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Checklist supplement and illustrative financial statements for investment companies : a financial accounting and reporting practice aid, December 1999 edition

American Institute of Certified Public Accountants. Accounting and Auditing Publications

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AICPA

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

DECEMBER 1999 EDITION

**CHECKLIST
SUPPLEMENT AND
ILLUSTRATIVE
FINANCIAL STATEMENTS
FOR INVESTMENT
COMPANIES**

*A Financial Accounting and
Reporting Practice Aid*

*To be used in conjunction with Checklists and
Illustrative Financial Statements for Corporations.*

Edited by

Robert Durak, CPA

Technical Manager, Accounting and Auditing Publications

Checklist Supplement and Illustrative Financial Statements for Investment Companies has not been approved, disapproved, or otherwise acted upon by any senior technical committees of the American Institute of Certified Public Accountants or the Financial Accounting Standards Board and has no official or authoritative status.

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FSP Section 12,000

Checklist Supplement and Illustrative Financial Statements for Investment Companies

.01 The checklist and illustrative financial statements included in this section have been developed by the staff of the Accounting and Auditing Publications Team of the AICPA as nonauthoritative technical practice aids. Readers should be aware of the following:

- These checklists include disclosures commonly encountered in investment company financial statements; they do not include all disclosures required by GAAP. Further, the illustrative financial statements are intended to provide sample financial statement formats and disclosures for a hypothetical investment company; they are not intended to illustrate all disclosures required by GAAP, nor do they illustrate all of the disclosures covered in the checklist.
- The checklist and illustrative financial statements are “tools” and in no way represent official positions or pronouncements of the AICPA.
- The checklist and illustrative financial statements are to be used in conjunction with the “Checklists and Illustrative Financial Statements for Corporations” (FSP sections 6000–6500) and have been updated to include relevant accounting pronouncements through FASB Statement of Financial Accounting Standards No. 137, FASB Interpretation No. 43, FASB Technical Bulletin No. 97-1, AICPA Statement of Position No. 99-3, AICPA Practice Bulletin No. 15, AICPA Audit and Accounting Guide *Audits of Investment Companies* (with conforming changes as of May 1, 1998), and EITF consensuses adopted up to and including the September 1999, Emerging Issues Task Force meeting. The checklist and illustrative financial statements should be modified, as appropriate, for subsequent pronouncements. In determining the applicability of a pronouncement, its effective date should also be considered.
- The checklist and illustrative financial statements should be used by, or under the supervision of, persons having adequate technical training and proficiency in the application of generally accepted accounting principles, generally accepted auditing standards, and statements on standards for accounting and review services.

.02 Users of the checklist and illustrative financial statements are urged to refer directly to applicable authoritative pronouncements when appropriate. If you have further questions, call the AICPA Technical Hotline at 1-888-777-7077 (AICPA members only).

Note: This publication was extracted from sections 12,000 through 12,400 of the AICPA *Financial Statement Preparation Manual* (FSP).

FSP Section 12,100

Introduction

.01 Investment companies generally are companies that pool shareholders' funds and invest the proceeds for the benefits of shareholders under the supervision of professional investment management. The investments are generally in securities that are intended to meet the investment objectives of the entity. The entity distributes the net income and realized net gains to its shareholders.

.02 The industry is subject to extensive governmental regulation by the Securities and Exchange Commission ("SEC"). The industry is also the subject of special tax treatment. The investment company industry usually is categorized by the type of security or the investment objective.

.03 There are many types of investment companies: management investment companies, unit investment trusts, collective trust funds, investment partnerships, certain separate accounts of life insurance companies, and offshore funds. Management investment companies are further divided into many sub-classifications, the most predominant of which is open-end funds, also called mutual funds. There are also closed-end funds and Small Business Investment Companies (SBICs).

.04 The checklist has been designed primarily for auditors of mutual funds and closed-end investment companies that register with the SEC under the Investment Company Act of 1940. However, the checklist would generally apply to all types of investment companies.

.05 Investment companies covered by the checklist are required to report their investment assets at fair value and have the following attributes (not applicable to real estate investment trusts):

- a. *Investment activity.* The primary activity is the investment in securities of nonaffiliates or entities not under common management for current income, appreciation, or both.
- b. *Unit ownership.* Ownership in the investment company is evidenced by units of investments, such as shares of stock or partnership interests to which proportionate shares of net assets can be attributed.
- c. *Pooling-of-funds.* The funds of the owners are pooled to avail owners of professional investment management.
- d. *Reporting entity.* The investment company is the primary reporting entity.

.06 The major accounting and auditing literature and applicable regulations for investment companies are as follows:

- a. *AICPA Audit and Accounting Guide Audits of Investment Companies.*
- b. *SOP 89-2, Reports on Audited Financial Statements of Investment Companies.*
- c. *SOP 93-1, Financial Accounting and Reporting for High-Yield Debt Securities by Investment Companies.*
- d. *SOP 93-2, Determination, Disclosure, and Financial Statement Presentation of Income, Capital Gain, and Return of Capital Distributions by Investment Companies.*
- e. *SOP 93-4, Foreign Currency Accounting and Financial Statement Presentation for Investment Companies.*
- f. *SOP 95-2, Financial Reporting by Nonpublic Investment Partnerships.*
- g. *SOP 95-3, Accounting for Certain Distribution Costs of Investment Companies.*
- h. *Article 6 of Regulation S-X of the Securities and Exchange Commission.*

- i.* The Securities Act of 1933.
 - j.* Investment Company Act of 1940.
-

FSP Section 12,200

Checklists—General

.01 AICPA disclosure checklists have been designed as practice aids to assist accountants in the preparation of financial statements and to assist auditors in their evaluation of the adequacy of disclosures in the financial statements they audit. Authoritative literature does not require the use of checklists, nor does it prescribe their format or content.

.02 This checklist consists of a number of questions or statements that are accompanied by references to the established sources of GAAP in which the disclosure requirements are found. These sources include Statements of Financial Accounting Standards, FASB Interpretations, Accounting Principles Board Opinions, Accounting Research Bulletins, AICPA Audit and Accounting Guides, AICPA Statements of Position, and EITF consensuses. Checklists are designed to serve as convenient memory aids but should not be used as a substitute for direct reference to authoritative literature.

.03 To use this checklist, simply check “yes,” “no,” or “not applicable” for each question. If additional information needs to be documented, include separate cross-referenced memoranda.

.04 As you use this checklist, please remember that:

- The exercise of sound professional judgment is of paramount importance in applying the checklist provisions.
- The checklist may require modification based on the engagement circumstances.
- The checklist may not be all-inclusive.
- Users need to modify the checklist for any pronouncements issued subsequent to those mentioned in the checklist.

FSP Section 12,300

Financial Statements and Notes Checklist

.01 This checklist has been developed by the staff of the Accounting and Auditing Publications Team of the AICPA as a nonauthoritative practice aid and is to be used in conjunction with the "Checklists and Illustrative Financial Statements for Corporations" (FSP sections 6000–6500).

