

## MINUTES



**To:** Board Members

**From:** AcSEC Team (Quiring, ext. 326)

**Subject:** Minutes of the AcSEC June 15,  
2004 Board Meeting **Date:** June 22, 2004

**cc:** Leisenring, Bielstein, Petrone, L. Smith, Laurenzano, Swift, Polley,  
Vernuccio, Gabriele, D. Noll (AICPA), Getz, Thompson, Sutay, Project  
Team, Intranet

Topic: Final clearance of the AICPA Statement of Position, *Clarification of the Scope of the Audit and Accounting Guide Audits of Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies*

Basis for Discussion: Memorandum dated May 27, 2004

Length of Discussion: 1:00 p.m. to 2:20 p.m.

Attendance:

Board members present: Herz, Batavick, Crooch, Schieneman,  
Schipper, Seidman

Board members absent: Trott

Staff in charge of topic: Laurenzano, L. Smith

Other staff at Board table: Quiring

Outside participants: Mark Bielstein, Chair, AcSEC; Mark Sever,  
Former Chair, AcSEC (by phone); Joel  
Tanenbaum, AICPA; Dan Noll, AICPA; Larry  
Dodyk, AcSEC; Brian Gallagher, AcSEC

## **Summary of Decisions Reached**

The Board met with representatives of the AICPA's Accounting Standards Executive Committee (AcSEC) and discussed final clearance of the AICPA Statement of Position, *Clarification of the Scope of the Audit and Accounting Guide Audits of Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies*. The Board did not object to issuance of the final SOP subject to certain changes being made.

### **Objective of Meeting**

The objective of the meeting was to discuss final clearance of the AICPA Statement of Position, *Clarification of the Scope of the Audit and Accounting Guide Audits of Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies*.

### **Matters Discussed and Decisions Reached**

Mr. Laurenzano asked the Board to consider a number of issues related to the SOP.

#### **Formal Documentation**

Mr. Laurenzano stated that the SOP does not discuss the documentation requirements for various components of the model. The staff recommended modifying the SOP to require formal documentation of investment plans including exit strategies in order for companies to obtain investment company status.

Ms. Seidman said that an explicit requirement for formal documentation does not need to be included in the SOP. She noted that documentation is an audit issue and that the SOP is similar to other existing guidance that does not explicitly require formal documentation.

Mr. Bielstein said that AcSEC expects that companies will maintain evidence of investment plans, even without an explicit requirement in the SOP for formal

documentation. He said that AcSEC does not want to allow companies to avoid investment company status simply by not documenting their investment plans.

The Board concluded that no explicit language in the SOP requiring formal documentation is necessary.

### **“Regulated” versus “Registered”**

Mr. Laurenzano said that the staff recommends that a unified reference should be used to denote investment companies that must follow certain regulatory requirements. In the SOP such investment companies are referred to as “regulated” in the scope section and as “registered” in the examples. The terms “regulated” and “registered” are presently used in a manner which may not be as inclusive as AcSEC intends for the SOP.

Mr. Bielstein said that in the SOP the term “regulated” refers to companies meeting the Internal Revenue Code requirements to be classified as regulated investment companies (RICs) and that the term “registered” refers to companies regulated under the Investment Company Act of 1940. He said that AcSEC does not want to change those definitions for purposes of the SOP, but instead will work with the FASB staff to clarify the use of those terms in the SOP.

### **Change in Status**

Mr. Laurenzano observed that the SOP requires that the effect of a change in status be reported in a manner similar to a change in accounting principle in conformity with APB Opinion No. 20, *Accounting Changes*. He said that the staff recommends that the SOP be modified so that the carrying amount of investments, previously accounted for under the investment company audit guide but for which the investor no longer meets investment company status, should not be adjusted but should be prospectively accounted for under other generally accepted accounting principles. He noted that this recommendation is consistent with the transition guidance in EITF Issue No. 03-16, “Accounting for Investments in Limited Liability Companies,” and the transition guidance being considered in EITF Issue No. 02-14, “Whether the Equity Method of Accounting Applies When

an Investor Does Not Have an Investment in Voting Stock of an Investee but Exercises Significant Influence through Other Means.”

Ms. Seidman noted that the change in status is similar to the change that occurs when (1) an investor that has not been using the equity method begins to use that method or (2) a security is transferred from trading classification to another classification under FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*.

Mr. Herz said that when new facts and circumstances are present that require a change in investment company status, the carrying basis of a company's investment should not change.

Mr. Bielstein said that AcSEC initially sought to make the guidance on changes in status in the SOP consistent with the guidance in APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, which requires a retroactive adjustment. He said that due to the difficulty in applying a retroactive adjustment, AcSEC instead decided to require a cumulative effect adjustment.

