business development companies transition away from LIBOR transition following the issuance of FASB ASUs 2020-04 and 2021, the SEC staff reminded that in evaluating the impact of these ASUs on the registrants' operations, registrants should consider SAB 74 Topic 11, section M guidance. This disclosure applies to all accounting standards issued and not yet adopted unless the impact is not expected to be material.

4. Observations on SEC Rule 8b-16 disclosures for closed end funds. Some closed end funds include information, such as objectives, strategy and risks, in notes to financial statements, others include a section outside of the notes, while others include it elsewhere. The rule does not explicitly describe where disclosures should be placed but the intention of the rule is to make easier for shareholder to find them. These disclosures should be combined in a separate section in MDP or elsewhere, but not in the notes to financial statements.

5. The SEC staff has offered the following observations:

a. The registrant should include an auditor's consent in the form 10-K. Refer to the May 2020 SEC Staff Update for more information.

b. If a registrant includes audited financial statements of a majority-owned subsidiary in its filing in accordance with the SEC Rule 3-09, the registrant should also include an opining auditor's consent [for the majority owned subsidiary's financial statements] in this filing.

c. Registrants should include a consent from a predecessor auditor if the financial statements audited by the predecessor auditor are included in the registrant's filing. "Dear CFO letter 1998-04" states, in part:

> the Staff generally believes the consent requirement is most important for investment companies for the years for which the traditional components of the financial statements are presented, including the statement of assets and liabilities, including the schedule of investments, statement of operations, statement of changes in net assets, statement of cash flows, if applicable, and the notes to the financial statements. It has been our observation that the practice by registered investment companies has been to include an accountant's consent in the filing made in the year following the registrant's change in accountant. The Staff has historically not objected to that practice.

d. The staff noted instances where a predecessor auditor's consent only mentioned financial highlights but not all financial statements that have been audited.

e. As it relates to Form N-14, the staff noted several instances where auditor consent referenced incorrect registrant (for example, target registrant but not the registrant that files Form N-14). "Dear CFO letter 2001-06" specifically noted that when an investment company files "a registration statement on Form N-14 when merging investment companies and may elect to file pursuant to Rule 488 under the 1933 Act, designating an automatic effective date for the registration statement thirty to fifty days after filing", the filing that does not include "the required audited annual financial statements, unaudited semi-annual financial statements (if applicable), supplemental financial information, consents, fee tables, capitalization tables or correct series and class identifier information or that require material revisions to the disclosure are considered materially incomplete by the staff."
f. The staff noted diversity in registrants' responses regarding disclosing if there are any material differences in accounting policies and if transaction results in a material change. Sometimes, the registrants only focus on valuation policies. Best practice is to include a definitive statement addressing all disclosure requirements.
g. The staff shared that when a registered investment company acquires a private fund, it is acceptable for financial statements of a private fund to have a GAAS audit opinion. However, as a reminder, those financial statements must be accompanied by the full schedule of investments (condensed schedule of investments is not permitted under Rule 6-11 of Regulation S-X).

6. N-CEN and N-PORT forms related comments:

a. If a fund is an in-kind exchange-traded fund (ETF) as defined in rule 22e-4 under the Act, it should clearly indicate that in Item E.5 on the Form N-CEN.
b. Item C.2.d of Form N-PORT requires a registered investment company or an ETF disclose a value of each investment as a percentage value to net assets of the fund. For consistency, the registrant should use a whole value as opposed to decimal.
c. The SEC staff reminded that registrants should holistically review information included in forms N-CEN and N-PORT to ensure no divergence exists between information reported on two forms.
d. The SEC has recently issued an updated FAQ outlining calculation methodologies for the "monthly average of the value of portfolio securities on loan" and the "monthly average net assets during the reporting period" for the form N-CEN that are best practices.

7. The EP sought the SEC staff's views regarding the application of FASB ASC 805 to fund mergers and asset acquisitions. The SEC staff acknowledged diversity in Form N-14 submissions. As stated in the AICPA TQA 6910.33, "A registration statement on Form N-14 is often filed in connection with a merger of management investment companies registered under the Investment Company Act of 1940 (the Act), or of business development companies as defined by the Act." The industry generally follows accounting described in the TQA 6910.33 for registered investment companies' mergers, which states that "an investment company, which is an acquirer

in a business combination structured as a tax-free exchange of shares, may make an accounting policy election to carry forward the historical cost basis of the acquiree's investment securities for purposes of measuring realized and unrealized gain or loss for statement of operations presentation in order to more closely align the subsequent reporting of realized gains by the combined entity with tax-basis gains distributable to shareholders. The basis for such policy election should be disclosed in the notes to the financial statements, if material." Generally, the SEC staff has not objected to registered investment companies making such policy elections.

However, the SEC staff acknowledged that there are a number of differences between BDCs and registered investment companies, and because of those differences, the SEC staff generally believe that BDCs should follow FASB ASC 805 asset acquisition accounting which would not allow carry forward of the acquiree's investments at their historical cost basis.

AICPA

Financial Reporting Center

AICPA Investment Companies Expert Panel

Meeting highlights

July 19-20, 2021

I. AICPA/Administrative:

1. AICPA Investment Companies Expert Panel (EP) May meetings highlights are being finalized.
2. The EP and staff discussed possible timing and format of the potential AICPA Investment Companies conference.
3. The EP and staff briefly discussed several current environmental, social, and governance (ESG) reporting activities related to asset managers and investment companies. The EP will continue monitoring ESG initiatives and engage as needed.

