Small Business Investment Companies

INSTRUCTIONS FOR PREPARATION OF SBA FORM 468 (Annual and Quarterly)

CORPORATION SBICs

Investment Division

January 1999

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A. INTRODUCTION

1. General. Every SBIC must complete SBA Form 468 annually and must submit the form to SBA no later than the last day of the third month following the end of its fiscal year. An SBIC must also complete a shorter version of Form 468 on a quarterly basis if it has an outstanding commitment to obtain leverage. On a case-by-case basis, SBA may also require some SBICs to complete all of part of Form 468 on an interim basis in order to monitor their financial condition more closely. The Form 468 filed at year-end must be audited by the SBIC's Independent Public Accountant (IPA); interim submissions typically are unaudited.

These instructions are for a complete SBA Form 468.1 that a corporate SBIC would file for a full fiscal year. Instructions for the corresponding short form, SBA Form 468.4, are also included (see section X).

A completed Form 468 contains basic financial statements in a standardized format, as well as supplementary schedules that give SBA additional information concerning the SBIC's financial condition, investing activities, and compliance with certain SBA regulations. The Independent Public Accountant's report and the notes accompanying the financial statements must be included in an audited Form 468. SBA strongly encourages SBICs to include notes to the financial statements in interim filings as well.

An SBIC which has formed a wholly-owned management services subsidiary should file a consolidated Form 468, including both the SBIC and its subsidiary.

2. Format of reports. SBA Form 468 must be prepared and submitted electronically, in accordance with 13 CFR 107.504 of SBA regulations. All Licensees must use the electronic reporting software provided by SBA for this purpose. A complete filing of Form 468 consists of the following:

(1) An electronic version of the financial statements in one of the following formats: a data diskette mailed to SBA, an attachment emailed to SBA, or a file uploaded to the SBA bulletin board;
(2) Two hard copy sets of the financial statements and supplementary schedules;
(3) For Licensees with outstanding SBA leverage or commitments, or those planning to apply for leverage in the current fiscal year, two copies of the Operating Plan Update (see instructions on page 21C);
(4) Two copies of the management certifications on page 23C of Form 468 (one with original signatures);
(5) Two copies of the IPA's report (one with original signature); and
(6) The notes to the financial statements (two sets).

An SBIC must include in its filing a copy of any transmittal letter, special report, or other communication furnished by its auditor.

The submission of unapproved forms will result in their rejection and will not be considered a timely filing of Form 468.

3. New Electronic Reporting Software. The SBA has released an updated version of the electronic reporting software (new version number 1.0), which should be used for all fiscal years ending December 31, 1998 or later. This software is a Windows-based program that is year 2000 compliant. Instructions for downloading and installing the software, as well as instructions for using the software to complete the Form 468 are provide in a new Electronic Reporting Manual (dated January 1999). The manual can be downloaded from the Investment Division web page at http://www.sba.gov/INV or from the Venture Lines bulletin board.

4. SBA regulations. Regulations for the SBIC program are found in the Code of Federal Regulations (CFR), title 13, part 107. Form 468 includes a number of schedules intended to allow SBA to assess regulatory compliance, and the instructions for those schedules may summarize or discuss certain regulations. Nevertheless, these instructions are not a substitute for the regulations themselves and should not be used by an SBIC as its only source of information. The full text of 13 CFR part 107 is available on the SBIC program web site (www.sba.gov/inv).

SBICs should obtain a copy of the "Accounting Standards and Financial Reporting Requirements for Small Business Investment Companies". While not a comprehensive accounting guide, this document covers accounting topics that are particularly relevant to the SBIC program. Copies of the document can be obtained from the Investment Division of SBA (telephone (202) 205-7589).

B. COVER SHEET (page 1C)

The cover sheet of Form 468 asks for basic identifying information about the SBIC, most of which is self-explanatory.

The address given should be the location of the SBIC's principal business office.

The employer identification number is the number assigned to the SBIC by the U.S. Treasury Department for payroll tax identification purposes. If an SBIC does not have such a number, it should apply for one by submitting Form SS-4, Application for Employer Identification Number, to the Director of Internal Revenue for the area in which its principal office is located. Until a number is assigned, the SBIC should put "applied for" under Employer ID Number.

In the "Summary Information" section of the cover sheet, the SBIC should fill in each box with the appropriate code number from the list provided.

Box A: Self-explanatory
Box B: Self-explanatory
Box C: If an SBIC has more than **one-third** of total Loans and Investments (at cost) in one industry, the SBIC is considered non-diversified and should enter the 4-digit SIC code for its industry specialty in the space provided.

C. STATEMENT OF FINANCIAL POSITION (pages 2C and 3C)

1. General. The Statement of Financial Position is a classified balance sheet. Loans and Investments are listed first in the asset section because they normally account for most of an SBIC's assets. In the liabilities section, long-term debt (to SBA and to others) is listed first for the same reason.

2. Assets.

a. Loans & Investments are assets created as a result of an SBIC providing financial assistance to small businesses. As required under generally accepted accounting principles for investment companies, Loans and Investments are presented at fair value. This is achieved by using a four-column format:

(1)		(2)		(3)		(4)
Cost	-	Unrealized Depreciation	+	Unrealized Appreciation	=	Value

To provide more information about the character of an SBIC's holdings, Loans and Investments are grouped in the following four categories:

(1) Portfolio Securities (lines 1 through 4) are loans, debt securities (which have a loan component, but also include one or more equity features, such as warrants, conversion rights or options), and equity securities of small business concerns. A new or follow-on investment in a small business is reported under this caption unless it clearly fits one of the other categories described below.

(2) Assets Acquired in Liquidation of Portfolio Securities (lines 5 through 7) are securities or other assets the SBIC has acquired as a result of the total or partial liquidation of its investment in a small concern. Liquidation may result from a variety of circumstances, including action taken by the SBIC in order to protect its investment. For example, a small business might default on a loan which is collateralized by real estate. If the SBIC then acquires the collateral through foreclosure, the real estate owned would be reported as an asset acquired (line 6). If the SBIC subsequently sells the real estate and accepts a note for part of the purchase price, the outstanding balance on the note would be reported as a receivable from the sale of an asset acquired (line 5).

(3) Operating Concerns Acquired (line 8) are investments in small businesses over which an SBIC has assumed temporary control in order to protect its investment. For this purpose, "control" means that the SBIC has voting control of the small concern or has the power to control, either alone or in concert with other Licensees and/or Associates. The element of control of an operating business entity distinguishes this category from Assets Acquired.

(4) Notes and Other Securities Received (line 9) are those financial assets an SBIC holds that did not result from providing financing to small businesses. It is sometimes difficult to determine whether securities should be classified here or as Portfolio Securities. In general, this category should include the following: (i) securities acquired for which the SBIC gives no consideration, such as stock received as a dividend in kind from a small concern; (ii) notes or other securities of a small business received by an SBIC in exchange for the securities of another small business; and (iii) notes or other securities received as part of the consideration for the sale of Portfolio Securities. However, if the SBIC sells a Portfolio Security back to the original issuer and receives a new note or other security of the small business, the new security should be classified in Portfolio Securities. Regardless of which line of the Statement of Financial Position is used to report investments, SBA will look at the substance of the investment in determining how it should be treated for overline or other regulatory purposes.

b. Investment in 301(d) Licensee. Although SBICs are generally prohibited from financing relending or reinvesting activities, an investment in a Section 301(d) Licensee is specifically permitted. The investor SBIC may actively participate in the management of the investee. Because of its distinctive characteristics, an investment in a 301(d) Licensee is classified separately (on line 13) from other investments.

An investment in a Section 301(d) Licensee should be reported on the equity method of accounting. SBA recognizes that this accounting treatment may constitute a departure from GAAP if the SBIC is the majority owner of the 301(d) Licensee. The IPA may wish to express a qualified opinion if the departure is considered material.

c. Current Assets consist of cash and assets expected to be either converted to cash or expensed within the Licensee's next operating cycle.

(1) Cash and Cash Equivalents (line 14) should include not only cash, but also short-term, highly liquid investments that meet the criteria for "cash equivalents" established in FASB Statement No. 95. Such investments must be readily convertible to known amounts of cash, and so near maturity that they present insignificant risk of changes in value because of changes in interest rates. In order to qualify under this definition, an investment generally must have an original maturity of three months or less. In a footnote to the financial statements, Licensees should indicate the definition of cash equivalents used in their financial reporting.

(2) Invested Idle Funds (line 15) include any investments, other than portfolio investments, that do not qualify as cash equivalents. Leveraged Licensees may invest idle funds only as permitted by 13 CFR 107.530; non-leveraged Licensees are not subject to any such restrictions. Examples of permitted investments of idle funds for leveraged Licensees that are not cash equivalents include certificates of deposit with a maturity of up to one year and U.S. Treasury securities which mature up to 15 months from the date of the investment.