.02 The form and content of the investment companies' financial statements required in SEC filings are governed by Regulation S-X, Article 6 that deals specifically with investment companies (SBIC's are covered in Article 5).

.03 Explanation of references:

AAG-INV =	AICPA Audit and Accounting Guide <i>Audits of Investment Companies</i> (with conforming changes as of May 1, 1998)
SFAS =	FASB Statement of Financial Accounting Standards
Reg. S-X =	SEC Regulation S-X
SOP =	AICPA Statement of Position

.04 Checklist Questionnaire:

This checklist is organized into the sections listed below. Carefully review the topics listed and consider whether they represent potential disclosure items for the investment company. Place a check mark by the topics or sections considered not applicable; these sections need not be completed.

Note: For general disclosures relating to areas such as Financial Instruments, Risks and Uncertainties, etc., refer to "Financial Statements and Notes Checklist for Corporations."

*Place ✓ by
Sections Not Applicable*

- General
 - A. Financial Statements Presented _____
 - B. Reporting Financial Position _____
- Statement of Assets and Liabilities
 - A. Assets _____
 - B. Liabilities _____
- Statement of Operations
 - A. Income _____
 - B. Expenses _____
 - C. Realized Gains or Losses on Investments _____
 - D. Changes in Unrealized Appreciation or Depreciation of Investments _____
 - E. Net Gain or Loss on Investments _____
 - F. Net Increase or Decrease in Net Assets Resulting From Operations _____

	<u>Place ✓ by Sections Not Applicable</u>		
• Statement of Changes in Net Assets	_____		
• Schedule of Investments—Nonpublic Investment Partnerships	_____		
• Supplementary Information	_____		
• Interim Financial Statements	_____		
• SEC Compliance Disclosures Per Regulation S-X	_____		
	<u>Yes</u>	<u>No</u>	<u>N/A</u>

General

A. Financial Statements Presented

1. Are the following financial statements presented:
 - a. Statement of assets and liabilities or a statement of net assets as of the close of the latest period?
 - (1) Does it include a detailed list of investments in securities? _____
 - (2) Covered call options written? _____
 - (3) Securities sold short? _____
 - (4) Other investments? _____
 - b. Statement of operations for the latest period? _____
 - c. Statements of changes in net assets for the latest two years? _____
 - d. Statement of cash flows for the latest period if the conditions of SFAS 102 are not met? _____
 - e. Financial highlights including selected per-share data, total investment return, supplemental data, and ratios for the latest five years or from the date of inception?
[AAG-INV, par. 5.01; SEC Form N-1A, Item 9; SFAS 102, pars. 6 and 7] _____

B. Reporting Financial Position

1. If a statement of net assets is permitted, is at least 95 percent of total assets invested in securities of nonaffiliated issuers?
[AAG-INV, par. 5.05] _____
2. If a statement of assets and liabilities is used, does it list assets and liabilities in sufficient detail and an amount for net assets?
[AAG-INV, par. 5.06] _____
3. Does the statement of net assets present a detailed list of portfolio securities and a net amount for all other assets and liabilities?
[AAG-INV, par. 5.07] _____
4. If a statement of net assets is used, are details of other assets and liabilities presented in the statement or in the notes to the financial statements, if the amounts are material to total assets or liabilities?
[AAG-INV, par. 5.07] _____

Yes No N/A

Statement of Assets and Liabilities

A. Assets

1. Investments

- | | | | |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------|-------|-------|
| <p><i>a.</i> Are investments in securities the first item in the asset section?
[AAG-INV, par. 5.09]</p> | _____ | _____ | _____ |
| <p><i>b.</i> Are securities reported at value with acquisition cost shown parenthetically by major classification of securities?
[AAG-INV, par. 5.10]</p> | _____ | _____ | _____ |
| <p><i>c.</i> Are investments in foreign securities reported at value by converting their foreign currency value into U.S. dollars using current exchange rates?
[AAG-INV, par. 5.10]</p> | _____ | _____ | _____ |
| <p><i>d.</i> Are individual securities held by the fund listed:</p> <p style="margin-left: 20px;">(1) In the statement if a statement of net assets is used?</p> <p style="margin-left: 20px;">(2) In an accompanying list by major classifications of the investments in the portfolio if a statement of assets and liabilities is used?
[AAG-INV, par. 5.10]</p> | _____ | _____ | _____ |
| <p><i>e.</i> Are significant investments in foreign securities disclosed and presented separately in a representative grouping?
[AAG-INV, par. 5.10]</p> | _____ | _____ | _____ |
| <p><i>f.</i> Are securities arranged in the most meaningful manner within each classification by industry or group with disclosure of the percentage of assets in each group?
[AAG-INV, par. 5.10]</p> | _____ | _____ | _____ |
| <p><i>g.</i> Does the portfolio listing indicate the number of shares or principal amount and value of each security issue?
[AAG-INV, par. 5.11]</p> | _____ | _____ | _____ |
| <p><i>h.</i> If short-term investments are summarized by issuers (money market mutual funds should present in detail) is disclosure made of their ranges of interest rates and maturity dates?
[AAG-INV, par. 5.11]</p> | _____ | _____ | _____ |
| <p><i>i.</i> Is specific disclosure made of investments in restricted securities, affiliated companies and securities subject to call options?
[AAG-INV, par. 5.11]</p> | _____ | _____ | _____ |
| <p><i>j.</i> Have the following been considered for disclosure with respect to investments in foreign securities:</p> <p style="margin-left: 20px;">(1) Liquidity?</p> <p style="margin-left: 20px;">(2) Size?</p> <p style="margin-left: 20px;">(3) Valuation?
[AAG-INV, App. K (SOP 93-4, par. 37)]</p> | _____ | _____ | _____ |
| <p><i>k.</i> Is the amount of investments in securities of unaffiliated issuers shown on the statement?
[Reg. S-X, 6-04.1]</p> | _____ | _____ | _____ |
| <p><i>l.</i> Are investments in the following stated separately:</p> <p style="margin-left: 20px;">(1) Controlled companies?</p> <p style="margin-left: 20px;">(2) Other affiliates?
[Reg. S-X, 6-04.2]</p> | _____ | _____ | _____ |

