another entity or person, or between the Licensee and its stockholders or partners. The cost of an asset acquired in a nonmonetary transaction is the fair value of the asset relinquished to obtain it, and a gain or loss should be recognized on the exchange. Any gain recognized shall be reported on SBA Form 468 as a Non-cash Gain.

ii. Nonmonetary transactions in which the Licensee exchanges certain securities or assets for other securities or assets will result in the realization of gain or loss for financial reporting purposes, regardless of whether such transactions are taxable or non-taxable exchanges.

iii. Fair value of a nonmonetary asset transferred to or from a Licensee should be determined by referring to estimated realizable values in cash transactions of the same or similar quoted market prices, independent appraisals, estimated fair values of assets, or other available evidence.

iv. In cases where the values are not clearly determinable, assets received will have the same accounting basis as the assets transferred.

v. Dividends In Kind and Spin-offs. Dividends or other distributions in kind, consisting of shares of a small business concern or other securities, are nonreciprocal transfers of non-monetary assets from a Licensee to its owners. Such transfers shall be reported at the fair value of the assets distributed.

N. Interest, Notes and Accounts Receivable

i. Interest Receivable. In reporting interest receivable, Licensees should make certain that amounts are properly classified between current and noncurrent assets. Current assets are those providing benefits which are expected to be realized within the next fiscal year.

ii. Interest receivable is reported net of an allowance for uncollectible amounts, which represents a conservative estimate of probable losses. The allowance shall be adjusted, at a minimum, as of the end of the fiscal year. Interim adjustment to reflect changes in the status of receivables is strongly encouraged. See paragraph E ("Interest Income") of this section V for guidelines to be used by SBICs in evaluating the collectibility of interest income.

iii. Expense is recognized whenever the allowance for uncollectible amounts is adjusted to reflect a change in the valuation of interest receivable. An actual write-off of interest receivable is normally recorded as a reduction of the receivable and a corresponding reduction of the allowance, and does not result in the recognition of expense.

iv. The total expense recognized during a fiscal year with respect to uncollectible interest receivable appears on Form 468 in the Statement of Operations Realized, under the caption, "Provision for Losses on Accounts Receivable."

v. Requirements concerning the recording of interest receivable and the related interest income appear in this appendix under the heading, "Interest Income."

vi. Notes and Accounts Receivable. The accounting treatment of notes receivable and

accounts receivable shall be governed by the same rules which apply to interest receivable, as previously described in this paragraph N.

vii. Notes Receivable represents the unpaid balance of miscellaneous notes which do not fit into any category of Loans and Investments. It does not include notes representing amounts due from purchasers of assets acquired in liquidation of portfolio securities, which are presented separately in the Loans and Investments section of the Statement of Financial Position on Form 468.

viii. Accounts Receivable represents amounts due on account, such as for management consulting, appraisal, or other services rendered. Accounts Receivable also includes accrued fees for services rendered in connection with participations or joint financings and accrued fees receivable from small concerns.

O. Compensating Balances

i. In those instances where idle funds are encumbered or are required to be maintained at a financial institution as compensating balances in connection with debt of the SBIC, the nature of the encumbrance and the terms of any applicable agreements shall be disclosed in a footnote to the financial statements.

ii. Depending upon the specific terms, it may be necessary to classify idle funds subject to a compensating balance agreement as non-current assets.

P. Organization Costs

i. Organization costs are incurred in the formation of an SBIC and may include such items as legal fees, incorporation and various other fees imposed by states, and promotional expenditures. SBICs should amortize organization costs over a term of not more than five years.

ii. If an SBIC incurs organization costs which are deemed by SBA to be unreasonable or excessive, such costs must be excluded from Regulatory Capital as long as they are carried as an asset by the SBIC. Once such costs have been amortized to expense, the regulatory deduction is no longer required. No deduction is ever required for organization costs accepted by SBA as reasonable.

iii. Operating losses incurred by a company prior to licensing as an SBIC are not considered organization costs and shall not be capitalized.

Q. Contingent Liabilities

i. Licensees shall accrue or disclose contingent liabilities, as appropriate, in accordance with the requirements of FASB Statement No. 5. Such requirements vary depending upon whether the likelihood of realizing a loss is evaluated as "probable", "reasonably possible", or "remote". Contingent liabilities may arise from such transactions or events as the issuance of guarantees, pending litigation, and the sale of portfolio interests with recourse.

ii. In addition to the reporting requirements of FASB Statement No. 5, Licensees and their IPAs should be familiar with SBA's requirements for reporting of certain contingencies. These additional requirements include the completion of the Schedule of Guarantees (include in SBA Form 468) by Licensees which have guaranteed the obligations of small concerns and the filing of a litigation report by Licensees which become a party to litigation (see § 107.1002(f)).

iii. A Licensee which has sold portfolio securities (or any interest therein) on a recourse basis should be aware that any amounts for which it may be contingently liable must be treated as investments in small concerns for overline purposes (see §§ 107.707(b) and 107.303).

R. Transactions with Related Parties

i. Licensees shall disclose material transactions with related parties in accordance with FASB Statement No. 57. In applying the requirements of this pronouncement to SBIC financial statements, a Licensee shall consider the term "related party" to encompass any person or entity which is an Associate as defined in § 107.3. Footnote disclosures of related party transactions shall include the name of the related party as well as the nature of the relationship.

ii. Licensees and their IPAs should be aware that certain transactions involving Associates are either prohibited by SBA regulations or permitted only with SBA's prior written approval. See § 107.903 ("Conflicts of Interest").

S. Leverage—Debentures Guaranteed or Purchased by SBA

i. SBICs which qualify on the basis of financial soundness and regulatory compliance are eligible to receive long-term leverage in the form of five-year or ten-year debentures guaranteed (or, in some cases, purchased directly) by SBA. Debentures with an interest rate subsidy of three percentage points for the first five years of their term are available to Section 301(d) Licensees only.

ii. Debentures, net of current maturities, shall be classified in the financial statements as long-term debt, and shall be shown at face value in the Statement of Financial Position of Form 468.

iii. Licensees issuing debentures pay a user fee (currently 2 percent of the amount borrowed) and an underwriter's fee (currently .625 percent). These fees shall be capitalized and amortized over the life of the debenture. Generally accepted accounting principles normally require that debt be reported net of the unamortized portion of related fees; Licensees, however, should report the unamortized fees as an asset and the debentures at their gross amount. SBA does not believe that this treatment will constitute a material departure from GAAP for most Licensees.

iv. Debentures are subject to the terms and conditions set forth in SBA regulations. In most respects, debentures incorporate by reference the regulations as amended from time to time. With respect to events of default, however, debentures incorporate those events and associated remedies in existence at the date of issue. Thus, debentures issued at different times may be subject to different default provisions. Events of default include both financial and regulatory conditions, which may result in