Via electronic submission to: smcosper@fbs.org

Ms. Susan M. Cosper,
Technical Director
Financial Accounting Standards Board (FASB),
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116


Dear Ms. Cosper;

I have been a preparer and reviewer of many financial statements over the course of many years. Most of these financial statements pertained to investment companies. The reason that I am writing is to request that the FASB add to its agenda a project to review and, hopefully, amend the reporting elements presented in the financial statement conveying an investment company’s financial performance/results of operations – i.e., the financial statement elements in the income statement, aka the *Statement of Operations* (“SOO”).

I am attaching to this cover letter an exposition that was compiled to explain why I believe that there is such a need and that this need is substantial. Succinctly put, current US GAAP reporting practices present information in the SOO which, at best, is not useful to its readers for understanding how financial performance resulted from transactions with non-owners and from events that impacted an investment company; at worse, the information presented misleads those readers with respect to this understanding.

Although the attached exposition is being submitted as part this request to FASB, one of the foremost authorities on matters of financial reporting, it was written to serve both such experts and those who are much less knowledgeable in this field. For this reason and to develop a logical basis for my conclusions and recommendations within the document, this exposition was compiled in a manner that cited and explained concepts and practices that one might, otherwise, consider too rudimentary to require explanations. Accordingly, I ask you, in advance, to excuse the lengthiness of that document.

To mitigate some of that wordiness, the exposition includes an executive summary as the first of a three-section document. These sections are as follows –

1) Executive Summary
2) (In-depth) Explanatory Memorandum
3) Appendices that demonstrate key points, introduce less significant ones, and, otherwise, add to the discourse of this subject matter.

I appreciate the FASB’s consideration of this request. If you have any questions regarding this request or if I can be of any assistance, please contact me using the contact information provided at the top of this letter or at my email address provided after my signature.

Sincerely,

Kenneth Leung
Principal
kleung@faarservices.com
Fundamental Deficiencies in Financial Statements of Investment Companies

Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Finance Accounting Analysis & Reporting Services, LLC
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FUNDAMENTAL DEFICIENCIES OF US GAAP FINANCIAL STATEMENTS FOR INVESTMENT COMPANIES

EXECUTIVE SUMMARY

To achieve greater brevity and improved readability, this Executive Summary (“Summary”) may –

1. Not define, within its text, many acronyms and terms – even upon their first instance or appearance (A glossary has been included as Appendix V for this purpose);
2. Omit citations and other references to specific topics, sub-topics and paragraphs of the ASC and other pronouncements of the FASB;
3. Limit logical reasoning, argumentation, remedies, and explanation presented;
4. Describe proposals in broad terms for reporting effects desired;
5. Restrict the descriptions of transactions, events, bookkeeping mechanics, accounting principles and reporting practices to those applicable to investment positions described as “long positions” (It is implied that the reasoning used to assess the appropriateness of current reporting practices and to develop the proposed improvements is equally valid for “short positions” and derivative contracts);
6. Omit detailed implementation guidance.

For the factors noted above, the points made in this Summary may not be as complete and clear as they would otherwise be. Such omissions, limitations, generalities, and restrictions are avoided in the attached Explanatory Memorandum and appendices to bring about greater completeness and clarity.

Italicized words identify captions, names of statements, and other specialized terminology.
Capitalized Words (other than words capitalized in accordance with the general norms of the English language) indicate a term which has been defined in the glossary.
Underlined words and phrases indicate emphasis.

PURPOSE AND SCOPE

The purpose of this Summary is to identify i) significant shortcomings in general-purpose financial statements of Investment Companies compiled in accordance with US GAAP and ii) possible remedies to such shortcomings. US GAAP financial statements for Investment Companies may be judged to possess certain shortcomings in one way or another and at one point in time or another. This Summary has been written to focus attention only on those shortcomings that have very significant impacts and are fundamentally unsound. Their failings in these respects rise to the level to be characterized as deficiencies and, hence, should be remedied as soon as is practical.

DEFICIENCIES IN REPORTING FINANCIAL PERFORMANCE

These deficiencies manifest themselves in the financial statement Elements\(^1\) of the Statement Of Operations ("SOO"), and this manifestation results in the reporting of amounts which should be of little use to its readers. This assertion of an absence of usefulness is based upon the fact that the information reported lacks the necessary Relevance and Representational Faithfulness to meet the financial reporting objective of the SOO – which is to report the financial effects arising from transactions with non-owners, from events, and from other phenomena (together, “Transactions and Events”) in terms of how they changed Net Asset Value (“NAV”) – in other words, in terms of financial performance. The specific informational deficiencies identified are as follows (hereinafter referred to as the “Deficiencies”):

\(^1\) The meaning ascribed to this term in the Summary (as defined in Appendix V) varies from the definition put forth by the SFAC No.6 which describes “elements” as broad categories. As used in this Exposition, “Element”, in variations of that term, is more analogous with the term “item” as defined in SFAC No.6.
DEFICIENCIES IN REPORTING FINANCIAL PERFORMANCE

1. Although Realized Gains/Losses purportedly report gains and losses from the selling of investments, the amounts reported next to those captions do not actually report the increases/decreases in NAV resulting from transactions which entailed the selling of investments.

2. The amounts reported next to the caption net Changes in Unrealized Appreciation/Depreciation (also referred to as Unrealized Gains/Losses\(^2\)) are irrelevant for the purpose of understanding the financial impacts on NAV arising from events which occurred while holding investments (e.g., accounting events such as valuation changes).

3. In certain circumstances, the amounts reported as Investment Income may not faithfully report cash or other value to be received while holding investments.

(See Appendix I for examples that demonstrate these Deficiencies.)

The net increase/decrease to NAV from operations (the “Bottom-Line”) is one of the key gauges of financial performance. Thus, the inability of the SOO to inform its readers as to how Transactions and Events increased or decreased the Bottom-Line is troubling in and of itself. It can be argued that an even more important measure of financial performance is an Investment Company’s Rate-Of-Return (“ROR”) as a ROR conveys the efficiency experienced in bringing about the Bottom-Line. As the Bottom-Line(s) are key inputs to that ROR calculation, the convoluted, and even distorted, reporting of the results of operations by the SOO is an obstacle to the financial statement reader being able to attribute the ROR to its instigators. If the Elements of the SOO do not faithfully represent the increases and decreases to NAV caused by Transactions and Events, then, it is extremely difficult, if not outright impossible, to understand the ROR by that same perspective.

IMPETUS OF DEFICIENCIES

COST BASIS REPORTING

One of the reasons that current reporting practices in the SOO are “deficient” is that the information reported is irrelevant to understanding how NAV increased or decreased from Transactions and Events. In the simplest of terms, the primary explanation of this assertion is found in the fact that all of the amounts reported as investment gains and losses in the SOO are derived with reference to the investments’ cost bases and not their fair values. As Investment Companies must measure their investments at fair value, the fair values of investments (not their cost bases) are the driver of an Investment Company’s NAV, and changes in those fair values cause changes in NAV and drive financial performance. Thus, it is not surprising that determining gains and losses by measuring the value to be received (from a Transaction) or booked (from a re-valuation Event) against a benchmark that does not determine NAV (i.e., the cost basis) offers no insight as to how that Transaction or that Event (or those Transactions or those Events) increased or decreased NAV.

As a result of measuring gains and losses with reference to the investments’ cost bases, Realized Gains reported by the SOO do not necessarily indicate that the selling transactions from which they were derived impacted NAV and ROR in a positive manner, and, conversely, Realized Losses do not necessarily indicate that the selling of the related investments impacted NAV and ROR negatively. Similarly, Unrealized Gains do not necessarily report favorable Transactions and Events with respect to NAV and ROR nor must Unrealized Losses reflect unfavorable ones. Even the Element Investment Income may not report the accrual of cash (or other value) to be received from holding an investment as the amount reported for interest income may be distorted by the amortization of premiums/accretion of discounts and by adjustments for Realized Gains/Losses from prepayments (or paydowns).

\(^2\) The less descriptive terms Unrealized Gains and Unrealized Losses may be used in parts of this Summary to improve readability.
USE OF MISLEADING CAPTIONS

Another reason to characterize current reporting by the SOO as “deficient” is that the information in that statement does not faithfully represent the phenomena that it purports to represent. A layman-English interpretation of the main captions used in the SOO and the definitions of those captions in the notes to the financial statements mislead the financial statement reader to understand that Realized Gains/Losses report the changes in NAV from the sales of investments. They also lead the reader to think that the amounts of Unrealized Gains/Losses or Unrealized Appreciation/Depreciation show the changes in NAV caused by changes in the values of individual investments.

RECHARACTERIZATION OF DERIVATIVE INCOME AND EXPENSES

The primary impetus of SOO’s shortcomings is cost basis reporting and the use of misleading captions; however, there is a secondary impetus – found in how income/expense from derivative contracts is commonly reported in SOOs. Specifically, the terms of some derivative contracts call for the receipt or payment of cash from or to derivative contract counterparties during the period that derivative contracts are held (as opposed to when the contracts were initiated or when they expire or are closed-out). Current US GAAP practice is to report the receipts/payments of Derivative Income/Expense as Realized Gain/Loss, and any accrued balances of such Derivative Income/Expense are reported as adjustments to the fair values of the related derivative contracts. The effect of this practice is to change what would otherwise be reported as Investment Income to reporting such amounts as Capital Appreciation and to change the “holding” nature of the activity to one reported as arising from “disposition”.

OFFSETTING DEFICIENCIES

This Summary asserts that the financial statement Elements of the SOO are “deficient” in the ways described in the previous section and, for this reason, require replacing. However, such an assertion is not made about the Bottom-Line or the ROR derived from the Bottom-Line(s). As the deficient reporting Elements of Investment Income, Realized Gains/Losses, and Unrealized Gains/Losses comprise three of the four components of the Bottom-Line (with the fourth component, fund expenses, not characterized as being deficient), a logical question that might arise is “How is this possible that the parts are deficient, but the whole resulting from these parts is not (deficient)?” The answer rests in the fact that the distortive effects in those three components of profits and losses offset each other. The component in which lie almost all of the compensating distortions is Unrealized Gains/Losses (aka net Changes in Unrealized Appreciation/Depreciation). Key to understanding these compensating distortions is the ability to identify the drivers of Unrealized Gains/Losses and to isolate the amounts of Unrealized Gains/Losses attributed to each driver.

Changes in Unrealized Appreciation/Depreciation are caused by Transactions (i.e., sales of investments) and by Events (i.e., revaluations and/or the recognition of amortization/accretion). The amounts of net Change in Unrealized Appreciation/Depreciation resulting from each of these drivers report a portion of the total financial effects of those Transactions and Events. When these portions are combined with the portions reported next to other captions of the SOO, the complete and accurate financial impacts of Transactions and Events can be understood in terms of the Investment Income Vs Capital Appreciation nature of the return and the buying, holding, and selling activities that would have generated them. The table which follows matches and nets the amounts of net Change in Unrealized Appreciation/Depreciation attributed to these drivers to the amounts of income, gains and losses reported next to other SOO captions attributable to these same drivers.
OFFSETTING DEFICIENCIES (CONTINUED)

Exhibit ES-1

<table>
<thead>
<tr>
<th>Drivers and Related Amounts of &quot;Net Change in Unrealized Appreciation/Depreciation&quot;</th>
<th>Amounts in Other SOO Captions</th>
<th>Capital Appreciation and/or Investment Income from Transactions and Events</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Amortization of premium/accretion of discount ~ Interest income ~ Interest income from holding investments in debt securities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(b) Reversal of Unrealized Gain/Loss on non-Derivative investments sold ^ Net Realized Gain (Loss) on non-Derivative investments ^ Gain/loss from Capital Appreciation sustained on investments disposed</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(c) Valuation increase/decrease on investments held at end of period NOT APPLICABLE Gain/loss from Capital Appreciation sustained from holding investments</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(d) Reversal of Unrealized G/L on Derivatives disposed * Net Realized Gain (Loss) on Derivative Contracts * Investment Income from holding and disposing Derivative Contracts</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* The accounting recognition of the amortization of premium/accretion of discount results in an adjustment to interest income and an offsetting adjustment to Unrealized Gain/Loss. Thus, netting the amount of Unrealized Gain/Loss driven by amortization/accretion effectively backs that adjustment out of interest income.

^ As Net Realized Gain (Loss) reports Capital Appreciation/Depreciation experienced at disposition since the acquisition of the investment (and not just during the Reporting Period), Unrealized Gain (Loss) driven by the reversal of Unrealized Gain (Loss) already recognized in prior Reporting Periods avoids double-counting that Capital Appreciation/Depreciation in the current Reporting Period.

* Net Realized Gain (Loss) on Derivative Contracts reports Capital Appreciation/Depreciation experienced at contract CLOSE-OUT since the inception of the contracts AND, where applicable, receipts from contract counterparties on OPEN contracts during the Reporting Period. Unrealized Gain (Loss) driven by the reversal of Unrealized Gain (Loss) already recognized in prior Reporting Periods avoids double-counting that Capital Appreciation/Depreciation in the current Reporting Period AND the change in the accrual of Derivative Income converts receipts from those counterparties to Derivative Income accrued for the Reporting Period.

RECOMMENDED REMEDIES

The best way to correct the Deficiencies, by way of modifications to the ASC, is to change the amounts reported on the face of the SOO. The following encompass the specific changes to US GAAP that are being proposed:

1. Require that gains and losses from investment dispositions be reported under the caption Disposition Gains/Losses and to define such Disposition Gains/Losses as the difference between i) the amount of disposition proceeds (or other value) to be received and ii) either the fair value of the investment disposed as of the end of the previous Accounting Period, if applicable, or if the investment disposed was not held as of the end of the previous Accounting Period, the cost incurred to acquire it.

2. Require that gains and losses from valuation changes be reported under the caption Holding Gains/Losses and to define such Holding Gains/Losses as the difference between i) the fair value of an investment as of the end of the current Accounting Period and ii) either the fair value of that same investment as of the end of the previous Accounting Period, if applicable, or if the investment was not held as of the end of the previous Accounting Period, the cost incurred to acquire it.

3. Require that purchased premium/discount on debt securities be amortized/accreted as adjustments to interest income only for debt securities classified as cash equivalents or short-term investments.

4. Require accruals of the receipts and the payments to be made against derivative contracts (other than those to be received or to be made at the initiation or termination of those contracts) be reported under the captions Derivative Income or Derivative Expenses. Accrued Derivative Income/Expense is to be reported as...
RECOMMENDED REMEDIES (CONTINUED)

*derivative income receivable* or *derivative income payable*, as applicable. Payments made at the initiation of the derivative contracts are to be treated as “cost...to acquire” for the purposes of measuring Disposition Gains/Losses and Holding Gains/Losses. Proceeds (or other value) received at the disposition of the derivative contract are to be referenced as “disposition proceeds” for the purposes of measuring Disposition Gains/Losses.

(See Appendix I for examples that demonstrate how these Recommended Remedies rectify the Deficiencies.)

CONCLUSION

The significance of the impacts of the individual Deficiencies is self-evident as is the severe flaw in their conceptual underpinnings. In the context of reporting useful financial information, this significance and the severity are amplified as the Deficiencies distort the reporting of financial performance – the fundamental objective of the SOO. Not being able to understand what caused the Bottom-Line does little to help investors assess the efficacy of the investment manager’s stewardship and to evaluate which aspect of the Bottom-Line is relevant to the investor’s attempts to predict future results.

Information which would be useful for assessing the financial performance of Investment Companies helps the reader of the SOO to understand how Transactions and Events gave rise to the Company’s profits and losses. Due to the underlying nature of Investment Companies’ activities such Transactions and Events encompass primarily the buying, holding, and selling of investments. By definition, the profits and losses generated by such activities are limited to *Capital Appreciation* and *Investment Income*. Thus, information which would be useful for assessing financial performance should help readers understand how the buying, holding, and selling of investments produced returns of a *Capital Appreciation* or an *Investment Income* nature. Current reporting practices in the SOO do not accomplish this; implementing the Recommended Remedies would make them do so.

This Exposition is focused on failings in the financial reporting of Investment Companies the impacts from which are most significant and the remedies of which are quite feasible. The scope of this examination has been narrowly defined so that these failings could be rectified by FASB as soon as is practical. After this has been accomplished, FASB is urged to undertake a more comprehensive review of the specialized reporting practices of Investment Companies as most of these specialized practices were developed outside the full deliberative processes of FASB. The distortion and convolution in the SOO make the reporting of financial performance by Investment Companies a prime candidate for FASB’s Simplification Initiative. It is almost certain that such unhelpful reporting and unnecessary complexity require management to resort to the use of non-GAAP measures to analyze and explain financial performance. As the use of customized and tailored non-GAAP performance measures has garnered the attention and concern of FASB and the SEC, eliminating unhelpful reporting and complexity should bring about the significant reduction in the use of such non-GAAP measures. Finally, much effort was made in this Exposition to base problem identification and solutions development on FASB’s own Conceptual Framework so that any change in reporting practices result from FASB’s own stated desire to follow a more principles-based approach to standard-setting.
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FUNDAMENTAL DEFICIENCIES OF US GAAP FINANCIAL STATEMENTS FOR INVESTMENT COMPANIES

EXPLANATORY MEMORANDUM

This Explanatory Memorandum ("Memorandum") has been written for an audience with a basic familiarity of financial accounting and financial statements prepared in accordance with US GAAP – including those prepared for Investment Companies. This presumed knowledge base includes a familiarity with the bodies and industry associations whose pronouncements and other guidance have authority or are generally accepted with respect to the subject matter of this Memorandum.

For greater clarity, a glossary has been provided as Appendix V, but the listing of the terms contained in that appendix may not cover the needs of a reader who does not possess the presumed knowledge base. To the extent practical and applicable, in many instances, the definitions in the glossary have been sourced from FASB-issued pronouncements. In a few instances, the terms used have been developed by the Author for the specific purposes of this Memorandum. The standard convention followed is not to define all acronyms and terms in the text (including not doing so for the first instance in which such an acronym or term appears) unless it has been judged that doing so would significantly improve understanding, clarity, or readability. (A glossary has been included as Appendix V to provide such definitions).