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
<i>m.</i> Are investments, other than securities, stated separately by major category? [Reg. S-X, 6-04.3]	_____	_____	_____
<i>n.</i> Is an amount for total investments shown on the statement? [Reg. S-X, 6-04.4]	_____	_____	_____
2. Cash			
<i>a.</i> Are cash on hand and demand deposits included under the general caption "Cash"?	_____	_____	_____
<i>b.</i> Are foreign currencies, if material, disclosed separately?	_____	_____	_____
<i>c.</i> Are time deposits and other funds subject to withdrawal or usage restrictions presented separately with disclosure of applicable interest rates and maturity dates? [AAG-INV, par. 5.12]	_____	_____	_____
3. Receivables			
<i>a.</i> Are the following receivables listed separately:			
(1) Dividends and interest?	_____	_____	_____
(2) Investment securities sold?	_____	_____	_____
(3) Capital stock sold?	_____	_____	_____
(4) Other accounts receivable, such as receivables from related parties or expense reimbursements from affiliates? [AAG-INV, par. 5.13]	_____	_____	_____
(5) Directors and officers? [Reg. S-X, 6-04.6]	_____	_____	_____
(6) Notes receivable, if the aggregate amount exceeds 10 percent of the aggregate amount of the receivables? [Reg. S-X, 6-04.6]	_____	_____	_____
4. Deposits for securities sold short and open option contracts:			
<i>a.</i> Are amounts held by others in connection with short sales and open option contracts presented separately? [AAG-INV, par. 2.107; Reg. S-X, 6-04.7]	_____	_____	_____
5. Other Assets			
<i>a.</i> Do other assets include items, such as deferred organization expense,* prepaid taxes, prepaid and deferred expenses, pension and other special funds, and furniture and fixtures, with only significant items separately disclosed? [AAG-INV, par. 5.14; Reg. S-X, 6-04.8]	_____	_____	_____
6. Is the unamortized balance of deferred start-up costs or organization costs and remaining amortization period disclosed? [SOP 98-5, par. 23]	_____	_____	_____
7. Total Assets			
<i>a.</i> Is the amount of total assets shown on the statement? [Reg. S-X, 6-04.9]	_____	_____	_____

* In accordance with SOP 98-5, *Reporting on the Costs of Start-Up Activities*, organization costs should be expensed as they are incurred.

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
B. Liabilities			
1. Accounts Payable			
a. Are accounts payable listed separately for investment securities purchased, for capital stock reacquired, for securities sold short, for dividends or other distributions on capital shares, and for other items? [AAG-INV, par. 5.16; Reg. S-X, 6-04.10]	_____	_____	_____
b. Are call or put options written, future contracts sold, and securities sold short disclosed?	_____	_____	_____
(1) Are call options written and securities sold short at the end of the period presented separately?	_____	_____	_____
(2) Does the information for covered call options include the number of shares subject to call for each option written, the value of each option, the strike price, and exercise date?	_____	_____	_____
(3) Does the information presented for securities sold short, other options written, and futures contracts sold include data about quantities, values, and proceeds? [AAG-INV, par. 5.17]	_____	_____	_____
2. Accrued Liabilities			
a. Are accrued liabilities reported, including taxes, investment advisory, management fees, interest, compensation expenses, and other expenses incurred in the normal course of operations? [AAG-INV, par. 5.18]	_____	_____	_____
b. Are (1) amounts payable for investment advisory, management and service fees, (2) the total amount payable to (a) officers and directors, (b) controlled companies, and (c) other affiliates, excluding any amounts owing to noncontrolled affiliates which arose in the ordinary course of business and which are subject to usual trade terms stated separately? [Reg. S-X, 6-04.12]	_____	_____	_____
c. For funds with a 12b-1 plan, do the financial statements disclose:			
(1) The principal terms of the plan? (traditional and enhanced plans)	_____	_____	_____
(2) Any provisions permitting or requiring payments of excess costs after termination of the plan? (traditional and enhanced plans)	_____	_____	_____
(3) The aggregate amount of distribution costs subject to recovery through future payments by the fund and by current shareholders? (board-contingent and enhanced plans)	_____	_____	_____
(4) The methodology used to estimate future contingent-deferred sales load payments by current shareholders? (enhanced plans) [SOP 95-3, pars. 7-10]	_____	_____	_____
d. Are notes payable to banks and to others and other funded debt reported separately with separate disclosure of related-party amounts? [AAG-INV, par. 5.19]	_____	_____	_____
e. Are amounts payable to (1) banks or other financial institutions for borrowings, (2) controlled companies, (3) other affiliates, and (4) others stated separately, showing for each category amounts payable within one year and amounts payable after one year? [Reg. S-X, 6-04.13a]	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
f. Is disclosure made regarding unused lines of credit for short-term financing and unused commitments for long-term financing arrangements? [AAG-INV, par. 5.57; Reg. S-X, 6-04.13b]	_____	_____	_____
g. Do other liabilities include amounts payable to affiliates for collateral on return of securities loaned, for deferred income, and for dividends? [AAG-INV, par. 5.20]	_____	_____	_____
h. Is the value of securities loaned and the nature of any collateral received as security for the loan stated? [Reg. S-X, 6-04.11]	_____	_____	_____
3. Total Liabilities			
a. Is the amount of total liabilities shown on the statement? [Reg. S-X, 6-04.14]	_____	_____	_____
b. Are commitments and contingent liabilities disclosed? [Reg. S-X, 6-04.15]	_____	_____	_____
4. Net Assets			
a. Is the amount of net assets shown in the statement? [Reg. S-X, 6-04.19]	_____	_____	_____
b. If not required to be disclosed separately in the statement of assets and liabilities, do the statement or notes disclose the following:			
(1) The title of each class of capital shares or other capital units, the number authorized, and the number outstanding and dollar amounts?	_____	_____	_____
(2) Paid-in capital, which includes the net proceeds received on sale of capital shares less the cost of reacquired shares, adjusted for amounts apportioned to the equalization account, if that accounting procedure is followed?	_____	_____	_____
(3) Undistributed investment income, which includes cumulative net investment income or loss, equalization apportionments, if necessary, less dividends from net investment income (amounts at the end of the periods presented are normally disclosed in the statement of changes in net assets)?	_____	_____	_____
(4) Accumulated net realized gains and losses from security transactions, net of actual or deemed dividends to shareholders?	_____	_____	_____
(5) Unrealized appreciation or depreciation of investments? [AAG-INV, par. 5.21; Reg. S-X, 6-04.16a and 17]	_____	_____	_____
c. Is net asset value per-share disclosed? [AAG-INV, par. 5.23; Reg. S-X, 6-04.19]	_____	_____	_____
d. Are any other elements of capital or residual interests appropriate to the capital structure of the reporting entity disclosed? [Reg. S-X, 6-04.18]	_____	_____	_____
e. For unit investment trusts, including those which are issuers of periodic payment plan certificates, are the following items stated in a note to the financial statements: (1) the total cost to the investors of each class of units or shares, (2) the adjustment for market depreciation or appreciation, (3) other deductions from the total cost to the investors for fees, loads, and other charges, including an explanation of such deductions, and (4) the net amount applicable to the investors? [Reg. S-X, 6-04.16b]	_____	_____	_____

