pay for them with federal funds.<sup>20</sup> According to the commenter, because an investor's money is not available for investment by a fund until federal funds have been received, the payment of dividends to the investor before receipt of federal funds would dilute the holdings of other shareholders.<sup>21</sup>

Therefore, the rule as adopted allows different methods of allocation for daily distribution funds than for non-daily distribution funds. Non-daily distribution funds must allocate these items based on the relative net assets. Money market funds (including those calculating net assets on an amortized cost basis) and other funds making daily distributions of their net investment income may allocate these items to each share regardless of class,<sup>22</sup> or based on the relative net assets (settled shares).<sup>23</sup> The parenthetical reference in the rule to calculation of net assets using amortized cost recognizes that money market funds may allocate fund expenses based on the relative amortized cost net assets.24 The allocation method selected by the fund must be applied consistently.

A commenter requested that the Commission provide guidance about the allocation of costs of implementing a multiple class structure.<sup>25</sup> If a fund is organized initially with a multiple class

structure, these costs are part of the fund's organization expenses and usually are capitalized. Funds may allocate the amortization of these expenses among the classes like other expenses under paragraph (c) of the rule. If the class structure is added after the fund has been organized, or if new classes are added, these expenditures would not be capitalized. Instead, they would be expenses of the class or classes in existence before the addition of the class structure or the new classes,26 and therefore would be recognized by, and allocated to, those existing classes as an expense under paragraph (c) and not charged to the new class or classes.27

c. Accountant's Report on System of Internal Control. The Commission is not adopting the proposed amendment to Form N-SAR, relating to an accountant's report on a fund's system of internal controls. As proposed, Item 77B would have required accountants preparing the report on a multiple class fund's system of accounting controls to refer expressly to the procedures for calculating the classes' net asset values. This provision was intended to replace the requirement in the exemptive orders that an expert file a separate report on the adequacy of accounting procedures of multiple class funds. One commenter supported the proposal's omission of a requirement for the expert's report as no longer necessary. It believed that the orders granted to date, and the additional guidance in rule 18f-3, adequately define the methodology that a fund should follow in allocating income, realized and unrealized capital gains and losses, and expenses of the company to a class of shares.<sup>28</sup> The commenter, however, disagreed with the proposal's requirement of a specific reference in the internal controls report to the procedures for calculating multiple class net assets, arguing that because the internal control structure, required to be reviewed by Statement on Auditing Standards No. 55,29 includes the procedures for calculating multiple class net assets, the report required by Item 77B need not be modified to emphasize only one of the aspects of the internal control structure. The Commission believes that since under current accounting standards, a review of the fund's internal control structure must include a review of procedures for calculating multiple class net assets, it is unnecessary to require the independent accountant's report to include such a reference.

d. Waivers and Reimbursements of Expenses. As adopted, rule 18f–3(b) expressly allows a fund's underwriter, adviser, or other provider of services to waive or reimburse the expenses of a specific class or classes. The proposal would have permitted only waivers or reimbursements by the fund's adviser or underwriter of class expenses, and would not have permitted waivers or reimbursements for specific classes of fund expenses, such as advisory fees. Despite the prohibition on differential waivers of fund expenses, fund sponsors could have achieved the same result indirectly by waiving or reimbursing class expenses. Therefore, the Commission is deleting the restrictions on waivers in the final rule. This modification is not intended to allow reimbursements or waivers to become de facto modifications of the fees provided for in advisory or other contracts so as to provide a means for cross-subsidization between classes.30 Consistent with its oversight of the class system and its independent fiduciary obligations to each class, the board must monitor the use of waivers or reimbursements to guard against crosssubsidization between classes.31

## 3. Voting and Other Rights and Obligations

The Commission is adopting the provisions relating to shareholder voting substantially as proposed.<sup>32</sup> These provisions elicited little comment. Paragraph (a)(2), which provides that each class must have exclusive voting rights on any matter submitted to

<sup>&</sup>lt;sup>20</sup> Memorandum to file from Karrie McMillan regarding telephone conversation with Richard Peteka, Oppenheimer Management Corporation (May 11, 1994) (Peteka Comment Memorandum). The term "net assets" includes the value of any receivables, including subscriptions to purchase shares for which the fund has not yet received payment. See AICPA Audit Guide, supra note 26, at ¶ 2.22. Because daily distribution fund portfolio transactions settle daily against federal funds (in contrast to other securities that have "regular way" (e.g., currently T+5) settlement), many of these funds only record income and expenses on their books for shareholders whose subscriptions have cleared in federal funds. See T. Rowe Price Associates, Inc. (pub. avail. Dec. 22, 1986). Thus, allocating on the basis of relative net assets would be in conflict with typical daily distribution fund allocations.

<sup>&</sup>lt;sup>21</sup> According to the commenter, this problem is exacerbated when a large disparity exists between the size of the classes or feeder funds, as each subscription to the smaller class or feeder fund will be large relative to the size of the other classes or feeder funds, and will dilute the classes or feeder funds having greater assets. Peteka Comment Memorandum, *supra* note 20.

<sup>&</sup>lt;sup>22</sup>Like some exemptive orders, paragraph (c)(2)(i) requires funds allocating these items equally to all shares regardless of class to obtain the agreement of their service providers that, to the extent necessary to assure that all classes maintain the same net asset value, the providers will waive or reimburse class expenses.

<sup>&</sup>lt;sup>23</sup>The rule defines "relative net assets (settled shares)" to mean net assets valued in accordance with generally accepted accounting principles, but excluding the value of subscriptions receivable, in relation to the net assets of the fund.

 $<sup>^{24}</sup>$  See Fidelity Comment Letter, supra note 18, at A–2.

<sup>25</sup> Id. at 3.

<sup>&</sup>lt;sup>26</sup> See Financial Accounting Standards Board, Financial Accounting Standards No. 7, §§ 8 and 9, Accounting and Reporting by Development Stage Enterprises, and AICPA, Audits of Investment Companies: Audit and Accounting Guide ¶ 8.10 (May 1993).

<sup>&</sup>lt;sup>27</sup> Organization expenses should be distinguished from other expenses, such as printing of prospectuses. These other non-organizational expenses may appropriately be capitalized and amortized in accordance with the provisions of generally accepted accounting principles. The amortization of these expenses would be allocated to all classes which benefit from the expense.

<sup>&</sup>lt;sup>28</sup> Letter from the American Institute of Certified Public Accountants to Jonathan G. Katz, Secretary, SEC 2 (Mar. 18, 1994).

<sup>&</sup>lt;sup>29</sup> Codification of Statements on Auditing Standards, American Institute of Certified Public Accountants, AU § 319 (1994).

<sup>&</sup>lt;sup>30</sup> Rule 18f–3 is only a limited exemption from the literal application of the prohibitions of section 18 and may not be used to undermine that section's role in effecting the statutory purpose of preventing the issuance of "securities containing inequitable or discriminatory provisions." 15 U.S.C. § 80a–1(b)(3).

<sup>&</sup>lt;sup>31</sup> See infra section II.A.5.

<sup>&</sup>lt;sup>32</sup> Paragraphs (a)(2) and (a)(3) of the final rule were paragraphs (a)(3) and (a)(4), respectively, in the rule as proposed. They have been renumbered as a result of the transfer of certain provisions of proposed paragraph (a)(2) into paragraph (b) of the final rule