(3) Receivables are separated into three categories: Interest and Dividends Receivable, Notes and Accounts Receivable, and Receivables from Parent or Other Associates (lines 16, 17 and 18). Line 19, Allowance for Losses, is an aggregate allowance figure for all three of the preceding lines. If the allowance is material, the Licensee should indicate in a footnote how it applies to each category of receivables.

(4) Current Maturities (lines 20-23) include any Loans and Investments expected to mature within the next operating cycle. The total of all amounts reported on these lines should equal the amount shown on line 11. Current maturities of loans should be reported at the amount expected to be realized.

d. Other Assets (lines 26 through 28) are noncurrent assets. In addition to furniture and equipment, assets reported in this section may include real property used as business premises by the Licensee, leasehold improvements, deferred tax assets, noncurrent receivables. In the past, SBICs have also been asked to report unamortized organization costs in this section. However, on April 3, 1998, the American Institute of Certified Public Accountants issued AICPA Statement of Position 98-5, which requires that organization costs be expensed as they are incurred. SBA is conforming its accounting guidelines to the Statement of Position, which is effective for fiscal years beginning after December 15, 1998 (earlier application is encouraged in fiscal years for which financial statements have not been issued).

3. Liabilities.

a. Long-Term Debt (lines 30 and 31) is shown net of current maturities, which are reported in the Current Liabilities section. Notes and debentures which are payable to or guaranteed by SBA are presented separately from long-term debt payable to others.

SBICs that issue debentures guaranteed or purchased directly by SBA pay a “leverage fee” to SBA equal to 3 percent of the face amount of the leverage issued. SBICs issuing SBA-guaranteed debentures that are pooled and sold through a public offering also pay an underwriting fee (currently .5 percent). These fees are debt issue costs which are amortized over the life of the debenture. To accommodate SBIC program requirements, notes and debentures payable to or guaranteed by SBA must be reported on line 30 at their face value; unamortized debt issue costs should **not** be netted against the liability on this line. Licensees may report such costs under "Other Assets."

b. Current Liabilities generally are those for which payment of cash will be required within the Licensee's next operating cycle. This section includes declared dividends as a current liability ("Dividends Payable", line 37); however, accumulated undeclared dividends on 4 percent redeemable preferred stock issued to SBA are not reported in this section (see paragraph 4 below). Short-term Notes Payable/Lines of Credit (line 38) encompasses revolving lines of credit, demand notes, notes with an original maturity of less than one year, and similar short-term liabilities which are not properly classified as current maturities of long-term debt on line 36.

c. Other Liabilities (lines 41 through 43) are noncurrent liabilities other than long-term debt. Liabilities reported in this section may include such items as deferred tax liabilities and funds held in escrow.

4. Redeemable Securities. Any outstanding preferred stock issued to SBA by a Section 301(d) Licensee on or after November 21, 1989 should be shown in this section. All such stock carries a 4% preferred and cumulative dividend. The stock must be redeemed at par value no later than 15 years from the date of issuance, together with any unpaid dividends accrued to the redemption date, regardless of whether such dividends have been declared (see 13 CFR 107.1400 and 107.1410).

a. Carrying Amount. Redeemable preferred stock is initially recorded at its par value on the date of issue. The par value is shown on line 45a of the Statement of Financial Position.

b. <u>Undeclared Dividends.</u> Cumulative undeclared dividends are presented on line 45b as an addition to the carrying amount of redeemable preferred stock. Such dividends are charged against Undistributed Net Realized Earnings (line 54b).

5. Capital. The presentation of the "Capital" section of the Statement of Financial Position is tailored to the SBIC program and is intended to accommodate program objectives and regulatory requirements.

a. <u>Capital Stock</u> (line 47) represents the par or stated value of shares issued by an SBIC (excluding shares issued to SBA).

b. <u>Paid-In Surplus</u> (line 48) represents all other capital contributed by a Licensee's private investors. It does not include capital which has been committed by investors but not yet drawn down by the SBIC.

c. <u>Restricted Contributed Capital Surplus</u> (line 49) is created when a Section 301(d) Licensee repurchases its 3% preferred stock from SBA at a price less than par value and retires the shares. The amount reported on this line is the difference between the par value and the repurchase price. This amount represents an addition to capital, but is reported separately from Paid-in Surplus because it is subject to certain permanent regulatory restrictions. In particular, it does not count towards an SBIC's minimum capital requirement or its eligibility for SBA leverage.

d. <u>3% Preferred Stock</u> (line 51) was issued by Section 301(d) Licensees prior to November 21, 1989, and purchased directly by SBA (see 13 CFR 107.1440). Unlike 4% preferred stock, it has no mandatory redemption date. While 3% preferred stock is considered to be equity, it is not reported as Capital Stock and Paid-in Surplus; rather, it is reported separately because it represents part of the financial assistance obtained from SBA by 301(d) Licensees.

e. <u>Unrealized Gain (Loss) on Securities Held</u> (line 52) is the difference between value and cost of an SBIC's entire portfolio of Loans and Investments, after taking into account estimated future tax effects. An SBIC with net unrealized ***appreciation*** on its Loans and Investments would report Unrealized Gain on Securities Held equal to the net unrealized appreciation, reduced by an estimated tax ***provision***. An SBIC with net unrealized ***depreciation*** on its Loans and Investments would report Unrealized Loss on Securities Held equal to the net unrealized depreciation, which may be reduced by an estimated tax ***benefit*** (provided the criteria given in FASB Statement No. 109 concerning likelihood of realization are satisfied).

Unlike some other types of investment companies, such as mutual funds, SBICs do not report changes in net unrealized appreciation or depreciation in the Statement of Operations. Instead, such changes are recorded directly in the capital account, Unrealized Gain (Loss) on Securities Held.

f. <u>Undistributed Realized Earnings</u> is equivalent to what most corporations would report as "retained earnings". SBA uses an alternate term to avoid confusion with Retained Earnings Available for Distribution, which has a specific meaning in SBA regulations. In general, Undistributed Realized Earnings is the cumulative balance of periodic net investment income (loss) and realized gain (loss) on investments, less dividends or distributions (occasionally, an SBIC may need to make an adjustment which is not reflected in the general formula). To accommodate regulatory requirements, two components of Undistributed Realized Earnings are presented separately:

(1) <u>Non-cash Gains/Income</u> (line 53) includes income or gains that have been recognized in the Statement of Operations, but are not expected to be realized in cash within the next accounting cycle. Examples include: (1) gains on the disposition of securities realized in the form of notes, securities or any other non-cash assets; (2) dividends received in kind ("PIK dividends"); (3) interest income accrued on deferred interest notes, zero coupon bonds or similar instruments; and (4) any other accrued interest converted into a new note or added to the

principal of an existing note (any such interest which was previously included in Undistributed Net Realized Earnings must be reclassified to Non-cash Gains/Income).

Non-cash Gains/Income should always have a credit balance, representing income or gain arising from one of the sources listed in the previous paragraph. There are no circumstances in which an SBIC would report a net "non-cash loss" on line 53. However, it is possible for an SBIC to make a debit entry to Non-cash Gains/Income in its general ledger representing the reversal of a previously recorded credit. For example, if accrued interest income is classified as non-cash and later is deemed to be uncollectible, the write-off of such interest would reduce Non-cash Gains/Income, not Undistributed Net Realized Earnings. A debit entry would also be made to reflect "collection" (i.e., realization in cash) of non-cash gains/income; the credit side of the entry would be to Undistributed Net Realized Earnings.

Non-cash Gains/Income represents realized earnings of an SBIC which have been recognized in the Statement of Operations. They are segregated in the Statement of Financial Position only because they are subject to certain restrictions under SBA regulations, primarily concerning distributions.

(2) Undistributed Net Realized Earnings is a residual, computed by subtracting the balance in Non-cash Gains/Income from Undistributed Realized Earnings. If an SBIC holds Treasury Stock, Undistributed Net Realized Earnings are restricted (i.e., not available for distribution) to the extent of the cost of such Treasury Stock. The restricted amount is shown on a separate line in the Statement of Financial Position (line 54a), while the remaining unrestricted amount is shown on line 54b.

g. Treasury Stock is shown, at cost, as a deduction at the end of the Capital section (line 57).

D. STATEMENT OF OPERATIONS REALIZED (page 4C)

1. General. The Statement of Operations Realized presents net income or loss as the sum of two components: net investment income (loss) and net realized gain (loss) on investments. As discussed under "Unrealized Gain (Loss) on Securities Held" (paragraph 5e of section C, above), changes in net unrealized appreciation or depreciation are not reported in this statement.

2. Net Investment Income (Loss) is the result of operations of an SBIC during the reporting period, exclusive of capital gains and losses. Many of the line items in this section are self-explanatory; instructions are provided below only for those areas where questions tend to arise.

a. Gross Investment Income consists of the operating revenues of the SBIC.

(1) Interest Income earned on Loans and Investments should be shown on line 1; interest on cash equivalents and invested idle funds is shown separately on line 7. Interest income should be accrued in accordance with generally accepted accounting principles and accounting guidelines for the SBIC program. Premiums or discounts associated with debt instruments represent adjustments to interest income which should be amortized over the stated life of the instrument.