Yes No N/A

Statement of Operations

A. Income

- | | | | |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------|-------|-------|
| 1. Are income from dividends, interest on securities, and other income that exceeds 5 percent of the total income stated separately?
[Reg. S-X, 6-07.1] | _____ | _____ | _____ |
| 2. Are dividends from affiliates and controlled companies reported and disclosed separately?
[AAG-INV, par. 5.25; Reg. S-X, 6-07.1] | _____ | _____ | _____ |
| 3. If noncash dividends are included in income, are the amounts and basis of recognition and measurement disclosed?
[Reg. S-X, 6-07.1] | _____ | _____ | _____ |
| 4. Is interest from affiliates and controlled companies reported and disclosed separately?
[AAG-INV, par. 5.26] | _____ | _____ | _____ |
| 5. Is the method of amortizing bond discounts and premiums disclosed?
[AAG-INV, par. 2.126] | _____ | _____ | _____ |
| 6. Is income from securities loaned and from miscellaneous sources included as other income?
[AAG-INV, par. 5.27] | _____ | _____ | _____ |
| 7. For nonpublic investment partnerships, is the statement of operations presented in conformity with paragraphs 5.24–5.37 of the Guide?
[AAG-INV, App. L (SOP 95-2, par. 12)] | _____ | _____ | _____ |

B. Expenses

- | | | | |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------|-------|-------|
| 1. Are the following expenses reported separately: | | | |
| a. Investment advisory (management) fees (or compensation)? | _____ | _____ | _____ |
| b. Shareholder service costs, including fees and expenses for the transfer agent and dividend disbursing agent? | _____ | _____ | _____ |
| c. Distribution expenses? | _____ | _____ | _____ |
| d. Custodian fees? | _____ | _____ | _____ |
| e. Reports to shareholders? | _____ | _____ | _____ |
| f. Federal income taxes? | _____ | _____ | _____ |
| g. Other taxes? | _____ | _____ | _____ |
| h. Interest? | _____ | _____ | _____ |
| i. Dividends on securities sold short? | _____ | _____ | _____ |
| j. Professional fees? | _____ | _____ | _____ |
| k. Directors' fees? | _____ | _____ | _____ |
| l. Registration fees and expenses? | _____ | _____ | _____ |
| m. Research, selection, and supervision of investments?
[AAG-INV, par. 5.28; Reg. S-X, 6-07.2(a)] | _____ | _____ | _____ |
| 2. Are amounts of expenses incurred from transactions with affiliated persons disclosed together with the identity of the related amount applicable to each such person accounting for five percent or more of the total expenses shown under this caption together with a description of the nature of the affiliation?
[Reg. S-X, 6-07.2(a)] | _____ | _____ | _____ |

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
3. Are expenses incurred within the person's own organization in connection with research, selection and supervision of investments stated separately? [Reg. S-X, 6-07.2(a)]	_____	_____	_____
4. Are reductions or reimbursements of management or service fees shown as a reduction of total expenses? [Reg. S-X, 6-07.2 (a)]	_____	_____	_____
5. Based on SEC requirements, are expenses that represent 5 percent or more of total expenses disclosed? [AAG-INV, par. 5.28; Reg. S-X, 6-07.2(b)]	_____	_____	_____
6. If expenses are paid other than in cash, are the details disclosed? [Reg. S-X, 6-07.2 (d)]	_____	_____	_____
7. Is the amount of brokerage commissions paid to affiliated brokerdealers in connection with purchases and sales of investment securities disclosed? [Reg. S-X, 6-07.2 (e)]	_____	_____	_____
8. Is the aggregate remuneration paid to the following people disclosed:			
a. To all officers?	_____	_____	_____
b. To directors and members of any advisory board for regular compensation?	_____	_____	_____
c. To each director and members of any advisory board for special compensation?	_____	_____	_____
d. To each person of whom an officer or director is an affiliated person? [Form N1-A, Item 22(b)(3)]	_____	_____	_____
9. Is information concerning management and service fees, the rate of the fee, and the base and method of computation disclosed? [Reg. S-X, 6-07.2(c)]	_____	_____	_____
10. Is a description and amount of any fee reductions or reimbursements representing expense limitation agreements or commitments disclosed? [Reg. S-X, 6-07.2(c)]	_____	_____	_____
11. Is a description and amount of any fee reductions or reimbursements representing offsets received from broker-dealers showing separately for each amount received or due from (a) unaffiliated persons, and (b) affiliated persons disclosed? [Reg. S-X, 6-07.2(c)]	_____	_____	_____
12. If no management or service fees are incurred, have the reasons therefore been disclosed? [Reg. S-X, 6-07.2(c)]	_____	_____	_____
13. Are payments pursuant to a 12b-1 distribution plan disclosed? [AAG-INV, par. 5.29]	_____	_____	_____
14. Is the amount of sales charges deducted from the proceeds of sale of capital shares that were retained by any affiliated underwriter or other affiliated broker-dealer disclosed? [Reg. S-X, 6-07.2(e)]	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
15. Is the company's status as "regulated investment company" (as defined in the Internal Revenue Code) disclosed, including a description of the principal assumptions on which the company relied in making or not making provisions for income taxes? [Reg. S-X, 6-03(h)]	_____	_____	_____
16. Is the excess of investment income over total expenses shown as investment income—net? [AAG-INV, par. 5.32]	_____	_____	_____
17. For nonpublic investment partnerships, are fees paid to the general partner for advisory services disclosed either as management fees paid in the statement of operations or as allocations of net income from the limited partners capital accounts in the statement of changes in partners' capital? [AAG-INV, App. L (SOP 95-2, par. 13)]	_____	_____	_____
18. For nonpublic investment partnerships, is the method of computing payment or allocations to the general partner for advisory services disclosed in the notes to the financial statements? [AAG-INV, App. L (SOP 95-2, par. 13)]	_____	_____	_____
19. Have appropriate expenses been increased for amounts under brokerage/service arrangements and expense offset arrangements and total expenses reduced by the total amount of such arrangements? [AAG-INV, pars. 5.30–5.31, Reg. S-X, 6-07.2(g)]	_____	_____	_____
20. Have required disclosures been made in the notes to the financial statements related to brokerage/service arrangements and expense offset arrangements? [AAG-INV, pars. 5.30–5.31, Reg. S-X, 6-07.2(g)]	_____	_____	_____
C. Realized Gains or Losses on Investments			
1. Are significant net realized gains or losses from security transactions, short sale transactions, written option transactions, and investments other than securities stated separately? [Reg. S-X, 6-07.7]	_____	_____	_____
2. Are net realized gains or losses reported net of brokerage commissions? [AAG-INV, par. 5.33]	_____	_____	_____
3. Are income tax provisions charged against realized gains disclosed separately? [AAG-INV, par. 5.33]	_____	_____	_____
4. Are distributions of realized gains by other investment companies disclosed separately? [Reg. S-X, 6-07.7(b)]	_____	_____	_____
5. Are gains arising from in-kind redemptions disclosed? [AAG-INV, par. 5.33]	_____	_____	_____
6. Is disclosure made of the proceeds from sales of securities and the cost of securities purchased separately for U.S. government obligations and other than U.S. government securities? [AAG-INV, par. 5.34]	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
7. For a money market fund, is consideration given to combining net realized gains or losses (usually insignificant) with interest income? [AAG-INV, par. 5.34]	_____	_____	_____
8. Is the primary reason for any significant difference between total GAAP-basis net income and realized capital gains and actual distributions disclosed in the notes to the financial statements? [AAG-INV, App. J (SOP 93-2, par. 13c)]	_____	_____	_____
9. Is the entity's practice of either including or excluding that portion of realized and unrealized gains and losses on investments that result from foreign currency changes with or from other foreign currency gains and losses disclosed? [AAG-INV, App. K (SOP 93-4, par. 35)]	_____	_____	_____
D. Changes in Unrealized Appreciation or Depreciation of Investments			
1. Are changes in unrealized appreciation or depreciation of investments reported in the statement of operations? [AAG-INV, par. 5.35]	_____	_____	_____
2. Is a provision for deferred taxes on changes, if any, reported separately? [AAG-INV, par. 5.35]	_____	_____	_____
E. Net Gain or Loss on Investments			
1. Is the sum of net realized and change in unrealized gain or loss on investments presented in the statement of operations as a net gain or loss on investments? [AAG-INV, par. 5.36]	_____	_____	_____
2. Are the significant effects of futures or options trading activities disclosed separately? [AAG-INV, par. 5.36]	_____	_____	_____
F. Net Increase or Decrease in Net Assets Resulting From Operations			
1. Is the sum of investment income-net and net gain or loss on investments shown as a net increase or decrease in net assets resulting from operations? [AAG-INV, par. 5.37]	_____	_____	_____

