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Amendment to scope of Statement of position 95-2, Financial reporting by nonpublic investment partnerships, to include commodity pools; Statement of position 01-1;

American Institute of Certified Public Accountants. Accounting Standards Executive

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**STATEMENT OF
POSITION 01-1**

AICPA

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

March 27, 2001

**Amendment to Scope of
Statement of Position 95-2,
*Financial Reporting by
Nonpublic Investment
Partnerships, to Include
Commodity Pools***

*Issued by the
Accounting Standards Executive Committee*

NOTE

Statements of Position on accounting issues present the conclusions of at least two-thirds of the Accounting Standards Executive Committee, which is the senior technical body of the Institute authorized to speak for the Institute in the areas of financial accounting and reporting. Statement on Auditing Standards No. 69, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles in the Independent Auditor's Report*, identifies AICPA Statements of Position that have been cleared by the Financial Accounting Standards Board as sources of established accounting principles in category *b* of the hierarchy of generally accepted accounting principles that it establishes. AICPA members should consider the accounting principles in this Statement of Position if a different accounting treatment of a transaction or event is not specified by a pronouncement covered by rule 203 of the AICPA Code of Professional Conduct. In such circumstances, the accounting treatment specified by the Statement of Position should be used, or the member should be prepared to justify a conclusion that another treatment better presents the substance of the transaction in the circumstances.

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SUMMARY

This Statement of Position (SOP) amends SOP 95-2, *Financial Reporting by Nonpublic Investment Partnerships*, to include within the scope of SOP 95-2 investment partnerships that are commodity pools subject to regulation under the Commodity Exchange Act of 1974.

FOREWORD

The accounting guidance contained in this document has been cleared by the Financial Accounting Standards Board (FASB). The procedure for clearing accounting guidance in documents issued by the Accounting Standards Executive Committee (AcSEC) involves the FASB reviewing and discussing in public board meetings (1) a prospectus for a project to develop a document, (2) a proposed exposure draft that has been approved by at least ten of AcSEC's fifteen members, and (3) a proposed final document that has been approved by at least ten of AcSEC's fifteen members. The document is cleared if at least five of the seven FASB members do not object to AcSEC undertaking the project, issuing the proposed exposure draft or, after considering the input received by AcSEC as a result of the issuance of the exposure draft, issuing the final document.

The criteria applied by the FASB in its review of proposed projects and proposed documents include the following.

1. The proposal does not conflict with current or proposed accounting requirements, unless it is a limited circumstance, usually in specialized industry accounting, and the proposal adequately justifies the departure.
2. The proposal will result in an improvement in practice.
3. The AICPA demonstrates the need for the proposal.
4. The benefits of the proposal are expected to exceed the costs of applying it.

In many situations, prior to clearance, the FASB will propose suggestions, a number of which are included in the documents.

Amendment to Scope of Statement of Position 95-2, *Financial Reporting by Nonpublic Investment Partnerships*, to Include Commodity Pools

Introduction and Background

1. Statement of Position (SOP) 95-2, *Financial Reporting by Nonpublic Investment Partnerships*, requires that nonpublic investment partnerships present the following:
 - a. A condensed schedule of investments
 - b. A statement of operations in accordance with the provisions of the Audit and Accounting Guide *Audits of Investment Companies* (Investment Companies Guide)
 - c. Management fees and disclosure of the calculation of management fees

Nevertheless, paragraph 5(b) of SOP 95-2 excludes from its scope “investment partnerships that are commodity pools subject to regulation under the Commodity Exchange Act of 1974.”

2. Paragraph 5 of SOP 95-2 says that investment partnerships excluded from the scope of SOP 95-2 should comply with the financial reporting requirements of the AICPA Audit and Accounting Guides applicable to those entities. Footnote 1 of SOP 95-2 says that the then-current Audit and Accounting Guide *Audits of Brokers and Dealers in Securities* (the Broker-Dealer Guide) specified requirements for commodity pools¹ but adds that the Broker-Dealer Guide was being revised and that a forthcoming Guide that would apply to commodity pools was being prepared for comment.

1. Part 4 of the Commodity Futures Trading Commission Regulations defines pool as any investment trust, syndicate, or similar form of enterprise operated for the purpose of trading commodity interests.