Interest income should not be recorded if collection is doubtful. SBICs may choose to handle doubtful interest receivable in either of two ways: (i) make no entry to accrue interest in the regular general ledger accounts and track interest due in a memorandum account; or (ii) accrue the interest and provide a 100% reserve (debit Provision for Losses on Receivables, credit Allowance for Losses). The method used by an SBIC must be disclosed in the footnote summarizing significant accounting policies.

Collection of interest is ***presumed*** to be in doubt when either or both of the following conditions occur: (i) the small concern is in bankruptcy, insolvent, or if there is substantial doubt about its ability to continue as a going concern; or (ii) 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.

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 to conclude that collection is in doubt.

When interest income is not being recorded on one or more loans or debt securities, the SBIC should so indicate in a footnote to the financial statements. For each such investment, the note should include the date at which interest accrual was discontinued. The aggregate amount of interest not accrued because collection is in doubt should also be disclosed.

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, unless the SBIC can provide evidence of collectibility satisfactory to SBA.

(2) Dividend Income (line 2) may be recorded as of the date of record (the date at which ownership of shares is determined for the purpose of paying the dividend), or when actually received. A cash distribution which represents a return of capital should reduce the cost basis of the investment rather than being credited to income.

Stock splits and stock dividends do not result in recognition of income if the SBIC's proportional interest in a small business 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.

Dividends in kind that increase an SBIC’s proportionate ownership interest are recorded as income at the fair value of the shares received. Such income should be classified as Non-Cash Gains/Income in the Statement of Financial Position. If an SBIC 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.

(3) Income (Loss) from Investments in Partnerships/Flow-through Entities (line 3) arises from an investment in an unincorporated small business concern, such as a limited partnership or limited liability company. Investors in such entities typically use the equity method of accounting, under which the cost basis of the investment is adjusted at the end of each accounting period to recognize the investor’s allocated share of earnings or losses, and the amount of the adjustment is included in the net income of the investor. However, this method is not appropriate for investors such as SBICs, which account for the investments at fair value.

Instead of using the equity method, Licensees with portfolio investments in flow-through entities must report these investments at their fair value in the Statement of Financial Position, with the difference between cost and value reflected as unrealized appreciation or depreciation. Any income or loss allocated to the Licensee may, if appropriate, be a factor in the Licensee’s estimate of the investment’s fair value, but such allocations are not recognized as income or loss in the Statement of Operations Realized; furthermore, the Licensee’s cost basis is not adjusted to reflect such allocations. Licensees are to recognize income or loss when realized upon disposition or liquidation of all or part of their ownership interest. Income is also recognized when the Licensee receives a distribution from the investee, other than a return of capital (returns of capital do not result in the recognition of income, but are treated as a reduction of the Licensee’s cost basis).

Licensees which have previously used the equity method to account for investments in flow-through entities, based on previous SBIC accounting guidelines, should contact SBA to determine whether it would be appropriate to implement a change of method for these investments.

(4) Income (Loss) from Investment in Section 301(d) Licensee (line 4) is reported using the equity method of accounting. The equity method, rather than consolidation, must be used even if the Licensee is the majority owner of a Section 301(d) subsidiary.

(5) Fees for Management Services (line 5) are revenues earned by providing services to small concerns as permitted under 13 CFR 107.900.

(6) Application, Closing and Other Fees (line 6) includes income from application and closing fees that Licensees are permitted to charge pursuant to 13 CFR 107.860. Other sources of fee income may include appraisal, investigation and related services rendered to small concerns, and fees for services rendered to other lenders or investors as permitted by section 308(a) of the Small Business Investment Act.

(7) Income from Assets Acquired in Liquidation of Loans and Investments (line 8) represents income, net of related expenses, generated by assets the SBIC has acquired as a result of the total or partial liquidation of its investment in a small concern. Income reported on this line is derived from assets reported on lines 5 and 6 of the Statement of Financial Position.

b. Expenses.

(1) Commitment Fees (line 12) refers to fees paid by the SBIC to a non-SBA lender in order to borrow funds. This line should not be used to expense leverage fees paid to the SBA. Instead, leverage fees paid to the SBA should be treated as deferred financing costs which are capitalized and amortized in accordance with accounting guidelines for the SBIC program. Periodic amortization expense should be included on line 23.

(2) Investment Advisory and Management Services (line 16) may be provided to SBICs by a third party, pursuant to a management agreement approved by SBA. Many SBICs pay a management fee which covers substantially all operating expenses. Such Licensees should report the entire fee on this line; it is not necessary to break down the fee into specific expense categories.

(3) Depreciation and Amortization (line 23) refers to depreciation of fixed assets and amortization of assets such as deferred financing costs. Unrealized depreciation of Loans and Investments is not reported on this line.

(4) Insurance (line 24) does not include expenditures for employee health and life insurance benefits, which should be included in Compensation and Benefits.

(5) Provision for Losses on Receivables (line 27) applies to accounts receivable, interest and dividends receivable, and other "current asset" receivables. SBICs should not record a provision for losses on Loans and Investments on this line. Loans and Investments may be valued downward using the unrealized depreciation accounts or may be charged off, in whole or in part, using a realized loss account. Charge-offs (also referred to as write-offs) should be shown on line 33 of the Statement of Operations Realized.

(6) Miscellaneous Expenses. If the amount shown on line 30 is material, all significant items included in the total should be separately identified in a supporting schedule.

3. Net Realized Gain (Loss) on Investments is the net capital gain or loss of the SBIC. Typically, this line consists of gains and losses resulting from the disposition or write-off of portfolio securities. However, it may also reflect gains and losses on certain idle funds investments, such as Treasury securities. The total (before income taxes) reported on line 33 of the Statement of Operations Realized must agree to the total in the Schedule of Realized Gains and Losses on Loans and Investments (page 14C), which shows details of each gain or loss transaction.

Changes in unrealized appreciation and unrealized depreciation are not reported on this line. Such valuation adjustments are shown as Unrealized Gain (Loss) on Securities Held in the equity section of the Statement of

Financial Position. When an investment is sold, written off, or otherwise disposed of, any entries previously made to record unrealized appreciation or depreciation are reversed, and a realized gain or loss is computed based on the cost of the investment.

4. Income Tax Expense (Benefit), which appears on line 35, applies to both Net Investment Income (Loss) and Net Realized Gain (Loss) on Securities. SBICs should determine this amount in accordance with FASB No. 109.

E. STATEMENT OF CASH FLOWS (pages 5C and 6C)

1. General. The purpose of the Statement of Cash Flows is to show the sources of change in total "cash and cash equivalents" between the beginning and end of a fiscal period. Items classified as cash and cash equivalents for cash flow purposes must be similarly classified on line 14 of the Statement of Financial Position (page 2C). Items classified as "invested idle funds" on line 15 of the Statement of Financial Position are not considered cash equivalents, usually because they have original maturities greater than three months (for example, SBICs are permitted under 13 CFR 107.530 to invest in U.S. government obligations which mature within 15 months of the date of the investment). Cash flows related to these investments should be shown in the "Investing Activities" section of the Statement of Cash Flows.

The definition of "cash equivalents" used by an SBIC should fall within the guidelines of FASB Statement No. 95 (see paragraphs 8-10). The SBIC's policy concerning the definition and classification of cash equivalents should be disclosed in the notes to the financial statements.

The Statement of Cash Flows calls for SBICs to derive cash flows from operating activities using both the direct and indirect methods. Use of the direct method is "strongly encouraged" by FASB Statement No. 95 and is required on Form 468.

2. Supplemental Disclosures. Paragraph 32 of FASB Statement No. 95 requires that information about noncash investing and financing be disclosed. SBICs may provide such disclosures, if any, in the form of either a narrative or a supplementary schedule.

3. Operating Activities vs. Investing Activities. The format of the Statement of Cash Flows calls for cash receipts representing investment income--such as interest or dividends received--to be shown as operating cash flows. In contrast, cash receipts representing the proceeds from disposition of investments are shown as cash flows from investing activities. Cash disbursements to portfolio concerns in the form of new loans or equity investments are treated as investing activities, as are cash receipts representing repayments of loan principal or redemption of equity interests.

4. Operating Activities (lines 1 through 15). This section shows operating cash flows of the Licensee using the direct method. The presentation of operating cash flows based on the more conventional indirect method is found in lines 42 through 58 on page 6C. In general, under the direct method, cash flows are derived by converting income and expense accounts, as shown in the Statement of Operations Realized, from an accrual basis to a cash basis. For example, cash interest received from portfolio concerns (line 1 of the Statement of Cash Flows) should be determined as follows:

(1) Interest income from portfolio concerns recognized during the fiscal year (line 1 from the Statement of Operations Realized); ***plus***
(2) Accrued interest receivable from portfolio concerns at beginning of fiscal year; ***minus***
(3) Accrued interest receivable from portfolio concerns at end of fiscal year.