II. Accounting/Reporting Issues:

1. The EP members are monitoring FASB developments regarding fair value measurement of equity securities subject to contractual sale restrictions project.
2. The EP members considered whether cryptocurrency staking would impact an entity's status as an investment company. Staking is a consensus mechanism used for certain cryptocurrencies to verify transactions within the blockchain. At the September 2019 meeting, the EP members considered situations where cryptocurrency mining may disqualify an entity from being an investment company. Similar to mining activities, staking participants contribute to the validation of transactions to the blockchain and can earn additional cryptocurrency in exchange. However, in contrast to mining, some forms of staking involve depositing a portion of an entity's cryptocurrencies to guarantee the legitimacy of new transactions added to the blockchain, rather than validating cryptocurrency transactions through complex proof of work computations. In addition, staking generally requires the deposited cryptocurrencies to be locked up for a certain period of time, and participants can lose part of their stake if they attempt to attack the network or if transactions are discovered to be invalid. Some of the EP members discussed whether staking activities could be analogous to securities lending activities, which generates investment income and may be consistent with the activities of an investment company. One EP member observed an instance of a staking fee as being significantly higher than returns customary to securities lending and questioned whether such returns would be commensurate with the substantive activities to generate investment income. The EP members will continue this discussion at a future meeting.

3. The EP continued its discussion from the May 2021 meeting regarding airdrops of digital assets. An EP member discussed allocating a portion of the cost basis from a preexisting digital asset held by a fund (Crypto A) to an airdrop of a newly created digital asset (Crypto B) on a relative fair value basis (or using an alternative allocation basis in systemic and rational manner) when there is no preexisting connection between Crypto A and Crypto B. The EP discussed whether in those circumstances, an airdrop would not be analogous to a spinoff or a stock dividend, but rather a fund is instead receiving the airdrop as part of the promotion of the newly created digital asset (i.e., Crypto B). The EP members will consider discussing this topic at a future meeting.
4. The EP discussed potential considerations of cross trades involving digital assets between funds and other related parties. The EP will revisit this topic in the future.
5. The EP discussed potential accounting issues when a fund is the lead lender in a loan syndication. In a loan syndication arrangement, a group of lenders agree to fund a particular loan, with each lender assuming a direct creditor relationship with the borrower but with uniform lending terms applied by all the lenders in the group. The entity that manages the syndication is referred to as the syndicator. Typically, the group will appoint one lender as the agent or lead institution, or the syndicator may act as the agent or lead lender if it retains a portion of the syndicated loan. The lead institution may also service all loans in the group. In those circumstances, the lead lender functions as a servicer and does not recognize the aggregate loan as an asset. In circumstances where some of the lenders in the group are not involved in the negotiation of the lending terms at the inception of the arrangement, the arrangement may be considered to be a loan participation rather than a loan syndicate, particularly if those lending participants do not have the same lending rates as the initial group. If the arrangement is not considered to be a loan syndication, this may require an analysis on whether sale accounting under FASB ASC Topic 860 is met. An EP member encountered an instance where a business development company (BDC) is the lead lender under the arrangement, and if the conditions for a loan syndication are not met, it could have implications on whether the arrangement would be evaluated under ASC 860 as sale accounting or a secured borrowing, which the latter could have an impact to a BDC's asset coverage ratios. Other EP members mentioned that the determination would depend on the facts and circumstances and should consider whether all the lenders are at the same negotiating table at the inception of the arrangement, whether the entity is involved in direct lending or is part of a syndicate, and whether any of the entities have entered into different terms under the arrangement.
6. The EP discussed their experiences and observations with investment advisors that have recently or are planning to go public that have preexisting profits interests arrangements, where certain employees of the adviser receive a share of the adviser's incentive allocation or carried interests in the form of partnership or LLC distributions. The EP will consider continuing this discussion at a future meeting.
7. The EP discussed a scenario where a fund that invests directly (or through a wholly owned subsidiary formed by the fund manager) in aviation assets (such as aircraft or engines) that are leased to third parties. The EP considered whether such activities would be consistent with the fundamental characteristics of an investment company if it was engaged in the origination of leases or the maintenance or improvements of the leased assets. The EP members discussed that the determination of whether such activities would be consistent with

the fundamental characteristics of an investment company would require professional judgment.

