**CL 137S**

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DUBLIN FUNDS INDUSTRY ASSOCIATION

Dear Paul

**Re: FRED 30 "Financial Instruments: Disclosure and Presentation, Recognition and Measurement"**

The Technical Committee of the Dublin Funds Industry Association ("DFIA") appreciates the opportunity to comment on Financial Reporting Exposure Draft 30 "Financial Instruments: Disclosure and Presentation, Recognition and Measurement".

The DFIA is the representative body for the international investment fund community in Ireland. At 30 June 2002, the value of Irish administered funds amounted to approximately EUR400 billion.

We broadly welcome the provisions of FRED 30 and understand the need to clarify guidance and to stamp out abuse in this complex area.

We have not responded directly to the questions posed in the exposure draft as we feel that the majority of them do not apply directly to the funds industry. However, there are a number of areas which we believe will significantly dis-improve financial reporting of the funds industry, particularly for open-ended funds. These include:

1 Treatment of units in a fund as a liability
2 Distinction between capital and income

**Treatment of units in a fund as a liabifity**
Paragraph 22B states effectively that units of a fund are "puttable instruments" and hence financial liabilities. This assertion is based on the fact that unit-holders have the right to receive cash from the issuer for their units.

We disagree with this treatment for a number of reasons:

a) This would cause significant confusion to the primary users of the accounts, the unit-holders. Industry practice in Ireland, the UK and other significant areas (e.g. USA) has been to treat unit-holders as the equity owners. The confusion would be particularly pronounced given the marketing and distribution worldwide of Irish administered funds.

b) Treating units as liabilities means that the fund may have no equity owners. This does not accord with the substance of investment funds, where the unit-holders effectively own the fund. They are subject to all risks associated with the performance of the fund (e.g. they can lose their entire capital) and typically are the only party that own the residual interest in the assets of the fund after deducting liabilities.

c) Unit-holders do not have an automatic right to receive cash from the issuer for their units. The fund manager, directors or trustee usually have the discretion to refuse to redeem units in certain circumstances.

d) Typically, unit-holder rights rank pan passu no single group can demand redemption in preference to another group, voting rights are similar, etc. Again, we believe that this adds to the argument that unit-holder shares are equity in nature.

The treatment of units as a liability would have the following financial statement implications:

a) the financial statement net asset value of the fund would by definition always equal zero. While paragraph B8 of FRED 30 Appendix B indicates that narratives such as "net asset value available to unit-holders" can be used on the face of the balance sheet before the liability for units is deducted, we believe that this is confusing for users of the accounts. Similarly, the net asset value per unit, arguably the key metric used by readers, would also equal zero.

b) the change in net asset value from year to year would by definition equal zero. This again would cause considerable confusion among readers who wish to know whether the fund has generated positive or negative returns, and how those returns are analysed between income and capital. In particular, the reader may find transfers to and from the income statement to effect a nil result difficult to understand.

c) any distributions paid on the units would be treated as an interest expense and not as a dividend. As indicated above, we believe that units should be treated as equity and hence distributions thereon would be treated as dividends. In our view, this treatment also accords with the underlying substance the fund is returning an amount to the owners, and is not paying a third party for the use of finance.

Distinction between capital and income
The distinction between capital and income transactions is often important in the financial statements of funds. Depending on the type of fund (e.g. distributing, capital appreciation, etc), users may base their decision to buy, hold or sell units on this split of information.

The proposals in FRED 30 would significantly alter current industry practice. As noted above, dividends paid on units would be treated as an interest expense as opposed to a distribution of capital. Indeed, paragraph 32A indicates that all changes in the net asset value from year to year should be treated as income or expense, and not as part of capital. We believe that this will negatively impact the users of accounts and cause further unnecessary confusion.

**Other comments**
Certain funds, particularly non-retail types, may acquire large security holdings in a particular company. The fair value of a significant quantity of securities may not equate to the market price due to illiquidity discounts. In response to Question *5* "Fair value measurement considerations (paragraphs *95* 1 OOD)", we believe that guidance should be included in the standard regarding adjustments to fair value to take into account the size of the holding.

**Conclusion**
In summary, we believe that certain of the proposals included in FRED 30 are likely to adversely affect the relevance, understandability and comparability of fund financial statements. We believe that they do not improve current financial reporting in this area but will increase confusion among the primary users, the unit-holders.

If you have any queries in relation to this, please do not hesitate to contact the Technical Committee of the Association.

Yours sincerely,

Brian Clavin
Chairman of the Technical Committee
Dublin Funds Industry Association