AICPA

Financial Reporting Center

AICPA Investment Companies Expert Panel

March 14-15, 2022, meeting highlights

I. Accounting/Reporting Issues:

1. Ukraine/Russia conflict and its impact on funds – the EP discussed accounting and reporting implications of the geopolitical conflict, including lack of accessibility of securities trading on Russian stock exchanges, negative impact on fair valuation, expectation of collecting payments for trade settlements and income, recording income accruals for corporate and non-sovereign debt securities, what would constitute meaningful financial statement disclosures, and evaluation of subsequent events.
2. The EP members considered the recognition of cryptocurrency transactions that have been initiated before midnight of the reporting date but have not been finalized until after midnight. Although FASB ASC Subtopic 946-325 does not address recognition of other investments, the guidance in ASC paragraph 946-320-25-2 may be appropriate to consider in determining whether a fund has obtained the right to demand the cryptocurrency and the obligation to pay for the cryptocurrency as of the reporting date. The EP members generally agreed that the enforceability of the transaction, including confidence and ability to close the trade would affect the timing of recognition of the transaction. The EP members acknowledged that the entity may need to engage legal counsel to assist in such determination.
3. The EP members shared preliminary views regarding SEC proposed rule on private funds reform. Please refer to the SEC Staff Update below for details of the proposal.
4. The EP has discussed considerations related to the North American Security Trust no-action letter (pub. avail. Aug. 5, 1994) (also known as NAST) analysis following comments by the SEC IM staff during the January 2022 meeting. The EP members observed that when evaluating a merger involving a newly organized shell fund, the shell would generally not be an accounting survivor. With regards to the 5 NAST factors, the EP members agreed that the analysis is based on the facts and circumstances of each merger; however, EP members noted that the investment strategy of the fund going forward, as well as the professionals making investment decisions would be important factors to consider when determining the accounting survivor.

II. Audit/Attest Issues

1. The EP considered modifications (for the new going concern language) to the audit opinions prepared under GAAS when limited-life investment companies that have liquidation plans established at inception are liquidating within a year.

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 noted that ongoing Ukraine/Russia conflict has created hardship for millions of people affected and issues in market. The staff inquired what EP members are seeing regarding liquidity concerns, valuation, and disclosures. The staff also reminded registrants that even in times of strain, registrants should look to their existing accounting policies and procedures (e.g., in determining fair value and evaluating income accruals).
2. Leadership changes:
    a. William Birdthistle was named Director, Division of Investment Management. Sarah G. ten Siethoff returned to the role of Deputy Director for the Division of Investment Management and will lead rulemaking activities for the division.
    b. Commissioner Allison Herren Lee will be stepping down in June 2022
3. Public statements and speeches:
    a. The SEC staff highlighted several points from the March 9, 2022 Statement by Paul Munter, Acting Chief Accountant Assessing Materiality: Focusing on the Reasonable Investor When Evaluating Errors, including:
        - SAB No. 99 indicates circumstances where a quantitatively small error could be material because of qualitative factors. However, the staff noted that as the quantitative magnitude of the error increases, it becomes increasingly difficult for qualitative factors to overcome the quantitative significance of the error.
        - SAB No. 99 states that while the intent of management does not render a misstatement material, it may provide significant evidence of materiality. The SEC staff noted certain registrants attempt to apply that SAB No. 99 premise in reverse (the lack of intentional misstatement is viewed as providing evidence that the error is not material) and they have not found this argument to be persuasive.
        - Reminding that the registrants and their auditors to consider whether each misstatement is material, irrespective of its effect when combined with other misstatements. Then the aggregate effect should be considered to determine whether an otherwise immaterial error, when aggregated with other misstatements, renders the financial statements taken as a whole to be materially misstated.

- Management's assessment of internal control over financial reporting should consider what *could* happen, as while the existence of a material accounting error is an indicator of the existence of a material weakness, a material weakness may also exist without the existence of a material error.

b. February 15. 2022, Commissioner Hester M. Peirce Audit Regulators and Cliff Hangers

c. Policy focused:
   - President Biden's March 9, 2022 Executive Order Ensuring Responsible Development of Digital Assets
   - Adjustable Interest Rate (LIBOR) Act of 2021

4. SOX and registration statement review comments:

a. The staff issued a reminder specific to closed end fund seasoned issuers filing on Form N-2 about including senior securities. Item 24 instruction 4(h) of Form N-2 requires registrants to include senior securities in accordance with Item 4.3. The instructions don't specify the location of the senior securities; therefore, there is some diversity in practice related to the location of the disclosure. Some registrants chose to include the information in the financial highlights in the annual report. Regardless of the location, all required disclosures in Item 4.3 of Form N-2 should be included.

b. The staff has identified filings which have included outdated language in Form N-CSR:
   - The SEC staff highlighted certification language within 4(d) to Item 13(a)(2) on certifications and Item 11(b) on Controls and Procedures. The current Form N-CSR instructions make reference to the period covered by the report; however, some registrants are using outdated language that references the most recent fiscal quarter. This language was updated due to the replacement of Form N-Q with Form N-PORT. The SEC staff has asked registrants to file an amended Form N-CSR to update language so that it includes the proper period covered by the report and to confirm that there no changes during the period.