Beyond the basic familiarity noted above, the intended audience for this Memorandum includes those who are much more knowledgeable about the subject matter than the Author and also those who may be less informed. With that in mind, this Memorandum has been written to justify and support the assertions and recommendations contained herein to the well-informed and to explain the same to those who may be less familiar with the fundamental underpinnings of financial reporting. For this reason, this Memorandum has been written with very extensive explanations, citations and other references to authoritative literature – including those which one might consider too rudimentary to be necessary for the well-informed.

To improve readability, the descriptions of transactions, events, bookkeeping mechanics, accounting principles, reporting practices, and other observations and recommendations have been restricted to investment positions described as “long positions”. It is implied that the reasoning used to assess the appropriateness of current reporting practices and to develop the proposed improvements is equally valid for “short positions” and derivative contracts.

The appendices form an integral part of this Memorandum.

Italicized words identify captions, names of statements, and other specialized terminology.

Capitalized Words (other than words capitalized in accordance with the general norms of the English language) indicate a term which has been defined in the glossary.

Underlined words and phrases indicate emphasis.

PURPOSE AND SCOPE

Purpose

The purpose of this Memorandum is to put forth clear and comprehensive arguments that –

A. Identify significant shortcomings in general-purpose financial statements of Investment Companies compiled in accordance with US GAAP and

B. Develop, recommend, and support possible remedies to such shortcomings.
PURPOSE AND SCOPE (CONTINUED)

Scope

All aspects of US GAAP for Investment Companies (like those for all companies in general) are periodically reassessed for issues needing improvements, and changes are made by FASB to the ASC to turn proposed improvements into practice. The breadth and recurrent nature of this process is acknowledged here to recognize the fact that the listing of shortcomings described in this Memorandum is not meant to be exhaustive. Not only will there be issues identified in the future which are applicable to the present, no doubt, there are also issues that have already been identified presently which have been omitted from this Memorandum so as to make this exercise more manageable. The shortcomings which are examined in this Memorandum, it is concluded, are deficient fundamentally, significant in their impacts, and feasible with respect to their resolution.

INFORMATION LACKS USEFULNESS

The general assertion of this Memorandum is that the prescriptions for the financial statement Elements in the statement of comprehensive income for Investment Companies result in the reporting of amounts which could not possibly be useful to its readers for understanding financial performance. [It is noted that such a statement of comprehensive income for Investment Companies is referred to as a “Statement Of Operations” or “SOO” in the parlance of specialized Investment Company accounting as described by Topic 946 of the ASC – Investment Companies].

The assertion that the SOO reports information which is not sufficiently useful to its readers is based upon the fact that the information reported lacks the necessary Relevance and Representational Faithfulness to meet the financial reporting objective of the SOO. FASB has defined this objective to be the reporting of the financial effects on an Investment Company’s assets and the claims on those assets (i.e., Net Asset Value or NAV) arising from transactions with non-owners, from events, and from other phenomena ("Transactions and Events") arising from transactions with non-owners, from events, and from other phenomena ("Transactions and Events"). The specific informational deficiencies identified are as follows (hereinafter referred to as the “Deficiencies”):

1. Although Realized Gains/Losses purportedly report gains and losses from the selling of investments, the amounts reported next to those captions do NOT actually report the increases/decreases in NAV resulting from transactions which entailed the selling of investments.
2. The amounts reported next to the caption net Changes in Unrealized Appreciation/Depreciation (also referred to as Unrealized Gains/Losses) are irrelevant for the purpose of understanding the financial impacts on NAV arising from events which occurred while holding investments (e.g., accounting events such as valuation changes).
3. In certain circumstances, the amounts reported as Investment Income may NOT faithfully report cash or other value to be received while holding investments.

(See Appendix I for examples that demonstrate the effects of these Deficiencies, and see Appendix IV for less significant shortcomings.)

The meaning ascribed to this term in the Memorandum (as defined in Appendix V) varies from the definition put forth by the SFAC No.6 which describes “elements” as broad categories. As used in this Exposition, “Element”, in variations of that term, is more analogous with the term “item” as defined in SFAC No.6.

ASC 220-10-15-2b explicitly affirms that guidance pertaining to Comprehensive Income applies to Investment Companies. ASC 946-225-05-01 equates SOOs with income statements. Before being eliminated by ASU 2011-05, ASC 220-10-45-9 stated that entities are “…encouraged to display …total comprehensive income…in a statement that reports results of operations…,” and ASC 946-225-45-7 defines the final Element of the SOO, Net Increase or Decrease in Net Assets from Operations, as “…a net increase or decrease in net assets resulting from operations”.

It is emphasized that “Transactions and Events” excludes transactions entered into with owners.

SFAC No.8, paragraph OB12.

The less descriptive terms Unrealized Gains and Unrealized Losses may be used in parts of this Memorandum to improve readability or to accommodate space limitations in presentation.
The remainder of this Memorandum will i) lay the foundation for what qualities useful information should possess for reporting the financial performance of an Investment Company, ii) analyze the root causes for the aforementioned Deficiencies, iii) expound on the phenomena through which the Deficiencies manifest themselves without affecting the Bottom-Line, and iv) describe possible remedies for the Deficiencies. The appendices which follow this Memorandum will demonstrate the effects of these Deficiencies and their Recommended Remedies; present a comparison of financial statements compiled in accordance with current practices versus those resulting from applying the Recommended Remedies; justify the greater divergence in reporting practices vis-à-vis those of Operating Companies; examine less significant reporting shortcomings and implementation considerations; and provide a glossary to acronyms and terms.

DISCERNING USEFUL P&L INFORMATION FOR INVESTMENT COMPANIES

To best appreciate how the Deficiencies affect the usefulness of SOO information (by way of that information’s Relevance and Representational Faithfulness8), it is essential to recognize what Investment Companies are all about. Investment Companies are best described by the following:

1. By definition, Investment Companies invest to generate returns via Capital Appreciation, Investment Income, or both.9
2. By nature, the operations of Investment Companies primarily entail the buying, holding, and disposing of investments.
3. Most times, Investment Companies are managed on a fair-value basis10 and transact with its equity investors on a NAV basis11.

Most times, it is along the first two constructs that a Fund’s investment objective and investment strategy differentiate themselves from those of other Funds and is how the Fund was introduced to its investors in the Investment offering. Thus, in the context of Investment Companies, the Relevance and Representational Faithfulness of information should be judged based on how they inform the SOO’s reader as to how the Company’s primary activities of buying, holding, and disposing investments increased or decreased the NAV of the Company and whether the profits and losses were of a Capital Appreciation or Investment Income nature.

Capital Appreciation has come to mean the difference between the value to be received when an investment is sold and the value given up when the investment was acquired. For the purpose of determining Capital Appreciation before an investment is actually sold, an investment’s fair value as of Reporting Date serves as a proxy of the value to be received upon a hypothetical sale. Investment Income has come to mean cash or other value that an Investment Company is entitled to receive from the Investee during the period that the investment is held excepting receipts which terminate the investments (e.g., return of the principal of lent, settlement of callable instruments). This Investment Income is normally accrued into NAV as a receivable and is done so upon the passage of time or the occurrence of particular milestones or events. Oftentimes, the value to be received in an actual sale or to be recognized for an hypothetical one is affected my many factors and, hence, is less predictable and/or less controllable than the cash or value to be received from the Investee during the period that the investment is held. Thus, returns generated as Capital Appreciation may be interpreted by some as being less controllable in their past occurrence and being less predictable in terms of repeating themselves in the future than the returns generated as Investment Income.

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8 SFAC No.8, paragraphs QC4 and QC5.
11 It is acknowledged that there are circumstances in which NAV may not be the basis for an Investment Company to transact with its equity investors (e.g., funds with multiple “fund closings”, and business development companies).
For all practical purposes, the primary activities of Investment Companies are restricted to the buying, holding, and disposing of investments because one of the fundamental characteristics that an entity must possess in order to apply the accounting and reporting practices of Investment Companies is that it cannot invest for “strategic operating purposes”. Thus, operating an Investee for the purpose of producing, selling, or delivering goods and/or services (i.e., anything other than buying, holding, and disposing investments) would disqualify that entity from being classified as an Investment Company. The buying of investments does not normally generate changes in NAV. The holding of investments normally changes NAV i) by the recognition of a change in an investment’s fair value (Capital Appreciation) and ii) by the receipt of cash or other value from the Investee, or more accurately – the accrual of that receipt (Investment Income). The disposing of an investment (from sale or offset) can also generate a change in NAV caused by the difference between the recognition of the value to be received and the derecognition of the value of the investment disposed (Capital Appreciation).

ASC 946-10-15-7 spells out that one of the typical characteristics of Investment Companies is that they manage their investments on a fair value basis. ASC 946-10-55-27 elaborates as to what this might mean – which includes having fair value being a key component in evaluating investment performance and in transacting with its equity investors. A consequence of evaluating financial performance and transacting with equity investors on a fair value/NAV basis is that distinct and discrete Accounting Periods (with a separate period being established for each interval in which invested capital is constant) are usually used for reporting financial performance and for allocating profits and losses between investors. In effect, each of these Accounting Periods is a reset from the one immediately preceding it for the purposes of performance measurement and profit and loss allocation.

Put into practice, an amount representing the total change in NAV resulting from operations (the “Bottom-Line”) is calculated for each Accounting Period. In these circumstances, the Rate-Of-Return (“ROR”) reported is calculated from discreet RORs calculated for each of these Accounting Periods.

There are a number of factors that bring about the Deficiencies. They include i) the determination of income, gains, and losses with reference to the investments’ cost bases, ii) the use of captions and the definition of those captions that together are misleading, and ii) the re-characterization of income/expense from derivative contracts as gains/losses from the revaluations and from the dispositions of such contracts.

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12 It is acknowledged that this terminology of “strategic operating purposes” was formerly incorporated into the ASC as pending content ASC 946-10-55-15 through ASC 946-10-55-16, and this terminology was replaced with the issuance of ASU 2013-08. However, the substance of that term was maintained by ASC 946-10-15-6b which states “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”.

13 Transacting with equity investors on a NAV-basis involve determining an individual investor’s equity as the investor’s pre-capital transaction equity i) PLUS value received from that investor as capital contributions or ii) MINUS value set aside as capital withdrawals/distributions for that investor. The ownership percentage utilized for allocating profits and losses is determined as an individual investor’s equity in an investor class DIVIDED by the total equity of that investor class.

14 Refers to the “linking” of discreet RORs as mandated by ASC 946-205-50-20 through ASC 946-205-50-22. The Author acknowledges that this may not be applicable in circumstances in which an Investment Company meets the criteria described in ASC 946-205-50-23, in which case, an internal rate-of-return is reported. The Author also acknowledges that this linking of RORs is not applicable for funds which meet the criteria for classification as a unitized fund, in which case ASC 946-205-50-19 directs that the ROR be calculated based on the change in NAV per unit during the Reporting Period.
COST BASIS REPORTING

A primary cause of these Deficiencies is the fact that income from and gains and losses sustained on investments as reported in the SOO are derived with reference to the investments’ cost bases and not their fair values. As Investment Companies must measure their investments at fair value, the fair values of investments (not their cost bases) are the driver of an Investment Company’s NAV, and changes in those fair values cause changes in NAV and financial performance. Determining income, gains, and losses with reference to the investments’ cost bases gives rise to the reporting of information which is NOT relevant to understanding increases and decreases in NAV over the Reporting Period arising from the holding and disposition of investments.

As a result of measuring gains and losses with reference to the investments’ cost bases, Realized Gains reported by the SOO do NOT NECESSARILY indicate that the selling transactions from which they were derived impacted NAV and ROR in a positive manner, and, conversely, Realized Losses do NOT NECESSARILY indicate that the selling of the related investments impacted NAV and ROR negatively. Similarly, Unrealized Gains do NOT NECESSARILY report favorable Transactions and Events with respect to NAV and ROR nor must Unrealized Losses reflect unfavorable ones. Even the Element Investment Income may NOT report the accrual of cash (or other value) to be received from the Investee from holding an investment as the amount reported for interest income may be distorted by the amortization of premiums/accretion of discounts and by adjustments for Realized Gains/Losses from prepayments (or paydowns).

To better explain the phenomenon that Realized Gains/Losses do NOT report the increase/decrease in NAV from transactions disposing investments, it is necessary to recognize that Realized Gains/Losses report only a portion of the increase/decrease in NAV from such transactions; the “other portion” is embedded in the Element net Change in Unrealized Appreciation/Depreciation. This “other portion” represents a reversal of Unrealized Gains/Losses recognized in prior Accounting Periods. (See Exhibit EM-I on page 14) As a Realized Gain or a Realized Loss may have been reported and as this “other portion” reported as a component of net Change in Unrealized Appreciation/ Depreciation may be NAV-increasing or NAV-decreasing, the realized and unrealized components may amplify or offset each other. The net result from disposing an investment may be an increase or a decrease in NAV. The reader of the SOO will not be able to discern which result that is, and, oftentimes, the preparer of the financial statements will also find this difficult to do. As a result, Realized Gains reported by the SOO do NOT NECESSARILY indicate that the selling transactions from which they were derived impacted NAV and ROR in a positive manner, and, conversely, Realized Losses do NOT NECESSARILY indicate that the selling of the related investments impacted NAV and ROR negatively. In almost all cases, the amounts reported as Realized Gains/Losses do NOT report the increases/decreases in NAV from transactions disposing investments.

The phenomenon in which the Element net Change in Unrealized Appreciation/Depreciation, in most cases, can NOT be interpreted as reporting changes in NAV arising from an “appreciation” or a “depreciation” in the value of investments held is also explained by Exhibit EM-I. Although such valuation changes are reflected in the amounts reported as Unrealized Gains/Losses, as expounded upon in the previous paragraph and made clear by Exhibit EM-I, this reporting Element also incorporates the impacts of the reversal of Unrealized Gains/Losses recognized in prior Accounting Periods on investments disposed in the current Accounting Period. Exhibit EM-I also shows that the recognition of amortization/accretion re-characterizes some of these Unrealized Gains/Losses as increases/losses.

\[\text{an} \quad \text{15} \quad \text{The exception to this would be the rare instances in which the fair value (at the end of the previous Accounting Period) of the investment disposed equaled its cost basis or the investment disposed was acquired in the current Accounting Period.}\]
COST BASIS REPORTING (CONTINUED)

decreases to Interest Income. Hence, Unrealized Gains do NOT NECESSARILY report favorable events with respect to NAV and ROR NOR MUST Unrealized Losses reflect unfavorable ones. In almost all cases, the amounts reported as Unrealized Gains/Losses do NOT report the increases/decreases in NAV from valuation changes of investments held.

Even the reporting Element Investment Income may NOT report the accrual of cash or other value that an Investment Company is entitled to receive from the Investee during the period that the investment is held (excepting the proceeds to be received which terminate an investment – e.g., return of the principal of lent, settlement of callable instruments). An example of this phenomenon is the amount of interest income reported. This amount of interest income to be received is based upon the coupon rate multiplied by the principal (both stipulated in the debt instrument) prorated for the number of days outstanding during the Reporting Period; however, the amount of interest income reported in the SOO may be distorted by the recognition of the amortization of premiums/accretion of discounts. When premiums are amortized and discounts accreted, a portion of the Holding Gains/Losses is re-characterized as an increase/decrease in interest income. Thus, in some cases, the amounts reported as Investment Income do NOT report the increases in NAV from the accrual of cash or other value that an Investment Company is entitled to receive from the Investee.

USE OF MISLEADING CAPTIONS

“Cost Basis Reporting”, on its own, results in the reporting of amounts which are NOT RELEVANT to understanding increases and decreases in NAV arising from Transactions and Events. Using captions which describe these amounts in ways that suggest they report the financial effects of Transactions and Events when, in fact, they do not, is misleading to the reader.

Realized Gains/Losses

A layman-English understanding of the caption Realized Gain/Loss and the definition of that caption in the notes to the financial statements as describing gains and losses which arose from the dispositions of investments would lead many readers to understand that the amounts reported next to those captions as reporting the increases and decreases in NAV which arose from Transactions that sold, or otherwise disposed of, investments. As explained in the previous section pertaining to “Cost Basis Reporting”, the reporting Elements Realized Gains and Realized Losses do not report such increases and decreases in NAV from the dispositions of investments.

Unrealized Gains/Losses

In the context of misunderstanding the significance of Realized Gains/Losses and together with a layman-English understanding of the term “unrealized”, it would not be unreasonable for readers to interpret the amounts reported as Unrealized Gains/Losses as meaning increases and decreases in NAV which arose from valuation changes while holding the investments. If some other form of this term which includes the words “appreciation” and/or “depreciation” is used, this erroneous implication in meaning is even stronger. As put forth in the section pertaining to “Cost Basis Reporting”, the Elements Unrealized Gains and Unrealized Losses do not report increases and decreases in NAV from the valuation increases and valuation decreases of investments.

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16 The exception to this would be instances in which there were no investment dispositions during the Reporting Period or the fair value(s) (at the end of the previous Accounting Period) of the investment(s) disposed equaled its (their) cost basis (bases).
USE OF MISLEADING CAPTIONS (CONTINUED)

Investment Income

Investment Income has come to mean the cash or value received or to be received from Investees during the period the investments are held (with the exception of receipts which terminate the investments – e.g., return of the principal of lent, settlement of callable instruments). Current US GAAP directs that certain amounts reported as Investment Income should deviate from this broad meaning. The distortive effects of the recognition of amortization/accretion on the amount of interest income reported is one example explained in the previous section “Cost Basis Reporting”. This reporting practice inappropriately re-characterizes an increase/decrease in NAV arising from Capital Appreciation to one resulting from Investment Income.

Another example of current US GAAP practices causing the reporting Elements of Investment Income to deviate from the conceptual meaning noted in the previous paragraph is the reporting of Realized Gains/Losses on paydowns of certain securities. Specifically, under current US GAAP, Realized Gains/Losses on paydowns on asset-backed or mortgage-backed securities are to be reported as adjustments to interest income. This reporting practice not only inappropriately re-characterizes an increase/decrease in NAV arising from Capital Appreciation to one resulting from Investment Income; it also inappropriately re-characterizes an increase/decrease in cash inflow which occurred upon the disposition of the investment as an increase/decrease in cash inflow from holding the investment.

RECHARACTERIZATION OF DERIVATIVE INCOME AND EXPENSES

Cost basis reporting and the use of misleading captions are the primary impetus of SOO’s shortcomings; however, a secondary impetus is one found in how income/expense from derivative contracts is commonly reported in SOOs.