III. SEC Staff Update

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1. The SEC staff updated the EP members on the recent SEC leadership appointments.
2. Recent speeches and statements by the SEC Commissioners and staff and other Commission activities relevant to investment companies and investment advisers:
    a. Prepared Remarks LIBOR Statement Before the Financial Stability Oversight Council by Chair Gary Gensler June 11, 2021
    b. The SEC staff highlighted several forthcoming topics, including Amendments to the Custody Rules for Investment Advisers, Amendments to the Custody Rules for Investment Companies, Amendments to Rule 17a-7 Under the Investment Company Act, Money Market Fund Reforms, rules related to ESG factors for investment companies and investment advisers, and SPACs, from the SEC agency rule Spring 2021 agenda.
    c. July 7, 2021, AMAC meeting where two subcommittees presented recommendations to the SEC before voting on diversity and inclusion and ESG initiatives.
3. Reporting focus updates:
    a. In connection with an increased number of inquiries on European tax reclaims, the SEC staff revisited the previously discussed (see March 2018 and September 2020 SEC Staff Updates) topic of accounting treatment of foreign withholding tax reclaims received by U.S. regulated investment companies (RICs) due to favorable court rulings, where certain European countries have paid refunds (reclaims) of dividend withholding taxes previously withheld by these European countries.
    The SEC staff acknowledged application of FASB ASC 740 guidance on reclaims, which would result in recognition of a receivable for the reclaim if it is "more likely than not" (MLTN) that the tax position would be sustainable and then identifying the greatest amount of reclaim that is more likely than not to be received. As stated in November 2020 meeting, the SEC staff have not objected to registrants accounting for the reclaims under FASB ASC Topic 740 and the IRS compliance fee as contra-income versus expense.
    The Staff also provided observation related to presentation of the reclaimed income on the statement of operations. Considering the requirements of Regulation S-X 6-07, the Staff generally expects foreign tax reclaims to be presented separately from dividend income on the statement of operations when the reclaimed income exceeds 5% of total investment income.
    As it relates to professional fees paid to accountants and lawyers that assist RICs in receiving the reclaims, the SEC staff received a question regarding whether such fees could be offset against the related income when the professional fees are

contingent upon ultimate collection of the reclaimed income. In this case the SEC staff concluded that they would object to net presentation and would expect RICs present these professional fees as an expense on the statement of operations.
The SEC staff reiterated their previous comments from September 2020 meeting that the audit fees, proxy fees, or professional fees in connection with filing foreign tax reclaims should not be treated as extraordinary for annual fund operating expenses presentation within the registration statement when the fees exist for more than one year or would be expected to occur in future periods. The staff reminded registrants that an item or transaction would need to be both unusual in nature and infrequent in occurrence to potentially qualify as "extraordinary". The staff acknowledged that compliance with expense limitation agreements is a separate legal determination.

b. Fund mergers (Form N-14) activities:
The SEC staff requested funds clearly disclose an "accounting survivor" when filing Form N-14 with the Commission. Excluding it from Form N-14 could result in delay in processing the registration statement.
The SEC staff noted they have had questions on several recent accounting survivor analyses. They also noted that in situations where multiple funds have merged into a single newly formed entity (a "shell" entity), they would not expect the shell entity to be determined to be the accounting survivor. The staff reminded registrants to consider the guidance in North American Security Trust no-action letter (pub. avail. Aug. 5, 1994). As previously described in May 2016 (and discussed in May 2012 and other prior meetings), that letter identified five factors, including 1) investment advisers, 2) investment objectives, policies, and restrictions, 3) expense structures and expense ratios, 4) asset size, and 5) portfolio composition (NAST Factors) in determining which entity is the performance and accounting survivor. The SEC staff also revisited the scenarios previously discussed at the May 2016 and September 2009 Expert Panel meetings where the staff objected to the registrant's determination of an accounting survivor. Refer to those meeting highlights for more information. The staff also encouraged the registrant reach out with specific facts and circumstances.

c. Timely filing requirements:
    1. As most recently communicated during September 2019 SEC Staff Update, the SEC staff reminded 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. Refer to September 2019 meeting highlights for additional information.

The SEC staff also highlighted the SEC Rule (and related Form) 12b-25 - when delayed filing is requested by a registrant due to anticipated restatement or correction, Form NT should be amended. The SEC staff shared that recently, the SEC have brought the enforcement actions eight companies for failure to disclose in SEC Form 12b-25 (notification of a late filing) that their request for delay in annual or quarterly filing was due to anticipated restatement or correction of prior financial reporting.

AICPA

Financial Reporting Center

AICPA Investment Companies Expert Panel

Meeting highlights

September 20, 23, 27, 2021 meeting highlights

I. Accounting/Reporting Issues:

1. Representatives of the AICPA Digital Assets Working Group joined the Expert Panel (EP) meeting to discuss the following topics:
    a. The EP previously discussed potential considerations of cross trades involving digital assets between funds and other related parties. An EP member raised the issue that given the anonymity of blockchain transactions, there may be auditing challenges in identifying related party transactions, as well as potential risks of self-dealing between a fund and its related parties or market manipulation. Another EP member discussed the differences between transactions that take place on the blockchain and those that take place off the blockchain and noted that there would not be anonymity between book transfers between entities that are not on the blockchain. The EP members and representatives of the AICPA Digital Assets Working Group representatives acknowledged facts and circumstances would determine the audit approach.
    b. The EP revisited the May 2021 meeting discussion regarding airdrops of digital assets. An EP member previously discussed allocating a portion of the cost basis from a preexisting digital asset held by a fund (Crypto A) to an airdrop of a newly created digital asset (Crypto B) on a relative fair value basis (or using an alternative allocation basis in a systemic and rational manner) when there is no preexisting connection between Crypto A and Crypto B. The EP discussed whether in those circumstances, an airdrop would not be analogous to a spinoff or a stock dividend, but rather a fund is instead receiving the airdrop as part of the promotion of the newly created digital asset (i.e., Crypto B). The group discussed that the majority of "dropped" digital assets have no or little value and are promotional in nature. As a result, these airdrops may not correlate to the already owned digital assets; therefore, it may be inappropriate to allocate a portion of the cost basis from a preexisting digital asset to a newly created one. EP members acknowledged that in many cases these may not be material.
    c. The EP also discussed accounting and financial reporting considerations including

