

MEMO# 6357

November 4, 1994

SEC ISSUES "GENERIC COMMENT LETTER" FOR MUTUAL FUND CFOS

November 4, 1994 TO: ACCOUNTING/TREASURERS MEMBERS NO. 34-94 INDEPENDENT ACCOUNTANTS ADV. GROUP NO. 10-94 SEC RULES MEMBERS NO. 81-94 RE: SEC ISSUES GENERIC COMMENT LETTER FOR MUTUAL FUND CFOS

The Division of Investment Management recently issued the attached letter to the investment company industry to provide guidance on certain accounting issues. Set forth below is a brief summary of the issues addressed in the letter. Accounting For Certain Transactions With Affiliates During the past year certain funds have undertaken transactions with affiliates to prevent or mitigate declines in net asset value. (See Institute Memorandum to Accounting/Treasurers Members No. 27-94, Money Market Members-One Per Complex No. 9-94, and SEC Rules Members No. 67-94 dated September 23, 1994.) These transactions generally take one of two forms: 1) a direct contribution by the affiliate to the fund to offset a realized loss, or 2) the purchase by the affiliate of securities from the fund at a price in excess of current market value. The staff's letter notes that, in both instances, the accounting for the loss on the investment and the resulting payment should be reflected as a realized loss in the statement of operations and a contribution to capital in the statement of changes in net assets. Footnotes to the financial statements and the financial highlights table should describe these contributions and quantify the effect on total return. Valuation of Certain Portfolio Investments The Commission's Accounting Series Releases (ASRs) 113 and 118 provide guidance in the valuation, accounting and auditing of portfolio securities. ASR 118 indicates that in connection with the annual audit of the fund's financial statements, the auditor should independently verify quotes used by the fund at the balance sheet date. The staff's letter indicates that where there are few market makers providing quotes (as in the case of structured notes), the auditor should seek verification from a market maker different from that used by the fund. In those instances where only one market maker provides a quote, the auditor should employ alternative valuation procedures that provide an accurate and reasonable valuation. Audited Balance Sheet for New Series The letter notes that the staff has traditionally interpreted Section 14(a)(2) of the Investment Company Act of 1940 to permit a new series added to an existing fund to make a public offering without \$100,000 in net assets. The letter goes on to state that in those instances where the new series sells one or more shares to an affiliated shareholder prior to effectiveness of the registration, an audited balance sheet is required in accordance with Item 25, Schedule A of the Securities Act of 1933. Securities With Zero Value A fund that owns securities considered to be worthless should list the securities in the schedule of investments, indicating a zero value. Securities with zero value should be omitted from the schedule of investments only after the fund has classified the security as a worthless

security for federal income tax purposes. Please see the attached letter for additional details. Gregory M. Smith Director - Operations/ Compliance & Fund Accounting Attachment

Source URL: <https://icinew-stage.ici.org/memo-6357>

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.