Investing in and/or writing most derivative contracts usually involve minimal cash flows at inception of contract and much more significant cash flows at that contract’s termination – with no cash flows occurring between these inception and termination dates. However, for certain derivative contracts (e.g., many total return swap contracts), the terms of the contract spell-out cash settlements between the counterparties during the period that derivative contracts are held (as opposed to cash received/paid at contract initiation or contract expiration/close-out). The amounts arising from some terms are fixed in nature and can be and are accrued. The amounts of other terms are variable and are determined in accordance with the specific terms of the contract. In both cases, cash is paid/received between the contract’s counterparties, but the contract itself is not terminated. Current US GAAP practice is to disclose such interim cash receipts and cash payments as Realized Gains and Realized Losses on derivative contracts despite the fact that such cash flows do not represent receipts/payments to dispose the contracts and to terminate the risks associated with them. The accrued balances of such receipts or payments at Reporting Date are reported as adjustments to the fair values of the related derivative contracts, and the changes in such accruals are reported as adjustments to the net Changes in Unrealized Appreciation/ Depreciation.

The financial reporting practice described in the previous paragraph for Derivative Income/Expense is not directed by any specific ASC guidance in Topic 946 or Topic 815 – Derivatives and Hedging. Neither is this reporting practice the result of guidance contained in the industry handbook – AICPA Audit and Accounting Guide: Investment Companies (the “Guide”). Thus, the genesis and the underlying rationale for this practice are unclear. What is clear is that the effect of this practice is to change what would otherwise be reported as Investment Income to reporting such amounts as Capital Appreciation and to change the “holding” nature of the activity to one reported as arising from “disposition”.

AR-2017
Comment Letter No. 2
OFFSETTING DEFICIENCIES

This Memorandum asserts that the financial statement Elements of the SOO are deficient and, for this reason, require replacing. However, such an assertion is not made about the Bottom-Line or the ROR derived from the Bottom-Line. As the deficient reporting Elements of Investment Income, Realized Gains/Losses, and Unrealized Gains/Losses comprise three of the four components of the Bottom-Line (with the fourth component, fund expenses, not characterized as being deficient), a logical question that might arise is “How is this possible that the parts are deficient, but the whole resulting from these parts is not (deficient)?” The answer rests in the fact that the distortive effects in those three components of profits and losses offset each other. The component in which lie almost all of the compensating distortions is Unrealized Gains/Losses (aka net Changes in Unrealized Appreciation/Depreciation). Key to understanding these compensating distortions is the ability to identify the drivers of Unrealized Gains/Losses and to isolate the amounts of Unrealized Gains/Losses attributed to each driver.

The SOO and the accompanying notes to the financial statements define net Change in Unrealized Appreciation/Depreciation on investments as the change in the difference between the investments’ aggregate fair values and their aggregate cost bases during a Reporting Period. In short, it is nothing more than the meaningless arithmetic change in that difference which, almost always, can NOT be (or more accurately, is NOT) related back to the drivers of those changes – drivers such as Transactions (i.e., sales of investments) and Events (i.e., accounting adjustments from revaluations or from the recognition of amortization/accretion). The amounts of net Change in Unrealized Appreciation/Depreciation resulting from each of these drivers report just a portion of the financial effects of Transactions and Events. When these portions are combined with the portions reported next to other captions of the SOO, the complete and accurate picture of the financial impacts of Transactions and Events can be understood in terms of the “appreciation” Vs “income” nature of the return and the buying, holding, and disposing activities that would have generated them. The table below outlines what these basic drivers are and the other SOO Elements in concert with which such Changes in Unrealized Appreciation/Depreciation must be assessed in order to appreciate the changes in NAV arising from Transactions and Events along the lines that would be most relevant for readers and that would most faithfully represent those Transactions and Events.

Exhibit EM-I

<table>
<thead>
<tr>
<th>Drivers and Related Amounts of &quot;Net Change in Unrealized Appreciation/Depreciation&quot;</th>
<th>Amounts in Other SOO Captions</th>
<th>=</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Amortization of premium/accretion of discount ~</td>
<td>Interest income ~</td>
<td>Career Appreciation and/or Investment Income from Transactions and Events</td>
</tr>
<tr>
<td>(b) Reversal of Unrealized Gain/Loss on non-Derivative investments sold ^</td>
<td>Net Realized Gain (Loss) on non-Derivative investments ^ NOT APPLICABLE</td>
<td>Gain/loss from Capital Appreciation sustained on investments disposed</td>
</tr>
<tr>
<td>(c) Valuation increase/decrease on investments held at end of period</td>
<td>Net Realized Gain (Loss) on Derivative Contracts *</td>
<td>Gain/loss from Capital Appreciation sustained from holding investments</td>
</tr>
<tr>
<td>(d) Reversal of Unrealized G/L on Derivatives disposed *</td>
<td>Change in accrued Derivative Income *</td>
<td>Investment Income from holding and disposing Derivative Contracts</td>
</tr>
</tbody>
</table>

~ The accounting recognition of the amortization of premium/accretion of discount results in an adjustment to interest income and an offsetting adjustment to Unrealized Gain/Loss. Thus, netting the amount of Unrealized Gain/Loss driven by an amortization/accretion effectively backs that adjustment out of interest income.

^ As Net Realized Gain (Loss) reports Capital Appreciation/Depreciation experienced at disposition since the acquisition of the investment (and not just during the Reporting Period), Unrealized Gain (Loss) driven by the reversal of Unrealized Gain (Loss) already recognized in prior Reporting Periods avoids double-counting that Capital Appreciation/Depreciation in the current Reporting Period.
OFFSETTING DEFICIENCIES (CONTINUED)

Exhibit EM-I – continued

* Net Realized Gain (Loss) on Derivative Contracts reports Capital Appreciation/Depreciation experienced at contract CLOSE-OUT since the inception of the contracts AND, where applicable, receipts from contract counterparties on OPEN contracts during the Reporting Period. Unrealized Gain (Loss) driven by the reversal of Unrealized Gain (Loss) already recognized in prior Reporting Periods avoids double-counting that Capital Appreciation/Depreciation in the current Reporting Period AND the change in the accrual of Derivative Income converts receipts from those counterparties to Derivative Income accrued for the Reporting Period.

In principle, the substance, if not the form, of the analysis encapsulated by Exhibit EM-I is required as a disclosure in current US GAAP – specifically, by ASC 220-10-45-17. This conclusion is based on the following premises:

1. ASC 220-10-15-2b explicitly affirmed that guidance pertaining to Comprehensive Income apply to Investment Companies.
2. Unrealized Appreciation/Depreciation for Investment Companies is an Element of Accumulated Other Comprehensive Income.
3. net Changes in Unrealized Appreciation/Depreciation driven by the recognition of amortization/accretion and by the disposition of investments represent Reclassification Adjustments as defined in ASC 220-10-20.

ASC 220-10-45-17 requires disclosures which explain how Reclassification Adjustments impacted Net Income – which is defined as Comprehensive Income which has not been classified as Other Comprehensive Income. For Investment Companies and their SOOs, that would describe all reporting Elements other than Changes in Unrealized Appreciation/Depreciation despite the fact that Net Income is not a caption found in the SOO. Although the analytical disclosure demonstrated by Exhibit EM-I is required for Investment Companies in principle, in practice, such a disclosure is almost never provided. The reason for this, no doubt, is that the terminology utilized in SOOs does not align with the terms used in ASC Topic 220 – Comprehensive Income – terms such as Net Income, Other Comprehensive Income, Comprehensive Income and Accumulated Other Comprehensive Income.

RECOMMENDED REMEDIES

The best way to correct these Deficiencies is to change the Elements reported on the face of the SOO (as opposed to requiring additional disclosures for the purpose of mitigating the effects of the Deficiencies. See the section “Alternative Remedy” on page 20). The following encompass the specific changes to the SOO that are being recommended:

1. Require that gains and losses from investment dispositions be reported under the caption Disposition Gains/Losses and to define such Disposition Gains/Losses as the difference between i) the amount of disposition proceeds (or other value) to be received and ii) either the fair value of the investment disposed as of the end of the PREVIOUS Accounting Period, if applicable, or if the investment disposed was not held as of the end of the previous Accounting Period, the cost incurred to acquire it.

2. Require that gains and losses from valuation changes be reported under the caption Holding Gains/Losses and to define such Holding Gains/Losses as the difference between i) the fair value of an investment as of the end of the CURRENT Accounting Period and ii) either the fair value of that same investment as of the end of the PREVIOUS Accounting Period, if applicable, or if the investment was not held as of the end of the previous Accounting Period, the cost incurred to acquire it.\(^{17}\)

\(^{17}\) Holding Gains/Losses is a term already in the ASC’s Master Glossary and in the Glossary of ASC 320-10-20 and is used by Operating Companies for describing such gains/losses from valuation changes. The Glossary of ASC 946-225-20 would either need to define “Holding gains/losses” as stated in the Recommended Remedies, or a different caption would have to be used.
3. Require that purchased premium/discount on debt securities be amortized/accreted and reported as adjustments to interest income only for debt securities classified as cash equivalents or short-term investments.

4. Require accruals of the receipts and the payments to be made against derivative contracts (other than those to be received or to be paid at the initiation or termination of those contracts) be reported under the captions Derivative Income or Derivative Expense. Accrued Derivative Income/Expense is to be reported as derivative income receivable or derivative expense payable, as applicable. Payments made at the initiation of the derivative contracts are to be treated as “cost...to acquire” for the purposes of measuring Disposition Gains/Losses and Holding Gains/Losses. Proceeds (or other value) received at the disposal of the derivative contract are to be referenced as “disposition proceeds” for the purposes of measuring Disposition Gains/Losses.

(See Appendix I for examples that demonstrate how these Recommended Remedies rectify the Deficiencies, and see Appendix IV for implementation considerations.)

DIVERGENCES FROM GENERIC US GAAP

Greater Divergence from US GAAP for Operating Companies

It is acknowledged that the Recommended Remedies to the reporting Deficiencies represent substantial departures from US GAAP for Operating Companies (also referred to hereinafter as “Generic US GAAP”). In assessing whether such departures are appropriate, it should be noted that US GAAP for Investment Companies already deviates from US GAAP for Operating Companies in very significant ways, and these deviations have been affirmed by FASB as being necessary by the very existence of the specialized Investment Company guidance contained in ASC Topic 946. Thus, precipitating a significant divergence from Generic US GAAP should not be an impediment to the consideration and possible implementation of the Recommended Remedies.

The section which follows argues that the need to diverge from US GAAP for Operating Companies is driven by fundamental differences in the general nature of how Investment Companies operate as compared to their Operating Company counterparts. Appendix III examines how the current financial statement Elements of the statement of Comprehensive Income and the SOO might serve Operating Companies well, but they are not suitable for Investment Companies.

Fundamental Differences in Nature of Operations

The nature of every industry is different from the nature of every other industry. However, the nature of an Investment Company’s operations is fundamentally dissimilar from that of an Operating Company so that the reporting needs of its stakeholders are dramatically unlike those of the stakeholders of an Operating Company. In the paragraphs that follow, these differences in nature and in reporting needs will be examined.

Firstly, equity investors of Investment Companies usually achieve a return of their investments and a return on their investments by transacting directly with the Investment Company on a NAV basis where, for all practical purposes, NAV represents the aggregate fair value of the Company’s assets minus the aggregate fair value of the Company’s liabilities. The NAV attributed to an individual investor is increased dollar-for-dollar by the value received from that investor as capital contributions. This attributed NAV is then increased for that investor’s

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18 The phrase,“...for all practical purposes...”, acknowledges that the measurement attributes of all assets and of all liabilities do not meet the definition of “fair value” as that term is define by ASC Topic 820 – Fair Value Measurements. However, the essence of that term captures the substance the Author is seeking to communicate.
allocated share of income and gains, and it is decreased for the allocated share of expenses and losses. The resulting attributed NAV is decreased dollar-for-dollar for value to be paid to that investor as capital withdrawals/distributions. The ownership percentage of an individual investor is determined as an individual investor’s attributed NAV in an investor class divided by the total NAV of that investor class.\(^{19}\)

Operating Companies, on the other hand, usually generate returns for their equity investors through profit distributions (e.g., dividends) and from proceeds that these equity investors receive for transferring their ownership stake to another party. The amounts of these distributions and sale proceeds are not tied to a calculation of attributed NAV. The sale proceeds to be received are based on the supply and the demand for that ownership instrument. Even if the instruments evidencing this equity ownership have call or put options or are executed as part of a stock buy-back program (i.e., resulting in treasury shares), it is extremely unlikely that such transactions are executed on a NAV-basis since Operating Companies seldom, if ever, calculate NAV. Thus, unlike equity investors of Investment Companies, the value that equity investors of Operating Companies realize from their investment in and their divestiture from their ownership stake is NOT TIGHTLY LINKED to the amount of equity reported in US GAAP financial statements,\(^{20}\) and, hence, the change in that equity need not be understood in the same light.

Secondly, Operating Companies’ operations usually involve the utilization and combining of a multitude of resources the nature of which is characterized by equipment, material, land, infrastructure, labor, management, etc. These resources are employed for the purpose of providing the Company’s customers with goods and/or services in return for receiving sales or service revenues. In contrast, the primary activities of Investment Companies involve the buying, holding, and selling of investments; and, by definition, the returns generated by those activities are in the form of Capital Appreciation and Investment Income.

The financial impacts of an Operating Company’s primary activities (e.g., selling inventory) are reported in its statement of Net Income/Comprehensive Income as sales/service revenues and as cost of goods/services sold. Understanding the operating results of an Operating Company centers on understanding the drivers of these two financial statement Elements and the drivers of operating expenses. Gains and losses on the statement of Net Income/Comprehensive Income report the financial impacts of transactions which are only peripheral to the Operating Company’s operations.\(^{21}\) In contrast, the gains and losses on an Investment Company’s SOO report the financial impacts of that Company’s primary activities. Thus, understanding the operating results of an Investment Company REQUIRES understanding the drivers of these gains and losses. Due to these stark differences in the nature of the primary activities and in the form of the return to the Company and its investors, the nature of the information that readers of financial statements of Investment Companies require is substantially different from that of readers of financial statements of Operating Companies.

Sameness of accounting and reporting practices across all types of Companies has not been identified by FASB as a goal onto its own. However, FASB has identified comparability as a quality of information that enhances the usefulness of that information. According to FASB, comparability is supposed to aid readers in identifying and

\(^{19}\) The economic effects from these accounting mechanics described for a non-unitized fund are achieved for a unitized fund by issuing and redeeming ownership units at the NAV per unit price prevailing at the time of issuance or redemption.

\(^{20}\) SFAC No.8, paragraph OB7 affirms that GAAP financial statements (for Operating Companies) are not designed to show the value of the Company. In contrast, the NAV reported in the financial statements for Investment Companies are designed to show the value of those companies. The NAV attributed to an individual investor is often utilized by that investor as an estimate of the fair value of their ownership stake.

\(^{21}\) SFAC No.3.
RECOMMENDED REMEDIES (CONTINUED)

DIVERGENCES FROM GENERIC US GAAP (CONTINUED)

understanding similarities in and differences between items being compared. Comparability is not uniformity. For information to be comparable, like things must look alike and different things must look different. Investment Companies and Operating Companies are clearly different “things”. Although the qualities that make information useful to the financial statement readers of those respective types of Companies are the same, the manner through which financial statements instill such qualities in the respective information reported should look different as the needs are different. Greater divergence in comparing the manifestations of US GAAP for these two types of Companies should NOT be a deterrent for making the proposed changes.

FEASIBILITY OF RECOMMENDED REMEDIES

It should be expected that accounting systems and financial reporting processes already deployed have been designed to meet the accounting and reporting requirements currently in force. Thus, it would not be remarkable that they are not currently suited for capturing, recording, archiving, and reporting gains and losses in accordance with the proposed reporting methodology. However, implementing the proposed changes should NOT require significant costs to develop the required information and processes for generating the required reports. To better understand this assessment, the following paragraphs will review the challenges to implementation and the solutions that are available to address those challenges.

Characteristics of Current Systems and Processes

Accounting systems are usually designed around the requirements of tax reporting and the general paradigm in US GAAP accounting and reporting. Specifically, transactions are recorded following the bookkeeping mechanics which characterize cost-basis accounting. Adjustments are made to certain assets and liabilities to reflect them at their fair values and, if applicable, at their functional currency equivalents. For the SOO, this means that income, expenses, gains and losses are, first, determined utilizing cost-basis accounting. Assets and liabilities that are to be re-measured at fair value are, then, trued-up to their fair values (aka “marking-to-market”) through the use of specific Unrealized Appreciation/Depreciation accounts. The counter-balancing entry in “marking” certain assets and liabilities “to market” is posted to the accounts, Change in Unrealized Appreciation/Depreciation. Assets and liabilities that are denominated in a currency other than the functional currency are adjusted in a similar fashion – with the end result being that the true-up is to their translated values. For assets and liabilities that are measured at fair value and are denominated in a currency other than the functional currency, their balances are marked-to-market as determined in the currency of denomination and, then, adjusted to state that fair value in terms of their functional currency equivalents.

As marking-to-market basically involve the trueing-up of period-end balances to fair values, the counter-balancing entry to Change in Unrealized Appreciation/Depreciation does not capture separately the change resulting from valuation fluctuations VERSUS the change resulting from the reversal of Unrealized Appreciation/Depreciation recognized on assets and liabilities disposed VERSUS the change resulting from the recognition of amortization/accretion.

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22 SFAC No.8, paragraph OC23.
23 Refers to the translation of balances denominated in a currency other than the functional currency into amounts expressed in the functional currency.
FEASIBILITY OF RECOMMENDED REMEDIES (CONTINUED)

Financial reporting processes compile financial statements from the data housed in these accounting systems by –

i) Assigning and aggregating amounts of different general ledger accounts (sourced from a trial balance) to the different financial statement Elements of the balance sheet, the SOO, and the statement of changes in equity. This assignment and aggregation (often referred to as “account mapping”) is done in a manner that will generate financial statements that will, as much as is possible by way of automated processing, contain the requisite content and represent that content in the form required by US GAAP.

ii) Applying a few off-book (aka “top-side”) adjustments to the balances and amounts from i) above to bring about the reporting of the required amounts. These top-side adjustments are developed from data that are apart from the trial balance but are sourced mostly from the accounting system.