Statement of Changes in Net Assets

1. Does the increase or decrease in net assets include the following categories:			
a. Operations			
(1) Net investment income or loss?	_____	_____	_____
(2) Net realized gains and losses?	_____	_____	_____
(3) Changes in unrealized gains or losses on investments?	_____	_____	_____
b. If equalization accounting is followed, is the undistributed investment income included in the price of capital shares issued or reacquired shown separately?	_____	_____	_____
c. Distributions to shareholders			
(1) Distribution from undistributed investment income?	_____	_____	_____
(2) Distribution from undistributed realized gains from investment transaction?	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
(3) Per share amounts of distributions? [AAG-INV, par. 5.39]	_____	_____	_____
2. Is disclosure of declared but undistributed per share amounts disclosed in the notes? [AAG-INV, par. 5.39]	_____	_____	_____
3. Are the following components of capital share transactions disclosed on the face of the statement or in the notes as follows:			
a. The number and value of shares sold?	_____	_____	_____
b. The number and value of shares issued in reinvestment of distributions?	_____	_____	_____
c. The number and value of shares reacquired?	_____	_____	_____
d. The net change? [AAG-INV, par. 5.39]	_____	_____	_____
4. Are net assets disclosed at the beginning and end of the year, including an indication (usually parenthetically) of undistributed investment income (this amount should agree with the comparable amount in the statement of assets and liabilities)? [AAG-INV, par. 5.39]	_____	_____	_____

Schedule of Investments—Nonpublic Investment Partnerships

1. Do the financial statements include at a minimum a condensed schedule of investments in securities and does the schedule:			
a. Categorize investments by:			
(1) Type?	_____	_____	_____
(2) Country or geographical region?	_____	_____	_____
(3) Industry?	_____	_____	_____
b. Report the percent of net assets by category?	_____	_____	_____
c. Report the total value and cost for:			
(1) Type?	_____	_____	_____
(2) Country or geographical region?	_____	_____	_____
(3) Disclose the name, shares or principal amount, value, and type of each investment or aggregate of all investments in any one issuer totaling more than 5 percent of net assets? [AAG-INV, App. L (SOP 95-2, par. 10)]	_____	_____	_____

Supplementary Information

1. Does the information include selected per share data and ratios for a period of at least five years or from the date of inception? [AAG-INV, par. 5.40]	_____	_____	_____
2. Are per share amounts presented based on a share outstanding throughout the period? [AAG-INV, par. 5.40]	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
3. Is the following per share information presented:			
a. Per share investment income—net?	_____	_____	_____
b. Distributions from undistributed investment income, undistributed net realized gain through investment transactions, and from other sources?	_____	_____	_____
c. Realized and unrealized gains and losses per share which are balancing amounts necessary to reconcile the change in net asset value per share with other per share information presented?	_____	_____	_____
d. The increase or decrease in net asset value for each period?	_____	_____	_____
e. The net asset value at the beginning and end of each period? [AAG-INV, par. 5.41]	_____	_____	_____
4. Are the ratios of investment income-net and expenses to average net assets presented? [AAG-INV, par. 5.42]	_____	_____	_____
5. Is disclosure made that ratios of net investment income and expenses to average net assets for periods of less than one year are annualized? [SEC Form N-1A, Item 9(1)(a)]	_____	_____	_____
6. Are ratios of net investment income and expenses to average net assets disclosed prior to expense reimbursement/waivers in accordance with AAG-INV?	_____	_____	_____
7. Is disclosure made of the method of calculating the per share data where the results obtained by following the instructions to Form N-1A are unreasonable? [AAG-INV, par. 5.41]	_____	_____	_____
8. Is other information necessary for comparability between periods disclosed?	_____	_____	_____
9. Is consideration given to presenting additional ratios, such as turnover rates, number of shares outstanding at the end of each period, period-end net assets, and the total return or yield information for money market investment companies? [AAG-INV, par. 5.42]	_____	_____	_____
10. Are the per share amounts of distributions from undistributed net investment income of municipal bond funds stated separately for amounts applicable to taxable and tax-exempt dividends? [AAG-INV, par. 5.43]	_____	_____	_____

Interim Financial Statements

1. Is semiannual financial information to shareholders complete and based upon GAAP in a manner that conforms to principles used in preparing annual financial statements? [AAG-INV, par. 5.44]	_____	_____	_____
2. Does the statement of changes in net assets present information on the latest interim period and the preceding fiscal year? [AAG-INV, par. 5.45]	_____	_____	_____
3. Is unaudited interim financial data marked accordingly? [AAG-INV, par. 5.46]	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
4. Is data summarized in condensed form labeled as unaudited? [AAG-INV, par. 5.46]	_____	_____	_____
5. If the independent accountant does not perform an audit or review, but is identified in the interim report, does he or she insist that the reference be deleted or that a disclaimer of opinion be included? [AAG-INV, par. 5.46]	_____	_____	_____
6. Is the fact that management determines that a tax return of capital is likely to occur for the entity's fiscal year disclosed in the interim financial statements? [AAG-INV, App. J (SOP 93-2, par. 13e)]	_____	_____	_____

Note: Form N-SAR is the SEC reporting form used for semiannual and annual reports by all registered investment companies that have filed a registration statement that has become effective pursuant to the Securities Act of 1933.
[AAG-INV, par 1.23]

