



# Asset management accounting matters

## Overview

### Common instructions to schedules required under Article 12

#### Futures contracts

#### Forward foreign currency contracts

#### Swap contracts

#### Other investments

#### Parting thoughts

#### Contact information

## Impact of Financial Reporting Guidance for Registered Funds and BDCs – Part III of III

### Overview

As introduced in [Part I of this series](#), the SEC adopted amendments to Articles 6 and 12 of Regulation S-X (the Amendments) that prescribe the form and content of financial statements reported by registered investment companies and business development companies. The compliance date for the Amendments is **August 1, 2017**.

The rules described herein represent the amended rules, except where specified otherwise.

Part III of this series discusses the changes relating to:

- Open futures contracts
- Open forward foreign currency contracts
- Open swap contracts
- Investments – Other than those presented in Rules 12-12 through 12-13C (other investments).

The schedules required under the Amendments are presented in the following table. The rules affected by the topics discussed in Part III are highlighted below.

| Amended rules  |
|--|
| 12-12 (Investments in securities of unaffiliated issuers)  |
| 12-12A (Investments – securities sold short)   |
| 12-12B (Summary of schedule of investments in securities of unaffiliated issuers)                                  |
| 12-13 (Open option contracts written)  |
| <b>12-13A (Open futures contracts)</b>   |
| <b>12-13B (Open forward foreign currency contracts)</b>  |
| <b>12-13C (Open swap contracts)</b>  |
| <b>12-13D (Investments other than those presented in 12-12, 12-12A, 12-12B, 12-13, 12-13A, 12-13B, and 12-13C)</b> |
| 12-14 (Investments in and advances to affiliates)  |



## Common instructions to schedules required under Article 12

Changes to common instructions to schedules required under Article 12 are described as follows:

- Funds will be required to list separately investments or derivatives where key terms or characteristics differ, such as descriptions, counterparties, or contract expiration/settlement/maturity dates.
- Funds will be required to disclose the counterparty to each of their derivative transactions. However, this information is not required for derivatives that are exchange-traded or centrally cleared.
- Funds will be required to indicate by an appropriate symbol each investment whose value was determined using significant unobservable inputs (e.g., investments classified as Level 3 in the fair value hierarchy).
- Funds will be required to indicate by an appropriate symbol each investment that cannot be sold because of restrictions or conditions applicable to the investment.

In addition, funds are generally required to present totals for amounts presented in the schedules required under Article 12 that correlate to the related balance sheet. Funds that report derivatives on a gross basis may consider presenting separate columns for unrealized appreciation and depreciation to facilitate reconciling those amounts to the related balance sheet but are not required to do so.



## Futures contracts

Rule 12-13A will require the following columns to be presented for open futures contracts:

- Column A – Description
- Column B – Number of contracts
- Column C – Expiration date
- Column D – Notional amount
- Column E – Value
- Column F – Unrealized appreciation/depreciation.

The description of futures contracts should include the name of the reference asset or index. Long purchases of futures contracts should be presented separately from futures contracts sold short.

The instructions to Rule 12-13A state that notional amounts reported in Column D should be the current notional amount at the close of the period rather than the notional amount at the inception of the contract.



## Forward foreign currency contracts

Rule 12-13B will require the following columns to be presented for open forward foreign currency contracts:

- Column A – Amount and description of currency to be purchased
- Column B – Amount and description of currency to be sold
- Column C – Counterparty
- Column D – Settlement date
- Column E – Unrealized appreciation/depreciation.



## Swap contracts

Rule 12-13C will require the following columns to be presented for open swap contracts:

- Column A – Description and terms of payments to be received from another party
- Column B – Description and terms of payments to be paid to another party
- Column C – Counterparty
- Column D – Maturity date
- Column E – Notional amount
- Column F – Value
- Column G – Up-front payments/receipts
- Column H – Unrealized appreciation/depreciation.

## ***Terms of financing payments***

Funds will be required to provide information sufficient for financial statement users to understand the terms relating to financing payments to be paid or received under its swap contracts. Depending on the type of swap contract, those terms might include descriptions of the reference asset (or index) or obligation, fixed or floating interest rates, whether floating interest is paid or received, and the frequency of payments. Although the instructions to Rule 12-13C include examples that may be provided for more common types of swap contracts, significant judgment may be necessary in order to determine the appropriate information to allow investors and other users to understand the terms of financing payments for other types of swap contracts.

Funds will also be required to list swaps by major category (e.g., credit default swaps [CDS], interest rate swaps, total return swaps). In addition, funds should list CDS where credit protection is sold separately from CDS where credit protection is purchased.

## ***Disclosures when the underlying investment is an index or a basket of investments***

Some swap contracts may have an underlying investment that is either an index or a basket of investments. In instances where either (1) the components to the index or basket are publicly available on a Web site as of the reporting date or (2) the components to the index or basket are not publicly available but the notional amount of the swap contract does not exceed 1 percent of the net assets of the fund, the fund will only be required to identify the index or basket.

If the components of the index or basket are not publicly available, and the notional amount of the swap contract exceeds 1 percent of the net assets of the fund, the following disclosures are required:

- A description of the index or custom basket
- The 50 largest components in the index or custom basket
- Any other components where the notional value for the component exceeds 1 percent of the notional value of the index or custom basket.

For each investment separately listed, a fund should include the following information:

- The description of the underlying investment as would be required elsewhere under Article 12
- The quantity held
- The value at the close of the period
- The percentage value compared to the net assets of the index or custom basket.



## Other investments

Rule 12-13D applies to investments other than those required to be presented under Rules 12-12 through 12-13C. Investments reported under Rule 12-13D may include real estate properties or physical commodities but could apply to other investments or derivatives not addressed in Rules 12-12 through 12-13C.

Investments reported in accordance with Rule 12-13D should be categorized by (1) type of investment and (2) the related industry, country, or geographic region of the investment.

Rule 12-13D also requires funds to include information sufficient for a user of financial information to understand the nature and terms of the investment. Examples of such information may include, but are not limited to, the reference security, asset or index, currency, geographic location, payment terms, payment rates, call or put features, exercise price, expiration date, and counterparty for non-exchange-traded investments.

Current Rule 6-10 includes an exception to reporting other investments under current Rule 12-13 if the investments at both the beginning and end of the period amount to 1 percent or less of the value of total investments. The SEC observed that some funds may have significant notional exposure from other investments that are valued as less than 1 percent of the value of total investments. Accordingly, the SEC decided to remove this exception from the Amendments.



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## Parting thoughts

To prepare for the upcoming compliance date, we recommend that funds perform a gap analysis to evaluate the differences between their current reporting requirements and the requirements under the amended rules. In particular, funds may require significant updates to their financial reporting systems to track and process the information necessary to comply with the new disclosure requirements. Funds should also consider updating their financial statement templates and to perform a dry run of their updated financial reporting processes in advance of the compliance date.

In addition, certain rule changes have been recently implemented by central clearing parties that treat certain payments associated with certain derivative contracts as the legal settlement (settled-to-market [STM]) of the outstanding derivative contract exposure rather than as posting of collateral (collateralized-to-market). As discussed in our recent article, [\*Accounting implications for investment companies: Rule changes for variation margin\*](#), the effects of the rule changes may have significant implications for the reporting of STM derivatives on the balance sheet, income statement, and other related disclosures included in a fund's financial statements. Funds should also consider these implications when reporting STM derivatives in accordance with the new and amended Regulation S-X requirements upon the compliance date.







## Contact information

For more information on this alert, please contact [Timothy Jinks](#), [Rich Sumida](#), or one of our Audit Quality & Professional Practice – Investment Management topic team members.

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