Approaches For Implementing Recommended Changes

Longer-Term

It should be recognized here that the Deficiencies relate to financial reporting and NOT to accounting (or the “keeping of the books”). Doing so acknowledges the fact that the maintenance of accounting data serves ends other than the compilation of general-purpose financial statements. An obvious example of such a purpose is tax compliance and tax reporting. For this reason, even if the Recommended Remedies are adopted, fund accounting systems must continue to account for transactions on the basis of cost so as to be able to capture realized and unrealized gains and losses referencing that cost basis. To implement the Recommended Remedies, such systems must only be enhanced so that they also capture the accounting data needed to support the reporting of Disposition Gains/Losses and Holding Gains/Losses as such gains and losses are determined by references to the prior Accounting Period’s fair values. Specifically, the accounting systems must be improved so that they are able to, and do, disaggregate the amounts currently reported by general ledger accounts as total Change in Unrealized Appreciation/Depreciation into separate general ledger accounts that capture sub-totals reflecting the changes driven by valuation changes, by dispositions, and by amortization/accretion.

In short, the system changes pertaining to data architecture and programming that are required to support the Recommended Remedies should not be extensive. Once these system changes have been implemented, compiling a SOO that reports Disposition Gains/Losses and Holding Gains/Losses (as opposed to Realized Gains/Losses and Unrealized Gains/Losses) can be carried-out WITHOUT the use of top-side adjustments.

Near-Term

Undoubtedly, it will take some (though not extensive) time to make the necessary system modifications described in the previous paragraphs. Until that occurs, financial reporting processes have the means for arriving at the same results through the use of top-side adjustments. Applying the top-side adjustments will be a simple matter; the challenge will probably be in ensuring that the financial statement preparers have the requisite analytical competency to develop the proper amounts for those adjustments.

Such top-side adjustments basically involve re-allocating and re-characterizing the total realized and unrealized gains and losses (and, where applicable, interest income from amortization/accretion) between Disposition Gains/Losses and Holding Gains/Losses. The following illustrates the NAV-neutrality of this adjustment:

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24 The statement of cash flows cannot be compiled by sourcing its data solely from trial balances, and, thus, its preparation follows a different process.
RECOMMENDED REMEDIES (CONTINUED)

FEASIBILITY OF RECOMMENDED REMEDIES (CONTINUED)

Exhibit EM-II

<table>
<thead>
<tr>
<th>Realized Gains and Losses</th>
<th>Disposition Gains and Losses</th>
</tr>
</thead>
<tbody>
<tr>
<td>PLUS</td>
<td>PLUS</td>
</tr>
<tr>
<td>Unrealized Gains and Losses</td>
<td>MINUS/PLUS</td>
</tr>
<tr>
<td>PLUS</td>
<td>PLUS</td>
</tr>
<tr>
<td>adjustment to interest income for amortization/accretion</td>
<td>equals</td>
</tr>
</tbody>
</table>

The data needed to develop this top-side adjustment are readily available (i.e., data such as the quantity and pricing inputs at the end of the previous Accounting Period, at the end of current Accounting Period, and those realized at disposition).

IMPROVING RATE-OF-RETURN ATTRIBUTION

One of the disclosures that US GAAP requires of Investment Companies that it does not require of Operating Companies is the disclosure of some form of ROR. Since ROR allows investors to relate the amount of the Bottom-Line to the level of net resources employed to bring it about, it is a key performance measure used for assessing management’s efficiency in terms of its utilization of the Investment Company’s net assets/invested capital. A ROR allows each equity investor a means for estimating the change in the value of his/her/its ownership stake in the Investment Company over the Reporting Period. It also allows that investor to compare the performance achieved by the Investment Company to that of other investments in other Companies (of the same or different asset class). For these reasons, the ROR is, probably, one of the reported metrics which garners the most attention.

The ROR achieved by an Investment Company is tied most directly to the amount of the Bottom-Line reported by the SOO for an Accounting Period (as the numerator of the ROR calculation) and to the amount of capital invested at the beginning of that same Accounting Period (as the denominator of the ROR calculation). Being able to disaggregate the SOO’s Bottom-Line into amounts derived from the buying, holding, and disposing of investments and into amounts arrived at from valuation changes and from income allows the ROR to be understood along the lines of its performance drivers. Thus, the mangled and distorted reporting by the SOO makes it extremely difficult, if not outright impossible, to attain such an understanding from reading the SOO. Correcting this distortion will permit the Investment Company’s management to attribute the ROR to its underlying performance drivers.

ALTERNATIVE REMEDY

An alternative remedy to changing the financial statement Elements reported on the face of the SOO (as is proposed by the Recommended Remedies) is to require the disclosure of additional information which would permit SOO’s readers to understand how net Changes in Unrealized Appreciation/Depreciation resulted from –

1. the recognition of changes in the valuations of investments still held at the end of the Accounting Period
2. the recognition of amortization/accretion and how that recognition affected the amount of interest income reported
3. the reversal of the net appreciation/depreciation recognized in prior Accounting Periods on investments disposed in the current Accounting Period (and how that reversal should be interpreted together with Realized Gains/Losses to discern the total gains/losses from disposing investments).
ALTERNATIVE REMEDY (CONTINUED)

In principle, such a disclosure is already required by ASC 220-10-45-17; however, this guidance has been disregarded by Investment Companies due to the fact that the terminology utilized in SOOs does not align with the terms used in ASC Topic 220 – terms such as Net Income, Other Comprehensive Income, and Comprehensive Income.

To effect such a requirement should probably involve adding guidance to ASC Topic 946 so that the requirements of ASC 220-10-45-17 are effectively applied by Investment Companies. Specifically, additional guidance should be inserted into ASC Topic 946 (possibly as ASC 946-220-10??) requiring the disclosure of information in the notes to the financial statements that disaggregate the amounts of investment income, net Realized Gains/Losses and net Changes in Unrealized Appreciation/Depreciation in such a manner so as to distinguish i) between amounts resulting from holding investments and those from disposing investments and ii) between amounts that arise from Capital Appreciation and those amounts that arise from Investment Income. Doing so will permit the readers of the SOO to understand the increases and decreases in NAV from Transactions and Events and the “valuation” Vs “income” nature of these changes.

The financial reporting practices described in this section (and elaborated upon further in Appendix IV as part of implementation considerations) are hereinafter referred to as the “Alternative Remedy”.

AN INFERIOR ALTERNATIVE

This Alternative Remedy is being offered for consideration for those who are uncomfortable with the far-reaching changes being proposed by the Recommended Remedies. However, it is the opinion of the Author that this Alternative Remedy is inferior due to the following reasons –

1. The lack of usefulness of the information currently reported on the face of the SOO is not rectified.
2. This low degree of utility of SOO information hinders ROR attribution with respect to performance drivers.
3. Uncorrected, this low degree of utility of SOO information is carried forward by down-stream allocations as such allocations are based on the components reported in the SOO.
4. Uncorrected, the distortions in SOO reporting cause distortions in the Financial Highlight ratios of net Investment Income and of expenses relative to average net assets and, in the case of unitized Funds, also in the reporting of changes in the NAV per ownership unit. These distortions in the Financial Highlights ratios are carried forward to Financial Highlight disclosures prepared for down-stream entities such as feeder funds in a master-feeder fund structure.

The preparation of a SOO is done to serve a purpose – to help readers understand how Transactions and Events changed the Investment Company’s NAV. If this purpose is not served, then, the reason for issuing a SOO should be in doubt. The statement of changes in owners’ equity would suffice if all that is being asked to be answered in terms of financial performance is “what” (is the Bottom-Line) and not “how” (that Bottom-Line came to be).

It should be self-evident that any distortive reporting in the SOO is carried forward to financial performance reporting derived from that distorted information. In a master-feeder investment structure, this would be true for the SOOs of feeder funds as most of their reporting Elements are allocated from those of the master fund(s). In circumstances in which the “character of income” is reported to each individual investor in the statements reporting the value of his/her/its equity investment in the Investment Company and the change in that value, the components reported do little to explain “why” their particular investment performed the way that it did.

ASC 220-10-15-2b explicitly affirms that guidance pertaining to comprehensive income apply to Investment Companies.
ALTERNATIVE REMEDY (CONTINUED)

AN INFERIOR ALTERNATIVE (CONTINUED)

Generally, the Financial Highlight ratios of expenses and of net investment income to average net assets are computed utilizing the respective amounts of expenses and net investment income reported on the face of the SOO as inputs. For unitized Funds, the total change in the NAV per ownership unit is disaggregated into changes in the NAV per ownership unit associated with the individual Elements of the SOO. Thus, distortions in SOO reporting with regards to these Elements cause distortions in the reported percentages of these Financial Highlight ratios and in the reporting of the change in the NAV per ownership unit. In a master-feeder fund structure, this is true not only for the ratios of the master fund, but this distortion in the master fund also infects the ratios of the feeder fund(s) and, if applicable, in the reporting of the change in the NAV per ownership unit.

In short, the fact that this Alternative Remedy in the notes to the financial statements only compensates for the Deficiencies but permits the distorted reporting on the face of the SOO to continue fails to i) affirm the purpose of the SOO and ii) correct the distorted downstream reporting resulting upon the distortions existent on the face of the SOO. For this reason, this Alternative Remedy is found to be better than current practice but inferior to the Recommended Remedies.

THE NEED TO RE-REASSESS

By now, it is clear that this Memorandum is being submitted in an attempt to rectify what has been characterized as significant financial reporting Deficiencies. However, this Memorandum is also being submitted because most of the reporting guidance and practices as they relate to Investment Companies (aka “specialized Investment Company accounting”) were originally developed outside of FASB’s full deliberative processes. It is hoped that this Memorandum could be the impetus for initiating more in-depth deliberations on this subject matter.

To begin, it is worthy to note that most of the reporting practices which deviate from Generic US GAAP and which comprise specialized Investment Company accounting were mandated by, derived from, and/or influenced by laws, regulations, and industry pronouncements NOT issued by FASB or FASB’s predecessors. These include the Investment Company Act of 1940; regulations issued by the Securities and Exchange Commission, the Internal Revenue Service, and other governmental bodies; and pronouncements issued by the American Institute of Certified Public Accountant (“AICPA“) and by other industry associations. A much more limited scope of these specialized practices was the result of guidance issued by FASB itself. Before the issuance of the ASC, specialized Investment Company accounting found its voice through the AICPA Guide. Although these Guides had come to have been cleared by FASB in the years leading up to the inclusion of their content into the ASC (as industry Topic 946), they were never the subject of comprehensive and substantive reviews by FASB as might result in the issuance of a Statement of Financial Accounting Standards or an Accounting Standards Update.

Not being the product of FASB’s full deliberative processes increases the risk that some of the practices comprising specialized Investment Company accounting may cause the financial statements of Investment Companies to veer further from the financial reporting objectives delineated by FASB than practices that have been subjected to such thorough reviews. In some circumstances, these specialized practices may cause ambiguities which lead to Investment Companies not applying a guidance which FASB has explicitly stated is applicable to Investment Companies. In other respects, the industry guidance in ASC Topic 946 does not direct Investment Companies to utilize reporting practices which are more conducive to their financial statements meeting the financial reporting

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26 ASC 946-205-50-14.
27 The subject matter of ASU 2013-08 pertained primarily to guidance concerning the definition of and the determination as Investment Companies and not to the reporting practices of Investment Companies.
THE NEED TO RE-REASSESS (CONTINUED)

objectives put forth by FASB (i.e., the practices which are the subject of this Memorandum). Appendix III analyzes how the same financial statement Elements used by Operating Companies and Investment Companies alike in reporting financial performance may serve the needs of the former but not the latter.

In assessing reporting practices for their value in helping Investment Companies achieve the financial reporting objectives defined by FASB, this Memorandum was written making numerous references to the Conceptual Framework put forth by FASB. These references borrowed not only the fundamental concepts but also the language and terminology utilized in the SFACs. While acknowledging that the Conceptual Framework does not define US GAAP nor does it bind US GAAP and the underlying ASC guidance (to comply with SFAC’s objectives), FASB has articulated its intention that, “...in due course, the Conceptual Framework will serve as a basis for evaluating existing guidance and practices”. Again, this Memorandum is being submitted to seek such an evaluation.

Acknowledging that sound concepts are the basis of rational and effective solutions, it is also recognized that the designs of those solutions must take into account issues observed empirically. Thus, this Memorandum was also guided by practical real-world experiences the Author acquired from being a preparer and a reviewer of more than a thousand financial statements for Investment Companies and Operating Companies. This real-world experience included many occasions in which the Author was asked by auditors to explain the results reported in the SOO in terms of actual Transactions and Events that occurred. This experience also included observing the disconnect often present between the amounts reported in the SOO and the communications offered to investors by way of management commentaries to explain those results. Hands-on experience compiling financial statements together with discussions with reviewers, fellow preparers, and readers of those statements have convinced the Author that the reporting practices of the current SOO need to be re-examined under the auspices of FASB’s full deliberative processes.

CONCLUSION

FASB has set out that an overall aim of general-purpose financial statements (for all companies, Investment Companies included) is to provide financial information which is useful to a broad constituency of users of those statements. One of the primary uses of this information is to get informed regarding an entity’s net result from operations AND to understand how that result was achieved. For Investment Companies, this entails explaining how Transactions and Events triggered changes in NAV. These Transactions and Events occur in the context of buying, holding, and selling investments; and the results take the form of Capital Appreciation/Depreciation and income/expenses. As detailed in this Memorandum, the Deficiencies make it extremely difficult, if not impossible, for the SOO to accomplish these objectives.

These Deficiencies stem primarily from i) the reporting of gains and losses determined with reference to an attribute (i.e., cost basis) which is irrelevant to obtaining the desired understanding and ii) the use of captions that describe those amounts in ways that lend them to be easily misinterpreted. The ease with which such a misinterpretation can occur and the absence of information from within other parts of the financial statements necessary to avoid such a misinterpretation, together, make the information reported in the SOO misleading. Information which is severely flawed in these respects is of little usefulness. As a result, although much time and effort are expended to prepare and audit the information contained in the SOO, in the end, the SOO is seldom the primary source of any useful information other than the one-line Bottom-Line.

The inability of the SOO to deliver insight into how the Bottom-Line was achieved hinders its readers in their efforts to evaluate past efforts by management, to confirm or adjust previous expectations for results going forward, and to assess future uncertainties. Management affects an Investment Company’s Bottom-Line primarily by utilizing the resources made available to it (i.e., the Company’s net assets) to buy, hold, and sell investments.
The expected “appreciation” versus “income” nature of the profits and losses produced by these activities is, most times, one of the main descriptors in the investment offering presented to an Investment Company’s investors. Thus, it is logical that an evaluation of management’s stewardship of those resources focuses on how investment activities affected NAV and in what form those effects manifested themselves. Each investor/creditor formulates his or her own expectations regarding future results. Information about the variability and driving components of financial performance are useful for resetting these expectations and for assessing the uncertainties surrounding them.29 The informational distortions arising from the Deficiencies obfuscate this information.

This Exposition is focused on failings in the financial reporting of Investment Companies the impacts from which are most significant and the remedies of which are quite feasible. The scope of this examination has been narrowly defined so that these failings could be rectified by FASB as soon as is practical. After this has been accomplished, FASB is urged to undertake a more comprehensive review of the specialized reporting practices of Investment Companies as most of these specialized practices were developed outside the full deliberative processes of FASB. The distortion and convolution in the SOO make the reporting of financial performance by Investment Companies a prime candidate for FASB’s Simplification Initiative. It is almost certain that such unhelpful reporting and unnecessary complexity require management to resort to the use of non-GAAP measures to analyze and explain financial performance to the Investment Company investors. As the use of customized and tailored non-GAAP performance measures has garnered the attention and concern of FASB and the SEC,30 eliminating unhelpful reporting and unnecessary complexity should bring about the favorable consequence of a significant reduction in the use of such non-GAAP measures. Finally, much effort was made in this Exposition to base problem identification and solutions development on FASB’s own Conceptual Framework so that any change in reporting practices result from FASB’s own stated desire to follow a more principles-based approach to standard-setting.

29 SFAC 8 paragraph OB16
30 FASB’s quarterly publication “From the Chairman’s Desk”, Q1 2017.
APPENDICES
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FUNDAMENTAL DEFICIENCIES OF US GAAP FINANCIAL STATEMENTS FOR INVESTMENT COMPANIES

APPENDIX I
DEMONSTRATING DEFICIENCIES AND REMEDIES

This appendix will demonstrate i) the reporting impacts of the Deficiencies and other reporting shortcomings of current US GAAP and ii) the remediation brought about by the Recommended Remedies.