- cash flow statement presentation for trading one digital asset for another - would transactions be considered non-cash transactions and therefore, be parenthetically disclosed, or should they be grossed up;
- accounting considerations for stable cryptocurrencies;
- presentation on the schedule of investments - whether country and industry disclosure is appropriate;
- considerations around credit risk disclosures, when digital assets are held through a private wallet on behalf of the fund.

d. The EP also discussed balance sheet presentation of digital assets, specifically whether they should be presented within the schedule of investments as investments owned or in a separate line item on the balance sheet. The EP members expressed a view that if the investment company invests in digital assets or cryptocurrency, then such assets would meet a definition of investments and should be separately presented on the balance sheet at fair value and also included in schedule of investments as investments owned.

2. The EP members offered initial observations on recent FASB Exposure Draft on equity securities subject to contractual restrictions.

3. The EP discussed investment companies focused on real estate that hold investment portfolios through underlying holding companies. If these underlying holding companies are determined to be investment companies under FASB ASC 946 and the reporting investment company's proportional share of any investment owned by an individual investee exceeds 5% of the reporting company's net assets at the reporting date, each such investment should be named and categorized in accordance with FASB ASC 946-210-50-9. The EP members shared that certain investment companies may acquire (and eventually would exit) a portfolio of real estate investments as a group of assets. The EP discussed potential implications related to disclosures. Certain EP members discussed that the financial statement preparer should focus on what information may be most useful and significant to the users of the financial statements. Such disclosures may include the type of real estate investments held within the portfolio (for example, are they residential properties or commercial properties), the number of properties that make up the portfolio, and/or any specific geographic concentration.

4. The EP discussed accounting for loan origination costs incurred by an investment company. If an investment company incurs direct loan origination costs as defined by ASC 310-20-20 (either payable by the investment company to a third party or incurred directly by an internally managed investment company (i.e., the internally managed investment company's employees perform loan origination activities)) in connection with a loan made by an investment company to a borrower, the EP considered whether it would be appropriate for an investment company to analogize to the guidance in FASB ASC 310-20 to account for these costs in the absence of guidance in Topic 946 [while FASB ASC 946-325-30-1 provides guidance on the accounting for commissions and other charges in a "purchase transaction," this guidance may not apply to loan originations as they are not "purchase transactions."] Generally, applying the guidance in FASB ASC 310-20 results in deferral of loan origination costs and recognizing them as a reduction in yield in accordance with FASB ASC 310-20-35-2. As per the January 2018 EP meeting highlights, the EP discussed the accounting for loan origination fees received

by an investment company and noted certain investment companies follow the guidance in FASB ASC 310-20 by analogy on the income side.
At the September 2021 meeting, certain EP members expressed a view that it seemed reasonable to analogize to the guidance in FASB ASC 310-20 for loan origination costs incurred by an investment company that are payable to a third party. This is not inconsistent with ASC 946 which contemplates capitalizing certain costs incurred in a purchase transaction as opposed to expensing them. The EP considered whether certain internally managed investment companies may follow guidance in FASB ASC 310-20 with respect to loan origination costs incurred directly by the internally managed investment company and how to present these loan origination costs. Since following the guidance in ASC 310-20 could result in compensation costs incurred by an internally managed investment company being recognized as contra interest income as opposed to in compensation expense and excluded from the expense ratio, the EP members expressed a view that if such loan origination costs are significant, a registrant should consider consulting with the SEC staff on whether analogy to ASC 310-20 would be appropriate.

5. The EP revisited a topic from the July 2021 meeting regarding a fund that invests directly (or through a wholly owned subsidiary formed by the fund manager) in aviation assets such as aircraft or engines that are leased to third parties. The EP considered whether engaging in the origination of leases or the maintenance or improvements of the leased assets would be consistent with the fundamental characteristics of an investment company. The EP members discussed that the determination of whether such activities would be consistent with the fundamental characteristics of an investment company would require professional judgment.
At the September 2021 meeting, the EP members discussed a scenario where a registered investment adviser (RIA) with existing funds launches a fund with an aviation-related strategy. The fund obtains capital from investors and debt financing and buys airplanes to lease to third parties. It then hires a third party (or has a joint venture partner) to help find lessees and contracts out all the maintenance, repairs etc. In this scenario, the RIA is not involved in operations and the fund earns cash flows from the leases; at the end of the lease, the fund sells the plane outright or in parts to extract additional capital. Management and performance fees/carried interest are paid to the RIA over the life of the fund, consistent with the RIA's other funds. The EP members agreed that these facts by themselves would not necessarily, impair a potential conclusion that the entity may be an investment company.

The EP members identified several other factors that could be relevant to such determination, including whether the entity views itself as an investment vs. operating company, if the entity has a single investor or multiple investors, how the investors view the entity, and the significance of any fees relating to the origination of the leases. Other relevant factors may include who the competitors of the entity are (other funds or operating companies), whether the operation and maintenance of the aviation assets is being performed by the entity itself or through a third party and how the entity will exit the investments (such as through a sale of the leased asset or sales of individual parts of the assets, which may be consistent with an exit strategy under FASB ASC 946 to extract the remaining value).

