(v) *Alternate procedure for filing Declaration*—(1) *Scope.* An alternate procedure[1] for filing Declarations covering general license shipments (other than temporary exports made under the provisions of General License GTE; § 371.22 of this subchapter) via aircraft or vessel to destinations in Country Group T, V, or X is established, under which such a Declaration may be delivered to the exporting carrier or his shipping agent at the port of export, or to a domestic airline[2] at or near the point of origin of the cargo, without first having been authenticated by the customs office.

* * * * *

PART 387—ENFORCEMENT

In § 387.11, paragraph (c) is amended to read as follows:

§ 387.11 Recordkeeping.

* * * * *

(c) *Records to be kept.* The records to be kept pursuant to this § 387.11 shall include memoranda, notes, correspondence, books, export control documents, and other written matter pertaining to the transactions described in paragraph (a) of this section, which may be made or obtained by a person described in paragraph (b) of this section. In addition to the records required to be kept by this § 387.11, the provisions of §§ 368.2, 371.22, 372.1, 372.5, 372.6, 373.3, 373.4, 373.5, 373.6, 373.7, 373.8, 374.7, 376.8, 376.10, 378.2, 379.4, 386.3, and 386.6 of the Export Control Regulations of this subchapter require certain records to be made and kept by persons in the United States or abroad in connection with export transactions. The revocation or revision of any such provision of the Export Control Regulations which requires the making and keeping of records shall not be retroactive in effect unless specifically provided and shall not affect the original requirement to keep such records for the prescribed period.

* * * * *

[F.R. Doc. 70-17590; Filed, Dec. 30, 1970; 8:49 a.m.]

[1] The alternate procedure does not apply when an inland shipper elects to have his Declaration authenticated under the port-of-origin procedure set forth in § 386.8.

[2] For purposes of this regulation an "exporting carrier" is defined as the office of either a steamship line or an airline at the port of export, or the shipping agent of a steamship line at the port of export. A "domestic airline" is one that (a) holds a certificate of public convenience and necessity issued by the Civil Aeronautics Board for scheduled service pursuant to section 401(d)(1) or 401(d)(2) of the Federal Aviation Act of 1958, as amended (49 U.S.C. 1371), and (b) carries cargo to a port of export for transfer to an international flight of the same or another airline.

Title 17—COMMODITY AND SECURITIES EXCHANGES

Chapter II—Securities and Exchange Commission

[Releases Nos. 33-5118, 34-9046, 35-16940, 39-288, IC-6297]

PART 200—ORGANIZATION; CONDUCT AND ETHICS; AND INFORMATION AND REQUESTS

Assignment of Functions to Director of Division of Corporation Finance

The Securities and Exchange Commission has amended § 200.18 of Title 17 of the Code of Federal Regulations. This section relates to the assignment of function to the Director of the Commission's Division of Corporation Finance. The amendment authorizes that Division to institute injunctive proceedings arising under sections 12, 13, and 15(d) of the Securities Exchange Act of 1934 with the General Counsel retaining supervision over civil litigation. This has been done because it is believed that the Division of Corporation Finance by reason of its familiarity with the facts involved in a particular case is in a position to proceed expeditiously and efficiently with the institution and prosecution of injunctive proceedings. The change will also serve to lighten, somewhat, the workload of the Office of General Counsel. Section 200.18 has also been further amended to clarify the Division's functions with reference to sections 12(g), 14(c), and 15(c) of the Act.

The Commission reemphasizes the necessity for timely compliance by issuers and others with the periodic reporting requirements of the Securities Exchange Act.

Commission action. Section 200.18 of Chapter II of Title 17 of the Code of Federal Regulations is hereby amended as follows:

§ 200.18 Director of the Division of Corporation Finance.

* * * * *

(b) All matters, except those pertaining to investment companies registered under the Investment Company Act of 1940, arising under the Securities Exchange Act of 1934 in connection with:

(1) The registration of securities pursuant to section 12.

(2) The examination and processing of periodic reports filed pursuant to sections 13 and 15(d).

(3) The examination and processing of proxy soliciting material filed pursuant to section 14(a) and information material filed pursuant to section 14(c).

(4) The denial or suspension, pursuant to section 19(a)(2), of registration of securities registered on national securities exchanges pursuant to section 12(b) arising from failure to comply with the reporting provisions of the Act.

