MEMO# 14988

August 2, 2002

IASB ISSUES PROPOSAL TREATING FUND SHARES AS LIABILITIES

[14988] August 2, 2002 TO: ACCOUNTING/TREASURERS COMMITTEE No. 38-02 INTERNATIONAL COMMITTEE No. 57-02 RE: IASB ISSUES PROPOSAL TREATING FUND SHARES AS LIABILITIES The International Accounting Standards Board recently issued proposed amendments to IAS 32 Financial Instruments: Disclosure and Presentation and IAS 39 Financial Instruments: Recognition and Measurement.1 The proposal incorporates guidance first proposed in IASB Interpretation SIC – D34 Financial Instruments – Instruments or Rights redeemable by the Holder, which indicates that fund shares are liabilities since they enable the holder to redeem or "put" the shares to the fund for cash.2 Under the proposal funds and other entities that issue redeemable shares will report no equity or net assets for financial accounting purposes. Comments on the IASB proposal are due Monday, October 14, 2002. If there are comments that you would like the Institute to consider in a comment letter on the proposal, please provide them to Greg Smith at 202/326-5851 (phone), 202/326-8314 (fax), or smith@ici.org by Friday, September 13, 2002. Paragraph 22B of the proposal notes that open-ended mutual funds, unit trusts, and partnerships frequently provide their unitholders with the right to redeem their interests in the entity at any time for cash equal to their proportionate share of the entity's net assets. The proposal indicates that even when the legal form of a puttable instrument gives the holder a right to the residual interest in the assets of an entity, the inclusion of an option for the holder to put that right back to the issuer for cash means that the puttable instrument meets the definition of a liability and must be presented as such. Income Statement Paragraphs 30-32 of the proposal indicate that interest, dividends, losses, and gains relating to a financial instrument classified as a liability (i.e., fund shares) should be recognized in the income statement as expense or income. Thus, dividend payments on fund shares classified as liabilities are treated as expenses in the same way as interest on a bond and 1 The proposal is available at the IASB's website http://www.iasc.org.uk/docs/ias32-39/02-32_39-ed.pdf. 2 The Institute filed a comment letter with the IASB opposing Interpretation SIC – D34. See Accounting/Treasurers Committee No. 32-01 (November 5, 2001). 2 recognized in the income statement. Further, gains and losses related to changes in the carrying amount of a financial instrument classified as a liability are to be reported in the income statement as expense or income. Paragraph A21A of the proposal indicates that the liability to repay unitholders interests may be presented in the balance sheet using a caption such as "net asset value available to unitholders." The change in the liability to repay unitholders may be presented in the income statement using a caption such as "change in net asset value available to unitholders." Disclosure of Accounting Policies The proposal also addresses disclosure of accounting policies for financial instruments, including securities in which the fund invests. Paragraph 77B requires disclosure of methods for valuing securities, including the extent to

which values are determined by reference to published price quotations in active markets. If value is estimated using a valuation technique that is sensitive to assumptions that are not supported by observable market prices, the issuer must provide appropriate disclosure, including the effect on the estimated value of using a range of reasonably possible alternative assumptions. In addition, the issuer must disclose the total amount of the change in value included in profit or loss during the period attributable to value estimation techniques. Fair Value Measurement Considerations IAS 39 at paragraphs 95-102 provides guidance on valuation of financial assets, including securities. The proposed guidance is by and large consistent with U.S. generally accepted accounting principles. International Accounting Standards The proposal has no effect on U.S. registered investment companies, which are subject to U.S. generally accepted accounting principles. Several European countries currently permit, but do not require adoption of international accounting standards. In addition, the European Commission recently approved a proposal requiring adoption of international accounting standards by companies listed in European Union member states for fiscal years starting on or after January 1, 2005. Gregory M. Smith Director - Operations/Compliance & Fund Accounting