5. The EP offered the following scenario to the staff for consideration. A fund adviser plans to set up a newly registered BDC that will acquire certain structured credit investments held by a privately owned fund, which is a related party of the BDC. The investments to be acquired by the BDC are expected to be less than substantially all of the private fund's assets. Under Rule 6-11(a)(2)(ii), determining whether a fund has been acquired or will be acquired is based on a facts and circumstances assessment, where the acquisition by the registrant of all or substantially all of the portfolio investments held by another fund is among the facts and circumstances that should be considered. The EP inquired whether the staff has observed instances of a fund acquisition when the BDC acquired less than substantially all of the investments held by another fund, other factors to consider when evaluating whether a fund acquisition has occurred, and whether the Staff would expect other information when the acquisition of investments held by another fund does not result in a fund acquisition. First, the SEC staff noted that the concept of 'substantially all' is purposefully not defined by a bright line threshold in the rule. Evaluating

'substantially all' requires a full understanding of all of the relevant facts and circumstances surrounding the transaction.

In evaluating the transaction, the staff offered the following considerations:

a. How was it determined that the acquisition of investments equates to less than less than 'substantially all' of the private fund assets? (As mentioned, this is not defined in the rule.)
b. What is the underlying business purpose of the transaction?
c. What is the nature of the relationship between the transacting parties?
d. What are the future operating plans of the selling fund and the retained assets? Will the selling fund continue its operations? Will it be winding down? Will it be changing its strategy?
e. Will any LPs from the selling fund be transferring into the purchasing entity? Will any of the selling fund management be involved with the purchasing entity post asset purchase?
f. How will the purchase impact the future strategy of the purchasing entity?
g. In the fact pattern provided, the purchasing entity was noted as being newly registered – is this a newly launched entity? Or simply newly registered? Is the transaction meant to seed the purchaser with assets? Is it akin to a warehousing transaction?

The SEC staff indicated that these are just a few initial reactions, and should not be taken as a checklist, or complete inventory of all of the facts and circumstances to consider in evaluating this transaction.

Second, with regard to the EP's question on whether the Staff would expect other information to be provided when the acquisition of investments held by another fund does not result in a fund acquisition, the SEC staff generally would expect information to be provided about the investments to be acquired. This allows for investors to better understand the investments the fund (or BDC) seeks to acquire, even if the transaction is not within the scope of Rule 6-11. This is a facts and circumstances based determination, and consideration should be given such that investors of the existing private fund do not have more information than the potential investors of the acquiring fund (or BDC) about the product being offered.

The SEC staff encouraged registrants to consult with the SEC as needed.

6. Proposed rules:

a. Cybersecurity Risk Management for Investment Advisers, Registered Investment Companies, and Business Development Companies
    - Require advisers and funds to adopt and implement written policies and procedures that are reasonably designed to address cybersecurity risks;
    - Require advisers to report significant cybersecurity incidents to the Commission on proposed Form ADV-C;
    - Enhance adviser and fund disclosures related to cybersecurity risks and incidents; and
    - Require advisers and funds to maintain, make, and retain certain cybersecurity-related books and records.

b. Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews

The proposed amendments are designed to provide greater transparency to private fund investors regarding the full cost of investing in private funds and the performance of such private funds. The proposed rules would:

- Require private fund advisers registered with the Commission to provide investors with quarterly statements detailing information about private fund performance, fees, and expenses;
- Require registered private fund advisers to obtain an annual audit for each private fund and cause the private fund's auditor to notify the SEC upon certain events;
- Require registered private fund advisers, in connection with an adviser-led secondary transaction, to distribute to investors a fairness opinion and a written summary of certain material business relationships between the adviser and the opinion provider;
- Prohibit all private fund advisers, including those that are not registered, from engaging in certain activities and practices that are contrary to the public interest and the protection of investors; and
- Prohibit all private fund advisers from providing certain types of preferential treatment that have a material negative effect on other investors, while also prohibiting all other types of preferential treatment unless disclosed to current and prospective investors.

Additionally, the SEC is proposing to require all registered advisers, including those that do not advise private funds, to document the annual review of their compliance policies and procedures in writing. [Update: the comment period for this proposed rule has been reopened. For more information, visit https://www.sec.gov/news/press-release/2022-82 and https://www.sec.gov/rules/proposed/2022/34-94868.pdf]

c. Amendments to Form PF to Require Current Reporting and Amend Reporting Requirements for Large Private Equity Advisers and Large Liquidity Fund Advisers
d. Shortening the Securities Transaction Settlement Cycle
e. Short Position and Short Activity Reporting by Institutional Investment Managers
f. Reopening of Comment Period for Reporting of Securities Loans

7. The SEC staff briefly discussed January 27, 2022 Risk Alert: Observations from Examinations of Private Fund Advisers

8. Enforcement update:

a. February 14, 2022 BlockFi Agrees to Pay $100 Million in Penalties and Pursue Registration of its Crypto Lending Product
b. February 15. 2022, SEC Charges 12 Additional Financial Firms for Failure to Meet Form CRS Obligations
c. February 18, 2022 SEC Charges Infinity Q Founder with Orchestrating Massive Valuation Fraud

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