II. Audit/Attest Issues:

1. The EP and AICPA staff discussed the following future updates to the AICPA Audit and Accounting Guide *Investment Companies*:
    a. The illustrative examination reports prepared under attestation standards issued by the AICPA in chapter 12 of the guide would be updated when SSAE 21 becomes effective (for reports on or after June 15, 2022) as follows sometime in May 2021 (for the online version of the guide):

        > Our examination was conducted in accordance with attestation standards established by the AICPA.[1]

    Also, immediately after the sentence "We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion." the following paragraph would be added:

        > We are required to be independent and to meet our other ethical responsibilities in accordance with relevant ethical requirements relating to the engagement.

    b. The EP and staff also discussed replacing instances of "the auditor should" throughout the guide.

III. AICPA/Administrative:

1. The 2021 guide has been launched and will be available later this fall.
2. AICPA Investment Companies Expert Panel May and July meetings highlights are being finalized.

[1] American Institute of Certified Public Accountants spelled out is struck out and replaced with AICPA.

IV. SEC Staff Update

Disclaimer

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1. The SEC staff briefly covered the September 14, 2021, testimony by Chairman Gensler Testimony Before the United States Senate Committee on Banking, Housing, and Urban Affairs, which focused on market structure, predictive data analytics, issuers and issuer disclosure, and funds and investment management.
2. China related:
    a. To address challenges with accessing work of registered public accounting firms in certain foreign jurisdictions, including China, the Public Company Accounting Oversight Board (PCAOB) has adopted a new rule related to the PCAOB's responsibilities under the Holding Foreign Companies Accountable Act (HFCAA).
    b. The SEC's Office of Investor Education and Advocacy, along with the Office of the Chief Accountant and the Division of Corporation Finance, has issued an Investor Bulletin to educate individual investors about risks associated with investing in certain companies that provide exposure to China-based businesses. The bulletin addresses common scenarios for a US listed company with a Chinese subsidiary or variable interest entity (VIE) to get around the Chinese laws' restriction on non-Chinese ownership of companies in certain industries.
    c. An EP member asked the staff whether they expected funds to include China-related disclosures in the registration statement or in the financial statements. The SEC staff acknowledged that this would depend on facts and circumstances of the particular registrant, including materiality considerations. Registrants should consider whether these risks constitute principal risks that should be disclosed in the prospectus, and also consider requirements under FASB ASC 275 for inclusion in the financial statements.
3. The staff discussed the FASB Exposure Draft on equity securities subject to contractual restrictions noting that the comment period is open until November 14, 2021 and encouraged people to submit comment letters for consideration.
4. An EP member asked whether it would be acceptable to apply the SEC staff guidance from the March 2005 minutes [allowing the presentation of a range of maturities and coupon rates of U.S. government and Agency securities in a full schedule of investments] to any other types of securities in a condensed schedule of investments for investments that exceed 5% of a fund's net assets. At this time, the staff would object to the expansion of this guidance outside U.S. government and Agency securities. The staff posed questions back to the panel members to better understand the basis for a reduction in disclosure and how that would be beneficial to investors.
5. Business Development Companies (BDCs):

a. The staff reminded registrants that BDCs should file the Form 10 with complete information, including the financial statements, at least 15 days before the effective date of the registration to enable staff enough time to review the complete filing.
b. One of the common reasons for amended filings is when a registrant omits certain financial statement information pursuant to Rule 3-09 under Regulation S-X. The SEC staff mentioned several instances where a BDC's financial statements failed to include a schedule of investments or were missing summarized financial information for a significant unconsolidated joint venture or subsidiary. The staff encouraged registrants to reach out to the staff for consultation, as needed, and also referred registrants to the May 2014 SEC Staff Update, where for BDCs, the SEC staff suggested including, in the notes to their interim and annual financial statements: (1) a schedule of investments of the joint venture that complies with Article 12 of Regulation S-X and (2) summarized financial information of the joint venture. The summarized financial information has typically included detailed information related to the assets, liabilities and results of operations of the joint venture (e.g., investments, cash, other assets, total assets, debt, other liabilities, total liabilities, members equity, interest income, dividend income, other income, total income, management fees, incentive fees, interest expense, other expenses, total expenses, net investment income, change in unrealized gain/loss, realized gain/loss, etc.). BDCs should also evaluate whether to file separate financial statements of the joint venture pursuant to rule 3-09 of Regulation S-X.

6. Operations related:

a. 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 reviews of certain types of investment companies. During the 2021 fiscal year, the SEC staff has reviewed 4,000 individual funds and 700 registration statements.

   The staff highlighted that not every review results in comments issued to a registrant and emphasized a large portion of reviews result in no comments. The staff provided perspectives on reviews and highlighted during SOX reviews the staff reviews its prior comments made to determine whether the registrant has addressed previous staff comments. Comments may be reissued if certain comments are still applicable or have not been addressed.

   In addition, the staff will often evaluate the interplay of disclosures in various forms, as well as compliance with U.S. GAAP, and relevant regulations. The staff's reviews consider consistency between information included in registration statements and the annual report, as well as information included in Forms N-CEN and N-PORT.

