MEMO# 7395

November 7, 1995

SEC ISSUES GENERIC COMMENT LETTER FOR INVESTMENT COMPANY CFOS

November 7, 1995 TO: ACCOUNTING/TREASURERS MEMBERS No. 49-95 INDEPENDENT ACCOUNTANTS ADV. GROUP No. 7-95 SEC RULES MEMBERS No. 77-95 UNIT INVESTMENT TRUST MEMBERS No. 55-95 RE: SEC ISSUES GENERIC COMMENT LETTER FOR INVESTMENT COMPANY CFOs ____ The Division of Investment Management recently issued the attached letter to the investment company industry to provide guidance on certain accounting and financial reporting issues. Set forth below is a brief summary of the issues addressed in the letter. Transactions With Affiliates in a Master/Feeder Structure In its November 1, 1994 CFO letter, the staff indicated that funds that are compensated by affiliates for losses on certain of their portfolio securities should account for such transactions as contributions to capital. The attached letter indicates that feeder funds in master/feeder arrangements must also recognize in their financial statements their pro rata portion of the capital contributions made at the master level. Disclosure of the capital contribution in the master funds financial statements alone is insufficient, notwithstanding that a feeder fund includes the financial statements of its master in its annual and semi-annual reports to shareholders. Accounting For Organization Expenses and Other Deferred Costs Organization expenses may be capitalized by all investment companies and should be amortized over the period of benefit, not to exceed sixty months. In the attached letter, the staff distinguishes offering costs, which include the costs of registering securities with the SEC and the states, from organization costs. Open-end funds should include offering costs in their expense accrual rate over a period not to exceed one year. Closed-end funds and UITs should charge offering costs to paid-in-capital. Closed-end funds and UITs may capitalize offering costs until the offering period commences. For closed-end funds, the costs should then be charged to paid-in-capital immediately. For UITs, such costs should be charged to paid-in- capital no later than the close of the period during which units of the trust are first sold to the public. Financial Statements of Depositors for UITs The staff will not object to the omission of depositor financial statements otherwise required by Form N-8B-2 and Form S-6 unless the depositor meets one of the following conditions: the depositor has liabilities pursuant to a periodic payment plan; the depositor is considered the issuer of the securities whose reserves will be relied upon to ensure payments (e.g., insurance companies issuing variable products); the depositor has a legal obligation to maintain a secondary market for the securities; or the depositor must continuously function as the issuer because of the nature of the offering. Financial Statement Presentation of Fee Waivers Rule 6-07 of Regulation S-X requires fee reductions or reimbursements to be stated separately in the statement of operations as a negative amount or as a reduction of total expenses. The Audit and Accounting Guide - Audits of Investment Companies indicates that voluntary waivers must be disclosed, but that they do not need to be stated separately in the statement of operations. In the attached letter the staff notes that Rule 6-07 makes no distinction between voluntary and involuntary waivers and indicates that while the Audit and Accounting Guide represents GAAP, registrants should follow the requirements of Regulation S-X in filings with the Commission. Income and Expense Allocation for Multi-Class Funds Under Rule 18f-3 Paragraph (c)(2) of rule 18f-3 allows income, realized and unrealized capital gains and losses, and expenses not allocated to a particular class to be allocated on a "settled share" basis for money funds operating under Rule 2a-7 and other daily dividend funds. This provision of the rule recognizes that many daily dividend funds do not declare dividends on newly subscribed shares until the purchase money is converted to federal funds. However, daily dividend bond funds typically allocate realized and unrealized capital gains and losses upon issuance of the shares. In the attached letter the staff indicates that it will not object if funds relying on rule 18f-3 allocate realized and unrealized capital gains and losses on the basis of relative net assets and income and expenses on the basis of settled shares. Pro Forma Financial Information for Business Combinations Form N-14, the registration statement used to register securities to be issued in a business combination, generally requires the preparation of pro forma financial statements. In the attached letter the staff indicates that it will not object to the omission of certain pro forma information where the transaction involves the combination of two or more target funds with the acquiring fund and the transaction is not conditioned on all target funds receiving shareholder approval. Correction of Errors The staff indicates that capitalization and subsequent amortization of NAV error amounts are not acceptable under GAAP. Accounting Principles Board Opinion No. 20 requires the correction of errors to be recorded when identified, regardless of the effect on NAV. 3Gregory M. Smith Director - Operations/ Compliance & Fund Accounting Attachment

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