



# Financial reporting challenges in the COVID-19 environment

## Key questions for mutual fund audit committees

Mutual fund financial-statement preparers may face significant reporting challenges as a result of the business disruption and economic uncertainty arising from the COVID-19 response.

The COVID-19 environment is heightening sentiments of insecurity and risk, in the wake of greater volatility in asset prices and currency-exchange rates and a marked decline in long-term interest rates in developed economies.

This paper highlights those areas that will be the most challenging for mutual fund financial-statement preparers in the current environment. We believe that a robust dialogue between management, the auditor, and the audit committee in these areas will best assist the audit committee in fulfilling its oversight responsibilities.

### Accounting for the investment portfolio

#### Valuation of investments

The first and most obvious challenge is the impact that the current market environment resulting from the COVID-19 protocols is having on the value of the investment portfolio and the resulting ramifications to financial accounting and reporting. Certain aspects of the market, such as domestic equities, are still liquid and providing good price transparency. However, other market areas are seeing liquidity decreasing, providing less price transparency. Understanding any strain on pricing procedures, including those performed by pricing vendors, is important to judging the reliability of the valuation estimates being made. Common questions the audit committee may ask management or pricing vendors include:

- Where in the market are you seeing decrease in liquidity? How does this correlate to what we are seeing from any of our liquidity-information sources?
- For those markets where we are seeing decreased liquidity, what are we doing to assess the reliability of the pricing coming from our pricing sources? What are the findings from those efforts?
- Has the volume of our pricing challenges to our pricing sources changed significantly? If yes, why has this change occurred, and what are we learning from those challenges? How have we incorporated those learnings into the performance of the valuation procedures?

- How are the volume and results of our back-testing procedures?
- Are any other areas of pricing causing us challenges?
- For those using consensus pricing services for private-credit investments: ask questions about the depth of quote sources in the current environment in relation to prior periods.
- What changes, if any, have been made to valuation procedures or methodologies? What was the rationale for the change?
- Do we believe our procedures are robust enough to reflect what is known or knowable to market participants?
- For those with funds with significant investments in alternative-investment funds where net asset value (NAV) as a practical expedient is used in the fair value estimate:
  - Are we receiving the underlying fund NAVs on a timely basis?
  - Are any of the underlying funds causing us concern? If so, why, and what are we doing to address those concerns?
  - What due diligence procedures are we currently employing to assess the reliability of the NAVs we are receiving?
  - Have any of the underlying funds placed liquidity constraints on our investment?

#### Collectibility of interest income

For those with significant investments in fixed income, the issues around the collectibility of interest income is another focus area. Common questions the audit committee may ask management include:

- How are we monitoring the portfolio for significant credit downgrades and potential or actual events of default, and how are we factoring this information into our assessment of collectability and ultimately reflecting it in the accounting records?

- For private loans: Have we needed to provide any forbearances or modifications, or are we in an active negotiation or expect to be in an active negotiation for such? If yes, are we reflecting this action in the accounting records timely and accurately? Is portfolio management informing fund accounting and financial reporting of such situations in a timely manner?
- Do we believe our procedures are robust enough to reflect what is known or knowable to market participants?
- Have any payments been missed recently? If so, have we assessed whether there was market information that reflected this was a probable outcome? Did we reflect the market information in the correct accounting period?
- Are our procedures sufficient to timely and accurately identify non-income-producing investments and to reflect that information in our financial reporting?

### > Fund-level debt

Decreases in the value of fund assets can create circumstances where covenant compliance issues arise or where collateral demands impose a burden on the fund. Common questions the audit committee may ask management include:

- For debt and financings with collateral requirements, are we seeing a need to post significantly additional collateral and are such postings creating fund-level liquidity concerns? Are there any resulting regulatory compliance concerns?
- For debt and financings with covenants, are we currently in violation of any covenants or concerned with future covenant compliance? If so, what are we doing to address the matter and how is this impacting fund-level liquidity? Are there any resulting regulatory compliance concerns?
- Are our financial reporting disclosures pertaining to these matters in compliance with the U.S. generally accepted accounting principles (GAAP)?
- GAAP requirements? Who was involved in making this assessment?

### > Related-party transactions

The current environment coupled with expanded regulatory relief has resulted in some additional related-party transactions. Such transactions may include an adviser, sponsor, or sister fund in providing additional financial or liquidity support to a fund or purchasing investments from the fund. Common questions the audit committee may ask management include:

- Have we incurred any additional related-party transactions, such as obtaining financial or liquidity support from affiliates or additional interfund dealings? If so, are fund accounting and financial reporting made known of these arrangements on a timely basis?
- Are our procedures robust enough to assess the accounting and disclosure treatment under U.S. GAAP and reflect that in our accounting records and financial reporting?
- Who is involved in such analysis, and do they have the resources they need to adequately assess the matter and draw appropriate conclusions?

### > Subsequent events and significant risks and uncertainties

The current environment's constantly evolving nature and its effects on the markets and companies demand a rigorous focus on identifying subsequent events and their accounting and disclosure ramifications. Moreover, these changing risks and uncertainties could be so significant they will require the modification of existing disclosure or the addition of new disclosure. Common questions the audit committee may ask management include:

- How are we focusing our efforts to identify and assess the accounting and disclosure ramifications of subsequent events?
- How are we assessing the significant risks and uncertainties and assessing whether our financial reporting disclosure requires any updating?
- Are fund accounting and financial reporting receiving the information they need from others in the organization in order to perform their responsibilities?
- Who is involved in such analysis, and do they have the resources they need to adequately assess the matter and draw appropriate conclusions?

We believe these questions will help foster a productive discussion among management, the auditor, service providers, and the audit committee, enabling mutual-fund financial-statement preparers to best perform their financial reporting responsibilities amid the uncertainty, disruption, and volatility of the COVID-19 environment.

We're all in this together and are committed to helping you successfully emerge from these uncertain times as quickly as possible. For more information on how KPMG can assist in meeting your financial reporting, please contact:

<p><b>Sean McKee</b> National Practice Leader, Public Investment Management T: 609-947-2529 E: smckee@kpmg.com</p>	<p><b>Matt Giordano</b> Deputy Practice Leader, Public Investment Management T: 617-988-6327 E: mjgiordano@kpmg.com</p>
--	---

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities.

[kpmg.com/socialmedia](https://kpmg.com/socialmedia)



The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.

© 2020 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDP087876-1A