   The Staff discussed the following comment letter themes:

- Related party transactions
    - The staff identified inconsistencies between related party disclosures included in the notes to financial statements and information included in the registration statement (e.g., disclosures around a fund's advisors or subadvisors)
    - Reimbursement by management included on form N-CEN, but not disclosed in the financial statements
    - Incomplete disclosures in the financial statements around cross-trades under Rule 17a-7
- Limited or omitted derivative disclosures in Management's Discussion on Fund Performance (MDFP) by investment companies with a significant exposure to derivatives;
- Omitted or generic (as opposed to specific) risk and strategy disclosures about investment exposure in the registration statement.

7. The Staff described an inquiry they received related to Rule 6-11:

a. The registrant files Form N-14 in connection with an acquisition or a merger with another fund. According to rule 6-11, the registrant must provide certain supplemental financial information, including current fees and expenses for the registrant and the acquired fund and pro forma fees, if different, for the registrant after the acquisition is effective. The SEC staff provided a scenario where an amended N-2 was filed in between the period of shareholder approval and effectiveness. The staff did not take exception to including both the current fees of the existing entity and the pro forma fees of the proposed merged entity. The SEC staff provided a view on the location of such supplemental information – in prospectus and not in the fee table. The staff noted that management would need to consider the location of the fees and expenses information to avoid confusion with other information presented on Form N-2.

8. Digital assets related:

a. The staff noted increased interest and indirect exposure to digital assets by mutual funds (e.g., bitcoin futures). In his August 3, 2021, Remarks Before the Aspen Security Forum, chairman Gensler provided views related to the digital asset space, including thoughts on investment vehicles providing exposure to digital assets. In his remarks, he highlighted investor protections provided by the Investment Company Act of 1940 and other federal securities laws and communicated that he looked forward to the staff's review of ETF filings, particularly those that are limited to CME traded bitcoin futures.

b. In the May 11, 2021, Staff Statement on Funds Registered Under the Investment Company Act Investing in the Bitcoin Futures Market, highlights that as the Bitcoin futures market grows, the Division of Investment Management staff encouraged investors with exposure to the funds investing in the Bitcoin futures market to consider the fund's risk disclosures and the investor's own risk tolerance. The staff described several mechanisms that the IM staff, in coordination with staff from the Division of

Economic and Risk Analysis and Division of Examinations, would employ to monitor the impact of the mutual funds' investments in Bitcoin futures on investor protection, capital formation, and the fairness and efficiency of markets, including, but not limited to, analysis of the liquidity and depth of the Bitcoin futures market, ability of the fund to liquidate its position to meet daily redemption demands, monitoring the fund's valuation of holdings and the efficacy of derivatives risk management, impact of potential manipulation and fraud, and whether the Bitcoin futures market could accommodate ETFs if the ETF becomes too large or if the liquidity in the market starts to wane. The Statement also references the January 2018, Staff Letter: Engaging on Fund Innovation and Cryptocurrency-related Holdings, which covered several themes, including valuation, custody, arbitrage, potential manipulation and other risks, and liquidity, of the open-end funds investing in digital assets.

Registrants are encouraged to engage early with the staff on digital asset investments.

9. LIBOR transition:

a. Alternative Reference Rate Committee Symposium September 20, 2021: The staff noted that Chair Gensler spoke at the September ARRC Symposium and reinforced that LIBOR cessation is in fact happening so not to wait on transition efforts.

b. The staff noted that they have not received many accounting questions on LIBOR rate transitions related to investment companies but provided a reminder that they are available to discuss any that arise.

c. The staff noted that at this stage they would expect that people already have a handle on their LIBOR exposure, noting that could include not only investments referencing LIBOR, but also to performance fees, hurdle rates, or contracts with third parties (e.g., services providers), or others that may be linked to LIBOR.

d. Registrants should also focus on operational updates needed (e.g., updates to accruals and pricing models) and the impact to valuations and liquidity of investments. Lastly, registrants should consider the valuation risks as it relates to board oversight and due diligence procedures of service providers, particularly in light of the effectiveness of Rule 2a-5.

AICPA

Financial Reporting Center

AICPA Investment Companies Expert Panel

November 15-16, 2021, meeting highlights

I. Accounting/Reporting Issues:

1. The EP members briefly shared themes from comment letters, on the FASB's Exposure Draft on Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions.
2. The EP discussed a scenario where a nonregistered limited life fund (PE fund) plans to allow an investor to make an in-kind contribution of cryptocurrency to satisfy the investor's capital commitment. The investor is the sponsor of the cryptocurrency. The amount of the contribution will be determined based on an average value of the cryptocurrency prior to the date of contribution, less a significant discount to the average value. The PE fund intends for the other investors to proportionately share in the excess in the fair value of the cryptocurrency over the amount credited as a capital contribution to the contributing investor.
   The EP discussed whether the excess fair value should be accounted for as an additional capital contribution (i.e., as a capital contribution by the contributing investor to each other investor in proportion to their respective capital commitments) or as a day 1 gain to the PE fund. The EP members agreed that the cryptocurrency should be valued at fair value in accordance with ASC 820. Several EP members discussed that accounting for the excess as a capital contribution and allocating the amounts to the other investors in accordance with the limited partnership agreement (LPA) appears reasonable. An EP member noted that the trade-off from the discounted in-kind contribution resulting in the cryptocurrency being an investment of the PE fund could provide other direct or indirect benefits related to the investor's role as the sponsor of the cryptocurrency. An EP member inquired whether future investors would participate in the excess value of the fund and whether that would be addressed in the LPA of the fund. Another EP member raised considerations about whether there would be any issues from a fiduciary standpoint and whether the terms of the in-kind contribution would be appropriately disclosed in the LPA and the financial statements.
3. The EP members considered whether perpetual bonds that have no stated maturity date would have any premium or discount amortized, or if they are generally treated similar to equity investments where no amortization is recorded. Certain EP members acknowledged that they are not seeing many perpetual bonds in practice, but generally, to the extent the bond is callable, it would be amortized to the call date,

whereas if a bond does not have callable features, it would not be amortized. Other EP members noted that FASB ASC 310-20-35-33 provides that the amortization of premiums on purchased callable debt securities that have explicit, noncontingent call features that are callable at fixed prices on preset dates should be amortized to the earliest call date.

