

MEMO# 21351

July 12, 2007

AICPA Issues Investment Company Audit Guide Scope SOP

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TO: INTERNAL AUDIT ADVISORY COMMITTEE No. 4-07 RE: AICPA ISSUES INVESTMENT COMPANY AUDIT GUIDE SCOPE SOP

The AICPA recently issued Statement of Position 07-1, Clarification of the Scope of the Audit and Accounting Guide-Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies. The SOP is effective for fiscal years beginning on or after December 15, 2007.

The SOP provides guidance for determining whether an entity is within the scope of the AICPA Audit and Accounting Guide, Investment Companies. For those entities that are investment companies, the SOP also addresses whether the specialized industry accounting principles (i.e., investment company accounting) should be retained by a parent company in consolidation or by an investor that has the ability to exercise significant influence over the investment company and applies the equity method of accounting to its investment in the entity.

Investment Company

The SOP defines an investment company as a separate legal entity whose business purpose and activity is investing in multiple substantive investments for current income, capital appreciation, or both, with investment plans that include exit strategies. Entities regulated under the Investment Company Act of 1940 or similar regulations are considered investment companies for purposes of their financial statements.

Entities that hold investments for strategic operating purposes are excluded from the definition of investment company. Investments are held for strategic operating purposes if the entity or its affiliates obtain or have the objective of obtaining benefits as a result of

investments in any investee, through relationships with the investee or its affiliates, that are unavailable to noninvestor entities. Such benefits could include, for example, access to technology or processes owned by the investee or its affiliates.

Accounting for Investments in Investment Companies

A parent company or equity method investor in an investment company must determine whether investment company accounting should be retained in the financial statements of the parent company or equity method investor. Parent companies and equity method investors should retain investment company accounting in their consolidated financial statements only if: 1) the investee meets the SOP's definition of an investment company; 2) the consolidated group (the parent company and its consolidated subsidiaries) has established policies that effectively distinguish the nature and type of investments made by other entities within the consolidated group that are not investment companies; and, 3) the parent company or equity method investor is investing for current income, capital appreciation, or both, rather than for strategic operating purposes.

If the parent company or equity method investor determines that investment company accounting should not be retained in its consolidated financial statements, the financial information of the investment company should be adjusted as if the investee had not applied investment company accounting.

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