MULTI-FACETED DISTORTIONS

To illustrate the wide range of ways through which current US GAAP distorts financial reporting, the investment parameters in this example have been varied to fit the following hypotheticals:

(a) Alpha: Previously appreciated SOLD at a GAIN
(b) Beta: Previously appreciated SOLD at a LOSS
(c) Delta: Previously depreciated PAID-DOWN at a LOSS
(d) Epsilon: Previously depreciated SOLD at a GAIN
(e) Gamma: HOLDING GAIN with discount ACCRETION
(f) Kappa: SOLD 50% at GAIN & HOLDING LOSS on remaining 50%
(g) Sigma: Derivative contract w/ financing leg INCOME

Exhibit Appl-I: Recommended Remedies Versus Current US GAAP Reporting

<table>
<thead>
<tr>
<th>Investment</th>
<th>Repayment Principal/ Shares</th>
<th>Cost Basis</th>
<th>Unrealized Appreciation/ Depreciation</th>
<th>Fair Value</th>
<th>Proceeds from Sale/ Paydown</th>
<th>End of Period Fair Value</th>
<th>Interest/ Derivative Income</th>
<th>Transactions &amp; Events</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Alpha</td>
<td>NA $ 2,000 $ 150 $ 2,150</td>
<td>$ 2,488 $ - $ -</td>
<td>SOLD at a GAIN of $ 338</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(b) Beta</td>
<td>NA $ 3,303 $ 699 $ 4,002</td>
<td>$ 3,725 $ - $ -</td>
<td>SOLD at a LOSS of $ (277)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(c) Delta</td>
<td>NA $ 985 $ (1,160) $ 825</td>
<td>$ 778 $ - $ -</td>
<td>PAID-DOWN at LOSS of $ (47)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(d) Epsilon</td>
<td>NA $ 6,500 $ (1,377) $ 5,123</td>
<td>$ 5,445 $ - $ -</td>
<td>SOLD at a GAIN of $ 322</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(e) Gamma</td>
<td>$ 8,000 $ 7,818 $ 1,343 $ 9,152</td>
<td>$ - $ 9,633 $ 269</td>
<td>INCOME/HOLD GAIN $ 750</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(f) Kappa</td>
<td>$ 800 $ 1,213 $ 313 $ 1,526</td>
<td>$ 822 $ 751 $ -</td>
<td>SOLD GAIN/HOLD LOSS $ 47</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(g) Sigma</td>
<td>$ 133 $ 1,000 $ 1,133</td>
<td>$ - $ 1,011 $ 5</td>
<td>INCOME/HOLD LOSS $ (117)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

^ Accreted discount of $17
^ Sold 400 shares w/ $711 cost basis

$ 23,911 $ 13,258 $ 11,395 $ 274 $ 24,927 $ 1,016 BOP-NAV EOP-NAV NAV Change

Current US GAAP Reporting

<table>
<thead>
<tr>
<th>Investment</th>
<th>Interest Income</th>
<th>Realized Gain (Loss)</th>
<th>Unrealized Gain (Loss)</th>
<th>Total Gain (Loss)</th>
<th>Gain/Loss = (Proceeds or Fair Value&lt;sub&gt;EOP&lt;/sub&gt;) - Fair Value&lt;sub&gt;BOP&lt;/sub&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Alpha</td>
<td>$ - $ 488</td>
<td>(150)</td>
<td>$ 338</td>
<td>$ 338 ($2,488 - $2,150)</td>
<td></td>
</tr>
<tr>
<td>(b) Beta</td>
<td>- $ 422</td>
<td>(699)</td>
<td>(277)</td>
<td>(277) ($3,725 - $4,002)</td>
<td></td>
</tr>
<tr>
<td>(c) Delta</td>
<td>(207)</td>
<td>- 160</td>
<td>(47)</td>
<td>(47) ($778 - $825)</td>
<td></td>
</tr>
<tr>
<td>(d) Epsilon</td>
<td>- (1,055)</td>
<td>1,377</td>
<td>322</td>
<td>322 ($5,445 - $5,123)</td>
<td></td>
</tr>
<tr>
<td>(e) Gamma</td>
<td>286</td>
<td>- 464</td>
<td>750</td>
<td>750 ($9,633-$9,152+$269)</td>
<td></td>
</tr>
<tr>
<td>(f) Kappa</td>
<td>- 111</td>
<td>(64)</td>
<td>47</td>
<td>47 ($822 - 50% X $1,526)</td>
<td></td>
</tr>
<tr>
<td>(g) Sigma</td>
<td>- (117)</td>
<td>(117)</td>
<td>5</td>
<td>5 ($1,011-$1,133)</td>
<td></td>
</tr>
</tbody>
</table>

Per $00 $ 79 $ (34) $ 971 $ 1,016 $ 274 $ 395 $ 347 $ 1,016

At both the investment-level and in the aggregate, current US GAAP reporting Elements of Realized Gains/Losses and Unrealized Gains/Losses present information which is not only un-useful with respect to understanding the NAV impacts of Transaction and Events; the information is actually misleading.
ELIMINATING DISTORTIONS ➔ REVEALING INSIGHT

Obviously, SOOs do not present a detailed view of the Transactions and Events occurring during the Reporting Period as was done in Exhibit AppI-I; the information reported would be much more summarized. This summarization exacerbates the Deficiencies of Current US GAAP reporting. Reporting carried-out utilizing the Recommended Remedies is clear, straightforward, and insightful regardless of summarization.

Exhibit AppI-II

<table>
<thead>
<tr>
<th>Current US GAAP Reporting</th>
<th>Recommended Remedies</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>STATEMENT OF OPERATIONS</strong></td>
<td></td>
</tr>
<tr>
<td>Investment income</td>
<td>(1) $ 79</td>
</tr>
<tr>
<td>Expenses</td>
<td>-</td>
</tr>
<tr>
<td>Net investment income</td>
<td>79</td>
</tr>
<tr>
<td>Net realized loss</td>
<td>(2) (34)</td>
</tr>
<tr>
<td>Net unrealized gain</td>
<td>(3) 971</td>
</tr>
<tr>
<td>Net realized and unrealized gains and losses</td>
<td>937</td>
</tr>
<tr>
<td>Result of Operations</td>
<td>$ 1,016</td>
</tr>
</tbody>
</table>

**NOTES TO THE FINANCIAL STATEMENTS (OR MANAGEMENT COMMENTARY)**

(1) Investment Income
- Interest income $ 269
- Adjustment for accretion 17
- Adjustment for realized loss on paydowns (207)
  - ?? Meaningful?? $ 79
(2) Net Disposition Gain
- Proceeds from dispositions $ 13,258
  - Fair value of investment disposed (12,863)
- Gain on disposition $ 395
(3) Net Holding Gain
- Fair value at end of period $ 11,395
- Fair value at beginning of period (11,048)
- Gain from valuation increase $ 347

The example presented is a fairly simple one. It is for a Fund with a SMALL portfolio, with ZERO expenses, with NO leveraging, and with NO FOREIGN CURRENCY translations. Yet, even in such a simplistic scenario, Current US GAAP Reporting is erroneously communicating that the Fund’s dispositions caused NAV to DECREASE by $34 and is leaving the erroneous impression that investments APPRECIATED by $971. And although the Fund’s NAV increased by $274 from cash received as interest income and as income on the OPEN derivative contract, Current US GAAP Reporting is attributing only $79 to investment income. This example demonstrates that although the amounts presented by Current US GAAP Reporting can be repeatedly replicated by accountants and auditors, they cannot be verified to meaningful facts pertaining to the Transactions and Events that gave rise to those amounts. In contrast, amounts reported utilizing the Recommended Remedies can be reconciled to insightful facts about those Transactions and Events. And if it so difficult to reconcile the Current US GAAP Reporting above to the simple facts in Exhibit AppI-I, imagine the impossibility that readers will experience with all the complexities of most real-world Funds. As shown here, the reporting practices of the Recommended Remedies have no such difficulty.
### REVEALING INSIGHT ⇒ IMPROVED PERFORMANCE ATTRIBUTION

<table>
<thead>
<tr>
<th>Investment</th>
<th>Results of Operations</th>
<th>Attribution of Rate-Of-Return</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Income</td>
<td>Gain/ (Loss)</td>
</tr>
<tr>
<td>Alpha</td>
<td>$ -</td>
<td>$338</td>
</tr>
<tr>
<td>Beta</td>
<td>$ -</td>
<td>(277)</td>
</tr>
<tr>
<td>Delta</td>
<td>$ -</td>
<td>(47)</td>
</tr>
<tr>
<td>Epsilon</td>
<td>$ -</td>
<td>322</td>
</tr>
<tr>
<td>Gamma</td>
<td>$269</td>
<td>-</td>
</tr>
<tr>
<td>Kappa</td>
<td>$ -</td>
<td>59</td>
</tr>
<tr>
<td>Sigma</td>
<td>5</td>
<td></td>
</tr>
<tr>
<td><strong>Per S0O</strong></td>
<td>$274</td>
<td>$395</td>
</tr>
</tbody>
</table>

Replacing the current US GAAP financial statement Elements with more meaningful ones not only allows an Investment Company’s financial performance be understood in terms of the buy/hold/sell activities that gave rise to it but also the Capital Appreciation versus Investment Income nature of the returns generated. This significantly improved understanding of the impetus of financial performance stated in dollar terms is, then, carried onwards to ROR attribution for the purpose of assessing what drove the efficiency with which such performance was achieved. Such ROR attributions can be reported for classes of investments, for the fund as a whole, or for investor classes.

### ELIMINATING ARBITRARY & IRRELEVANT VARIATIONS IN GAINS AND LOSSES REPORTED

<table>
<thead>
<tr>
<th>Investment</th>
<th>Beginning of Period</th>
<th>Transaction and Event</th>
<th>End of Period</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Shares</td>
<td>Cost Basis</td>
<td>Unrealized Appreciation</td>
</tr>
<tr>
<td>Kappa</td>
<td>Tax Lot-A</td>
<td>400</td>
<td>$711</td>
</tr>
<tr>
<td></td>
<td>Tax Lot-B</td>
<td>400</td>
<td>$502</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Relieved Cost Lot-A</th>
<th>Relieved Cost Lot-B</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Investment</th>
<th>Realized Gain (Loss)</th>
<th>Unrealized Gain (Loss)</th>
<th>Total Gain (Loss)</th>
<th>Realized Gain (Loss)</th>
<th>Unrealized Gain (Loss)</th>
<th>Total Gain (Loss)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kappa</td>
<td>Tax Lot-A</td>
<td>-</td>
<td>111</td>
<td>(52)</td>
<td>59</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>Tax Lot-B</td>
<td>-</td>
<td>-</td>
<td>(12)</td>
<td>(12)</td>
<td>-</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Recommended Remedies</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Investment</th>
<th>Disposition Gain (Loss)</th>
<th>Holding Gain (Loss)</th>
<th>Total Gain (Loss)</th>
<th>Disposition Gain (Loss)</th>
<th>Holding Gain (Loss)</th>
<th>Total Gain (Loss)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kappa</td>
<td>Tax Lot-A</td>
<td>-</td>
<td>59</td>
<td>-</td>
<td>59</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>Tax Lot-B</td>
<td>-</td>
<td>-</td>
<td>(12)</td>
<td>(12)</td>
<td>-</td>
</tr>
</tbody>
</table>

Under current US GAAP reporting, the gains and losses “realized” and “unrealized” depend on which cost lot is relieved although in most cases the relief of either lot produces the same economic impacts for the Investment Company’s stakeholders. Implementing the **Recommended Remedies** the same Disposition Gain and Holding Loss are reported regardless of cost lot relieved. The information reported is more useful as the gains/losses reported are relevant, and they represent faithfully the Transactions and Events that generated them.

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31 For possible exceptions, see Appendix IV (page 46) under the section “PERMIT REPORTING OF REALIZED AND UNREALIZED GAINS/LOSSES IN NOTES”.

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AR-2017 Comment Letter No. 2
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FUNDAMENTAL DEFICIENCIES OF US GAAP FINANCIAL STATEMENTS FOR INVESTMENT COMPANIES

APPENDIX II
SIDE-BY-SIDE COMPARISON: RECOMMENDED REMEDIES VS CURRENT US GAAP AT DECEMBER 31, 20X2 AND FOR THE YEAR THEN ENDED

STATEMENT OF ASSETS AND LIABILITIES – AT DECEMBER 31, 20X2

<table>
<thead>
<tr>
<th>Description</th>
<th>Recommended Remedies ($/Mil)</th>
<th>Current US GAAP ($/Mil)</th>
<th>Diff ($/Mil)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment Portfolio - Fair Value</td>
<td>$702.1</td>
<td>$702.4</td>
<td>$ (0.3) (a)</td>
</tr>
<tr>
<td>Interest Receivable</td>
<td>7.6</td>
<td>7.6</td>
<td>-</td>
</tr>
<tr>
<td>Dividend Receivable</td>
<td>12.2</td>
<td>12.2</td>
<td>-</td>
</tr>
<tr>
<td>Derivative Income Receivable</td>
<td>0.3</td>
<td>-</td>
<td>0.3 (a)</td>
</tr>
<tr>
<td>Cash</td>
<td>49.9</td>
<td>49.9</td>
<td>-</td>
</tr>
<tr>
<td>Redemptions Payable</td>
<td>(19.8)</td>
<td>(19.8)</td>
<td>-</td>
</tr>
<tr>
<td>Mgmt Fees Payable</td>
<td>(2.2)</td>
<td>(2.2)</td>
<td>-</td>
</tr>
<tr>
<td>Non-Mgmt Fee Payable</td>
<td>(3.8)</td>
<td>(3.8)</td>
<td>-</td>
</tr>
<tr>
<td><strong>NET ASSET VALUE</strong></td>
<td><strong>$746.3</strong></td>
<td><strong>$746.3</strong></td>
<td><strong>$ -</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Description</th>
<th>($/Mil)</th>
<th>($/Mil)</th>
<th>($/Mil)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment Portfolio</td>
<td>$626.7</td>
<td>$626.7</td>
<td>$ -</td>
</tr>
<tr>
<td>Unrealized appreciation/depreciation</td>
<td>75.4</td>
<td>75.7</td>
<td>$ (0.3) (a)</td>
</tr>
<tr>
<td>Fair value</td>
<td>$702.1</td>
<td>$702.4</td>
<td>$ (0.3)</td>
</tr>
</tbody>
</table>

(a) Current US GAAP reclassifies accrued Derivative Income as of 12/31/20X2 as an adjustment to portfolio fair value. Recommended Remedies reports accrued Derivative Income as Derivative Income Receivable.
**STATEMENT OF OPERATIONS – FOR THE YEAR ENDED DECEMBER 31, 20X2**

### Recommended Remedies

<table>
<thead>
<tr>
<th>($/Mil)</th>
<th>Fund</th>
<th>Activity</th>
<th>Nature of P&amp;L</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Investment Income</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest income - Accrued</td>
<td>$2.2</td>
<td>0.30%</td>
<td>Hold</td>
</tr>
<tr>
<td>Interest income - Amort/Accret</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dividend income</td>
<td>3.4</td>
<td>0.46%</td>
<td>Hold</td>
</tr>
<tr>
<td>Derivative income</td>
<td>0.6</td>
<td>0.08%</td>
<td>Hold</td>
</tr>
</tbody>
</table>

| **Fund Expenses** | | | |
| Mgmt fee expense | (2.2) | -0.30% | Operate | Income |
| Non-mgmt fee expenses | (0.8) | -0.11% | Operate | Income |

| **Net Investment Income** | | | |
| | 3.2 | 0.43% | Income |

### Disposition Gain (Loss)

| | | |
| Proceeds | 33.5 | Sell |
| FV of Investments Sold | (29.5) | Sell |

| Disposition gain (loss) | 4.0 | 0.54% | Sell | Apprec |

### Holding Gain (Loss)

| Gain (loss) fm pricing changes | 19.0 | Hold | Apprec |

| Holding Gain (Loss) | 19.0 | 2.57% | Buy/Hold | Apprec |

| **Results of Operations** | | | |
| | $26.2 | 3.54% |

### Current US GAAP

<table>
<thead>
<tr>
<th>($/Mil)</th>
<th>Fund</th>
<th>Activity</th>
<th>Nature of P&amp;L</th>
<th>Diff ($/Mil)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Investment Income</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest income - Accrued</td>
<td>$2.2</td>
<td>Hold</td>
<td>Income</td>
<td>-</td>
</tr>
<tr>
<td>Interest income - Amort/Accret</td>
<td>0.1</td>
<td>NA</td>
<td>DISTORTION</td>
<td>(0.1) (a)</td>
</tr>
<tr>
<td>Dividend income</td>
<td>3.4</td>
<td>Hold</td>
<td>Income</td>
<td>-</td>
</tr>
<tr>
<td>Derivative income</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| **Fund Expenses** | | | |
| Mgmt fee expense | (2.2) | Operate | Income | - |
| Non-mgmt fee expenses | (0.8) | Operate | Income | - |

| **Net Investment Income** | 2.7 | 0.36% | ??? | DISTORTED | 0.5 |

### Net Realized Gain (Loss)

| Proceeds | 33.5 | Sell | Apprec | - |
| Cost basis of Investments Sold | (28.1) | Sell | Apprec | (1.4) (b) |
| Derivative income accrued | 0.6 | Hold | Income | (0.6) (c) |
| Change in accrued deriv income | (0.2) | NA | DISTORTION | 0.2 (c) |

| Net realized gain (loss) | 5.8 | 0.78% | ??? | DISTORTED | (1.8) |

### Net Unrealized Gain (Loss)

| Unrealized G/L fm pricing changes | 19.0 | Hold | Apprec | - |
| Reversal of Unrealized G/L on investments sold | (1.4) | Sell | Apprec | 1.4 (b) |
| Accretion/amortization | (0.1) | NA | DISTORTION | 0.1 (a) |
| Change in accrued deriv income | 0.2 | NA | DISTORTION | (0.2) (c) |

| Net unrealized gain (loss) | 17.7 | 2.39% | ??? | DISTORTED | 1.3 |

| **Results of Operations** | | | |
| | $26.2 | 3.54% | |

(a) Current US GAAP requires purchased premium/discount be amortized/accreted into *Investment Income*, the adjustment to the cost basis is offset by an adjustment to Unrealized Appreciation/Depreciation. The result is a Non-NAV impacting reclass in P & L between *interest income & Unrealized Gain (Loss)*.

(b) Current US GAAP determines *Realized G/L* as Proceeds LESS the Cost Basis of investments sold. The *Unrealized Appreciation/Depreciation* previously booked is "reversed" giving rise to *Unrealized G/L*. Thus, a portion of the gain (loss) from dispositions is reported as *Realized G/L* & a portion as *Unrealized G/L*.