Cash interest and dividend payments received from portfolio concerns should be reported on lines 1 and 2, respectively, of the Statement of Cash Flows. Line 3 ("Other Income Received from Portfolio Concerns") is intended to accommodate other cash distributions which represent income to the Licensee, such as profit distributions made by a limited partnership in which the Licensee has invested. Cash distributions which represent a return of the Licensee's original investment should not be shown on this line (see line 17 under Investing Activities).

The amount shown on line 5 should include cash interest received on any investments other than investments in portfolio concerns. Such investments are reported in the Statement of Financial Position (page 2C) on either line 14 (as cash equivalents) or line 15 (as invested idle funds).

The operating cash outflows (lines 8 through 14) are aggregated into much broader categories than the expenses shown in the Statement of Operations Realized. Licensees should group expenses into the cash outflow categories provided before converting them from the accrual to the cash basis.

5. Investing Activities (lines 16 through 25). Items shown in this section relate primarily to the making of loans or equity investments and their subsequent repayment, redemption, or disposition to a third party.

Cash disbursed to portfolio concerns in the form of equity investments should be shown on line 21 ("Purchase of Portfolio Securities"). Loans disbursed to portfolio concerns should be shown on line 22 (“Loans to Portfolio Concerns”).

Examples of "other" cash outflows in this section, which should be shown on line 24, may include such items as capital expenditures for the purpose of improving assets acquired in liquidation of portfolio securities, or purchase of property or equipment for use in the Licensee's operations.

Lines 23 and 19 reflect the making and liquidation of short-term idle funds investments, respectively. An SBIC may show these transactions as either (1) separate gross amounts of idle funds investments for inflows and outflows or (2) the net inflow or outflow resulting from idle funds investment activity.

Loan principal payments received from portfolio concerns should be shown on line 16. Cash received from portfolio concerns for the purpose of redeeming equity interests held by the Licensee should be shown on line 17.

Cash received upon sale of portfolio assets to a third party should be shown on line 18. Such amounts should represent the net cash proceeds of the sale (i.e., net of any required cash outlays directly associated with the transaction).

"Other" cash inflows (line 20) may include cash proceeds from disposal of property or equipment, or from disposition of assets acquired in liquidation of portfolio securities.

6. Financing Activities (lines 26 through 38). This section provides information about debt financing and equity capital obtained by the Licensee, and about repayments, redemptions and returns to investors. As a general rule, if a Licensee has replaced one source of financing with another, the repayment or redemption of the old funds should be shown as a cash outflow and the new funds obtained should be shown as a cash inflow, rather than showing only the net effect.

"Cash inflows" in this section (lines 26 through 29) represent the net cash proceeds from borrowing or from selling equity interests. There are separate lines for debt financing obtained by issuing SBA-guaranteed debentures (line 26) and by borrowing from non-SBA lenders (line 27). Funds obtained through stock purchases or other capital contributions by investors other than SBA should be shown on line 28. In all cases, the amounts shown should be the net proceeds after fees and expenses.

Leverage fees paid to SBA in order to obtain financing through the issuance of SBA-guaranteed debentures are shown as a cash outflow on line 30.

Repayments of principal on SBA-guaranteed and non-SBA borrowing are shown as cash outflows on lines 31 and 32, respectively. If a debt instrument is rolled over at maturity, or is otherwise refinanced, Licensees should show the repayment and the issuance of a new debt instrument as separate items.

Redemptions of stock are shown in three separate categories: Redemption of 4 percent preferred stock held by SBA (line 33); redemption of 3 percent preferred stock held by SBA (line 34); and redemption of any other stock of the Licensee (line 35). The first two categories apply to Section 301(d) Licensees only.

A number of Section 301(d) Licensees have participated in the 3 percent preferred stock repurchase program, which allows SSBICs to buy back their stock from SBA at 35 percent of par value (participants in the pilot program may have paid a slightly higher or lower price). Companies which completed the repurchase transaction during the past fiscal year should show a redemption of 3 percent preferred stock at the discounted price paid. Any Licensee that gave SBA a note for all or part of the repurchase price should identify the amount of the note as a cash inflow in the Financing Activities section, using line 29.

Dividends paid to shareholders (including SBA) should be shown on line 36. Dividends paid in a form other than cash (such as shares of portfolio concerns distributed in-kind) should not be included on this line, but should be included in the supplemental disclosures of noncash investing and financing activities required under FASB No. 95 (see paragraph 32).

7. Increase (decrease) in cash and cash equivalents (line 39). This line is the sum of lines 15, 25 and 38, the net cash provided by or used in operating, financing and investing activities, respectively. This amount is added to the balance of cash and cash equivalents at the beginning of the reporting period (line 40) to compute the ending balance of cash and cash equivalents (line 41).

8. Cash and cash equivalents at end of period (line 41). The result on this line must be the same as the amount reported as Cash and Cash Equivalents in the Statement of Financial Position (page 2C, line 14).

9. Reconciliation of net income (loss) to net cash provided by (used in) operating activities (page 6C, lines 42 through 58). The final section of the Cash Flow Statement shows the derivation of operating cash flow using the indirect method. This method uses net income or loss from the Statement of Operations Realized as the starting point and adjusts for noncash revenues and expenses and changes in the balances of operating asset and liability accounts. Licensee should be familiar with this format since it is typically used in all GAAP cash flow statements.

The net result of the reconciliation is net cash provided by (used in) operating activities. This amount, shown on line 58, must be the same as the amount shown on page 5C, line 15 (net cash from operating activities determined using the direct method).

Line 42 ("Net Income (Loss)") should be the same as the amount shown on page 4C, line 39.

The reconciling items (lines 43 through 48) are used to adjust net income or loss for the effects of noncash revenues and expenses. Depreciation and Amortization corresponds to line 23 of the Statement of Operations Realized (page 4C); Provision for Loss on Accounts Receivable to line 27; Provision for Deferred Income Taxes to the noncurrent portion, if any, of line 35; (Income) Loss from Investments in Partnerships/Flow-Through Entities to any ***noncash*** amounts on line 3; and Realized (Gains) Losses on Investments to line 33.

The changes in operating assets and liabilities shown on lines 49 through 57 should, in most cases, be the difference between the beginning and ending balance sheet amounts. However, if the balances in these accounts were affected by non-cash transactions, the effect of such transactions must be eliminated. For example, if interest receivable is reduced by $1,000 during the fiscal year because the accrued interest has been converted to a loan receivable, then a comparison of the beginning and ending interest receivable balances will yield a result on line 49 that is $1,000 too high.

F. STATEMENT OF STOCKHOLDERS' EQUITY (pages 7C and 8C)

1. General. These schedules roll forward, from the beginning to the end of the fiscal period, the balances in three major components of stockholders' equity: Capital Stock and Paid-in Surplus, Undistributed Realized Earnings, and Unrealized Gain (Loss) on Securities Held.

2. Capital Stock and Paid-in Surplus (Part I). The Capital Stock column should show any changes during the period in the aggregate par value or stated value of shares outstanding. Any other results of equity transactions with stockholders should be shown in the Paid-in Surplus column. The ending balances on line 7 of this schedule must agree with the corresponding amounts on lines 47 and 48 of the Statement of Financial Position (page 3C).

a. <u>Capitalization of Retained Earnings Available for Distribution</u> (line 2d). Subject to certain conditions, an SBIC is permitted to “capitalize” all or part of its Retained Earnings Available for Distribution, as defined in 13 CFR 107.50. This means that the SBIC reduces Undistributed Net Realized Earnings and increases Paid-in Surplus, thereby increasing its permanent capital base. In order to be eligible for this transaction, an SBIC must have positive Retained Earnings Available for Distribution and must have paid any amounts due to SBA on a priority basis (such as dividends on 3% or 4% preferred stock). For all regulatory purposes, capitalization of Retained Earnings Available for Distribution constitutes a distribution to the Licensee’s non-SBA investors.

3. Undistributed Realized Earnings (Part II). The two components of Undistributed Realized Earnings, Non-cash Gains/Income and Undistributed Net Realized Earnings, are discussed in the instructions for the Statement of Financial Position (page 3C).

a. <u>Gain on appreciation of securities distributed in kind</u> (line 2c). When an SBIC distributes appreciated securities of a small business concern to its shareholders, it must first write up the securities to fair market value (see Accounting Principles Board Opinion No. 29). Any gain recognized in connection with such an event should be shown on this line in the Undistributed Net Realized Earnings column.

b. <u>Dividends--Stock</u> (line 5b) refers only to stock of the SBIC, not to the distribution of shares of small business concerns held by the SBIC. Stock dividends do not affect the total equity of the SBIC, only the allocation of equity between Undistributed Realized Earnings and Capital Stock and Paid-in Surplus.

c. <u>Dividends--In-kind</u> (line 5c) are distributions of the securities of small business concerns (or other property of the SBIC). Dividends in kind are nonreciprocal transfers of nonmonetary assets. They should be recorded at the fair value of the assets transferred, and a gain or loss on disposition should be recognized by the SBIC. On line 5c, the fair value of the in-kind distribution should be reported as a deduction in the Undistributed Net Realized Earnings column.

d. <u>Collection of Non-cash Gains/Income</u> (line 8). This line shows the reclassification of amounts out of Non-cash Gains/Income and into Undistributed Net Realized Earnings as cash is received. The total of the two columns should always be zero.