(5) The institution and prosecution of administrative and injunctive proceedings arising under sections 12, 13, 15(c)(4), and 15(d) and the determination of whether the available evidence supports the allegations in the proposed complaint.

(c) All matters relating to the examination and processing of statements of beneficial ownership of securities and changes in such ownership filed under section 16(a) of the Securities Exchange Act of 1934, section 17(a) of the Public Utility Holding Company Act of 1935 and section 30(f) of the Investment Company Act of 1940.

(d) The examination and processing of proxy and information material filed under the Public Utility Holding Company Act of 1935 and subject to Regulation 14A (sections 240.14a-1 to 240.14a-12 of this chapter) or Regulation 14C (sections 240.14c-1 to 240.14c-7 of this chapter) issued under the Securities Exchange Act of 1934.

(e) All matters, except those pertaining to investment companies registered under the Investment Company Act of 1940, arising under the Trust Indenture Act of 1939.

The Commission finds that the foregoing amendment involves matters of agency organization, procedure or practice and that notice and procedure pursuant to 5 U.S.C. 553 are not required.

By the Commission, December 21, 1970.

[SEAL] ORVAL L. DUBOIS, *Secretary.*

[F.R. Doc. 70-17558; Filed, Dec. 30, 1970; 8:46 a.m.]

[Releases Nos. 40-6295, 33-5120, 34-9040, AS-118]

PART 211—INTERPRETATIVE RELEASES RELATING TO ACCOUNTING MATTERS (ACCOUNTING SERIES RELEASES)

PART 231—INTERPRETATIVE RELEASES RELATING TO THE SECURITIES ACT OF 1933 AND RULES AND REGULATIONS THEREUNDER

PART 241—INTERPRETATIVE RELEASES RELATING TO THE SECURITIES EXCHANGE ACT OF 1934 AND RULES AND REGULATIONS THEREUNDER

PART 271—INTERPRETATIVE RELEASES RELATING TO THE INVESTMENT COMPANY ACT OF 1940 AND RULES AND REGULATIONS THEREUNDER

Accounting for Investment Securities by Registered Investment Companies

The Securities and Exchange Commission today announced the publication of its views relating to some of the more important questions concerning the accounting by registered investment companies for investment securities in their financial statements and in the periodic computations of net asset value for the purpose of pricing their shares. The questions relate both to the amounts at which

investment securities should be carried and to the circumstances under which individual securities may be included among the assets. This release discusses certain accounting matters in order to give additional guidance to the management of investment companies, as well as certain related auditing procedures which are considered appropriate for the guidance of independent accountants. A release was issued by the Commission on October 21, 1969[1] on the specific subject of the problems relating to so-called "restricted securities," i.e., those which must be registered under section 5 of the Securities Act of 1933 prior to public sales, and the discussion of valuation herein does not alter any of the special considerations applicable to such securities as discussed in that release.

The financial statements of registered investment companies appearing in registration statements, proxy statements, and annual reports filed with the Commission are governed by various provisions of the Investment Company Act of 1940 (the "Act"), the rules thereunder, and by Regulation S-X, Article 6 (17 CFR 210.6) of which sets forth accounting rules applicable to such companies. While Regulation S-X does not by its terms apply to periodic reports to stockholders, section 30(d) of the Act provides that such reports "shall not be misleading in any material respect in the light of the reports" (including annual reports) required to be filed under section 30 (a) and (b). To the extent that any provisions in an investment company's articles of incorporation, trust indenture or other governing legal instruments specify accounting procedures inconsistent with those required by Regulation S-X, the latter must be followed in accordance with Rule 6-02-1 (17 CFR 210.6-02-1) thereof.

Inclusion of securities in the portfolio. The statement of assets and liabilities of a registered investment company comprises, for the most part, not only investments in securities which are held by a custodian or are on hand, but also frequently includes securities as to which contracts to purchase have been entered into but which have not been received. Securities held by a custodian or on hand that have been contracted to be sold are excluded from the investments in such statement. In the ordinary transaction through a broker, recording the transaction on the date the broker advises the investment company that the securities have been purchased or sold (the "trade date"), rather than when delivery is made or due (the "settlement date"), is the established and acceptable practice in investment company accounting.

