Audit and Enterprise Risk Services

Accounting Considerations Related to Redemption Restrictions on Money Market Funds

Financial Reporting Alert 08-17

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Background

As a result of recent market events, a number of "money market funds"[1] have incurred losses on their investments. This has caused some funds to "break the buck" (i.e., their per-share net asset value has fallen below a constant amount, typically $1 per share). With money market funds experiencing declines in fair value as a result of deterioration in the creditworthiness of their assets, general illiquidity conditions, or both, redemptions by investors have increased. Accordingly, some funds have been forced to liquidate their assets, impose limits on redemptions, or obtain support from related entities.

This Financial Reporting Alert addresses the investor's accounting for money market funds that were appropriately classified as cash equivalents and that have subsequently imposed restrictions on redemptions or have been frozen. Accounting considerations discussed include balance sheet classification, measurement, and classification in the statement of cash flows.[2]

Accounting Considerations

Balance Sheet Classification

As of the reporting date, an investment in a money market fund should remain classified as a cash equivalent for financial reporting periods ending **before** the money market fund imposed restrictions on redemptions. Reporting entities should consider the guidance in AU Section 560[3] on appropriate disclosure of a subsequent event. Entities should also consider the disclosure requirements of other relevant GAAP (e.g., SOP 94-6[4]).

For financial reporting periods ending as of or **after** the date on which amounts have been restricted for redemption or have been frozen, it is no longer appropriate to continue to classify any portion of an investment as a cash equivalent unless the investor has determined that it has the unconditional right to receive all of its investment within three months of the date of the restriction. However, prior-period amounts presented should not be reclassified from cash equivalents.

> **Editor's Note:** As indicated in Question 51 of FASB Staff Implementation Guide (Statement 115),[5] securities considered cash equivalents are subject to the accounting requirements of Statement 115.[6] However, investors should consider the legal form of their investment when determining the appropriate classification after the imposition of redemption restrictions.

When the money market fund is expected to liquidate its investments over an extended period, investors that present a classified balance sheet should appropriately reflect the current and long-term portions of their investment by considering the expected timing of the distributions in accordance with Chapter 3A of ARB 43.[7]

Measurement

For financial reporting periods ending **before** the date of a decline in the fair value of a money market fund investment, such a decline would represent a Type II subsequent event in accordance with AU Section 560 and would not be recorded (but may need to be disclosed) in the quarterly or year-end financial statements.

For financial reporting periods ending as of or **after** the date of a decline in the fair value of a money market fund investment, an investor should generally reduce the carrying amount of its investment to its fair value. (The investor should consider the redemption constraints and the anticipated timing of any liquidating distributions in determining the fair value of the investment in accordance with Statement 157,[8] and should provide the related disclosures required by Statement 157.)

> **Editor's Note:** If the investment is classified as trading, all changes in fair value are recognized in the income statement as they occur. Also, according to paragraph 16 of Statement 115, a decline in fair value of a held-to-maturity or available-for-sale security that represents an other-than-temporary impairment must be recognized in the income statement. The guidance in FSP FAS 115-1/124-1[9] should also be considered. Broker-dealers or other entities that are not required to comply with Statement 115 may need to apply other relevant guidance in accounting for their investments in money market funds.

Classification in the Statement of Cash Flows

The reclassification of amounts previously reflected as cash equivalents would be presented as an investing or operating activity, as appropriate, in the statement of cash flows. Prior-period cash flow statements should not be adjusted to reclassify amounts from cash equivalents if such amounts were appropriately classified in the prior period.

Editor's Note: On September 19, 2008, the U.S. Treasury Department established a temporary guarantee program (the "Program") for money market funds. Under the Program, the U.S. Treasury will guarantee investors that they will receive $1 per share for the lower of (1) the number of shares the investor held in the money market fund as of the close of business on September 19, 2008, or (2) the number of shares held in the money market fund as of the guaranteed event (the date on which the per-share net asset value falls below the constant amount). Investors who purchase interests in a money market fund after September 19, 2008, will not be covered by the Program. To participate in the Program, the money market fund must (1) be regulated under Rule 2a-7 of the Investment Company Act of 1940, (2) have a stable share price of at least $1 as of September 19, 2008, and (3) be publicly offered and registered with the SEC. Funds were required to elect their participation in the Program by October 10, 2008, which will run for an initial period of three months (until December 18, 2008). The secretary of the Treasury has the discretion to extend the Program to September 19, 2009. This Financial Reporting Alert does not address the accounting implications of a money market fund's participation in the Program.

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1 A money market fund is defined in the Glossary of the AICPA Audit and Accounting Guide *Investment Companies* as a "mutual fund whose investments are primarily or exclusively in short-term debt securities designed to maximize current income with liquidity and capital preservation, usually maintaining per share net asset value at a constant amount, such as one dollar."

2 On October 10, 2008, the AICPA issued a nonauthoritative Technical Practice Aid (TPA) on this topic. The TPA covers balance sheet classification, disclosures, debt covenants, subsequent events, and going-concern considerations. The TPA is available on the AICPA's Web site.

3 AICPA *Professional Standards,* AU Section 560, "Subsequent Events."

4 AICPA Statement of Position 94-6, *Disclosure of Significant Risks and Uncertainties.*

5 FASB Staff Implementation Guide (Statement 115), "A Guide to Implementation of Statement 115 on Accounting for Certain Investments in Debt and Equity Securities: Questions and Answers."

6 FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities.*

7 Accounting Research Bulletin No. 43, Chapter 3A, “Working Capital: Current Assets and Current Liabilities.”

8 FASB Statement No. 157, *Fair Value Measurements.*

9 FASB Staff Position No. FAS 115-1/124-1, “The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments.”