3. The revised Broker-Dealer Guide does not provide financial reporting requirements for commodity pools because the Accounting Standards Executive Committee (AcSEC) expected at the time the Broker-Dealer Guide was being prepared that it would issue a separate Guide for commodity pools.
4. AcSEC did not issue a separate Guide for commodity pools. Instead, the AICPA issued a nonauthoritative Practice Aid entitled *Audits of Futures Commission Merchants, Introducing Brokers, and Commodity Pools*. Therefore, AcSEC decided to develop an authoritative standard to address whether SOP 95-2 should apply to investment partnerships that are commodity pools subject to regulation under the Commodity Exchange Act of 1974.
5. AcSEC issued an exposure draft of a proposed SOP, *Amendment to Scope of Statement of Position 95-2, Financial Reporting by Nonpublic Investment Partnerships, to Include Commodity Pools*, on August 15, 2000. AcSEC received four comment letters in response to the exposure draft. See the section entitled "Basis for Conclusions" for a discussion of AcSEC's response to the comment letters received.

Scope

6. This SOP applies to investment partnerships that are commodity pools subject to regulation under the Commodity Exchange Act of 1974.

Conclusions

7. Paragraph 5(b) of SOP 95-2 is deleted. Therefore, SOP 95-2 applies to investment partnerships that are commodity pools subject to regulation under the Commodity Exchange Act of 1974.
8. Paragraph 5 of SOP 95-2 is replaced in its entirety with the following.

This SOP applies to investment partnerships that are exempt from SEC registration under the Investment Company Act of 1940 and defined as investment companies in the Guide, with one exception.¹ This SOP does not apply

to investment partnerships that are brokers and dealers in securities subject to regulation under the Securities Exchange Act of 1934 (registered broker-dealers) and that manage funds only for those who are officers, directors, or employees of the general partner. Investment partnerships identified in the previous sentence as being exempt from the scope of this SOP should comply with the financial reporting requirements in the AICPA Audit and Accounting Guide *Brokers and Dealers in Securities*.

Investment partnerships that are SEC registrants must comply with the financial statement reporting requirements as set forth in the Guide and as required by Articles 6 and 12 of the SEC's Regulation S-X.

1. Investment partnerships that are commodity pools subject to regulation by the Commodity Futures Trading Commission (CFTC) should also comply with the financial statement reporting requirements of Part 4 of the CFTC Regulations.

Effective Date

9. This SOP is effective for financial statements issued for periods ending after December 15, 2001. Earlier application is encouraged.

The provisions of this Statement need not be applied to immaterial items.

Basis for Conclusions

10. Prior to this SOP, existing authoritative literature did not require certain commodity pools to make disclosures that some, including AcSEC, believe are important and useful. As noted in a comment letter from the Commodity Futures Trading Commission (CFTC) on the September 1998 exposure draft of the Investment Companies Guide, the annual reports of many commodity pools do not contain condensed schedules of investments. A commodity pool operator could elect to become subject to the Commodity Exchange Act of 1974 without having to trade commodities, and thus was

able to exclude itself from the scope of SOP 95-2. Therefore, two pools with similar operations and investment portfolios could have had different disclosures in the financial statements if one was subject to CFTC regulation and the other was not.

11. The exclusion of certain commodity pools from the scope of SOP 95-2 is a consequence of AcSEC's original intent to issue a separate Audit and Accounting Guide for those entities. AcSEC believes that SOP 95-2 requires the disclosure of important and useful information and that commodity pools subject to regulation under the Commodity Exchange Act of 1974 should disclose that information. AcSEC determined that there was no compelling reason to continue to exempt those entities from the scope of SOP 95-2. Further, AcSEC believes that this SOP should help improve the transparency and comparability of financial statement disclosures made by commodity pools, hedge funds, and other kinds of funds.
12. AcSEC considered the views of commentators on the September 1993 exposure draft of the proposed SOP, *Financial Reporting for Investment Partnerships* (which resulted in the issuance of SOP 95-2), and the August 15, 2000, exposure draft of this SOP. Certain commentators recommended that investment partnerships registered with the CFTC as commodity pool operators be exempt from the scope of SOP 95-2. A number of those views are summarized and discussed in appendix B of SOP 95-2, which describes comments received on the exposure draft of that SOP.
13. Among the views expressed by commentators on the September 1993 exposure draft was that a condensed schedule of investments (as required by paragraph 10 of SOP 95-2) may not be meaningful and may even be misleading because of the frequent turnover of most commodity portfolios. That is, investments held at the date of the balance sheet may not represent trading strategies used during the past year or that will be used in the coming year.
14. In addition, some believe that a condensed schedule of investments, which may include investments in derivative instruments, may not convey the risks associated with derivative investments.