In the case of purchases or sales of securities other than in the usual brokerage transactions, the date on which the investment company obtains an enforceable right to demand the securities or the payment therefor—the date the transaction should be recorded—is sometimes difficult to determine. The considerations involved in determining such transaction date are similar to those discussed at page 3 of the aforementioned release on restricted securities. When a question arises as to the date an enforceable right is obtained by the investment company, an opinion of legal counsel as to when the right occurred should normally be obtained by the company's management and made available to the independent accountant. Such an opinion should be in writing, and a copy should be included in the accountant's working papers.

Where the propriety or validity of an investment in a security by an investment company is questionable because of particular provisions of the Act (or State law, or the company's investment policy or other representations as stated in its filings with the Commission, or legal obligations in respect of a contract or transaction, a written opinion of legal counsel should also be obtained by the company's management, made available to the independent accountant, and a copy included in the working papers. If the questions of propriety or validity are not satisfactorily resolved, the circumstances of the investment should be disclosed in the financial statements or notes thereto.

Securities held by the company or its custodian should be substantiated by the company's independent accountant in the course of an audit by inspection of such securities or by obtaining confirmation from a custodian which maintains the securities in custody pursuant to clause (1) of section 17(f) of the Act. When securities contracted to be purchased but not yet received are included in the statement of assets and liabilities, confirmation of the contract to purchase should be obtained from the bank, broker, or other person responsible for the delivery of such securities. Where satisfactory confirmation has been received, audit procedures normally need not be extended to obtain evidence of subsequent receipt of the securities by the company or its custodian unless additional substantiation is considered necessary by the independent accountant under the circumstances. Where satisfactory confirmation has not been received, subsequent receipt of such securities should be substantiated by other appropriate procedures.

In accordance with section 30(c) of the Act, the certificate of the company's independent accountant should include a brief statement concerning the substantiation of securities owned. Except for securities contracted to be purchased but not received, the certificate should state that the securities were either inspected by the independent accountant or, where the company's securities were maintained in custody pursuant to clause (1) of section 17(f) of the Act, were confirmed to him by the custodian. In the case of securities contracted to be purchased but not received by the company or its custodian, reference should be made to confirmation by banks, brokers, or others or to alternative procedures, as appropriate in the circumstances.

Valuation of securities. Under Rule 6-02-6 (17 CFR 210.6-02-6) of Regulation S-X, the statements of assets and liabilities of open-end investment companies must reflect all assets at value, showing cost parenthetically, while closed-end companies may elect to use either this basis or to reflect all assets at cost, showing value parenthetically.

"Value" is defined in section 2(a)(39) of the Act. For purposes of determining the amounts at which securities and other assets are carried in the statements of assets and liabilities included in annual and other reports and in registration statements filed by investment companies, "value" is defined in pertinent part as: "(i) With respect to securities for which market quotations are readily available, the market value of such securities; and (ii) with respect to other securities and assets, fair value as determined in good faith by the board of directors * * *." This definition is also used in Rule 2a-4 (17 CFR 270.2a-4) under the Act as the required basis for computing periodically the current net asset value of redeemable securities of investment companies for the purpose of pricing their shares.

In some circumstances value can be determined fairly in more than one way. Hence, the standards set forth below should be considered as guidelines, one or more of which may be appropriate in the circumstances of a particular case. These standards should be followed, and a company's stated valuation policies should be consistent with them. Any variation from the standards should be disclosed in the financial statements or notes thereto even though the variation is in accordance with the company's stated valuation policy. In addition, any deviation from a stated valuation policy, whether or not in conformity with the standards, should be disclosed in the financial statements or notes thereto.

Securities listed or traded on a national securities exchange. Ordinarily, little difficulty should be experienced in valuing securities listed or traded on one or more national securities exchanges, since quotations of completed transactions are published daily. If a security was traded on the valuation date, the last quoted sale price generally is used. In the case of securities listed on more than one national securities exchange the last quoted sale, up to the time of valuation, on the exchange on which the security is principally traded should be used or, if there were no sales on that exchange on the valuation date, the last quoted sale, up to the time of valuation, on the other exchanges should be used. With respect to the time of valuation Rule 22c-1 (17 CFR 270.22c-1) under the Act requires that current net asset value shall be computed not less frequently than once daily as of the time of the close of trading on the New York Stock Exchange.

