



Financial Reporting Center



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

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 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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