SEC Compliance Disclosures Per Regulation S-X

1. Is the aggregate cost of securities for federal income tax purposes disclosed? [Reg. S-X, Rule 12-12, Note 8]	_____	_____	_____
2. Are the additional disclosures made as required by:			
a. Reg. S-X, Rule 12-12 (Note 2), pertaining to repurchase agreements?	_____	_____	_____
b. Reg. S-X, Rule 4-08(m), pertaining to carrying amounts of repurchase or reverse repurchase that exceed 10 percent of total assets?	_____	_____	_____
c. Disclosure of the average amount of borrowings outstanding during the period, the weighted-average interest rate, and the maximum amount of debt outstanding during the period, according to Rule 6-07.3, and Rule 6-04.13(b), referring to Rules 5.02.19(b) and 5.02.22(b) of Reg. S-X?	_____	_____	_____
d. Reg. S-X, Rule 6-03 pertaining to financial highlights?	_____	_____	_____
e. Reg. S-X, Rule 6-07, as amended in July 1995, including disclosures regarding expense offsets?	_____	_____	_____
f. The SEC's Codification of Financial Reporting Policies, section 404, and Reg. S-X, Rule 12-12 (Note 6), regarding restricted securities?	_____	_____	_____
g. Reg. S-X, Rule 12-12 (Note 8), pertaining to gross unrealized appreciation for all securities in which there is an excess of value over tax cost and gross unrealized depreciation for all securities in which there is an excess of tax cost over value, as well as net unrealized appreciation or depreciation?	_____	_____	_____
h. Reg. S-X, Rules 6-04.17-.19, pertaining to the elements of net assets as part of the statement of assets and liabilities, rather than in the notes to the financial statements?	_____	_____	_____
i. Reg. S-X, Rule 12-12 (Note 5), pertaining to non-income producing securities?	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
<i>j.</i> Reg. S-X, Rule 12-14, pertaining to the increase or decrease in investments in and advances to affiliates?	_____	_____	_____
<i>k.</i> Reg. S-X, Rule 6-05, pertaining to a statement of net assets?	_____	_____	_____
<i>l.</i> Reg. S-X, Rule 6-06, pertaining to special provisions applicable to the balance sheets of issuers of face-amount certificates?	_____	_____	_____
<i>m.</i> Reg. S-X, Rule 6-08, pertaining to special provisions applicable to the statements of operations of issuers of face-amount certificates?	_____	_____	_____
<i>n.</i> Reg. S-X, Rule 6-09, pertaining to statements of changes in net assets?	_____	_____	_____

Note: The SEC reporting Form N-1A is the registration statement used by open-end management investment companies under the 1940 and 1933 Acts. A comparable Form N-2 registration statement is used for closed-end management investment companies. The form and content of financial statements required in registration statements are governed by Regulation S-X, article 6.
[AAG-INV, pars. 1.23 to 1.26]

FSP Section 12,400

Illustrative Financial Statements

.01 The following illustrative auditor's report and financial statements demonstrate one form of currently acceptable practice. The checklists and illustrative financial statements do not include all disclosures and presentation items required by GAAP. The financial statements are reproduced from the AICPA Audit and Accounting Guide *Audits of Investment Companies*. Other forms of financial statements are acceptable. More or less detail should appear either in the financial statements or in the notes, depending on the circumstances.

.02

Independent Auditor's Report

To the Shareholders and Board of Directors

XYZ Management Investment Company:

We have audited the accompanying statement of assets and liabilities of XYZ Management Investment Company (or Statement of Net Assets), including the schedules of investments in securities, covered call options written, and securities sold short as of December 31, 19X4, the related statement of operations for the year then ended, the statement of changes in net assets for each of the two years in the period then ended, and the selected per share data and ratios for each of the five years in the period then ended. These financial statements, schedules, and selected per share data and ratios are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements, schedules, and per share data and ratios based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and per share data and ratios are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our procedures included confirmation of securities owned as of December 31, 19X4 by correspondence with the custodian and brokers. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements, schedules, and selected per share data and ratios referred to above present fairly, in all material respects, the financial position of XYZ Management Investment Company as of December 31, 19X4, the results of its operations for the year then ended, the changes in its net assets for each of the two years in the period then ended, and the selected per share data and ratios for each of the five years in the period then ended, in conformity with generally accepted accounting principles.

[Signature]

[City, State]

[Date]

The checklist and illustrative financial statements do not include all disclosures and presentation items promulgated.

XYZ MANAGEMENT INVESTMENT COMPANY

Statement of Assets and Liabilities*

December 31, 19X4

Assets	
Investments in securities, at value—identified cost \$19,294,000	\$21,721,000
Cash	199,000
Deposits with brokers for securities sold short	1,555,000
Receivables	
Dividends and interest	46,000
Investment securities sold	24,000
Capital stock sold	54,000
Other assets	26,000
Total assets	<u>23,625,000</u>
Liabilities	
Covered call options written, at value—premiums received \$110,000	230,000
Securities sold short, at value—proceeds \$1,555,000	1,673,000
Demand loan payable to bank (Note 5)	2,000,000
Payable upon return of securities loaned (Note 9)	620,000
Payables	
Investment securities purchased	52,000
Capital stock reacquired	8,000
Other	4,000
Accrued taxes	8,000
Distribution payable	168,000
Total liabilities	<u>4,763,000</u>
Net Assets	
Net assets (equivalent to \$4.47 per share based on 4,216,000 shares of capital stock outstanding) (Note 6)	<u>\$18,862,000</u>

The accompanying notes are an integral part of these financial statements.

* *Note:* A statement of assets and liabilities is an alternative presentation to a statement of net assets. The reader should be aware, however, that SEC rules do not always consider the two statement formats to be alternative presentations. See discussion in note following AAG-INV, par. 5.49.

XYZ MANAGEMENT INVESTMENT COMPANY

Investments in Securities

December 31, 19X4

Note: Securities may be arranged by industry groupings or other groupings (showing percentage of total portfolio or of net assets invested in each grouping) that the company believes are most meaningful to users. The basis of the computation of percentages shown, which in this illustration is based on the ratio of the specific category of securities to the total portfolio owned, should be disclosed.

	<i>Principal Amount or Shares</i>	<i>Value</i>
Common Stocks—54%		
Consumers' durable goods—5%		
Allied Manufacturing Corporation	25,000	\$ 620,000
Baker Industries, Inc.	15,000	150,000
Etc. (other common stocks)		316,000
Consumers' nondurable goods—2%		
Amalgamated Buggy Whips, Inc. (Note 2)	10,000	280,000
Etc. (other common stocks)		155,000
Service industries—4%		
Service Company, Inc.	10,000	465,000
Etc. (other common stocks)		404,000
Etc. (other industry groupings)—43%		<u>9,351,000</u>
Total common stocks (cost \$10,294,000)		<u>11,741,000</u>
Convertible bonds—25%		
American Retailing, Inc.—5.5% debentures due 19XX	\$500,000	525,000
Etc. (other convertible bonds)		<u>4,875,000</u>
Total convertible bonds (cost \$4,400,000)		<u>5,400,000</u>
U.S. government obligations—16%		
U.S. Treasury 6% notes due 20XX	\$500,000	490,000
Etc. (other long-term U.S. government obligations)		<u>2,985,000</u>
Total U.S. government obligations (cost \$3,500,000)		<u>3,475,000</u>
Short-term notes—3%		
Commercial Paper, Inc., due 2/5/X5	\$500,000	505,000
U.S. Treasury bills, due 1/20/X5	\$100,000	100,000
Total short-term notes (cost \$600,000)		<u>605,000</u>
Repurchase agreements collateralized by U.S. government obligations—2%		
Money Center Bank of Large City, 11%, due 1/3/X5 (cost \$500,000)	\$500,000	500,000
Total—100% (cost \$19,294,000)		<u><u>\$21,721,000</u></u>

The accompanying notes are an integral part of these financial statements.

