The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 10943

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ACSEC REVIEW OF DRAFT INVESTMENT COMPANY AUDIT GUIDE

[10943] April 29, 1999 TO: ACCOUNTING/TREASURERS COMMITTEE No. 13-99 RE: AcSEC REVIEW OF DRAFT INVESTMENT COMPANY AUDIT GUIDE ____ The AICPA Investment Companies Committee (ICC) met with the AICPA Accounting Standards Executive Committee (AcSEC) on April 28 to review comments filed with the AICPA on the Investment Company Audit Guide exposure draft. The following summarizes AcSEC's decision on each of the issues discussed. Amortization of Premium/Accretion of Discount - An industry representative gave a presentation arguing that existing accounting guidance, which permits an investment company to conform its amortization policy to its tax elections, should be maintained. The presentation argued that: 1) the proposed change would not enhance shareholder understanding, 2) costs associated with the proposed change outweigh perceived benefits, and 3) it is unclear that GAAP requires amortization for mark-to-market entities that report the change in value of securities in earnings. After considering the presentation, AcSEC voted to require amortization of premium and accretion of discount as originally proposed. Contributions to Capital and Corrections of Investment Restriction Violations - AcSEC decided that payments from the adviser or other party to the fund, which compensate the fund for losses incurred, should be recognized as a separate line item in the statement of operations immediately after the net realized gain or loss from investments caption. AcSEC did not distinguish between payments intended to compensate the fund for losses on a prohibited security, and payments intended to compensate the fund for losses on a permitted security that declined in value. AcSEC reaffirmed that these disclosures do not apply to immaterial items. Condensed Schedule of Investments - AcSEC decided to retain the condensed schedule of investments as originally proposed in the exposure draft. High Yield and Restricted Debt Securities - Paragraph 7.14 of the exposure draft requires funds to identify in the schedule of investments all high yield and restricted debt securities whose values have been estimated by directors. The requirement to identify these securities is also contained in SOP 93-1 Financial Accounting and Reporting for High-Yield Debt Securities by Investment Companies. AcSEC decided to omit this disclosure requirement. Instead, funds will be required to provide disclosure regarding "certain significant estimates" as described in SOP 94-6 Disclosure of Certain Significant Risks and Uncertainties. AcSEC also discussed UIT Offering Costs, Security Valuation, and Complex Capital Structures and decided to make no changes to the exposure draft. AcSEC also decided to defer effectiveness of the audit guide to fiscal years beginning after December 15, 2000. The ICC is scheduled to meet with AcSEC again in late July to receive final clearance. Thereafter, the audit guide must be approved by the FASB. Gregory M. Smith Director - Operations/ Compliance & Fund Accounting