(c) Under current US GAAP, reclassifications between *Investment Income*, *Realized G/L*, and *Unrealized G/L* are affected to report *Derivative Income* receipts as *Realized G/L* and to incorporate *accrued Derivative Income* into the portfolio fair value.
## STATEMENT OF CASH FLOWS – FOR THE YEAR ENDED DECEMBER 31, 20X2

### Recommended Remedies

<table>
<thead>
<tr>
<th>Description</th>
<th>$(/Mil)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash Flows From Operating Activities:</strong></td>
<td></td>
</tr>
<tr>
<td>Results From Operations</td>
<td>$26.2</td>
</tr>
<tr>
<td>Adjust for Disposition Gain/Loss</td>
<td>(4.0)</td>
</tr>
<tr>
<td>Adjust for Holding Gain/Loss</td>
<td>(19.0)</td>
</tr>
<tr>
<td>(Incr)/decr in Interest Receivable</td>
<td>(1.3)</td>
</tr>
<tr>
<td>(Incr)/decr in Dividends Receivable</td>
<td>(6.5)</td>
</tr>
<tr>
<td>(Incr)/decr in Derivative Income Receivable</td>
<td>(0.2)</td>
</tr>
<tr>
<td>Incr/(decr) in Mgmt Fee Pay</td>
<td>0.2</td>
</tr>
<tr>
<td>Incr/(decr) in Non-MF Exp Pay</td>
<td>0.8</td>
</tr>
<tr>
<td><strong>Net Cash Fm Operating Activities</strong></td>
<td>(3.8)</td>
</tr>
<tr>
<td><strong>Cash Flows From Investing Activities:</strong></td>
<td></td>
</tr>
<tr>
<td>Pymts for securities purchased</td>
<td>(97.1)</td>
</tr>
<tr>
<td>Receipts for securities sold</td>
<td>29.4</td>
</tr>
<tr>
<td>Receipts/(Pymts) for derivatives initiated</td>
<td>(0.2)</td>
</tr>
<tr>
<td>Receipts/(Pymts) for derivatives closed</td>
<td>4.1</td>
</tr>
<tr>
<td><strong>Net Cash Fm Investing Activities</strong></td>
<td>(63.8)</td>
</tr>
<tr>
<td><strong>Cash Flows From Financing Activities:</strong></td>
<td></td>
</tr>
<tr>
<td>Receipts from subscriptions</td>
<td>85.0</td>
</tr>
<tr>
<td>Payments for redemptions</td>
<td>(4.0)</td>
</tr>
<tr>
<td><strong>Net Cash Fm Financing Activities</strong></td>
<td>81.0</td>
</tr>
<tr>
<td><strong>Net Change in Cash</strong></td>
<td>13.4</td>
</tr>
<tr>
<td><strong>Cash at 12/31/20X1</strong></td>
<td>36.5</td>
</tr>
<tr>
<td><strong>Cash at 12/31/20X2</strong></td>
<td>$49.9</td>
</tr>
</tbody>
</table>

### Current US GAAP

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<thead>
<tr>
<th>Description</th>
<th>$(/Mil)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash Flows From Operating Activities:</strong></td>
<td></td>
</tr>
<tr>
<td>Results From Operations</td>
<td>$26.2</td>
</tr>
<tr>
<td>Adjust for Realized Gain/Loss</td>
<td>(5.8)</td>
</tr>
<tr>
<td>Adjust for Unrealized Gain/Loss</td>
<td>(17.7)</td>
</tr>
<tr>
<td>Adjust for Amortization/Accretion</td>
<td>(0.1)</td>
</tr>
<tr>
<td>(Incr)/decr in Interest Receivable</td>
<td>(1.3)</td>
</tr>
<tr>
<td>(Incr)/decr in Dividends Receivable</td>
<td>(6.5)</td>
</tr>
<tr>
<td>Incr/(decr) in Mgmt Fee Pay</td>
<td>0.2</td>
</tr>
<tr>
<td>Incr/(decr) in Non-MF Exp Pay</td>
<td>0.8</td>
</tr>
<tr>
<td><strong>Net Cash Fm Operating Activities</strong></td>
<td>(67.6)</td>
</tr>
<tr>
<td><strong>Cash Flows From Investing Activities:</strong></td>
<td></td>
</tr>
<tr>
<td>Pymts for securities purchased</td>
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<td>(0.2)</td>
</tr>
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<td>4.5</td>
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<td>(67.6)</td>
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<tr>
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</tr>
<tr>
<td><strong>Cash at 12/31/20X2</strong></td>
<td>$49.9</td>
</tr>
</tbody>
</table>

(a) See Statement of Operations

(b) Under current US GAAP, reclassifications of Derivative Income receipts (computed as $0.6 million accrued MINUS $0.2 million increase in accrual balance) as Realized G/L on derivatives results in the reporting of Derivative Income receipts as receipts from dispositions versus as receipts from income.

^ Difference between the sum of operating and investing activities of Recommended Remedies and operating activities for Current US GAAP.
SELECTED DISCLOSURES IN THE NOTES TO THE FINANCIAL STATEMENTS – FOR THE YEAR ENDED DECEMBER 31, 20X2

PORTFOLIO ROLLFORWARD

<table>
<thead>
<tr>
<th></th>
<th>Securities</th>
<th>Derivatives</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair Value at 12/31/20X1</td>
<td>605.5</td>
<td>9.8</td>
<td>615.3</td>
</tr>
<tr>
<td>Purchases of new investments</td>
<td>97.1</td>
<td>0.2</td>
<td>97.3</td>
</tr>
<tr>
<td>Proceeds from sale of investments</td>
<td>(29.4)</td>
<td>(4.1)</td>
<td>(33.5)</td>
</tr>
<tr>
<td>Disposition gains (losses)</td>
<td>1.0</td>
<td>3.0</td>
<td>4.0</td>
</tr>
<tr>
<td>Amortization/Accretion</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Holding gains (losses)</td>
<td>20.1</td>
<td>(1.1)</td>
<td>19.0</td>
</tr>
<tr>
<td>Fair Value at 12/31/20X2</td>
<td>694.3</td>
<td>7.8</td>
<td>702.1</td>
</tr>
</tbody>
</table>

(a) Under current US GAAP, reclassifications of Derivative Income receipts as Realized G/L results in the reporting of Derivative Income receipts as receipts from dispositions versus reporting them as receipts from income.

(b) See Statement of Operations

(c) Under current US GAAP, the balances of accrued Derivative Income as of 12/31/20X1 and as of 12/31/20X2 are reclassified as adjustments to the portfolio fair values as of these respective dates.

DISPOSITION GAINS (LOSSES)

<table>
<thead>
<tr>
<th></th>
<th>Securities</th>
<th>Derivatives</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proceeds from sale of investments</td>
<td>29.4</td>
<td>4.1</td>
<td>33.5</td>
</tr>
<tr>
<td>Fair value of investments sold</td>
<td>(28.4)</td>
<td>(1.1)</td>
<td>(29.5)</td>
</tr>
<tr>
<td>Disposition gains (losses)</td>
<td>1.0</td>
<td>3.0</td>
<td>4.0</td>
</tr>
</tbody>
</table>
APPENDIX III
DIVERGENCE OF INDIVIDUAL ELEMENTS FROM OPERATING COMPANY GAAP

The intended audience for this appendix includes those who are much more knowledgeable about the subject matter than the Author and also those who may be less informed. With that in mind, it has been written to compare, justify and support the proposed divergences in reporting practices to the well-informed and to those who may be less familiar with the subject matter. For this reason, this appendix has been written with explanations that are more rudimentary and more in depth than would, otherwise, be necessary for the well-informed readers.

PURPOSE

The Recommended Remedies described in the Explanatory Memorandum (the “Memorandum”) propose changes that will make the content in the Statement of Operations (“SOO”) for Investment Companies significantly different from the content found in the comparable statement of its Operating Company counterparts – i.e., the statement of Net Income and the statement of Comprehensive Income. These differences, it is argued in the Memorandum, are justified by the fundamental differences in the nature of how Investment Companies operate versus how Operating Companies operate. These differences in the general operations of Investment Companies were elaborated upon in the Memorandum. 32

The deficiencies identified in the SOO and the changes recommended to remedy them were explained in the Memorandum. However, as the financial statement Elements to be replaced have been in use and have been part of US GAAP for many years, this appendix has been written to better examine how these individual Elements and specific reporting practices might serve Operating Companies well but are not suitable for Investment Companies.

BASIS AND EVOLUTION OF FINANCIAL STATEMENTS FOR INVESTMENT COMPANIES

US GAAP guidance for financial accounting and reporting for Investment Companies has as its origins and as its current foundation the guidance put forth for all Companies in general. For this reason, many, if not most, of its financial statement Elements and reporting practices can be traced back to the guidance FASB and its predecessors have put forth for all Companies. The industry guidance which is applicable specifically to Investment Companies (codified in Topic 946 of the ASC) is incremental to the general guidance found in other topics of the ASC. FASB guidance was developed not only to meet the general objectives of financial reporting but also to address specific issues brought to FASB’s attention. These specific issues and the guidance that resulted were considered in the context in which Companies, in general, operate. Exempting Investment Companies from specific aspects of the general guidance or altering the manner in which it is applied is codified in ASC Topic 946 or applying such exemptions to Companies that fall within the scope of ASC Topic 946.

HISTORICAL CONVENTIONS AND KEY BENCHMARKS OF FINANCIAL PERFORMANCE

At the core of US GAAP is cost basis accounting. This is rooted in both the historical evolution of accounting and in the certainty and verifiability that this basis of accounting offers. At the heart of finance and the reporting of financial performance was the benchmark, Net Income (aka “earnings”). Net Income was delegated the function to

32 See RECOMMENDED REMEDIES – DIVERGENCES FROM GENERIC US GAAP (page 15).
measure the net effect on a Company’s equity from the transactions entered into by that Company and from the measurement and re-measurement of assets and liabilities. Under the guidance of specific recognition and measurement principles, these effects on equity were reported as revenues, expenses, gains and losses – all of which went into the computation of Net Income.

As financial reporting evolved, the changes in equity from some re-measurements of assets and liabilities were excluded from the computation of Net Income; instead, they were reported as direct changes to certain components of equity. One example germane to the subject matter of this Exposition is the requirement that debt and equity securities held as Available-For-Sale be measured at fair value. The impacts on equity of the revaluations of such securities were recognized and de-recognized directly in equity and were not components of Net Income. As the concept of Comprehensive Income was developed and adopted for US GAAP reporting, the impacts on equity from these revaluations were defined as Elements of Other Comprehensive Income.

ASSESSING CURRENT REPORTING PRACTICES

With the understanding described in the preceding section as our starting basis, the following paragraphs explain why the financial statement Elements reporting financial performance might present information which is useful for understanding how the Bottom-Line came to be for Operating Companies, but that can NOT be said for understanding the same for Investment Companies.

Much is explained by the importance of Net Income as a benchmark for financial performance for Operating Companies. This benchmark is not found in performance reporting for Investment Companies. For Investment Companies, prominence is given to the Element increase/decrease in net assets resulting from operations – the equivalence of Comprehensive Income for Operating Companies. As the rationale supporting many of the reporting practices of Operating Companies (including those for investments in financial instruments) is based upon the amounts to include in or exclude from the computation of Net Income, such rationale is not applicable to Investment Companies. As the related reporting practices results in information which misleads the readers of the SOO with regards to the financial impacts of Transactions and Events, such practices should be discontinued.

For the purpose of the comparative analyses that follow, the accounting and reporting practices of an Operating Company invested in a security classified as Available-For-Sale (and the rationale behind those practices) will be compared to those of an Investment Company. For securities so classified, fair value is the measurement attribute required to be reported by both Operating Companies and Investment Companies alike.

When Available-For-Sale securities are acquired, they are initially recognized onto the books at cost. They are subsequently re-measured at fair value (with such fair value adjustments commonly referred to as “mark-to-market” and results in the recognition of a Holding Gain or a Holding Loss). Operating Companies classify the impact of this mark-to-market adjustment on Comprehensive Income as Other Comprehensive Income (identified by the caption Unrealized Appreciation/Depreciation) and is included in the computation of Comprehensive Income but is NOT included in the computation of Net Income. Investment Companies classify mark-to-market adjustments as Change in Unrealized Appreciation/Depreciation.

The new guidance of ASU 2016-01 (which eliminated equity securities as an asset class that could qualify to be classified as Available-For-Sale) has been ignored for the purposes of this appendix. The substantive change of that new guidance to incorporate Holding Gains/Losses into earnings is irrelevant to Investment Companies.
REALIZED GAIN/LOSS

When an Operating Company sells an Available-For-Sale security, it records the transaction by recognizing onto its books the value of cash (or other asset) to be received and de-recognizes the cost balance of the security disposed – with the difference being recognized as a gain or a loss. In doing so, the total gain or loss is recognized in retained earnings by way of its recognition in Net Income as a Realized Gain/Loss. The net Holding Gain/Loss previously recognized for that security is reversed to avoid double-counting the gain/loss in total equity; this reversal is called a Reclassification Adjustment in the terminology of US GAAP. ASC 220-10-45-17 requires that the Operating Company disclose how this “reversal” impacted specific reporting Elements comprising Net Income.

As Investment Companies do not report (hence, cannot place prominence on) Net Income, the reporting of a disposition gain/loss derived from the security’s cost basis (i.e., as Realized Gain/Loss) serves no purpose. As Investment Companies do NOT provide information which disclose how Changes in Unrealized Appreciation/Depreciation resulting from the “reversal” of Unrealized Appreciation/Depreciation recognized in prior Accounting Periods for the security sold, the reporting of a Realized Gain/Loss would only mislead readers of the SOO to misunderstand that the amount of Realized Gain/Loss reports the change in NAV from the security’s disposition. For this reason, the continued reporting of Realized Gains/Losses should be discontinued for Investment Companies, and it should be replaced with the reporting of Disposition Gains/Losses which would be defined as the difference between the proceeds or value to be received at disposition and the fair value of that security at the end of the previous Accounting Period.

AMORTIZATION OF PREMIUM/ACCRETION OF DISCOUNT

When an Operating Company acquires a debt security at a premium or discount relative to the amount of principal to be repaid, following rote bookkeeping mechanics, a gain or loss would be recognized at the maturity of the debt security as the difference between the amount to be received as repayment and the security’s unadjusted cost basis. For conceptual reasons, FASB has directed that this gain or loss be recognized into interest income (as adjustments to interest income) over the periods the security is held; this interest income adjustment is a consequence of adjusting the cost basis to the terminal repayment amount.

The Operating Company’s total equity does not change as a result of recognizing amortization/accretion on securities classified as Available-For-Sale as such securities are measured at fair value. On the balance sheet, any adjustment to the security’s cost basis would be offset by an adjustment to the Unrealized Appreciation/Depreciation associated with that security to maintain that same fair value for that security. In the statement of Comprehensive Income, Comprehensive Income would not change as the adjustment to interest income is offset by a Reclassification Adjustment to Other Comprehensive Income. If an Operating Company were to classify this debt security as held-to-maturity, this security would be measured at its amortized cost basis on the balance sheet; therefore, the recognition of amortization/accretion would change the measurement amount of the security and, in turn, would change the amount of total equity. In this circumstance, Comprehensive Income would also change from there not being a Reclassification Adjustment to offset the adjustment to interest income.

As Investment Companies do not report (hence, cannot place prominence on) Net Income and as they measure all investments (debt securities or otherwise) at fair value, recognizing amortization/accretion on a debt security serves no purpose. When an Investment Company recognizes amortization/accretion, the reporting phenomenon described in the previous paragraph for Operating Companies holding such a debt security classified as Available-For-Sale should be discontinued.

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34 ASC 320-10-35-1.
For-Sale, would equally apply. From the perspective of distinguishing investment returns by way of an Investment Company’s buy, hold, sell activities and the Capital Appreciation versus Investment Income nature, the recognition of amortization/accretion wrongfully re-characterizes Capital Appreciation as Investment Income and, when the security is disposed, the recognition of amortization/accretion incorrectly re-characterizes returns between that which was generated from holding the security and that which was generated from disposing it. For these reasons, the continued recognition of amortization/accretion should be discontinued for Investment Companies.

**Accumulated Unrealized Appreciation/Depreciation and Changes Thereof**

As described in the last two sections of this appendix, when an Operating Company measures a security classified as Available-For-Sale at its fair value on the Operating Company’s balance sheet, the Holding Gain or Holding Loss for the period is reported as a component of Other Comprehensive Income on the statement of Comprehensive Income. This Holding Gain or Holding Loss is added to the balance of Holding Gains/Losses previously recognized and is reported as a component of equity under the caption accumulated Unrealized Appreciation/Depreciation. If and when amortization/accretion is recognized for a security, the amount of the adjustment to interest income is offset by a reversal, in the same amount, of accumulated Unrealized Appreciation/Depreciation previously recorded. When a security is sold, the total amount of accumulated Unrealized Appreciation/Depreciation previously recorded for the security is reversed upon the sale of the security, and a Realized Gain/Loss is concurrently recognized.

ASU 2013-02 in concert with ASU 2011-05 has modified ASC 220-10-45-17 (and its sub-paragraphs) to require financial statement disclosures that explain how changes in Accumulated Other Comprehensive Income which represent items reclassified out of Accumulated Other Comprehensive Income (i.e., Reclassification Adjustments) affected the line-items comprising Net Income. This disclosure requirement would apply to the Reclassification Adjustments precipitated by the recognition of amortization/accretion and precipitated by the sale of securities.

As Investment Companies do not report Net Income and, hence, does not give it prominence nor distinguishes it from Comprehensive Income, the practice and mechanics of reporting the gain or loss from selling a security by reference to that security’s cost basis (i.e., as Realized Gain/Loss) and concurrently reversing-out the Unrealized Appreciation/Depreciation previously recognized for that security disposed serve no purpose. These practices and mechanics render the amount reported as net Change in Unrealized Appreciation/Depreciation meaningless as it becomes an amalgamation of i) Holding Gain/Loss recognized for the Reporting Period and ii) Reclassification Adjustments from security sales and from amortization/accretion. For this reason, the net Change in Unrealized Appreciation/Depreciation has become nothing more than an arithmetic proof of the change in the difference between the fair value and the cost basis at the beginning of the Reporting Period and the difference between the fair value and the cost basis at the end of the Reporting Period. In short, this caption and the amount reported next to it has lost almost all of its informational value as it is not relevant to distilling any useful analytical insight. For this reason, the continued reporting of net Change in Unrealized Appreciation/Depreciation should be discontinued, and it should be replaced with the reporting of Holding Gain/Loss which would be defined as the difference between the fair value of the security at end of the current Accounting Period versus its fair value at the end of the previous Accounting Period.
ASSESSING CURRENT REPORTING PRACTICES (CONTINUED)

THE IMPACT OF COST RELIEF METHODOLOGY UTILIZED

The methodology utilized by an Operating Company for relieving costs from its portfolio of investment securities classified as Available-For-Sale affects the amount the Company reports for Net Income when it sells that security but does NOT affect the amount reported for Comprehensive Income. The differences in the amounts reported manifest themselves in the amounts of Realized Gain/Loss and the amounts of reversal of Accumulated Unrealized Appreciation/Depreciation. Thus, two Operating Companies selling an identical quantity of the identical security with the identical fair value carrying amount but different cost bases would report differing amounts of Realized Gain/Loss and differing amounts of reversal of Accumulated Unrealized Appreciation/Depreciation but report the same impact on Comprehensive Income. This phenomenon is true also for Investment Companies with two Investment Companies reporting differing amounts of Realized Gain/Loss and differing amounts of net Change in Unrealized Appreciation/Depreciation but reporting the same net impact on the results of operations. There is, however, a difference in how this phenomenon affects the understanding of the readers of those companies’ respective financial statements.