XYZ MANAGEMENT INVESTMENT COMPANY

Covered Call Options Written

December 31, 19X4

<u>Common Stocks/Expiration Date/Exercise Price</u>	<u>Shares Subject to Call</u>	<u>Value</u>
Allied Manufacturing Corporation/ July/25	10,000	\$ 50,000
Allied Manufacturing Corporation/ October/30	5,000	2,500
Etc. (other options written)		<u>177,500</u>
Total (premiums received \$110,000) (Note 3)		<u><u>\$230,000</u></u>

The accompanying notes are an integral part of these financial statements.

XYZ MANAGEMENT INVESTMENT COMPANY
Securities Sold Short
December 31, 19X4

<u>Common Stocks</u>	<u>Shares</u>	<u>Value</u>
International Widgets, Inc.	40,000	\$ 425,000
Paper Airplane Corporation	25,000	265,000
Etc. (other common stocks)		983,000
Total (proceeds \$1,555,000)		<u>\$1,673,000</u>

The accompanying notes are an integral part of these financial statements.

XYZ MANAGEMENT INVESTMENT COMPANY

Statement of Net Assets*

December 31, 19X4

Note: Securities may be arranged by industry or other groupings (showing the percentage of total portfolio or of net assets invested in each grouping) that the company believes will be most meaningful to the user.

	<i>Shares or Principal Amount</i>	<i>Value</i>
Assets		
Investments in securities—115% of net assets		
Common stocks—62%		
Consumers' durable goods—6%		
Allied Manufacturing Corporation	25,000	\$ 620,000
Baker Industries, Inc.	15,000	150,000
Etc. (other common stocks)		316,000
Consumers' nondurable goods—2%		
Amalgamated Buggy Whips, Inc. (Note 2)	10,000	280,000
Etc. (other common stocks)		155,000
Service industries—5%		
Service Company, Inc.	10,000	465,000
Etc. (other common stocks)		404,000
Etc. (other industry groupings)—49%		9,351,000
Total common stocks (cost \$10,294,000)		<u>11,741,000</u>
Convertible bonds—29%		
American Retailing, Inc.—5.5% debentures due 19XX	\$500,000	525,000
Etc. (other convertible bonds)		4,875,000
Total convertible bonds (cost \$4,400,000)		<u>5,400,000</u>
U.S. government obligations—18%		
U.S. Treasury—6% notes due 20XX	\$500,000	490,000
Etc. (other long-term obligations)		2,985,000
Total U.S. government obligations (cost \$3,500,000)		<u>3,475,000</u>
Short-term notes—3%		
Commercial Paper, Inc. due 2/5/X5	\$500,000	505,000
U.S. Treasury bills due 1/20/X5	\$100,000	100,000
Total short-term notes (cost \$600,000)		<u>605,000</u>
Repurchase agreements collateralized by U.S. government obligations—3%		
Money Center Bank of Large City, 11% due 1/3/X5 (cost \$500,000)	\$500,000	500,000
Total investments in securities (cost \$19,294,000)		21,721,000
Other assets—10%		1,904,000
Total assets		<u>\$23,625,000</u>
		<i>(continued)</i>

* A statement of assets and liabilities is an alternative presentation to a statement of net assets. The reader should be aware, however, that SEC rules do not always consider the two statement formats to be alternative presentations. [AAG-INV, par. 5.49]

	<i>Shares or Principal Amount</i>	<i>Value</i>
Liabilities		
Demand loans payable to bank—10% (Note 5)		2,000,000
Securities sold short—9%		1,673,000
Other liabilities—6%		<u>1,090,000</u>
Total liabilities		<u>4,763,000</u>
Net Assets		
Net assets (equivalent to \$4.47 per share based on 4,216,000 shares of capital stock outstanding) (Note 6)		<u>\$18,862,000</u>

The accompanying notes are an integral part of these financial statements.

XYZ MANAGEMENT INVESTMENT COMPANY

Statement of Operations

Year Ended December 31, 19X4

Investment income

Income		
Dividends	\$742,000	
Interest	<u>259,000</u>	
Total income		\$1,001,000

Expenses

Investment advisory fee (Note 8)	90,000	
Interest	55,000	
Professional fees (Note 8)	29,000	
Custodian and transfer agent fees	12,000	
Distribution expenses (Note 8)	4,000	
State and local taxes other than income taxes	15,000	
Directors' fees	12,000	
Dividends on securities sold short	<u>9,000</u>	
Total expenses		<u>226,000</u>
Investment income—net		<u>775,000</u>

Realized and unrealized gain (loss) on investments (Note 7)

Net realized gain on investments	1,089,000
Change in unrealized appreciation of investments for the year	<u>(1,649,000)</u>
Net loss on investments	<u>(560,000)</u>
Net increase in net assets resulting from operations	<u>\$ 215,000</u>

The accompanying notes are an integral part of these financial statements.

XYZ MANAGEMENT INVESTMENT COMPANY

Statement of Changes in Net Assets

Years Ended December 31, 19X4, and 19X3

	<u>19X4</u>	<u>19X3</u>
Increase (decrease) in net assets from operations		
Investment income—net	\$ 775,000	\$ 492,000
Net realized gain on investments	1,089,000	1,000,000
Change in unrealized appreciation	(1,649,000)	1,551,000
Net increase in net assets resulting from operations	<u>215,000</u>	<u>3,043,000</u>
Net equalization credits	9,000	6,000
Distributions to shareholders from—		
Investment income—net	(525,000)	(350,000)
Net realized gain on investments	(1,350,000)	(1,066,000)
Capital share transactions (Note 6)	<u>2,721,000</u>	<u>1,749,000</u>
Total increase	1,070,000	3,382,000
Net assets		
Beginning of year	<u>17,792,000</u>	<u>14,410,000</u>
End of year (including undistributed investment income of \$639,000 and \$380,000, respectively)	<u>\$18,862,000</u>	<u>\$17,792,000</u>

The accompanying notes are an integral part of these financial statements.

XYZ MANAGEMENT INVESTMENT COMPANY

Notes to Financial Statements

The following notes to the financial statements are illustrative only. In some circumstances, the information may be better presented within the financial statements; in other circumstances, information not required by regulation may not be sufficiently material to be disclosed.

Note 1: Significant Accounting Policies

The Company is registered under the Investment Company Act of 1940 as a diversified, open-end management investment company.