15. While concluding to no longer exempt commodity pools subject to regulation under Commodity Exchange Act of 1974 from the scope of SOP 95-2, AcSEC agrees that many commodity portfolios turn over frequently. However, AcSEC believes that a schedule of investments is nonetheless useful. For example, AcSEC understands that hedge funds held large derivative positions via over-the-counter trades in the summer and fall of 1998 and that some time elapsed before the funds could unwind those positions during the Asian liquidity crisis in 1998. AcSEC believes that presentations of condensed schedules of investments by hedge funds would have helped users to better assess their investments in such funds.
16. An attempt to improve disclosures of derivative investments to better convey the risks associated with those investments is beyond the scope of this SOP. In addition, commodity pools are subject to the provisions of chapter 7 of the Investment Companies Guide, which provides guidance on the disclosure of futures and forwards investments, and Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*.
17. Some believe that disclosure of a condensed schedule of investments could result in competitive harm because that information is proprietary and akin to trade secrets in other industries. They believe that competitors could mimic a partnership's trading strategies or devise strategies to profit at the expense of the partnership, such as in a short squeeze. Although AcSEC recognizes the need to balance a fair presentation with protection of proprietary information, complete confidentiality of investments is not a compelling reason for excluding information on material items from financial statements. AcSEC acknowledges that disclosure can produce certain detriments, but AcSEC believes that the need for adequate disclosure outweighs the possibility of negative results. Furthermore, as noted by several respondents to the exposure draft of SOP 95-2, although the disclosure of investment positions may be detrimental to a number of funds that have material short positions outstanding at a reporting date, many such positions will have

- expired or will have been covered before the availability of the financial statements.
18. AcSEC believes that reporting basic information about investments is vital for a fair presentation of commodity pools' financial statements. AcSEC notes that paragraph 10(b) of SOP 95-2 requires identification of only those individual investments constituting more than 5 percent of net assets; all other investments are categorized in accordance with paragraph 10(a) of SOP 95-2. In addition, AcSEC notes that funds outside the scope of SOP 95-2 are required to disclose individual investments that constitute more than 1 percent of net assets.
 19. Two respondents to the August 15, 2000, exposure draft propose that in lieu of identifying a fund-of-funds' individual investments (in other funds) constituting more than 5 percent of net assets, a pool should disclose other information, such as the size of each investment, the gross fees paid, net profit or loss, a description of the trading strategy, and terms of liquidity. The respondents note that, under their proposed approach, a pool would not be required to disclose the names of funds for which it has a greater than 5 percent investment. The respondents believe that disclosing the name of a pool's investee funds could harm the pool as potential investors might invest directly with the pool's investee funds instead of with the pool.
 20. AcSEC believes that a fund-of-funds should disclose the name of investee funds that constitute more than 5 percent of the net assets of the fund-of-funds because a fund name allows an investor to access information about the fund, such as its trading strategy. In addition, AcSEC notes that fund-of-funds not subject to SOP 95-2, as amended, are required by the Investment Companies Guide to disclose the name of the investee funds that meet the criteria of that Guide. This SOP does not require disclosure to any greater extent than what other investment partnerships are required to disclose.
 21. One respondent to the August 15, 2000, exposure draft believes that this SOP will result in increased diversity in financial reporting because managers of commodity pools may (a) move their businesses outside the United States to

avoid reporting under generally accepted accounting principles (U.S. GAAP) or (b) accept qualified opinions from the pools' auditors for not complying with the provisions of this SOP.

22. AcSEC notes that two main considerations in the development of financial reporting standards by U.S. standard setters are the usefulness of financial statements to owners and other general purpose users, and the comparability of financial information reported by those entities that comply with U.S. GAAP. As noted above, AcSEC believes that the disclosures required by this SOP are useful to investors and others. AcSEC could find no compelling reason for commodity pools subject to regulation under the Commodity Exchange Act of 1974 to present different information than other nonpublic investment partnerships.
23. Two respondents to the August 15, 2000, exposure draft believe that the final SOP should increase the percentage threshold of disclosing a fund-of-funds' investment in investee funds from greater than 5 percent of net assets to 10 percent of net assets. The respondents cite a January 19, 2000, letter from the CFTC to commodity pool operators, which requests that a fund-of-funds disclose investments in investee funds that are greater than or equal to 10 percent of the pool's net assets.
24. AcSEC understands that the CFTC based its disclosure requirement on an existing rule that defines "material investee pool." AcSEC also understands that the CFTC rule related to material investee pools is broader than CFTC disclosure requirements for annual reports. Further, AcSEC understands that the January 19, 2000, letter from the CFTC does not attempt to portray concentrations of investments, which is the intent of paragraph 10 of SOP 95-2. AcSEC continues to believe that the greater than 5-percent threshold in SOP 95-2 is a useful disclosure.

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(2000-2001)**

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