With Operating Companies, the note disclosures required by ASC 220-10-45-17 would help avoid the misunderstanding that would arise from misinterpreting Realized Gain/Loss as reporting the increase/decrease in equity from the sale of the security and would require that Holding Gain/Loss be reported separately from Reclassification Adjustments. With Investment Companies, there is no such equivalent disclosure and disaggregation requirement. Thus, having different amounts of gains/losses being reported as “realized” and “unrealized” by two different Investment Companies that held the same, and liquidated the same, investment position detracts from the comparability of the information and, hence, detracts from that information’s usefulness.

FAIR VALUE REPORTING AS AN AFTER-THOUGHT

Although Available-For-Sale securities are re-measured at fair value at Report Date, the accounting mechanics and the reporting Elements utilized in the financial statement reporting financial performance (i.e., the statement of Comprehensive Income for Operating Companies and the SOO for Investment Companies) are practically the same as those used when measuring such securities at their cost bases. The only difference is that those securities’ carrying values (i.e., the sums of their cost bases and the Unrealized Appreciation/Depreciation recorded) are adjusted to their fair values as of the Report Date by way of true-up adjustments to their Unrealized Appreciation/Depreciation component (aka “marking investments to market”). The impact on those Companies’ equity from these adjustments are captured and reported as Other Comprehensive Income for Operating Companies and as net changes in Unrealized Appreciation/Depreciation for Investment Companies. In short, for all practical purposes, “fair value reporting” under current US GAAP manifests itself as an after-thought. Thus, it is not surprising that these mechanics and reporting Elements, together, do such an unsatisfactory job in reporting financial performance. With Operating Companies, the rationale for current practices lie in the distinction made between Net Income and Comprehensive Income. With Investment Companies not needing to make such a distinction, the rationale for applying these same practices escapes identification.

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35 See the section “REPORTING DIFFERING GAINS & LOSSES FROM AN IDENTICAL TRANSACTION” on page 42 of Appendix IV for examples of how the economic impacts on these two Investment Companies would be identical, for circumstances in which this is possible, and for circumstances in which the gain or loss reported as “realized” or “unrealized” are determined by happenstance and do not reflect the activities of “holding” and “disposing” of investments.
LESS SIGNIFICANT SHORTCOMINGS

The Executive Summary and the Explanatory Memorandum focused on shortcomings that have been deemed to have significant impacts and are found to be fundamentally unsound. There does exist other less significant shortcomings that represent opportunities for improvement. These less significant shortcomings include i) a statement of cash flows which has eliminated investing activities as a major category of cash flows, ii) the absence of definitions for Investment Income and Capital Appreciation, and ii) the reporting of differing gains and losses from an identical disposition transaction.

THE STATEMENT OF CASH FLOWS

The classification of cash flow activities in the statement of cash flows of Investment Companies does not assist the readers in analyzing cash flows in terms of the buying, holding, and selling activities that generated them. Such an understanding should be particularly useful for –

1. Funds whose strategy is to acquire/originate private loans with the intent to hold on to them until maturity and to distribute to the fund’s equity investors i) the return received as interest income during the period the loan was outstanding and ii) the return of amounts received as repayment of the contractual principal loaned out
2. Funds that used borrowings as a significant source of financing.

ASC 230-10-45-10 requires that cash flows be classified into the following three categories – operating activities, investing activities, and financing activities. ASC 230-10-45-11 through ASC 230-10-45-13 direct that cash receipts and cash disbursements related to the purchase and disposition of securities be classified as investing activities. ASC Sub-Topic 946-230 (statement of cash flows for Investment Companies) does not include any guidance which contradicts these general directives. However, it is noted that the Guide does direct Investment Companies to classify the cash receipts and cash disbursements related to the purchase and disposition of securities as operating activities. Presumably, this was done as an acknowledgement that an Investment Company’s operations are defined primarily by investing activities, and, thus, operating activities is synonymous with investing activities.

The elimination of investing activities as a classification of cash flows obfuscate the cash generated from holding investments (net of the cash used to manage and administer the Fund) and the cash generated from/used in trading activities (i.e., the buying, selling, or maturing of investments). This unnecessary reduction in insight hinders a reader’s ability to –

- Correlate the distributions made to the Fund’s equity investors to the returns earned on investments
- Form their own predictions with regards to future distributions to the Fund’s equity investors
- Assess the sufficiency of the cash generated from holding (versus having to sell) investments to meet financial obligations

In many instances, the sufficiency of the cash generated from just holding investments is of particular interest to readers of an Investment Company’s statement of cash flows because the mere issuance of such a statement is usually an indication that it is probable that the Investment Company holds investments which are not highly liquid
LESS SIGNIFICANT SHORTCOMINGS (CONTINUED)

THE STATEMENT OF CASH FLOWS (CONTINUED)

and/or the Investment Company has utilized borrowings as a significant source of financing for its operations. 36 Having investments which are not highly liquid decreases the Investment Company’s ability to generate needed cash from selling those investments without possibly having to do so on unfavorable terms. Utilizing borrowings as a significant source of financing increases the probability that the financial obligations related to such borrowings may be more immediate, more material, and, possibly, recurring. If either or both of these conditions exist and the amount of cash generated from just holding investments is insufficient for the Investment Company to meet its financial obligations, the Investment Company may be constrained to sell investments at inopportune times or on unfavorable terms to generate cash to meet those obligations. Thus, having the cash flows classified in a meaningful way assists the readers of the statement of cash flows in evaluating liquidity and valuation risks.

DEFINING INVESTMENT INCOME AND CAPITAL APPRECIATION

ASC 946-10-15-6 describes a fundamental characteristic of Investment Companies is that the entity invests “…solely for returns from capital appreciation, investment income, or both...”. Yet, the ASC defines neither Capital Appreciation nor Investment Income. Having definitions for such terms is important for numerous reasons:

1. They would help FASB and preparers of Investment Company financial statements to formulate financial statement Elements which distinguish returns from Capital Appreciation versus those from Investment Income.
2. They would help the readers of SOOs distinguish amounts of a Capital Appreciation nature versus those of an Investment Income nature.
3. They would help management determine (and auditors validate) whether a Company has met one of the fundamental characteristics for being classified as an Investment Company – i.e., investing “…solely for returns from capital appreciation, investment income, or both...”.
4. They should improve the comparability of the operating results reported by different funds due to Points 1) through 3).
5. They would enhance the significance and reliance that potential investors can place on these terms when considering alternative funds as investment opportunities as the dichotomy between “income” and “appreciation” is one of the primary descriptors when investment funds are introduced to their investors (by way of their prospectus or placement memoranda).

The Author has ascribed the meanings defined in the Glossary (attacked as Appendix V) to these terms. Even should FASB find that the appropriate definitions for Capital Appreciation and for Investment Income should be something other than those included in Appendix V, it is important that terms that help describe one of the fundamental characteristics of an Investment Company not be left to ambiguity.

REPORTING DIFFERING GAINS & LOSSES FROM AN IDENTICAL TRANSACTION

As explained in both the Executive Summary and the Explanatory Memorandum, the financial reporting Deficiencies are conducive to financial statement readers misinterpreting Realized Gains/Losses as reporting the increases/decreases in NAV from investment dispositions and misinterpreting the net Changes in Unrealized Appreciation/Depreciation as reporting the increases/decreases in NAV from valuation changes. One more

36 This conclusion is based upon the fact that ASC 230-10-15-4c, for all practical purposes, exempted Investment Companies from the requirement to issue statements of cash flows unless an Investment Company holds significant amounts of investments which are illiquid or the Investment Company has utilized borrowings as a significant means for financing its operations.
LESS SIGNIFICANT SHORTCOMINGS (CONTINUED)

REPORTING DIFFERING GAINS & LOSSES FROM AN IDENTICAL TRANSACTION (CONTINUED)

undesirable reporting phenomenon from the use of these two financial reporting Elements is that DIFFERING amounts of Realized Gains/Losses and DIFFERING amounts of net Changes in Unrealized Appreciation/Depreciation can be reported by two Investment Companies selling an IDENTICAL quantity of the IDENTICAL investment with the IDENTICAL fair value for the IDENTICAL sales price over the IDENTICAL Reporting Period. This would be true despite the fact that two investment positions IDENTICAL in these regards would yield IDENTICAL asset ROR, would impact their respective Bottom-Lines for the IDENTICAL net dollar-amount, and the impacts resulted from the IDENTICAL “disposition” and “holding” activities. This “REPORTING DIFFERING GAINS & LOSSES FROM AN IDENTICAL TRANSACTION” is possible for these two separate, but identical, investment positions if any one of the following circumstances exists:

a) The respective investment positions were acquired for different costs and, as a result, they had different aggregate cost bases.

b) The respective investment positions were acquired for the same total cost and, as a result, had the same aggregate cost bases, BUT

   • They were acquired in more than one transaction with differing lot costs and
   • The sale entailed a partial disposition and the respective combinations of cost methodology and the ordering of the lot costs of the two Investment Companies resulted in differing cost lots being relieved.

SFAC 8 states that comparability is a qualitative characteristic that enhances the usefulness of the information by enabling users to identify and understand similarities in and differences among items. In other words, like things must look alike, and different things must look different. Thus, practices that cause the reporting of the same basic disposition Transaction by two Investment Companies over the same Reporting Period in two materially different fashions could not be characterized as engendering comparability. On the contrary, they probably detract from it, and as a consequence, they detract from the usefulness of the information.

Furthermore, if the transaction entailed a partial disposition and if the investment was acquired in more than one transaction with differing lot costs – i.e., the circumstance described by b) above, the gains and losses reported by the same Investment Company as “realized” and “unrealized” will vary for no reason other the happenstance of the combination of cost-relief methodology and the ordering of the lot costs. This would be true despite the fact that the impacts on NAV and ROR resulted from the ONE “disposition” Transaction. Practices that result in the reporting of “realized” and “unrealized” gains and losses that vary arbitrarily and that offers no difference-making insight into the Transaction cannot be characterized as having much Relevance. On the contrary, they probably detract from it, and as a consequence, they detract from the usefulness of the information.

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37 Asset ROR would be the identical as the beginning-of-period fair values and the total of the Realized Gain/Loss and the Unrealized Gain/Loss would be the same. However, their impacts on the ROR experienced by their respective funds may be different as the beginning-of-period fair value of that investment may represent differing proportions of beginning-of-period invested capital.

38 SFAC No.8, QC21 and QC23
IMPLEMENTATION CONSIDERATIONS

DETERMINING THE FAIR VALUES OF INVESTMENTS SOLD

The Recommended Remedies direct the computations of gains and losses by comparing the new values to be received (in the case of investments disposed) or to be recorded (in the case of investments retained) against i) the fair values recorded at the end of the previous Accounting Period where such values exist and ii) in instances in which the investments were not held at the end of the previous Accounting Period, to make such a measurement against the costs incurred to acquire those investments in the current Accounting Period. The gains and losses so determined would be the same as gains and losses reported under the current methodology if an Investment Company hypothetically sold-off the entire portfolio at the end of the previous Accounting Period for the individual investments’ fair values and, then, repurchased the entire portfolio back at those same fair values at the beginning of the current Accounting Period. Such a hypothetical sale-and-buy back would effectively establish the investments’ fair values at the end of the previous Accounting Period as their new cost bases. Effectively resetting each Accounting Period from the one immediately preceding it, the gains/losses that would be reported as “realized” would reflect NAV changes from dispositions and those that would be reported as “unrealized” would reflect valuation changes.  

With the conceptual understanding established in the previous paragraph as the foundation, the proof below (borrowed from basic financial accounting) can be used to prove-out the fair value (of investments) sold, Holding Gain/Loss, and ending fair value:

<table>
<thead>
<tr>
<th>Investment Company: (investments available for sale)</th>
<th>Operating Company: (inventory for resale)</th>
<th>Measurement attribute</th>
</tr>
</thead>
<tbody>
<tr>
<td>value_BOP</td>
<td>beginning fair value</td>
<td>Measurement attribute</td>
</tr>
<tr>
<td>value_PAID</td>
<td>purchases</td>
<td>measurement attribute</td>
</tr>
<tr>
<td>value_2ACCT</td>
<td>value available for sale</td>
<td>measure attribute</td>
</tr>
<tr>
<td>prorata X value_2ACCT</td>
<td>(fair value sold)</td>
<td></td>
</tr>
<tr>
<td>true-Up</td>
<td>fair value retained</td>
<td></td>
</tr>
<tr>
<td>value_EOP</td>
<td>Holding Gain/Loss</td>
<td></td>
</tr>
<tr>
<td></td>
<td>ending fair value</td>
<td></td>
</tr>
</tbody>
</table>

BOP - beginning of period  
PAID - acquired  
2ACCT - to account for  
EOP - end of period  
????? - Dependent upon the cost relief methodology (i.e., FIFO, LIFO, Average) utilized

The fair value (of the investments) sold should be determined as follows:

\[
\text{fair value sold} = \frac{\text{quantity sold}}{\text{quantity BOP} - \text{quantity bought}} \times \text{value}_{2ACCT}
\]

39 The Author is specifically referencing “Accounting Period” versus “Reporting Period” as a Reporting Period may encompass many Accounting Periods. (See respective definitions in Appendix V). This distinction affects the measurement of Disposition Gains/Losses as the investment disposed may have been acquired in a previous Accounting Period but acquired in the current Reporting Period. In such a circumstance, the gain/loss should be measured by referencing the investment’s fair value at the end of the Accounting Period immediately preceding the Accounting Period of disposition and not to its acquisition cost.
IMPLEMENTATION CONSIDERATIONS (CONTINUED)

DETERMINING THE FAIR VALUE OF INVESTMENTS SOLD (CONTINUED)

In cost basis accounting, the amount of goods available for sale is allocated between cost of goods sold and ending inventory. This allocation is affected by the selection of the cost flow methodology (i.e., First-In First Out, Last-In First-Out, or Average). Implementing the fair value reporting described by the Recommended Remedies, the amount of fair value available for sale is allocated between fair value sold and fair value retained. This allocation should be executed on an average basis as this would most accurately reflect the economics. The difference between the fair value retained and ending fair value equals Holding Gain/Loss.

INCREASING INSIGHT BEHIND DISPOSITION GAINS AND LOSSES

The first of the four Recommended Remedies calls for i) determining the gain or loss from an investment disposition as the proceeds to be received LESS the fair value to be removed (from the “books”) and ii) reporting this amount under the caption Disposition Gain/Loss. The Explanatory Memorandum argues that doing so produces information which is significantly more useful to the readers of the SOO for the purpose of understanding the financial performance of an Investment Company; and so, this assertion is affirmed here.

In implementing this Recommended Remedy, it is also argued here that significantly greater insight regarding Disposition Gains/Losses can be provided to the readers of an Investment Company’s financial statements if these statements report the underlying components of proceeds to be received and the fair values derecognized. Doing so will allow the readers of those financial statements to relate the dollar amounts of the gains and losses to the aggregate size of the investment positions that gave rise to them. In short, it makes a difference to a reader’s understanding if a hypothetical $1 million Disposition Loss was suffered from selling an investment just previously valued at $2 million (a 50% loss) or if that loss resulted from the sale of an investment just previously valued at $50 million (a 2% loss). It can be reasonably argued that it also makes a difference to that understanding if such a loss was the result from selling a long position versus covering a short position.

An Investment Company reporting the underlying components of Disposition Gains/Losses is analogous to an Operating Company reporting revenues, cost of goods sold, and gross profit as opposed to reporting just the net amount for gross profit. In general, Operating Companies report such gross amounts for asset enhancing activities that constitute that Operating Company’s “ongoing major or central operations” while they report netted amounts (i.e., gains and losses) for Transactions and Events that are peripheral or incidental to those operations. As the buying, holding, and selling of investments do NOT constitute the “on going major or central operations” of Operating Companies, the net reporting manifested by the reporting of “gains” and “losses” from the disposition of investments may be appropriate. However, as such activities DO CONSTITUTE an Investment Company’s “on going major or central operations”, according to SFAC No.6, it may be more appropriate for such Companies to report the gross amounts of proceeds to be received and the fair values derecognized when describing the financial impacts of transactions that disposed of investment positions. Doing so is not only more consistent with the Conceptual Framework put forth by FASB; doing so adds insight which is Relevant to a reader of the SOO for the purpose of understanding financial performance.

For the reasons given in the previous paragraphs in this section, it is suggested that disclosures be required in the notes to the financial statements that disaggregate Disposition Gains/Losses into the proceeds to be received from such dispositions and the fair values of the investments derecognized from the “books”.  

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40 SFAC No.6, paragraphs 78 through 89.
41 Similar arguments can be made to increase insight behind Holding Gains/Losses to relate the dollar amounts of the gains/losses to the aggregate size of the investment positions that gave rise to them. Such a disclosure would report the aggregate fair values at the end of the CURRENT Accounting Period, the aggregate fair values at the end of the PREVIOUS Accounting Period, and Holding Gains/Losses (as the difference between the two).
PERMIT REPORTING OF REALIZED AND UNREALIZED GAINS/LOSSES IN NOTES

Both the Executive Summary and the Explanatory Memorandum explained that the Deficiencies result from the measurement and reporting of investment gains and losses by referencing the investments’ cost bases, and that to remedy these Deficiencies they have recommended changes in current reporting practices which replace the current reporting Elements – *Realized Gains/Losses* and *Unrealized Gains/Losses*, with the amounts and captions *Disposition Gains/Losses* and *Holding Gains/Losses*, respectively.