Security valuation. Investments in securities traded on a national securities exchange (or reported on the NASDAQ national market) are stated at the last reported sales price on the day of valuation. Other securities traded in the over-the-counter market and listed securities for which no sale was reported on that date are stated at the last quoted bid price, except for short positions and call options written, for which the last quoted asked price is used. Short-term notes are stated at amortized cost, which is equivalent to value. Restricted securities and other securities for which quotations are not readily available are valued at fair value as determined by the board of directors.

Federal income taxes. The Company's policy is to comply with the requirements of the Internal Revenue Code that are applicable to regulated investment companies and to distribute all its taxable income to its shareholders. Therefore, no federal income tax provision is required.

Equalization. The Company uses the accounting practice of *equalization*, by which a portion of the proceeds from sales and costs of redemption of capital shares, equivalent on a per share basis to the amount of undistributed net investment income on the date of the transactions, is credited or charged to undistributed income. As a result, undistributed net investment income per share is unaffected by sales or redemptions of capital shares.

Distributions to shareholders. Dividends to shareholders are recorded on the ex-dividend date.

Other. The Company follows industry practice and records security transactions on the trade date. Dividend income is recognized on the ex-dividend date, and interest income is recognized on an accrual basis. Discounts and premiums on securities purchased are amortized over the life of the respective securities.

Note 2: Restricted Securities

The investment in 10,000 shares of Amalgamated Buggy Whips, Inc. common stock, the sale of which is restricted, has been valued by the board of directors after considering certain pertinent factors, including the results of operations of Amalgamated since the date of purchase in 19X1 and the sales price of recent private placements in its common stock. There is no quoted market for Amalgamated shares.*

Note 3: Covered Call Options Written

As of December 31, 19X4, portfolio securities valued at \$1,908,000 were held in escrow by the custodian in connection with covered call options written by the Company.

* If several restricted security investments are held, a general statement on the valuation methods may be given rather than individual descriptions.

Note 4: Distributions to Shareholders

On January 3, 19X5, a distribution of \$0.20 aggregating \$840,000 was declared from net realized gains from investment transactions (including \$0.02 applicable to short-term gains that are taxable to shareholders as ordinary income dividends) during 19X4. The dividend was paid on January 20, 19X5, to shareholders of record on January 10, 19X5.

As of December 31, 19X4, the Company had available for federal income tax purposes an unused capital loss carryover of approximately \$1,500,000 which will expire in 19X5.*

Note 5: Bank Loans

The Company has an unsecured \$3,000,000 bank line of credit. Borrowings under this arrangement bear interest at 110 percent of the bank's prime rate. As of December 31, 19X4, the Company was paying interest at 11 percent per year on its outstanding borrowings. No compensating balances are required.

Note 6: Capital Share Transactions

As of December 31, 19X4, there were 25,000,000 shares of \$0.50 par value capital stock authorized and capital paid-in aggregated \$15,184,000.

Transactions in capital stock were as follows:

	<i>Shares</i>		<i>Amount</i>	
	<u>19X4</u>	<u>19X3</u>	<u>19X4</u>	<u>19X3</u>
Shares sold	452,000	329,000	\$2,177,000	\$1,434,000
Shares issued in reinvestment of dividends	222,000	207,000	1,000,000	845,000
	674,000	536,000	3,177,000	2,279,000
Shares redeemed	104,000	121,000	456,000	530,000
Net increase	<u>570,000</u>	<u>415,000</u>	<u>\$2,721,000</u>	<u>\$1,749,000</u>

Note 7: Investment Transactions

Purchases and sales of investment securities (excluding short-term securities) were \$32,000,000 and \$23,300,000, respectively, for common stocks and bonds; purchases and sales of U.S. government obligations were \$3,300,000 and \$2,000,000. Net loss on investments for the year ended December 31, 19X4, was \$560,000. That amount represents the net decrease in value of investments held during the year. The components are as follows:

Long transactions	\$(501,000)
Short sale transactions	(75,000)
Covered call options written	16,000
	<u>\$(560,000)</u>

As of December 31, 19X4, the unrealized appreciation of securities was \$2,189,000; accumulated undistributed net realized gains on investment transactions totaled \$850,000.

Note 8: Investment Advisory Fees and Other Transactions with Affiliates

The Company pays advisory fees for investment management and advisory services under a management agreement (Agreement) that provides for fees to be computed at an annual rate of 0.5 percent of the Company's average daily net assets. Certain officers and directors of the Company are also officers and directors of the investment adviser. The Agreement provides for

* This would be disclosed if the Company had an available capital loss carryover as of December 31, 19X4.

an expense reimbursement from the investment adviser if the Company's total expenses, exclusive of taxes, interest on borrowings, dividends on securities sold short, brokerage commissions, and extraordinary expenses, exceed 1.5 percent of the Company's average daily net assets for any full fiscal year. An expense reimbursement was not required for either 19X4 or 19X3. An expense reimbursement of \$0.01 per share was required in 19X0.

The investment adviser also received \$10,000 in 19X4 and \$15,000 in 19X3 from commissions earned on sales of XYZ Management Investment Company capital stock and \$5,000 in 19X4 and \$8,000 in 19X3 from brokerage fees on its executions of purchases and sales of portfolio investments.

During 19X4, the Company incurred legal fees of \$7,000 to Brown and Smith, counsel for the Company. John F. Smith, a partner of the firm, is a director of the Company. MNO Service Company, an affiliate of the investment adviser, received \$4,000 in expense reimbursements for shareholder-related distribution expenses undertaken pursuant to a shareholder-approved plan.

Note 9: Portfolio Securities Loaned

As of December 31, 19X4, the Company loaned common stocks having a value of approximately \$570,000 and received cash collateral of \$620,000 for the loan.

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Supplementary Information—Selected Per Share Data and Ratios*

	<u>19X4</u>	<u>19X3</u>	<u>19X2</u>	<u>19X1</u>	<u>19X0</u>
Per Share Data					
Net investment income	.21	.20	.19	.17	.15
Distributions from investment income—net	(.16)	(.16)	(.17)	(.17)	(.15)
Net realized and unrealized gain (loss) on securities	(.12)	.71	.52	(.42)	.48
Distributions from realized gains on securities	<u>(.34)</u>	<u>(.33)</u>	<u>(.24)</u>	<u>(.23)</u>	<u>(.20)</u>
Net increase/decrease in net asset value	(.41)	.42	.30	(.65)	.28
Net asset value:					
Beginning of year	<u>4.88</u>	<u>4.46</u>	<u>4.16</u>	<u>4.81</u>	<u>4.53</u>
End of year	<u>\$4.47</u>	<u>\$4.88</u>	<u>\$4.46</u>	<u>\$4.16</u>	<u>\$4.81</u>
Ratios					
Ratio of expenses to average net assets (%)	1.33	1.31	.99	.82	.84
Ratio of investment income—net to average net assets (%)	4.56	2.82	4.22	5.42	5.10

* Selected data for a share of capital stock outstanding throughout the year.

Note: See AAG-INV 5.42 for a discussion of additional information that may be included in this schedule.

Comment Letter

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