Non-cash gains may arise when an SBIC sells securities and receives a note as part of the sale price. As the note is repaid, the SBIC receives some cash which represents a collection of non-cash gains, some which represents recovery of the cost of the securities sold, and some which represents interest income. If cash is received in a series of periodic payments, the SBIC may treat a portion of each payment as a collection of non-cash gains. To determine the amount which may be treated as such a collection, the SBIC must first determine the percentage of the face amount of the note which represents gain on sale of securities. This percentage is then multiplied by the portion of the payment which applies to the principal of the note. However, if collection is doubtful, this allocation method should not be used. Instead, SBICs should recover the full cost of the securities sold before reporting any collections of non-cash gains.

4. Unrealized Gain (Loss) on Securities Held (Part III). This schedule summarizes changes in the valuation of Loans and Investments during the reporting period and shows the estimated future tax effects associated with net unrealized appreciation or depreciation.

a. Net Unrealized Appreciation (Depreciation) at Beginning of Period (line 1). This amount should equal the sum of the amounts reported on line 10, columns 2 and 3, of page 2C of the Form 468 filed for the period immediately preceding the current period. In other words, it is the SBIC's beginning net unrealized appreciation or depreciation without regard to any estimated tax effects.

b. Increase (Decrease) in Unrealized Appreciation (line 2) shows changes in unrealized appreciation of Loans and Investments, broken down into the same categories that appear in the Statement of Financial Position. For Portfolio Securities (line 2a), such changes are further broken down by their source. Increases in unrealized appreciation (item i) result from upward valuation of securities by the Board of Directors, while decreases due to revaluation (item ii) result from downward valuations of previously appreciated securities. Decreases due to sale of securities (item iii) occur when an appreciated investment is sold and the unrealized appreciation is reversed. Similarly, decreases due to write-off of securities (item iv) occur when an appreciated investment is written off (an event which should occur rarely, if ever).

The explanations for increases and decreases in unrealized depreciation (line 5) are similar, but the changes flow in the opposite direction.

c. Estimated future tax expense (benefit) of net unrealized appreciation (depreciation) (line 8) should be recognized by SBICs in accordance with FASB Statement No. 109, "Accounting for Income Taxes". The unrealized appreciation or depreciation is then reported net of such tax effects, on this schedule (line 9) and on the Statement of Financial Position (line 52) as Unrealized Gain (Loss) on Securities Held.

FASB Statement No. 109 departs from earlier pronouncements by permitting current recognition of tax benefits which are expected to be realized in the future, provided certain criteria concerning the likelihood of realization are met. SBICs should pay careful attention to these criteria in determining whether a tax benefit associated with net unrealized depreciation may be recognized.

G. RETAINED EARNINGS AVAILABLE FOR DISTRIBUTION (page 9C, Part I)

Retained Earnings Available for Distribution is the maximum amount that an SBIC may distribute to investors (excluding permitted returns of capital) or transfer to private capital (except as otherwise approved by SBA). For most SBICs, Retained Earnings Available for Distribution is computed by subtracting unrealized depreciation on Loans and Investments from Undistributed Net Realized Earnings (excluding any restricted amounts). Unrealized depreciation and unrealized appreciation are *not* netted in this computation. For SSBICs which have issued 4% preferred stock purchased by SBA, there is one additional element in the computation. Because undeclared 4% dividends are accrued and charged against Undistributed Net Realized Earnings, they must be added back to determine Retained Earnings Available for Distribution. No distributions may be made to any shareholder other than SBA until all accrued 4% dividends have been paid in full.

As discussed in the instructions for the Statement of Stockholders' Equity (page 7C), an SBIC with positive Retained Earnings Available for Distribution has the option of capitalizing such earnings by reclassifying them as Paid-in Surplus. However, before capitalizing Retained Earnings Available for Distribution, an SBIC must have paid any amounts due to SBA on a priority basis (such as dividends on 3% or 4% preferred stock). For all regulatory purposes, capitalization of Retained Earnings Available for Distribution constitutes a distribution to the Licensee's non-SBA investors.

H. REGULATORY AND LEVERAGEABLE CAPITAL (page 9C, part II)

1. General. The capital contributed to an SBIC by its investors (other than SBA) is presented on line 1 of this schedule. This amount, which must agree with the aggregate amount shown as Capital Stock and Paid-in Surplus on the Statement of Financial Position, serves as the starting point for the regulatory adjustments presented in this schedule.

2. Regulatory Capital (line 6) is the basis for a number of regulatory computations, the most important of which are determining an SBIC's overline limitation and its capital impairment percentage. The determination of Regulatory Capital may require both additions to and deductions from Capital Stock and Paid-in Surplus.

a. Unfunded binding commitments from Institutional Investors (line 2). Investor commitments may be included in Regulatory Capital if they satisfy the criteria set forth in 13 CFR 107.50, in the definitions of "Institutional Investor," "Private Capital" and "Regulatory Capital. An SBIC that wants to include its commitments in Regulatory Capital is required to submit a Capital Certificate to SBA.

b. Organizational expenses not approved by SBA (line 3a). When an SBIC is licensed, SBA makes a determination as to the reasonableness of the costs incurred to organize the company. If the total expense is determined to be reasonable, no regulatory deduction is required. If, however, some amount of organizational expense is considered excessive by SBA, such amount must be deducted from Regulatory Capital on line 3a.

c. Capital stock issued for non-cash assets (line 3c). The issue price of shares issued in exchange for non-cash assets contributed to an SBIC is generally excluded from Regulatory Capital, but there are two exceptions to this general rule. A regulatory deduction is not required: (1) once a contributed non-cash asset is sold for cash; or (2) if SBA approves the contributed non-cash asset for inclusion in Regulatory Capital. SBA approval is generally granted when the contributed asset consists of an investment in a small business concern that meets all SBIC program eligibility requirements.

3. Leverageable Capital (line 9) is the amount used to determine an SBIC's maximum eligibility for SBA leverage. It is determined by subtracting the following items from Regulatory Capital:

a. Unfunded binding commitments from Institutional Investors (line 6). The amount shown as a deduction on this line should be the same as the amount shown as an addition on line 2.

b. Non-cash assets included in Regulatory Capital, other than eligible investments in Small Concerns (line 8). An SBIC which has issued shares in exchange for non-cash assets may include the issue price of such shares in its Leverageable Capital only if the contributed asset consists of an investment in a small business concern that meets all SBIC program eligibility requirements. Other types of non-cash assets cannot be included in Leverageable Capital, even if SBA has approved them for inclusion in Regulatory Capital.

4. Adjustments to Regulatory Capital for Capital Impairment and Overline Purposes (Part IIa). This section applies only to Licensees with one or both of the following conditions: (1) the Licensee is an SSBIC that has completed the repurchase of its 3% preferred stock from SBA; or (2) the Licensee wants to increase its overline limitations by adding net unrealized gains on certain marketable securities to Regulatory Capital, subject to the conditions set forth in 13 CFR 107.740(c).

SSBICs that have repurchased 3% preferred stock from SBA should show the Restricted Contributed Capital Surplus created by the repurchase transaction on line 12. Restricted Contributed Capital Surplus (the difference between the par value of the preferred stock and the repurchase price) is considered an addition to Regulatory Capital for both capital impairment and overline purposes.

Licensees wishing to increase their overline limits pursuant to 13 CFR 107.740(c) should show their net unrealized gains on marketable securities on line 13. A supporting schedule providing detailed information about each marketable security must be attached (see footnote (2) on page 9C for instructions). The SBIC's Retained Earnings Available for Distribution must be positive at the time the increased limit is established, but maintaining a positive balance is not required to keep the increased limit in effect. However, if the net unrealized gains used to compute the increased limit are more than 30 percent below their original level on the first business day of any calendar quarter, and remain so for the next 30 days, the SBIC's overline limit will be reduced accordingly. The SBIC will be required to cure any resulting overline financings within 30 days by increasing its Regulatory Capital or reducing the size of the financings to comply with its new overline limit.

I. SCHEDULE OF COMMITMENTS (page 10C)

This schedule shows commitments made by the SBIC to provide financial assistance to small business concerns. A commitment must be evidenced by a written agreement between the SBIC and the small business concern. Both the amount of financial assistance to be provided and the date by which it is to be provided must be either fixed or determinable under the terms of the agreement. The agreement may include reasonable conditions to be satisfied before the SBIC becomes obligated to fund the commitment (but such conditions may not include completion of actions that are under the control of the SBIC).

a. Loan, Debt, or Equity (column 5). Indicate the type of financing the Licensee has committed to provide. "Loans" have no equity potential, while "debt" encompasses both a loan component and one or more equity features, such as options, warrants or conversion rights.

b. New investment or follow-on (column 6). Indicate whether fulfillment of the commitment would represent the SBIC's initial financing of the small business concern or would follow earlier investments (of any type) in the same company.

c. Classification of existing investment (column 7). If the SBIC already has an investment in the small business concern, indicate how that investment is classified in the "Loans and Investments" section of the Statement of Financial Position (see page 2C, lines 1 through 8).