There could, however, exist certain circumstances in which the Elements to be replaced, *Realized Gains/Losses* and *Unrealized Gains/Losses*, may be relevant to certain aspects of the Investment Company’s financing structure. Such circumstances include those in which proceeds resulting from the return on investments (i.e., *net Investment Income* and *net Realized Gain/Loss*) are distributed to the equity investors along with the proceeds that resulted from the return of the amount originally invested. In these and other situations, Investment Companies should be permitted to report *Realized Gains/Losses* and *Unrealized Gains/Losses* in a specific note in the *notes to the financial statements* which report and describe such amounts. For the reasons explained in the Executive Summary and Explanatory Memorandum, these reporting Elements should **NOT** be used in the *SRO*, but neither should their disclosure in the *notes to the financial statements* be prohibited.

MODIFICATIONS TO ASC TO IMPLEMENT REMEDIES

The following are modifications to the ASC that are necessary to implement the Recommended Remedies and to rectify other less significant shortcomings identified in this appendix. (This listing is not meant to be exhaustive):

I. (a) Modify ASC sub-topics 946-320-40-1, 946-225-45-6a, and 946-225-50-2 to re-term gains and losses from investment dispositions from *Realized Gains/Losses* to *Disposition Gains/Losses* and to define such *Disposition Gains/Losses* as the difference between i) the amount of disposition proceeds (or other value) to be received and ii) either the fair value of the investment disposed as of the end of the PREVIOUS Accounting Period, if applicable, or if the investment disposed was not held as of the end of the PREVIOUS Accounting Period, the cost incurred to acquire it.

(b) Modify ASC sub-topic 946-205-50 to insert guidance that for *Disposition Gains/Losses* reported that information be required that enables users to assess the amounts of proceeds to be received and the fair values of investments derecognized from the investment portfolio.

II. Modify ASC sub-topics 946-225-45-6b to eliminate the *SRO* reporting Elements *net Changes in Unrealized Appreciation/Depreciation* and to replace them with Elements that report gains and losses from valuation changes terming such gains and losses as *Holding Gains/Losses*. *Holding Gains/Losses* is to be defined as the difference between i) the fair value of an investment as of the end of the CURRENT Accounting Period and ii) either the fair value of that same investment as of the end of the PREVIOUS Accounting Period, if applicable, or if the investment was not held as of the end of the PREVIOUS Accounting Period, the cost incurred to acquire it.

III. Modify ASC 946-320-35-20 to amortize premiums/accrete discounts only for investments classified as cash equivalents or short-term investments.

IV. Insert guidance to ASC Topic 946 (possibly, as sub-topic ASC 946-815) to direct that Investment Companies that do not apply hedge accounting to derivative contracts should report such contracts in a manner similar to that which is done for securities and to clarify that –

- Cash to be received from/cash payments to be made to the contract counterparty related to the termination of the derivative contract should be reported as *Disposition Gains/Losses*
- Cash to be received from/cash payments to be made to the contract counterparty NOT related to the termination of the derivative contract should be reported as *derivative income/expense*
IMPLEMENTATION CONSIDERATIONS (CONTINUED)

MODIFICATIONS TO ASC TO IMPLEMENT REMEDIES (CONTINUED)

V. Insert into or modify definitions in ASC sub-topic 946-10-20 to include definitions for Capital Appreciation, Investment Income, and Holding Gain/Loss.

VI. (a) Insert guidance into ASC sub-topic 946-230-45 to reaffirm that cash receipts and cash payments are to be categorized as resulting from investing, financing, or operating activities.
(b) Insert guidance into ASC sub-topic 946-230-20 to define investing activities, financing activities, and operating activities. Investing activities should be defined as activities which result in the recognition or derecognition of an investment by an Investment Company.

ALTERNATIVE REMEDY

The Alternative Remedy offered in the Explanatory Memorandum as one other means for rectifying the Deficiencies seeks to clarify and affirm that the requirements of ASC 220-10-45-17 are, with the absence of doubt, applicable to Investment Companies. This could be achieved by inserting the needed guidance into ASC Topic 946 (possibly, as ASC 946-220-10-45). However, since the reporting Elements and the format of the SOO are different enough from a statement of Comprehensive Income, some modifications in implementing the guidance found in ASC Topic 220 should be considered when applying it to Investment Companies.

Specifically, the disclosure described by ASC 220-10-45-17, when applied to Investment Companies, should disaggregate the amounts of Investment Income, net Realized Gains/Losses and net Changes in Unrealized Appreciation/Depreciation in such a manner so as to distinguish –

(A) Between amounts resulting from holding investments and those from selling investments and
(B) Between amounts that arise from a difference in value at disposition or at re-evaluation and those amounts that arise from accrual of value to be received from an Investee or a derivative contract counterparty during the period the investment is held.

To bring about greater clarity and comprehension, this Alternative Remedy disclosure should be made in tabular form in the notes to the financial statements. In this table, the amounts of Investment Income, net Realized Gains/Losses and net Changes in Unrealized Appreciation/Depreciation should be disaggregated into components to reflect their underlying causation as follows –

1) Investment Income
   • Dividend income
   • Interest income earned
   • Interest income adjustments from the amortization of premiums/accretion of discounts
   • Interest income adjustments from gain/loss sustained on loan prepayments

2) net Realized Gains/Losses
   • net Realized Gains/Losses measured against the investments’ cost bases at the end of the previous Reporting Period and if the investments were acquired during the current Reporting Period, those investments’ cost bases at acquisition (i.e., in both cases, before adjustments for amortization of premium/accretion of discount recognized in the current Reporting Period)
   • Adjustments to net Realized Gains/Losses resulting from the amortization of premiums/accretion of discounts recognized during the current Reporting Period
   • net Realized Gains/Losses representing receipts from/payments to derivative contract counterparties NOT related to the termination of derivative contracts (i.e., while contract was opened)
IMPLEMENTATION REMEDIES (CONTINUED)

ALTERNATIVE REMEDY (CONTINUED)

3) **net Change in Unrealized Appreciation/Depreciation**
   - change driven by the recognition of amortization of premiums/accretion of discounts on debt securities,
   - change driven by the reversal of *Unrealized Appreciation/Depreciation* recognized in prior Reporting Periods for investments disposed in the current Reporting Period and,
   - change driven by the change in the accrual of amounts to be received from/paid to derivative contract counterparties NOT related to the termination of derivative contracts (i.e., while contract was opened)
   - change driven by valuation changes on investments still held at the end of the current Reporting Period.

The amounts of the above components should be presented so as to report the net increase/decrease in NAV in conformity with objectives (A) and (B) defined in this section. (See Exhibit AppIV-I which follows):

**Exhibit AppIV-I**

<table>
<thead>
<tr>
<th></th>
<th>Investment Income</th>
<th>Net Realized Gain/Loss</th>
<th>Net Unrealized Gain/Loss</th>
<th>Net Increase/ Decrease In NAV from Operations</th>
</tr>
</thead>
<tbody>
<tr>
<td>From holding investments</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dividend Income (expense)</td>
<td>d,ddd</td>
<td>-</td>
<td>-</td>
<td>d,ddd</td>
</tr>
<tr>
<td>Interest income earned</td>
<td>i,iii</td>
<td>-</td>
<td>-</td>
<td>i,iii</td>
</tr>
<tr>
<td>Net amortization/accretion</td>
<td>-(a+b)</td>
<td>a,aaa</td>
<td>b,bbb</td>
<td></td>
</tr>
<tr>
<td>Receipts (payments) on open derivative contracts</td>
<td>-</td>
<td>r,rrr</td>
<td>-</td>
<td>r,rrr</td>
</tr>
<tr>
<td>Change in accrued derivative income</td>
<td>-</td>
<td>-</td>
<td>c,ccc</td>
<td>c,ccc</td>
</tr>
<tr>
<td>Income from holding investments</td>
<td>v,vvv</td>
<td>v,vvv</td>
<td>v,vvv</td>
<td>v,vvv</td>
</tr>
<tr>
<td>Capital appreciation from holding investments</td>
<td>w,www</td>
<td>w,www</td>
<td>w,www</td>
<td>w,www</td>
</tr>
<tr>
<td>From disposing investments</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital appreciation</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gain/loss on paydowns (reported as adjustment to interest income)</td>
<td>p,ppp</td>
<td>-</td>
<td>f,fff</td>
<td>p+f</td>
</tr>
<tr>
<td>Gain/loss on investments sold</td>
<td>-</td>
<td>e,eee</td>
<td>g,ggg</td>
<td>e+g</td>
</tr>
<tr>
<td>Capital appreciation from disposing investments</td>
<td>x,xxx</td>
<td>x,xxx</td>
<td>x,xxx</td>
<td>x,xxx</td>
</tr>
<tr>
<td>From holding and disposing investments</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Components of interest income:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest income earned</td>
<td>i,iii</td>
<td>-</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Net amortization/accretion</td>
<td>-(a+b)</td>
<td>a,aaa</td>
<td>b,bbb</td>
<td></td>
</tr>
<tr>
<td>Gain/loss on paydowns</td>
<td>p,ppp</td>
<td>-</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Total interest income</td>
<td>z,zzz</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The asset-class, sub-asset-class categorization should be consistent with that used in the SOO.
FUNDAMENTAL DEFICIENCIES OF US GAAP FINANCIAL STATEMENTS FOR INVESTMENT COMPANIES

APPENDIX V
GLOSSARY OF ACRONYMS AND TERMS

This appendix defines –

1. Acronyms
2. Terms
   • that have been developed by the Author
   • the meaning of which the Author considers to be extremely important to the arguments in this Exposition
   • that have been unclearly defined

ACRONYMS

AICPA
American Institute of Certified Public Accountants

ASC
Accounting Standards Codification® – the source of authoritative generally accepted accounting principles recognized by the FASB to be applied to nongovernmental entities.

ASU
Accounting Standards Update

ASU 2011-05
Accounting Standards Update No. 2011-05 Comprehensive Income (Topic 220)
Presentation of Comprehensive Income

ASU 2013-02
Accounting Standards Update No. 2013-02 Comprehensive Income (Topic 220)
Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income

ASU 2013-08
Accounting Standards Update No. 2013-08 Financial Services – Investment Companies (Topic 946)
Amendments to the Scope, Measurement, and Disclosure Requirements

ASU 2016-01
Accounting Standards Update No. 2016-01 Financial Instruments – Overall (Sub-Topic 825-10)

FASB
Financial Accounting Standards Board

NAV
Net asset value: Assets LESS Liabilities
ACRONYMS (CONTINUED)

ROR
Rate-of-Return

SFAC
Statement of Financial Accounting Concepts

SFAC No. 6
Statement of Financial Accounting Concepts No. 6 – Elements of Financial Statements

SFAC No. 8
Statement of Financial Accounting Concepts No. 8 – Chapter 1, The Objective of General Purpose Financial Reporting, and Chapter 3, Qualitative Characteristics of Useful Financial Information

US GAAP
Accounting principles generally accepted in the United States of America

TERMS

Accounting Period
A period in which invested capital is constant: In practice, the length of this period is determined by the Investment Company’s policies with respect to the acceptance of capital contributions and the effecting of capital withdrawals and capital distributions. Examples of possible lengths of this period may be one day, one month, one quarter, one year. [ASC 946-205-50-21]

Accumulated Other Comprehensive Income
A component of equity comprised of the residual balance of Other Comprehensive Income recognized from inception through the balance sheet date. [Developed by Author]

Accumulated Unrealized Appreciation/Depreciation
A component of Accumulated Other Comprehensive Income comprised of the residual balance of Unrealized Appreciation/Depreciation recognized from inception through the balance sheet date. [Developed by Author]

Author
Kenneth Leung, as principal of Finance Accounting Analysis and Reporting Services, LLC.

Available-For-Sale (Securities)
Investments not classified as either trading securities or as held-to-maturity securities. [ASC Master Glossary]

Bottom-Line
The net increase/decrease in NAV resulting from operations. [Developed by Author]

Capital Appreciation
The difference between the value to be received when an investment is sold and the value given up when the investment was acquired. For the purpose of determining Capital Appreciation before an investment is actually sold, an investment’s fair value serves as a proxy of the value to be received upon a hypothetical sale. [Developed by Author]
TERMS (CONTINUED)

Change In Unrealized Appreciation/Depreciation
See Unrealized Gain/Loss.

Comprehensive Income
The change in equity (net assets) of a business entity during a period from transactions and other events and circumstances from non-owner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. [ASC Master Glossary]

Company
Non-governmental reporting entities issuing US GAAP financial statements. The legal form of such an entity may include corporations, limited liability companies, sole proprietorships, partnerships (limited or non-limited). [Developed by Author]

Conceptual Framework
Comprises pronouncements issued by FASB entitled Statement of Financial Accounting Concepts. Although they do not define US GAAP, together, such statements lay-out the aspirational underpinnings of financial reporting undertaken in accordance with US GAAP. [FASB.org]

Deficiencies
Failings in current US GAAP financial reporting practices which distort and obfuscate information reported by the SOO for the purpose of reporting financial performance. (See pages 2 in the Executive Summary or pages 8 in the Explanatory Memorandum.) [Developed by Author]

Derivative Contracts
Paragraphs ASC 815-10-15-83 through ASC 815-10-15-139. [ASC Master Glossary]

Derivative Income
Cash settlements between the counterparties of a derivative contract during the period that that contract is held as opposed to cash received/paid at contract initiation or contract expiration/closed-out. [Developed by Author]

Disposition Gain/Loss
The difference between i) the amount of disposition proceeds (or other value) to be received and ii) either the fair value of the investment disposed as of the end of the previous Accounting Period, if applicable, or if the investment disposed was not held as of the end of the previous Accounting Period, the cost incurred to acquire it. [Developed by Author]

Elements (as Financial Statement Elements or Reporting Elements)
The captions and the amounts that those captions describe in general-purpose financial statements including the methodologies that determine the amounts reported and the definition of those captions in the notes to the financial statements. (This definition varies from the definition put forth by the SFAC No. 6 which defines “elements” as broad categories. As used in this Exposition, “elements”, in variations of that term, is more analogous with the term “item” as defined in that concepts statement.) [Developed by Author]

Financial Highlights
Guidance codified in ASC Sub-Topic 946-205-50. [ASC Master Glossary]
TERMS (CONTINUED)

**Fund**
Synonym for Investment Company. [Developed by Author]

**Guide**
AICPA Audit and Accounting Guide: Investment Companies. [Developed by Author]

**Holding Gain/Loss**
The difference between i) the fair value of an investment as of the end of the current Accounting Period and ii) either the fair value of that same investment as of the end of the previous Accounting Period, if applicable, or if the investment was not held as of the end of the previous Accounting Period, the cost incurred to acquire it. (This definition is not inconsistent with the definition found in the ASC’s Master Glossary although its scope is more expansive as it applies to all types of “investments” as opposed to limiting its application to a “security”.) [Developed by Author]

**Investee**
The issuer and counterparty of a financial instrument. [Developed by Author]

**Investment Company (aka Fund)**
A reporting entity that meets the criteria described by the paragraphs in Sub-Topic ASC 946-10-15 and applies the guidance in ASC Topic 946. [Developed by Author]

**Investment Income**
Cash or other value that an Investment Company is entitled to receive from the Investee during the period that the investment is held excepting receipts which terminate the investments (e.g., repayment of principal of amounts owed, settlement of callable instruments). [Developed by Author]

**Net Income (aka “Earnings”)**
A measure of financial performance resulting from the aggregation of revenues, expenses, gains, and losses that are not items of other comprehensive income. A variety of other terms such as net earnings of earnings may be used to describe net income.) [ASC Master Glossary]

**Operating Company**
A reporting entity not eligible and not required to apply accounting and reporting principles contained in the ASC Topics pertaining to specific industries. [Developed by Author]

**Other Comprehensive Income**
Revenues, expenses, gains, and losses that under generally accepted accounting principles (GAAP) are included in Comprehensive Income but excluded from Net Income. [ASC Master Glossary]

**Rate-of-Return**
Refers to various measures of the efficiency (with respect to time and/or value invested) with which an Investment Company achieved its operating results. Such a measure includes Total Return calculated in accordance with the methodologies described in ASC 946-205-50-19 or in ASC 946-205-50-21 or an internal rate-of-return if the reporting Investment Company meets the criteria described in ASC 946-205-50-23. [Developed by Author]
**TERMS (CONTINUED)**

**Realized Gain/Loss**
The difference between the value to be received when an investment is sold and the value given up when the investment was acquired. [Developed by Author]

**Reclassification Adjustments**
Adjustments made to avoid double counting in Comprehensive Income items that are displayed as part of Net Income for a period that also had been displayed as part of Other Comprehensive Income in that period or earlier periods. [ASC Master Glossary]

**Recommended Remedies**
Changes in financial statement Elements proposed to rectify the Deficiencies. (See page 4 of the Executive Summary or pages 15 of the Explanatory Memorandum.) [Developed by Author]

**Relevance (as a fundamental quality of useful financial information)**
Capable of making a difference in the decisions made by users. [Paraphrased from *Statement of Financial Accounting Concepts No.8*, paragraphs QC6 through QC10]

**Representational Faithfulness (as a fundamental quality of useful financial information)**
Depicting economic phenomena by way of words and numbers accurately in a manner that is complete, neutral and free from error. [Paraphrased from *Statement of Financial Accounting Concepts No.8*, paragraphs QC12 through QC16]

**Reporting Date**
Balance sheet date. [Developed by Author]

**Reporting Period**
The time period covered by the SOO. [Developed by Author]

**Topic 220**
Topic 220 of the ASC: Comprehensive Income [Accounting Standards Codification]

**Topic 946**
Topic 946 of the ASC: Investment Companies [Accounting Standards Codification]

**Transactions and Events**
Transactions with non-owners and changes in conditions that impact the amounts of assets or liabilities recognized by a Company. [Developed by Author]

**Unrealized Appreciation/Depreciation**
When applied to assets and liabilities, *Unrealized Appreciation/Depreciation* refers the difference between an investment’s fair value and its cost basis at measurement date. When applied to equity, *Unrealized Appreciation/Depreciation* is one of the components of *Other Comprehensive Income*, and *Accumulated Unrealized Appreciation/Depreciation* is one of the components of equity. [Developed by Author]
**TERMS (CONTINUED)**

**Unrealized Gain/Loss (aka Change In Unrealized Appreciation/Depreciation)**

The arithmetic change in the difference between an investment’s fair value and its cost basis during an Accounting Period. Other terms which may be used in practice include *net increase (decrease) in net assets from Changes in Unrealized Appreciation/ Depreciation* and *net Change in Appreciation (Depreciation).* [Developed by Author]