

MEMO# 20489

October 16, 2006

Draft Institute Comment Letter on IASB Proposal Treating Fund Shares as Equity

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ACCOUNTING/TREASURERS COMMITTEE No. 15-06 INTERNATIONAL COMMITTEE No. 28-06

RE: DRAFT INSTITUTE COMMENT LETTER ON IASB PROPOSAL TREATING FUND SHARES AS

EQUITY As we previously advised you, the International Accounting Standards Board issued proposed amendments to IAS 32 Financial Instruments: Presentation and IAS 1 Presentation of Financial Statements.¹ Currently, IAS 32 requires shares issued by open-end investment companies to be treated as liabilities on the balance sheet. The proposed amendments to IAS 32 would permit these shares to be treated as equity under certain circumstances. The attached draft comment letter strongly supports the proposed amendments to IAS 32.

Comments on the proposal are due to the IASB by October 23rd. Please provide your comments on the draft letter to the undersigned no later than Thursday, October 19th by phone (202/326- 5851) or e-mail (smith@ici.org). The draft letter indicates that IAS 32's current characterization of fund shares as liabilities causes funds to report no equity or net assets in the Statement of Financial Position. Further, changes in the fair value of the "liability" are recognized in profit or loss. Accordingly, when the value of the fund's securities increases, the value of the liability increases, requiring loss recognition in the Statement of Operations. The draft letter indicates that such presentation is counter-intuitive and confusing to shareholders, who understand their investment in fund shares to be an equity ownership interest in the fund's underlying securities. The draft letter notes that fund shares entail many of the economic characteristics and legal rights associated with equity ownership. For example, fund shares represent a residual interest in the assets of the fund after deducting all of its liabilities. Fund shares entitle the holder to participate in the fund's profits and losses, to receive distributions of investment income and realized gains, and to receive

¹ See Institute Memorandum to Accounting/Treasurers Committee No. 10-06, and International Committee No. 20-06 [No. 20244], dated August 3, 2006. ² their pro rata share of assets in liquidation. The letter argues that the proposed characterization of fund shares as equity results in financial reporting that more accurately portrays the financial position and results of operations of the fund. Gregory M. Smith Director - Operations/ Compliance & Fund Accounting Attachment (in .pdf format)