J. SCHEDULE OF GUARANTEES (page 11C)

This schedule shows guarantees by the SBIC of third-party debt incurred by small business concerns. Such guarantees are contingent liabilities of the SBIC.

a. Name of Guaranteed Party (column 5). Give the name and location (city and state) of the bank or other lender which has received the guarantee.

b. Collateral (column 6). If the SBIC's guarantee is secured by collateral, provide a specific description. For example, if the collateral is investment securities held by the SBIC, give the name of the company and number of shares.

c. Underlying Obligation of Small Business (column 7). Describe the debt which the SBIC has guaranteed. The description should summarize the significant terms of such debt.

K. SCHEDULE OF LOANS AND INVESTMENTS (Schedule 1, page 12C)

This schedule provides information about all financings extended to small business concerns and any other events which have an effect on the SBIC's aggregate amount of Loans and Investments (line 10 of the Statement of Financial Position, page 2C). Although the primary purpose of the schedule is to present supporting detail for the ending balance of Loans and Investments, it is also used as a source of information concerning investment activity during the reporting period. Therefore, any investment which had an outstanding balance at the beginning period should be included on the schedule, even if its ending balance is zero. Similarly, if an SBIC acquires and disposes of an investment within the period, this activity should be reported.

All Loans and Investments related to a single small business concern should be grouped together, and small business concerns should be listed in alphabetical order.

1. Description of Investment (column 1). The electronic reporting software provides a number of fields where specified information about each loan or investment is to be entered. In addition, there are various "memo boxes" which allow you to enter descriptive comments. These instructions will walk you through entering the relevant data for each investment. However, please note that the order in which these items appear in the software is somewhat different. For each loan or investment, the following identifying information must be shown:

- Name of the small business concern
- Location (street address, city, state and zip code)
- 4-digit SIC code
- Employer identification number (if the small concern does not yet have a number, indicate "applied for")

a. Loans. Provide the following information:
- Original amount of loan
- Date of loan
- Interest rate
- Maturity date
- Repayment terms (e.g., monthly P&I, interest only, balloon payment; include key dates and dollar amounts)
- Description of collateral (if none, indicate "unsecured")

b. Debt. Provide the same information required for Loans, as well as the following:
- Description of equity features (include potential ownership percentage)

c. Equity. Provide the following information:

For stock:
- Type of shares (e.g., common, preferred)
- Date of investment
- Amount of original investment
- Ownership percentage – total equity (actual)
- Ownership percentage – total voting shares (actual)

For interests in unincorporated concerns (limited partnerships or limited liability companies):
- Date of investment
- Amount of investment
- Ownership percentage (actual)
- SBIC's percentage share of profits/losses if different from ownership percentage (use the "Equity Features" memo field to show this information)

For warrants, options or other rights:
- Date of investment or acquisition
- Cost (if any)
- Expiration date (use the "Equity Features" memo field)
- Exercise price (use the "Equity Features" memo field)
- Potential ownership percentage (use the "Equity Features" memo field)

d. Receivables from sale of assets acquired. These receivables are typically in the form of notes and should be reported under the name of the maker. Provide the following information:
- Name of portfolio concern from which assets were acquired (use the "Other Comments" memo field)
- Original amount of note
- Date of note
- Interest rate
- Due date

e. Assets acquired in liquidation of portfolio securities. SBICs should report these assets under the name of the small business concern from which the assets were acquired. Provide the following information:
- Description of assets acquired (use the "Collateral" memo field)
- Date acquired (use the "Date of Investment" field)
- Cost basis at date of acquisition (use the "Amount" field)
- Description of any related liabilities assumed (use the "Other Comments" memo field)

f. Operating concerns acquired. Provide the following information:
- Date acquired (use the "Date of Investment" field)
- Cost basis at date of acquisition (use the "Amount" field)
- Description of operating concern (use the "Other Comments" memo field)

g. Notes and other securities received. SBICs should report notes under the name of the maker, and other securities under the name of the issuer. For notes or other securities received as a result of the sale or exchange of an investment in a portfolio concern, also provide the name of the portfolio concern in which the original investment was made (use the "Other Comments" memo field). Indicate how the notes or other securities were acquired (e.g., sale, exchange, stock dividend). Provide details of each note or other security using the guidelines in the preceding paragraphs for investments of the same type.

2. Portfolio characteristics (column 2). This column provides certain information about the portfolio which is used by SBA for monitoring and analytical purposes.

a. Delinquencies (column 2(a)). Put a "D" in this column if the financing has become delinquent as to principal and/or interest. A financing is considered delinquent when a scheduled payment of interest and/or principal is more than 30 days past due. Any financing identified as delinquent in this column should also appear in the Schedule of Delinquent Loans and Investments (page 16C).

b. Participations and joint financings (column 2(b)). Put a "P" in this column if the financing is a participation or a joint financing. These terms are defined in the instructions for Schedule 5 (page 17C) of Form 468.

c. <u>Smaller Enterprises</u> (column 2(c)). Put an "S" in this column if financing was extended to a "Smaller Enterprise" pursuant to 13 CFR 107.710. This regulation requires all Licensees to devote a percentage of their investment activity to businesses which meet certain special size standards. Only financings made after April 25, 1994 may qualify as Smaller Business financings.

Licensees are required to achieve a specific percentage of Smaller Enterprise financings as of the close of their first ***full*** fiscal year beginning on or after April 25, 1994. In general, licensees are required to invest at least 20 percent of their total dollar amount of financings in Smaller Enterprises. However, some licensees may be required to provide a higher percentage of Smaller Enterprise financings (see 13 CFR 107.710(c)), while new licensees are required to meet a Smaller Enterprise financings percentage of at least 10 percent for their first full fiscal year and 20 percent every fiscal year thereafter.

3. Security Type (column 3). This column provides information about the composition of the portfolio.

a. <u>Classification</u> (column 3(a)). Using one of the following letter codes, indicate the category in which each financing is included in the "Loans and Investments" section of the Statement of Financial Position (page 2C, lines 1 through 10):

L = Loans
D = Debt Securities
E = Equity Securities
R = Receivables from sale of assets acquired in liquidation of portfolio securities
AA =Assets acquired in liquidation of portfolio securities
OC = Operating concerns acquired
NS = Notes and other securities received

See the instructions for the Statement of Financial Position for information about each of the above investment classifications.

b. <u>Marketability</u> (column 3(b)). Categorize the marketability of each financing using one of the following letter codes:

P = Publicly Traded and Marketable, as defined in 13 CFR 107.50. "Publicly Traded and Marketable" refers only to investments which can be sold without restriction (or are salable within 12 months pursuant to Rule 144 of the Securities Act of 1933). Securities which are encumbered (for example, those pledged to a lender) are not Publicly Traded and Marketable, regardless of whether or not their sale is restricted under Federal securities laws.
PR = Public--Restricted.
PE = Public--Encumbered.
NP = Nonpublic.

c. <u>Special purpose investment categories</u> (column 3(c)). Licensees with SBA leverage may be required to maintain certain types of investments in certain amounts or as certain percentages of their investment portfolios. If a Licensee is not subject to any of these requirements, this column should be left blank. The following categories of investments are to be identified:

(1) <u>Equity Capital Investments</u> (indicate by entering "EC" in column 3(c)). **Issuers of SBA-guaranteed Participating Securities** are required to make Equity Capital Investments in an amount at least equal to the amount of Participating Securities issued. Equity Capital Investments are defined in 13 CFR 107.50.

(2) Venture Capital Financings (indicate by entering "V" in column 3(c)). **Licensees with SBA leverage in excess of 300 percent of Leverageable Capital and SSBICs with 3% or 4% Preferred Stock in excess of 100 percent of Leverageable Capital ("second tier preferred stock")** are required to maintain certain percentages of their portfolios in Venture Capital Financings (as defined in 13 CFR 107.1160(f)) as long as the leverage remains outstanding. Venture Capital Financings must equal at least 65 percent of Total Funds Available for Investment for regular SBICs and at least 30 percent of Total Funds Available for Investment for specialized SBICs. Specialized SBICs with 3% or 4% Preferred Stock in excess of 100 percent of Leverageable Capital must maintain Venture Capital Financings in an amount at least equal to the second tier preferred stock outstanding.

4. Cost at Beginning of Period (column 4). The amount in this column should be the same as the ending cost shown on Schedule 1 of the Form 468 filed for the fiscal year end immediately preceding the current reporting period. "Cost" in this column refers not necessarily to original cost, but to the carrying amount of an investment exclusive of any valuation adjustments (i.e., unrealized appreciation or unrealized depreciation).