If there was no sale on the valuation date but published closing bid and asked

[1] Investment Company Act Release No. 5847; Accounting Series Release No. 113. See also a supplementary release issued on Apr. 13, 1970, Investment Company Act Release No. 6026; Accounting Series Release No. 116. NOTE: Letter to the American Institute of Certified Public Accountants, attachment A filed as part of the original document.

prices are available, the valuation in such circumstances should be within the range of these quoted prices. Some companies as a matter of general policy use the bid price, others use the mean of the bid and asked prices, and still others use a valuation within the range considered best to represent the value in the circumstances; each of these policies is acceptable if consistently applied. Normally, it is not acceptable to use the asked price alone. Where, on the valuation date, only a bid price or an asked price is quoted or the spread between bid and asked prices is substantial, quotations for several days should be reviewed. If sales have been infrequent or there is a thin market in the security, further consideration should be given to whether "market quotations are readily available." If it is decided that they are not readily available, the alternative method of valuation prescribed by section 2(a)(39)—"fair value as determined in good faith by the board of directors"—should be used.

Over-the-counter securities. Quotations are available from various sources for most unlisted securities traded regularly in the over-the-counter market. These sources include tabulations in the financial press, publications of the National Quotation Bureau and the "Blue List" of municipal bond offerings, several financial reporting services, and individual broker-dealers. These quotations generally are in the form of inter-dealer bid and asked prices. Because of the availability of multiple sources, a company frequently has a greater number of options open to it in valuing securities traded in the over-the-counter market than it does in valuing listed securities. A company may adopt a policy of using a mean of the bid prices, or of the bid and asked prices, or of the prices of a representative selection of broker-dealers quoting on a particular security; or it may use a valuation within the range of bid and asked prices considered best to represent value in the circumstances. Any of these policies is acceptable if consistently applied. Normally, the use of asked prices alone is not acceptable.

Ordinarily, quotations for a security should be obtained from more than one broker-dealer, particularly if quotations are available only from broker-dealers not known to be established market-markers for that security, and quotations for several days should be reviewed. If the validity of the quotations appears to be questionable, or if the number of quotations is such as to indicate that there is a thin market in the security, further consideration should be given to whether "market quotations are readily available." If it is decided that they are not readily available, the security should be considered one required to be valued at "fair value as determined in good faith by the board of directors."

Securities valued "in good faith". To comply with section 2(a)(39) of the Act and Rule 2a-4 (17 CFR 270.2a-4) under the Act, it is incumbent upon the Board of Directors to satisfy themselves that all appropriate factors relevant to the value of securities for which market quotations are not readily available have been considered and to determine the method of arriving at the fair value of each such security. To the extent considered necessary, the board may appoint persons to assist them in the determination of such value, and to make the actual calculations pursuant to the board's direction. The board must also, consistent with this responsiblity, continuously review the appropriateness of the method used in valuing each issue of security in the company's portfolio. The directors must recognize their responsibilities in this matter and whenever technical assistance is requested from individuals who are not directors, the findings of such individuals must be carefully reviewed by the directors in order to satisfy themselves that the resulting valuations are fair.

No single standard for determining "fair value * * * in good faith" can be laid down, since fair value depends upon the circumstances of each individual case. As a general principle, the current "fair value" of an issue of securities being valued by the Board of Directors would appear to be the amount which the owner might reasonably expect to receive for them upon their current sale. Methods which are in accord with this principle may, for example, be based on a multiple of earnings, or a discount from market of a similar freely traded security, or yield to maturity with respect to debt issues, or a combination of these and other methods. Some of the general factors which the directors should consider in determining a valuation method for an individual issue of securities include: (1) The fundamental analytical data relating to the investment, (2) the nature and duration of restrictions on disposition of the securities, and (3) an evaluation of the forces which influence the market in which these securities are purchased and sold. Among the more specific factors which are to be considered are: type of security, financial statements, cost at date of purchase, size of holding, discount from market value of unrestricted securities of the same class at time of purchase, special reports prepared by analysts, information as to any transactions or offers with respect to the security, existence of merger proposals or tender offers affecting the securities, price and extent of public trading in similar securities of the issuer or comparable companies, and other relevant matters.

