

MEMO# 15560

January 16, 2003

AICPA PROPOSAL CLARIFYING SCOPE OF AUDIT GUIDE

[15560] January 16, 2003 TO: ACCOUNTING/TREASURERS COMMITTEE No. 4-03 RE: AICPA PROPOSAL CLARIFYING SCOPE OF AUDIT GUIDE The AICPA's Accounting Standards Executive Committee recently issued a proposal clarifying the scope of the Investment Company Audit Guide.¹ The proposal provides specific conditions for determining whether entities such as investment partnerships, private equity funds and venture capital companies are subject to the Guide. For those entities that are investment companies under the proposal, the SOP also addresses the retention of specialized industry accounting 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. Comments on the proposal are due to the AICPA by March 31, 2003. If you have any comments on the proposal that you would like to be considered in a possible comment letter, please contact the undersigned at 202/326-5851 or smith@ici.org by February 28. The proposed SOP recognizes three categories of investment companies. Entities that fall within these three categories must apply the Guide in preparing their financial statements. Entities that do not qualify as an investment company within these three categories are prohibited from applying the provisions of the Guide. These three categories are: 1. Investment companies regulated under the Investment Company Act of 1940 or the Small Business Investment Company Act of 1958, common (collective) trust funds, the separate accounts of insurance companies, and entities in foreign jurisdictions that are subject to regulations similar to the Investment Company Act; 2. Entities that pool funds from multiple investors where no one investor owns twenty percent or more of the outstanding shares. The primary business activity of these entities must be investing for current income, capital appreciation, or both. Such entities must meet the following conditions: 1 The proposed 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 is available from the AICPA website: http://www.aicpa.org/download/acctstd/021217_sop_invest.pdf. 2 a. The entity's expressed business purpose is to be an investment company that holds investments for current income, capital appreciation, or both; b. The entity holds multiple substantive investments; c. The entity's activities, assets, and liabilities are limited to investment activities, assets, and liabilities; d. The entity or its affiliates are not involved in the day-to-day management of investees, affiliates of investees, or other investment assets; and e. The entity has an exit strategy for equity investments. 3. Entities not owned by multiple investors whose primary business activity is investing for current income, capital appreciation, or both (i.e., they meet conditions a-e above). In addition, these entities must invest in "separate

autonomous businesses.” Factors that lead to the conclusion that an investee is not a separate autonomous business include: a. The entity obtains benefits from the investee that are unavailable to unrelated noninvestor entities; b. The entity or its affiliates provide significant administrative or support services to investees or affiliates of investees; c. Investees or affiliates of investees provide financing guarantees or collateral for borrowing arrangements of the entity or the entity’s affiliates; d. Compensation of management or employees of investees or affiliates of investees is dependent on the financial results of the entity or the entity’s related parties; or e. The entity or its affiliates direct the integration of operations of investees or affiliates of investees, or the establishment of business relationships between investees or affiliates of investees. The proposed SOP is scheduled to be effective for fiscal years beginning after December 15, 2003. Earlier application is encouraged. Gregory M. Smith Director - Operations/Compliance & Fund Accounting

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