5. Additions/Deductions (columns 5 and 6). Any change during the reporting period in the carrying amount of an investment (exclusive of changes in unrealized appreciation or unrealized depreciation) should be reported in column 5 and explained in column 6.

Examples of additions include:

- new investments in small business concerns (e.g., initial purchase of Series A preferred stock)
- follow-on investments of similar type (e.g., purchase of additional shares of Series A preferred stock)
- interest receivable added to outstanding principal balance

Examples of deductions include:

- sale or exchange of investments
- repayments of principal or returns of capital
- full or partial write-off of investments

Changes in the form of an investment should also be reported on Schedule 1. Such changes may involve restructuring the terms of debt financings, forgiving interest and/or principal, exchanging debt for equity, or exercising various contractual rights.

6. Cost at End of Period (column 7) is the sum of the amounts in columns 4 and 5. The sum of all amounts entered in this column should equal Total Loans and Investments at cost in the Statement of Financial Position (page 2C, line 10, column 1).

7. Unrealized Appreciation (Depreciation) (column 8) shows any upward or downward valuation adjustments determined by the SBIC's Board of Directors. The sum of all amounts entered in this column should equal the net unrealized appreciation or depreciation on Total Loans and Investments in the Statement of Financial Position (page 2C, line 10, column 2 plus column 3).

8. Fair Value as Determined by Board of Directors (column 9) is the sum of the amounts in columns 7 and 8. The sum of all amounts entered in this column should equal Total Loans and Investments at value in the Statement of Financial Position (page 2C, line 10, column 4).

L. SUMMARY OF LOANS AND INVESTMENTS (Schedule 1A, page 13C)

The purpose of this schedule is to show that the detail reported in Schedule 1 properly supports the totals reported in the Loans and Investments section of the Statement of Financial Position. The electronic reporting software will sum the amounts entered in columns 4, 5, 7, 8, and 9 of Schedule 1 for each security type, based upon the letter code you entered in column 3(a) of Schedule 1, and enter the totals in Schedule 1A. These totals must agree with the corresponding lines of the Statement of Financial Position. If the totals do not agree, you will see an error box on the screen. This error box will show the totals currently given in the Summary of Loans and Investments and the corresponding lines of the Statement of Financial Position. You can then use this check list to identify and resolve any differences.

M. SMALLER ENTERPRISE FINANCINGS (Schedule 1B, page 13C)

The purpose of this schedule is to determine whether the SBIC is in compliance with the provisions of 13 CFR 107.710 which require the SBIC achieve a specified percentage of financings to smaller businesses. The information on smaller enterprise financings (line 1) and total financings (line 2) in this schedule must be entered by the Licensee; it will no longer be filled in automatically by the electronic reporting software. The amount on line 1 represents the cumulative dollar amount of Smaller Enterprise financings extended between April 25, 1994 and the close of the reporting fiscal year. The amount on line 2 represents cumulative total financings extended during the same period. The electronic reporting software will calculate the percentage of total financings extended to smaller enterprises on line 3. The definition of a Smaller Enterprise can be found in 13 CFR 107.710(a).

N. SCHEDULE OF REALIZED GAINS AND LOSSES ON LOANS AND INVESTMENTS (Schedule 2, page 14C)

This schedule provides supporting detail for Net Realized Gain (Loss) on Investments Before Income Taxes, as reported on the Statement of Operations Realized (page 4C, line 33).

1. Security Type and Transaction Type (columns 2 and 3). Complete these fields by entering the appropriate letter codes from footnotes (1) and (2) at the bottom of the schedule. In column 3 (Transaction Type), "exchange" means a transaction in which the SBIC has received one or more non-monetary assets as defined under Accounting Principles Board Opinion No. 29. Transactions identified as charge-offs in this column may be either full or partial. Charging off an investment, in comparison with recording unrealized depreciation, represents a stronger judgment concerning loss of value. However, it is not necessary to have a definitive event (such as bankruptcy) in order to charge off an investment.

2. Cost (column 5) means the carrying amount of the investment, exclusive of any unrealized appreciation or unrealized depreciation. It is the basis used in the computation of realized gain or loss.

3. Net Realized Gain (Loss): Cash and Non-cash (columns 7 and 8). The events which may give rise to non-cash gains are discussed under "Undistributed Realized Earnings" in the instructions for the Statement of Financial Position (page 3C). In general, only positive amounts may be classified as non-cash items. However, it is possible to have a negative amount classified as non-cash if it represents the reversal of a previously recorded non-cash gain which is not expected to be collected.

When an SBIC sells an investment and accepts a note for the entire sale price, the entire gain is classified as non-cash. If both cash and a note are received, the SBIC should determine what percentage of the sale price is represented by each, and allocate the total gain between cash and non-cash according to the same percentages.

4. Name and address of purchaser (column 9). If the security sold was publicly traded, indicate "Public Sale" in this column. If a loss was incurred as the result of a charge-off, leave this column blank.

O. SCHEDULE OF NON-CASH GAINS/INCOME (Schedule 3, page 15C)

This schedule provides an analysis of the activity and supports the ending balance in Non-Cash Gains/Income (reported on the Statement of Financial Position, page 3C).

1. Description of non-cash gains/income (column 2). A summary description of items treated as non-cash gains/income appears in footnote (1) at the bottom of the schedule. For a more detailed description, see the instructions for the Statement of Financial Position.

2. Additions during period (column 4). For information concerning the allocation of gains on a transaction between cash and non-cash, see the instructions for columns 7 and 8 of the Schedule of Realized Gains and Losses on Loans and Investments (Schedule 2, page 14C).

3. Collections during period (column 5). For information on the treatment of cash received, see "Collections of non-cash gains/income" in the instructions for page 7C, the Analysis of Stockholders' Equity (Part II, Undistributed Net Realized Earnings).

4. Balance at end of period (column 6). The total in column 6 (Balance at End of Period) must equal the amount reported as Non-cash Gains/Income in the Statement of Financial Position (page 3C, line 53).

5. "Includible Non-cash Gain" for Capital Impairment purposes (column 7). Licensees generally cannot treat non-cash gains/income as realized earnings for the purpose of computing their capital impairment percentages. Only Includible Non-cash Gains may be counted for this purpose. These are defined as non-cash gains realized in the form of Publicly Traded and Marketable securities or investment grade debt.

P. SCHEDULE OF DELINQUENT LOANS AND INVESTMENTS (Schedule 4, page 16C).

This schedule should show delinquency information for each loan or investment identified as delinquent in Schedule 1 (page 12C). Any loan which has principal and/or interest payments ***more than 30 days past due*** must be included in Schedule 4.

1. Outstanding Principal Balance (column 2) should be the same amount shown in Schedule 1 as "Cost at End of Period" (page 12C, column 7).

2. ***Days Past Due*** (column 4) is determined based on the "oldest" missed payment.

3. Fair Market Value of Collateral (column 11) should reflect the net realizable value of the collateral after reasonable selling expenses.

Q. SCHEDULE OF PARTICIPATIONS AND JOINT FINANCINGS (Schedule 5, page 17C).

1. Definitions.

a. <u>Participation</u> means either of the following: (1) an undivided interest shared with one or more other **non-Associated lenders or investors (both SBICs and non-SBICs)** in a note, debenture, certificate of stock, or other instrument evidencing a loan to, or equity financing of, a small business concern; or (2) a contemporaneous co-investment with one or more other **non-Associated SBICs**, where each investor holds a separate instrument. **Any loan or investment made in concert with an Associate of the Licensee should be identified as a Joint Financing (see next paragraph).**

b. Joint Financing means financing provided to a small business concern contemporaneously with, or within six months before or after, the provision of financing to the same small business concern by an Associate of the SBIC. The term "Associate" is defined in 13 CFR 107.50. Joint financing with Associates are subject to certain restrictions set forth in 13 CFR 107.730(d).

2. Participations and Joint Financings Initiated by Licensee (Part I). All participations and joint financings for which the Licensee was the lead investor should be reported in this section.

a. Type of Investment (column 2). Use the letter codes given to indicate whether the investment is a Loan (L), Debt Security (D) or Equity Security (E).

b. Participation or Joint Financing (column 3). Use the definitions in paragraph 1 above to identify either a Participation (P) or a Joint Financing (J).

c. Total amount of financing--original cost (column 4). This amount should be the total amount of financing originally provided by all co-investors in the aggregate.

d. Financing provided by Licensee--original cost (column 5). This amount should be the portion of the amount in column 4 which was provided by the Licensee.

e. Financing provided by Licensee--current balance (column 6). This amount should be the current carrying amount of the financing on the books of the Licensee (excluding any unrealized appreciation or depreciation).

f. Names of co-investors (column 7). Give the name of each co-investor. The software provides space to identify up to six co-investors. If this is insufficient, you may exclude any parties who provided less than 5 percent of the total financing. If more space is still required, attach a list of additional co-investors to the printed copy of this schedule that you submit to SBA.

g. Sales with recourse (column 8). Indicate "yes" if the SBIC sold a participation with recourse. Attach a separate sheet which provides details of the agreement.