This release does not purport to delineate all factors which may be considered. The directors should take into consideration all indications of value available to them in determining the "fair value" assigned to a particular security.[2] The information so considered together with, to the extent practicable, judgment factors considered by the board of directors in reaching its decisions should be documented in the minutes of the directors' meeting and the supporting data retained for the inspection of the company's independent accountant.

Auditing security valuations. In the case of securities for which market quotations are readily available, the independent accountant should independently verify all the quotations used by the company at the balance sheet date and satisfy himself that such quotations may properly be used under the standards stated above.

In the case of securities carried at "fair value" as determined by the Board of Directors in "good faith," the accountant does not function as an appraiser and is not expected to substitute his judgment for that of the company's directors; rather, he should review all information considered by the board or by analysts reporting to it, read relevant minutes of directors' meetings, and ascertain the procedures followed by the directors. If the accountant is unable to express an unqualified opinion because of the uncertainty inherent in the valuations of the securities based on the directors' subjective judgment, he should nevertheless make appropriate mention in his certificate whether in the circumstances the procedures appear to be reasonable and the underlying documentation appropriate.

When considering values assigned to securities by the company, the independent accountant should consider any investment limitations or conditions on the acquisition or holding of such securities which may be imposed on the company by the Act, by its certificate or bylaws, by contract, or by its filings with the Commission. If such restrictions are met by a narrow margin, the independent accountant may need to exercise extra care in satisfying himself that the evidence indicates that the security valuation determinations were not biased to meet those restrictions.

Investments in affiliates or affiliated persons. Various rules of Regulations S-X (17 CFR Part 210) require that the financial statements of an investment company state separately investments in, investment income from, gain or loss on sales of securities of, and management or other service fees payable to, (a) controlled companies and (b) other "affiliates." As stated in Rule 6-02-4 (17 CFR 210.6-02-4) of Regulation S-X, the term "affiliate" means an affiliated person as defined in section 2(a)(3) of the Act, and the term "control" has the meaning given in section 2(a)(9) of the Act. The term "affiliated person" is defined in section 2(a)(3) of the Act in such a manner as to encompass such control relationships and also the direct or indirect ownership of 5 percent or more of the outstanding voting securities of any issuer. An affiliated person as there defined also includes any officer, director, partner, copartner, or employee or, with respect to an investment company, any investment adviser or member of an advisory board thereof.

[2] With regard to restricted securities, consideration should be given to the discussion on pages 2 through 5 of the release on this subject (see Note 1 supra).

In ascertaining the existence of any such affiliations, the independent accountant should consider the facts obtained during the course of an audit and also make inquiries of the company's management; and his working papers should include written representations from the management as evidence of such inquiries. The representations should be in the form of a statement that the company, except to the extent indicated, (i) does not own any securities either of persons who are directly affiliated, or, to the best information and belief of management, of persons who are indirectly affiliated, (ii) has not received income from or realized gain or loss on sales of investments in or indebtedness of such persons, (iii) has not incurred expenses for management or other service fees payable to such persons, and (iv) has not otherwise engaged in transactions with such persons. Where there is a question as to the existence of an affiliation, a written opinion of legal counsel should be obtained by the company's management, made available to the independent accountant, and a copy included in the working papers. Regulation S-X (17 CFR Part 210) requires disclosure in the financial statements or notes thereto of details of such investments and transactions.

By the Commission, December 23, 1970.

[SEAL] ORVAL L. DUBOIS, *Secretary.*

[F.R. Doc. 70-17557; Filed, Dec. 30, 1970; 8:46 a.m.]

[Releases Nos. 40-5847, AS-113]

PART 211—INTERPRETATIVE RELEASES RELATING TO ACCOUNTING MATTERS (ACCOUNTING SERIES RELEASES)

PART 271—INTERPRETATIVE RELEASES RELATING TO THE INVESTMENT COMPANY ACT OF 1940 AND RULES AND REGULATIONS THEREUNDER

Restricted Securities

The Securities and Exchange Commission today made public the following statement.

"Restricted securities". The Commission is aware that many investment companies have been acquiring substantial quantities of securities that cannot be offered to the public for sale without first being registered under the Securities Act of 1933 ("restricted securities"). For the year 1968, annual reports filed by registered investment companies indicate that open-end and closed-end companies together held in excess of $4.2 billion of restricted equity securities. Open-end companies—excluding exchange funds—accounted for about $3.2 billion of these restricted securities which represented 4.4 percent of their total net assets. The acquisition by investment companies of such securities raises certain problems under the securities laws of which shareholders, distributors, managements and directors of these companies should be aware. This statement discusses these problems. No inference should be drawn from publication of this statement, however, as to the desirability or merits of the acquisition of restricted securities by a registered investment company.