The Board agreed that the SOP should be modified to move from requiring a cumulative effect adjustment, based on retroactive computation, to requiring a prospective approach, where the basis of the investments is not modified but measured at fair value and changes are made prospectively. The Board noted that this notion should be consistent in the SOP and, accordingly, also should apply to transition guidance.

Mr. Bielstein said that AcSEC will consider the issue at its next meeting.

#### **Date of Reconsideration of Investment Company Status**

Mr. Laurenzano said that the staff recommends that the SOP clarify that a nonregulated investment company should reconsider whether it meets investment company status at the date of its acquisition by a new parent company, rather than waiting until the next reporting date to reconsider.

Mr. Bielstein said that it is AcSEC's intention for companies to reconsider at the date of acquisition and that AcSEC will work to modify the language in the SOP to clarify that point.

### **Number of Substantive Investors and Level of Ownership Interests in Investees**

Mr. Laurenzano noted that the guidance in the SOP related to the number of *substantive investors in the entity* and the *level of ownership interests in investees* should be clarified to indicate whether these two factors are simply more important than other factors in determining investment company status or whether the factors are in and of themselves determinative.

Ms. Schipper noted that in September 2002 she objected to clearance of the Exposure Draft of the SOP. She said that she continues to disagree with the guidance in the SOP because pooling of funds should be a condition to obtain investment company status, not simply a factor to consider.

Mr. Herz expressed concern about allowing wholly owned venture capital companies without unrelated outside investors to obtain investment company status, but noted that the SOP does address other problematic investment company practice issues.

Mr. Bielstein said that AcSEC's intention is that the two factors be more important than other factors in determining investment company status, but not be in and of themselves determinative. He said that the guidance in the SOP is responsive to the comments on pooled funds received by AcSEC on the Exposure Draft. He noted that AcSEC will modify the examples in the SOP to clarify that pooling of funds is not a presumption that must be overcome in order to obtain investment company status.

### **Small Business Investment Companies (SBICs)**

Mr. Laurenzano asked the Board to consider whether the SOP should be reexposed to allow parent companies of SBICs to comment on the effects of the SOP. The Board concluded that AcSEC does not need to reexpose the SOP.

### **Other Issues**

Mr. Bielstein indicated that AcSEC will modify the discussion on disclosures in the SOP to divide the disclosure requirements for parent companies and equity method companies into separate paragraphs.

Ms. Seidman expressed concern about the differences in the provisions in the SOP for accounting for investments in investment companies by parent companies and by equity method investors. She noted that if one investment company subsidiary of a parent company does not meet the investment company requirements for nonregulated investment companies in the SOP, investment company accounting cannot be applied in the consolidated financial statements for any of the parent company's investment company subsidiaries. However, if the investment company requirements are not met for one investment company that an equity method investor invests in, that equity method investor is not automatically prohibited from retaining investment company accounting for other investees.

Mr. Bielstein said that an entity should not receive different accounting treatment based on the number of investment company subsidiaries that it establishes. He noted that AcSEC was unable to identify an easy way to distinguish the activities of investment company subsidiaries in a manner that would allow the parent company to retain investment company accounting in certain situations. He also noted that whether an investment company subsidiary is disqualified from investment company status is within the control of the parent company.

Mr. Bielstein noted that AcSEC may modify the effective date of the SOP to give entities time to adopt the new guidance.

The Board did not object to issuance of the final SOP subject to certain changes being made to reflect the above decisions (Six Board members agreed: RHH, GJB, GMC, LFS, GSS, EWT (by proxy); one Board member disagreed: KAS).

### **Follow-up Items**

The objective of the meeting was met. The members of AcSEC committed to providing the FASB staff with a modified version of the SOP in advance of its July, 2004 AcSEC meeting which would include:

- Clarification of the use of the terms “regulated investment company” and “registered investment company” in the SOP.
- Clarification that the reconsideration of whether a company is an investment company in connection with its acquisition by a new parent should be made at the acquisition date.
- Modifications to the examples to clarify that pooling of funds is not a presumption that must be overcome in order to obtain investment company status.
- Modification to the discussion on disclosures to divide the disclosure requirements for parent companies and equity method companies into separate paragraphs.
- Modification to the effective date to give entities time to adopt the new guidance
- Modifications for other editorial items agreed to with the FASB staff that were not specifically discussed at this meeting.

At its July, 2004 meeting, AcSEC will consider the modifications made to the SOP described above and the recommendation to modify the reflection of the change in accounting associated with the change in status (from being an investment company within the scope of the SOP to no longer meeting the criteria established by the SOP) to a prospective approach.

### **General Announcements**

None.