3. Participations and Joint Financings Initiated by Other Investors (Part II). Participations and joint financings for which the Licensee was ***not*** the lead investor should be reported in this section. For columns 1 through 6, the information requested is the same as in Part I.

a. Names of co-investors (column 7). Give the name of each co-investor. Identify the party which initiated the investment. The software provides space to identify up to six co-investors. If this is insufficient, you may exclude any parties who provided less than 5 percent of the total financing. If more space is still required, attach a list of additional co-investors to the printed copy of this schedule that you submit to SBA.

b. Recourse to co-investors (column 8). Indicate "yes" if the SBIC purchased a participation in which it has recourse to any co-investor in the event of default by the small concern. Attach a separate sheet which provides details of the agreement.

R. SCHEDULE OF CASH AND INVESTED IDLE FUNDS (Schedule 6, page 18C)

This schedule must be completed by SBICs that have outstanding SBA leverage or leverage commitments, or that plan to apply for a leverage commitment within the next fiscal year. The purpose of the schedule is to show whether the SBIC is in compliance with the provisions of 13 CFR 107.530.

The total amount of cash, cash equivalents and invested idle funds shown in this schedule must equal the sum of the amounts shown on lines 14 and 15 of the Statement of Financial Position (page 2C). It is not necessary to provide supporting detail for the two lines separately.

S. SCHEDULE OF ACTIVITY (Schedule 7, page 19C)

The purpose of this schedule is to show whether the SBIC is in compliance with the provisions of 13 CFR 107.590. There are two different tests, either of which may be used to demonstrate that an SBIC is active. Part I of this schedule contains the simpler test, and SBICs which satisfy its requirements do not have to complete Part II. SBICs that have been in existence for less than 18 months also do not have to complete Part II, regardless of the result obtained in Part I.

In Part II, cash and invested idle funds balances and financing activity must be reported for the 18-month period ending with the date of the financial statements. "Financings" encompass not only completed loan, debt and equity financings, but also guarantees to small businesses which were made during the 18-month period and are still outstanding as of the date of the financial statements.

If the SBIC is not considered active under either Part I or Part II of the schedule, the reasons for inactivity should be explained in the Operating Plan Update (see page 21C) or a separate attachment. The explanation should include any extenuating circumstances. For example, the SBIC may have a temporarily high balance of cash and idle funds because it sold an investment, raised new capital, or received the proceeds of SBA leverage shortly before year end. If the inactivity is not explained by such circumstances, the SBIC should discuss its plans for becoming active.

T. SHAREHOLDERS, OFFICERS AND DIRECTORS, AND MANAGEMENT (Schedule 8, page 20C)

1. Who must be listed? This schedule provides information about the ownership and management of the SBIC. In column 1, give the names and addresses of any of the following that apply:

a. Shareholders. List each person or company which directly or indirectly owns, controls, or holds with power to vote, 10 percent or more of the outstanding voting shares of the SBIC. In addition, list each person or company which legally or beneficially owns or controls 10 percent or more of any other class of securities of the SBIC.

b. Manager, Officers and Directors. List the manager of the SBIC and all of its officers and directors, whether or not they have any ownership interest in the SBIC.

Indicate in column 2 whether each person listed in column 1 is a manager, officer or director (or combination of any of the three) and give the person's title. For persons who are shareholders but have no other relationship to the SBIC, leave this column blank.

2. Form of ownership/control and number of shares (columns 4 and 5). In column 4, indicate whether shares are owned legally ("of record") or beneficially, or whether they are controlled (for example, shares may be owned by a minor child and controlled by a parent). Give the number of shares corresponding to each form of ownership or control in column 5.

U. OPERATING PLAN UPDATE (page 21C)

Follow the instructions given on Form 468 for the preparation of this narrative. Licensees that have no outstanding SBA leverage or commitments, and that do not intend to apply for leverage in the current fiscal year, do not have to provide this information. The instructions for the Operating Plan Update can be viewed and printed using the electronic reporting software. The Update text cannot be entered on screen; Licensees should type the Update using a word processor and attach a copy to each of the Form 468 hard copies submitted to SBA.

V. ECONOMIC DATA FOR PORTFOLIO CONCERNS (page 22C)

This schedule is included in Form 468 in order to satisfy the requirements of 13 CFR 107.630(e), which calls for Licensees to provide an "assessment of the economic impact of each Financing". The information in the schedule is not covered by the Independent Auditors' Report.

The Economic Data schedule should include each company that was in the SBIC's portfolio as of the end of its fiscal year, in the form of either an outstanding loan or an equity investment. If the SBIC disposed of the entire investment in a company during the fiscal year, it does not have to provide any information for that company.

If the SBIC invested in a holding company or similar entity (as permitted under the exception to the passive business prohibition in 13 CFR 107.720(b)), the economic data provided should be for the active business that received the proceeds of the financing.

1. Most recent fiscal year end (column 2) should indicate the period for which information about the portfolio concern is provided. Estimates for the most recent fiscal year are acceptable, if there is sufficient basis for a reasonably accurate estimate. However, if there is significant doubt about the validity of estimates, actual figures for the prior fiscal year may be provided. In such cases, the ending date of the prior fiscal year should be shown in this column.

2. Full-time equivalent employees (column 3). If a portfolio concern uses part-time employees, such employees should be converted to "full-time equivalents" based on a 40-hour work week. For example, two employees each working 20 hours per week equal one full-time equivalent employee.

3. Employee income tax withholding (columns 5 and 6). Do not include employee FICA withholding.

4. Gross revenue (column 7) means total revenue from the sale of goods or provision of services, before cost of goods sold or any other expenses.

If extra time is needed to obtain the information for the Economic Data schedule, SBICs may file the Form 468 without it and submit it separately once completed. Attach a cover letter to the Form 468 indicating that the Economic Data schedule will be filed separately. SBICs may take up to two months beyond their normal filing deadline to submit the schedule. No formal extension is required as long as the remainder of Form 468 is filed on time. Once the Economic Data schedule is completed, send SBA the file on diskette as well as two hard copies.

W. CERTIFICATIONS (page 23C)

The two certifications on this page must be completed and signed by the appropriate official.

1. Management Certification. If the SBIC has not made all required tax filings, item 2 should be crossed out and an explanation attached. If any statements or schedules included in Form 468 have been omitted, they should be listed in the space provided; they may be referred to by schedule, page number, or title.

2. Secretary's Certification. If the SBIC is not in good standing under the laws of the State of incorporation, item 1 should be crossed out and an explanation attached. A copy of the minutes referred to in item 2 is not required to be submitted, but should be available for inspection in the SBIC's files.

X. QUARTERLY FINANCIAL STATEMENTS -- SHORT FORM 468 (for licensees with outstanding leverage commitments)

SBIC Program licensees with outstanding commitments must file quarterly financial statements (known as the "Short Form 468") with SBA. These financial statements are to be prepared on a year-to-date basis (i.e., the first quarter filing should be for three months, the second quarter for six months, and the third quarter for nine months). Do not file a Short Form 468 for the fourth fiscal quarter; this period is covered by the required annual filing of the long-form version of Form 468.

Required Statements and Schedules. For both corporate and partnership licensees, the Short Form 468 consists of fourteen statements and schedules:

<u>Corporations and Partnerships</u>
page 1 Cover page
page 2 Statement of Financial Position (Assets)
page 3 Statement of Financial Position (Liabilities and Capital)
page 4 Statement of Operations Realized
page 5 Statement of Cash Flows (Operating, Investing and Financing Activities)
page 6 Statement of Cash Flows (Reconciliation of Net Income)

<u>Corporations Only</u>
page 7 Statement of Stockholders Equity (Capital Stock and Undistributed Realized Earnings)
page 8 Statement of Stockholders Equity (Unrealized Gain (Loss) on Securities Held)

<u>Partnerships Only</u>
page 7 Statement of Partners' Capital (Partners Contributed Capital and Undistributed Realized Earnings)
page 8 Statement of Partners' Capital (Unrealized Gain (Loss) on Securities Held)

<u>Corporations and Partnerships</u>
page 9 Retained Earnings Available for Distribution/Regulatory and Leverageable Capital
page 10 Schedule of Commitments
page 11 Schedule of Guarantees
page 12 Schedule of Loans and Investments
page 16 Schedule of Delinquent Loans and Investments
page 23 Certifications (short-form version)

All the statements and schedules in the Short Form 468 are the same as for the Annual Form 468 report except the Certifications page. Licensees should prepare their quarterly statements using the same electronic reporting software that is used for the annual financial statements. Instructions for installing and using the new electronic reporting software are provided in the Electronic Reporting Manual (dated January 1999). This manual can be downloaded from the Investment Division web page or the Venture Lines bulletin board.

Once the Short Form 468 is completed, you should submit the following items to SBA:

a. One paper copy of the Short Form 468 with the required original signature(s) on the quarterly Certifications Page and one copy of the Notes to the Financial Statements.

b. One electronic copy of the Short Form 468.