4. An EP member discussed the scenario of a private equity fund that acquires carbon credits that will be held at the fund level to offset against emissions produced by its portfolio company investments. The EP members discussed the intent of the carbon credits and whether they would be investments that should be fair valued in accordance with ASC 820 or if the credits would have an impact on the fair value of the portfolio company. The EP members also discussed whether the use of carbon credits would impact the entity's investment company status. The EP members agreed that the design and purpose of the entity should be assessed against the fundamental and typical characteristics of an investment company under ASC 946 to determine whether it qualifies as an investment company. The EP will consider discussing this topic in a future meeting.

II. AICPA/Administrative:

1. AICPA Investment Companies Expert Panel September meeting highlights are being finalized.
2. The EP considered 2022 ZOOM meeting dates.

III. SEC Staff Update

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1. Commission update
    a. SEC Appoints New Chairperson and Board Members to the Public Company Accounting Oversight Board
    b. Remarks before the Asset Management Advisory Committee by Chair Gary Gensler, November 3, 2021
    c. Prepared Remarks At the Institutional Limited Partners Association Summit by Chair Gary Gensler, November 10, 2021
2. The SEC staff offered the following comments and reminders to registrants as a result of recent financial statement and registration statement reviews:
    a. Amendments to filings – the Staff reminded registrants that if they are making an amended filing, they should consider including an explanation for the amendment. They should also ensure that all certifications are updated appropriately for the amended filing.
    b. Consents - as communicated in several past SEC Staff Update portions of the Expert Panel meeting highlights, including February 2012 and May 2016, the auditor's consent letter should be filed when there is an amendment to a previously filed registration statement. The consent letter

should be dated within 5 business days of a filing, including the date of the filing. Additionally, a new consent letter is required when an extended period of time (that is, more than 30 days) has passed since the last amendment to a registration where a previous consent letter was filed.
The staff also noted that pursuant to Rule 439 under the Securities Act of 1933, consents cannot be incorporated by reference unless express consent to incorporation by reference is contained in the material to be incorporated by reference."
Further, the SEC staff reminded that when a majority-owned subsidiary's financial statements are filed pursuant to Rule 3-09 of Regulation S-X, an auditor's consent letter from the subsidiary's auditor must be included in the registration statement, and should mention the correct registrant and the accurate file number.

c. Mergers and N-14 Filings
    - S-X Rule 6-11 and amended Form N-14 no longer require pro forma financial statements for registered investment companies and business development company mergers. Instead, registrants are required to provide supplemental information about newly, combined entities that would include:
      (1) a table showing the current fees for the registrant and the acquired fund and pro forma fees, if different, for the registrant after giving effect to the acquisition using the format prescribed in the appropriate registration statement under the Investment Company Act;
      (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.
    - The Staff reminded registrants that the information in the capitalization table should be as current as possible; preferably, within 30 days of the filing date, but can be no earlier than the most recently filed balance sheet.
    - Item 3 of Form N-14 specifically requires the disclosure of current fees. The form does not define "current fees" so registrants should use their judgment. However, the staff's view is that the fees should be at least as current as the most recent annual report or registration statement update
    - The Staff believes that information around portfolio repositioning to align the target fund with the new strategy of the fund is important for investors to understand the changes and potential consequences of the fund merger. Registrants should quantify the change as percent of the target fund's securities that would be sold and include an estimate of

the capital gains distribution (as dollars per share) and brokerage costs (in dollars and basis points).

- The SEC staff also reminded registrants that the Form N-14 should clearly disclose the "accounting survivor."
- Registrants should also ensure that EDGAR is updated timely for any inactive funds (merged, liquidated, or closed funds).

d. The SEC staff noted that foreign tax reclaims can be material for some funds and they should consider breaking out these material claims on the income statement. The SEC staff offered a reminder that audit fees, proxy fees, or professional fees in connection with filing foreign tax reclaims should be properly classified and clear disclosure of accounting policies related to tax reclaims should be provided. Refer to the SEC Staff Updates in the July and September 2021 minutes for further details.

e. Closed-end funds and seasoned issuers – Changes in offering reform impacts disclosures in the annual report and registration statements for closed-end funds and BDCs. It also impacts how and when consents are filed for certain seasoned issuers, where these consents may be attached in the 10-K or N-CSR filing as opposed to the registration statement. The staff reminded registrants to consider disclosure changes related to offering reform in the instructions of Form N-2; particularly those related to the MDFP, senior securities tables and financial highlights.

f. Advisory and sub advisory fees disclosures, including related party fee arrangements. Additional consideration should be given to material items (what material information is included in prospectus related to the transaction and whether it is consistent with what is in financial statements).

