published regulations which included new § 107.101(g) as well as a new Appendix II to Part 107, ''Valuation Guidelines for SBICs''. These new valuation regulations supersede the guidelines previously published in SBA Policy and Procedural Release #2006. Licensees may adopt the model valuation policy included in Appendix II or submit an alternate policy to SBA for approval. In addition to valuation policy, § 107.101(g) and Appendix II also set forth requirements concerning frequency of valuation, documentation, and responsibility for valuations.

iii. The following statement is included in § 107.101(g): ''The boards of directors of corporations and the general partners of partnerships shall have sole responsibility for adopting the Licensee's valuation policy and, pursuant thereto, for valuing Loans and Investments of such Licensee.'' This statement establishes responsibility for all valuations assigned to portfolio securities by the Licensee. SBA, in its capacity as a regulator, retains the same oversight responsibilities over valuations as it does over all other issues affecting regulatory compliance.

iv. Accounting considerations. Licensees shall maintain separate general ledger accounts for the original cost of Loans and Investments and any valuation adjustments thereto. Valuation adjustments shall be in the form of unrealized appreciation or depreciation, respectively representing valuations above or below cost. The sum of cost and unrealized appreciation or depreciation represents fair value.

v. Unrealized appreciation may be recognized on equity investments and debt investments which contain equity features, such as options or warrants. Recognition of unrealized appreciation on loans is not permitted under SBA's valuation guidelines.

vi. A general allowance for losses on Loans and Investments is not utilized in fair value accounting. Rather, the Licensee's Board of Directors or General Partner(s) shall value Loans and Investments individually as of the financial statement date. This requirement applies equally to Licensees engaged in equity investing and in lending. A Licensee which is primarily engaged in lending, however, may also identify additional anticipated losses on the basis of its portfolio history, industry experience, or other relevant factors; such amounts may be reported in the Statement of Financial Position of SBA Form 468 as additional unrealized depreciation not associated with specific portfolio assets.

vii. An appropriate tax provision shall be established for net unrealized appreciation on securities held by taxable corporate Licensees. There may also be circumstances in which a tax benefit for net unrealized depreciation should be recognized, depending on the likelihood of realization. Such a provision or benefit shall be determined in accordance with FASB Statement No. 109, ''Accounting for Income Taxes''.

E. Interest Income

i. Interest income shall be accrued according to the terms of interest bearing loans and investments. Premiums or discounts associated with debt instruments represent adjustments to interest income which shall be amortized over the stated life of the debt instrument.

ii. *Collection in Doubt.* Interest income shall not be recognized if collection is doubtful. Licensees may choose to handle doubtful interest receivable in either of two ways: (1) Make no entry to accrue interest in the regular general ledger accounts and track interest due in a memorandum account; or (2) accrue the interest and provide a 100% reserve (debit provision for loss on receivables, credit allowance for uncollectible interest receivable). The method used by the Licensee must be disclosed in the footnote to the financial statements summarizing significant accounting policies.

iii. Collection of interest is presumed to be in doubt when either or both of the following conditions occur: (1) The small concern is in bankruptcy, insolvent, or there is substantial doubt about its ability to continue as a going concern; or (2) the small concern is in default more than 120 days to the Licensee. Licensees may rebut this presumption by providing evidence of collectibility satisfactory to SBA. Such evidence may include the existence of collateral, the value of which has been verified through an appraisal by an independent professional appraiser acceptable to SBA. Such an appraisal shall be at liquidation value (net of liquidation costs) and shall have been performed within the 12 months immediately preceding the valuation date. In considering whether collateral provides an appropriate basis for valuations, SBA will consider the nature of a Licensee's claim on the collateral (for example, whether other parties have security interests senior to the Licensee's, or whether the Licensee's security interest in an asset is perfected). SBA will also review the Licensee's operating history for evidence concerning its willingness and ability to pursue available remedies (including foreclosure) in default situations.

iv. The two conditions cited in the preceding paragraph are not the only possible indicators of a collection problem. Even if neither condition is present, other circumstances may cause the Board of Directors or General Partner(s) to conclude that collection is in doubt.

v. When interest income is not being recorded on a loan or debt security, the Licensee shall so note in its Annual Financial Report on Form 468. The note should include the date at which interest accrual was discontinued. In addition, the total amount of interest not accrued because collection is in doubt shall be disclosed in a footnote to the financial statements.

vi. When the accrual of interest is discontinued, the full amount of any interest receivable recorded in prior periods must be either reversed or fully reserved.

F. Dividend Income

i. Dividend income from investments in common or preferred stock is normally recognized as of the date of record (the date at which official ownership of shares is determined for the purpose of paying the dividend). Dividend income shall not be accrued in the absence of a dividend declaration by the small concern's board of directors. This treatment shall apply to all dividends, including dividends on redeemable preferred stock or similar securities with some debt-like characteristics.

ii. Any cash distribution which is identified as a return of capital shall not be recognized as income. Such distributions are a reduction in the cost basis of an investment.

iii. Stock splits and stock dividends (in stock of the same class as that owned) are not income because the Licensee's proportional interest in the small business concern does not change as a result of such events. The cost of the shares previously held should be allocated, on a rational basis, to the number of shares held after the split or dividend. Similarly, when stock rights are received, a portion of the cost basis of the related investment may be allocated to the rights.

iv. Dividends in kind are recorded as income at the fair value of the property received. Such income should be classified as Non-Cash Gains/Income in the Statement of Financial Position of SBA Form 468. If the Licensee has a choice between a dividend in cash or in kind, and chooses to receive an in-kind dividend, the fair value is deemed to be the amount of cash that could have been received.

G. Profit Participation in Small Concerns

Participation in the profits of a loan- or debt-financed small business concern represents additional interest income to the Licensee. For regulatory purposes, any profits received must be included in the calculation of the Cost of Money.

H. Fees Charged to Small Concerns

i. Income from nonrefundable fees charged by SBICs in connection with the origination of loans shall be deferred and amortized over the term of the financing, regardless of whether or not such fees are included in the Cost of Money. Licensees should be aware of the provisions set forth in § 107.402 (d) through (g) concerning permissible fees, prepayment penalties, obligations of SBICs to provide certain fee-related information in writing to small concerns, and circumstances in which SBICs may be required to refund fees paid by small concerns.

ii. If a Licensee has made a commitment for a financing which does not take place, any processing fees which the Licensee is permitted to retain pursuant to § 107.402(d) shall be recognized as income upon expiration of the commitment.

I. Accounting for Investments in Flow-Through Entities

i. On SBA Form 468, in the Statement of Operations Realized, Licensees are asked to report income (loss) from investments in partnerships or other types of flow-through entities. This category of investments is intended to include any entity which allocates its income and losses to its equity holders and is not taxed at the entity level. Any such investments made by SBICs would most commonly be in limited partnerships.

ii. For investments of this type, original cost is adjusted at the end of each accounting