Problems for the seller. Section 4(2) of the Securities Act of 1933 exempts from the registration requirements of that Act "transactions by an issuer not involving any public offering." This is the so-called "private offering" provision in the Securities Act. The securities involved in transactions effected pursuant to this exemption are referred to as restricted securities because they cannot be resold to the public without prior registration. They are also sometimes referred to as "investment letter securities" because of the practice frequently followed by the seller in such a transaction, in order to substantiate the claim that the transaction does not involve a public offering, of requiring that the buyer furnish a so-called "investment letter" representing that the purchase is for investment and not for resale to the general public.

The private offering exemption of section 4(2) of the Securities Act is available only where the offerees do not need the protections afforded by the registration procedure. As the Court of Appeals for the Second Circuit recently stated in Katz v. Amos Treat & Co., CCH Fed'l. Sec. Law Rep. paragraph 92,409 (1969):

> The Supreme Court has instructed that the applicability of the exemption should turn on whether the particular class of persons affected need the protection of the Act. SEC v. Ralston Purina Co., 346 U.S. 119, 125 (1953).

The test of the availability of the section 4(2) exemption is whether the offerees are in such a position with respect to the issuer as to have access to the kind of information that would be made available in a registration statement filed pursuant to the Securities Act. This test is no different when the offeree is an investment company.

Problems for the buyer—1. The problems of valuation. It is critically important that an investment company properly value its portfolio securities. It is obvious, for example, that any distortion in the valuation of a restricted security held by an investment company will distort the price at which the shares of the investment company are sold or redeemed. It is also clear that investment managers who are compensated on the basis of net asset value or performance may be unduly compensated if a restricted security, purchased at a discount from the market quotation for unrestricted securities of the same class, is overvalued. In such a case, investors may also be misled by the reported performance of the investment company.

The acquisition of restricted securities by both open-end and closed-end investment companies creates serious problems of valuation. Section 2(a)(39) of the Investment Company Act of 1940 and Rule 2a-4 (17 CFR 270.2a-4) thereunder requires that in determining net asset value, "securities for which market quotations are readily available" must be valued at current market value while other securities and assets must be valued at "fair value as determined in good faith by the board of directors."

Readily available market quotations refers to reports of current public quotations for securities similar in all respects to the securities in question. No such current public quotations can exist in the case of restricted securities. For valuation purposes, therefore, restricted securities constitute securities for which market quotations are not readily available. Accordingly, their fair values must be determined in good faith by the board of directors and this obligation necessarily continues throughout the period these securities are retained in the company's portfolio.

Restricted securities should be included in the portfolio of a company and valued to determine current net asset value on the date that the investment company has an enforceable right to demand the securities from the seller.

Where the investment company negotiates the acquisition of the restricted securities directly with the owner of the securities, there are three significant dates. The first occurs when the investment company and the seller orally agree upon the price and the amount of the securities (the "handshake date"). At this point, there would not seem to be any enforceable right of the investment company to demand the securities from the seller since, in most States, particularly those which have adopted the Uniform Commercial Code, there is no enforceable right unless there exists some writing "sufficient to indicate that a contract has been made for sale of a stated quantity of described securities at a defined or stated price" (section 8-319(a) of the Uniform Commercial Code). If the terms of the oral understanding do not contemplate compliance with any condition by the seller, it is suggested that the investment company procure, from the seller, a signed memorandum setting forth the price and quantity of securities to be sold. Upon receipt of that memorandum, an enforceable right would be obtained. The securities should be valued as of that date.

In those situations where the oral understanding contemplates the execution of a formal contract of purchase and sale, no enforceable right exists until the time the formal contract is signed (the "contract date"). If the formal contract does not require compliance with any conditions by the seller, an enforceable right is then obtained, and the securities should be valued as of that date.

Where the formal contract requires compliance with stated conditions which the investment company believes should not be waived, no enforceable right is obtained until the stated conditions are satisfied. In that situation, the valuation date should be the date upon which the conditions are satisfied (the "closing date").