3. Other policy matters:

a. 18f-4 questions

In response to an EP member's inquiry regarding timing for documentation requirement for business development company's unfunded commitments under the SEC rule 18f-4, the SEC staff stated that the rule:

- permits a fund to enter into these agreements if the fund "reasonably believes, at the time it enters into such agreement, that it will have sufficient cash and cash equivalents to meet its obligations" with respect to such agreements,
- requires a fund that enters into such agreements to "maintain a record documenting…the fund's basis for its reasonable belief," and
- requires a fund to make this record "each time it enters into such an agreement"

However, the SEC staff stated that consistent with other regulatory record keeping requirements, the rule release does not specifically address the timing of precisely when such documentation must be prepared.

Further, the SEC staff addressed another question related to private BDCs that have unfunded capital commitments from their investors and whether the BDC could consider their investors' unfunded capital commitments in forming their reasonable belief that it has sufficient cash and cash

equivalents to meet its obligations with respect to its unfunded commitment. It was noted that the rule states that in forming a reasonable belief, a fund may not consider cash that may become available from issuing additional equity. The staff noted while the release does not directly address this point, the basis of the prohibition against being able to consider the issuance of additional equity is that the Commission was concerned that a fund's ability to raise capital in the future depends on a variety of factors that are too speculative to support a fund's reasonable belief that it could fund an unfunded commitment agreement.

So, to the extent that capital calls don't raise this same concern, they would not raise the concern that the Commission stated as the basis for the prohibition. This determination would be based on a registrant's individual facts and circumstances.

Finally, the staff addressed a question related to when derivatives information will be required in an N-PORT filing. It was noted that the compliance date for Rule 18f-4 is Aug 19, 2022, and that N-PORT filings after that date must contain required disclosures as applicable. N-PORT filings will only include new derivatives information <u>for periods during which the fund relied on rule 18f-4</u>. For most funds that will be for <u>periods after</u> Aug. 19, although some funds may have complied earlier.

b. 2a-5 questions (ASR 118 question) – while ASR 118 was rescinded, the SEC staff reminded registrants and auditors that footnote 376 of new rule 2a-5 under the Investment Company Act states, that "the statutory requirement in section 30(g) of the Investment Company Act, which requires the independent public accountant to verify securities owned, implicates the auditor's requirement to test the existence assertion of all securities. The statutory requirement under section 30(g) remains distinct from the rescinded valuation guidance in ASR 118 and the auditing standards established by the PCAOB concerning accounting estimates, including fair value." The Staff's intention was not to change practice related to audit testing of the existence of securities.
c. Custody Rule-related questions:
    - The EP members offered a scenario where, in the course of conducting a surprise examination under the Custody Rule, an auditor identifies a noncompliance matter. The EP member inquired whether, when the auditor evaluates both quantitatively and qualitatively whether the matter constitutes a material noncompliance, it is appropriate to consider the materiality of the assets that are the subject to the noncompliance matter relative to the total assets subject to the Custody Rule, or rather, should be evaluated against only the total assets subject to the surprise examination procedures. In this particular scenario, the EP indicated that the majority of the assets under management subject to the Custody Rule are in pooled investment

vehicles that are audited (e.g., the noncompliance matter is not required for pooled investment vehicles that satisfy the audit provision). The SEC staff emphasized that determining whether a matter is material is subjective and requires auditor judgment, and accountants should apply and understand the requirements of AT-C Section 315 and 205 when evaluating non-compliance. The SEC staff would encourage registered investment advisors (RIA) and their auditors consult with the staff, to the extent they have questions.

- The EP offered another scenario where an RIA has the ability to disburse fees on behalf of its customer (with or without customer consent) but holds all customer funds at an independent qualified custodian and inquired whether an independent public accountant performing an annual surprise examination under this scenario would need to be registered and inspected by the PCAOB. Under Rule 206(4)-2(a)(4), if an RIA has custody of client funds and securities, those funds and securities must be verified by actual examination by "an independent public accountant". The SEC staff highlighted that the accountant must be registered and subject to inspection by the PCAOB
    1. To perform a surprise examination if an RIA or its related person has self-custody (that is, serves as a qualified custodian for its clients);
    2. To perform an internal control engagement if an RIA or its related person has self-custody, and the RIA must obtain and receive an internal control report;
    3. To audit a pooled investment vehicle (under the "audit provision" - where an RIA would be deemed to comply with an annual surprise examination requirement under the Custody Rule.)

4. Exams Update

a. Risk Alert: Observations from Examinations in the Registered Investment Company Initiatives
October 26, 2021

b. Observations from Examinations of Advisers that Provide Electronic Investment Advice November 9, 2021

c. Risk Alert: Division of Examinations Observations: Investment Advisers' Fee Calculations
November 10, 2021

d. Andrew J. Bowden, Spreading Sunshine in Private Equity (May 6, 2014) – although this speech is not new, the staff indicated that it highlights a number of valuation considerations and trends that continue to be relevant.

5. The staff highlighted a recent enforcement case where the SEC charged an accounting firm, one of its partners, two of its former partners and the Chief Accounting Officer of an issuer for violation of independence rules. Specifically, the accounting firm interfered with the issuer's selection of an independent auditor by soliciting and receiving confidential and competitive information from the issuer's Chief Accounting Officer.