

REPORT OF FINANCIAL REPORTING PANEL – ING REAL ESTATE ENTERTAINMENT FUND

Executive summary

Australian Securities and Investments Commission (“ASIC”) has referred to the Financial Reporting Panel (“Panel”) the financial report of ING Real Estate Entertainment Fund (“Fund”) with the claim that the Fund’s financial statements for the full-year ended 30 June 2009 and half-year ended 31 December 2009 were not in compliance with AASB 138 *Intangible Assets*.

The Fund is a managed investment scheme listed on the Australian Securities Exchange (“ASX”) and is required to lodge its financial report under Chapter 2M of the Corporations Act 2001.

The principal activity of the Fund is investment in real estate, being hotels and clubs that are subject to leases to tenants. The Fund holds a beneficial interest in liquor and gaming licences attached to those properties.

The Panel considered three questions in its evaluation of the claim by ASIC:

1. Should the Fund’s investment in those properties and licences be accounted for under AASB 140 *Investment Properties*?
2. Do the licences under these circumstances fall within the scope of AASB 138 *Intangible Assets*?
3. Is the disclosure in the notes to the accounts adequate in terms of setting out the accounting policy applied?

Based on the documents provided to The Panel and after hearing evidence both from ASIC and Fund, the Panel concluded that:

1. The properties and licences are covered by AASB 140 *Investment Properties* and are accounted for correctly.
2. The licences do not fall within the scope of AASB 138 *Intangible Assets*.
3. Accounting policy disclosure in the Notes to the accounts should be detailed fully and adequately explain the accounting treatment undertaken.

The reasons for reaching these conclusions are discussed below in section 3.

1. Background

The Fund's principal activity is investment in real estate. At 30 June 2009, the Fund owned the freehold interest in 38 hotels and clubs. The Fund also held a beneficial interest in 26 liquor licences and 496 gaming licences attached to those properties as at that date.

Also as at 30 June 2009, all properties and licences were subject to leases to tenants. In all cases, the leases covered the rental of property, fixture and fittings, gaming machines and licences to those tenants under a single contract. These lease contracts included no bifurcation of cash flows related to the components covered by the lease.

A liquor licence in New South Wales, Queensland and Western Australia needs to be registered in the name of an individual not a corporation. As such, all liquor licences are held in the name of an individual employed by the tenant. Under the lease, the tenant is required to hold and maintain a liquor licence that specifically relates to that premises. The said licence cannot be used in conjunction with any other property.

The Tenant is required to maintain and renew the liquor licence throughout the lease period. In the event of default under the lease, the Fund has the irrevocable right to transfer the liquor licence to another party.

Gaming licences in New South Wales and Queensland are required for the operation of gaming machines in those States. Gaming licences are held in relation to the premises pertaining to the lease with Fund. Under the lease, the tenant must maintain and renew those gaming licences throughout the lease period. The tenant is prohibited, under the lease, to surrender, remove the gaming licence to other premises, vary the gaming licence conditions and transfer or exchange the gaming licence, amongst other prohibitions.

2. Process

The Panel received written submissions both from ASIC and Fund with supporting evidence for their views. Both parties also appeared in a hearing before the panel to discuss their written submissions, to provide any additional evidence and to answer questions from the panel.

In forming its conclusion, the panel have taken account of all of the evidence provided via this process and considered the requirements of the relevant Australian Accounting Standards.

3. Reasons for conclusions

3.1 Does AASB 140 infer or allow for a composite asset relating to Investment Property?

AASB 140 defines an Investment Property under clause 5 as follows:

Investment Property “is property (land or a building – or part of a building – or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both, rather than for:

- (a) use in production or supply of goods or services or for administrative purposes; or
- (b) sale in the ordinary course of business.”

If we were to take a literal reading of the definition, it may be argued that an investment property can only comprise a lot of land, a building (or part of a building) or both. The Panel does not believe this literal approach is valid or intended.

Assets, other than land and buildings, can be part of an investment property if they are integral to the single operating lease and are fundamental to the nature of being able to earn that income as a lessor.

In the Scope of AASB 140, the only specific exclusions are biological assets related to agricultural activity and mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources. It is not contested by any party that these are relevant to this case. The Panel does feel that the scope of AASB 140 can be read as not excluding a composite asset that may include intangibles.

Paragraph B37 of the Basis for Conclusions to IAS 40 *Investment Property* implies that hotels, restaurants, bars, and nursing homes are conceivably classifiable as “investment property”. This arguably implies something beyond just land and buildings is to be included in an investment property.

The Panel believes that there is no requirement to recognise the separate components of an Investment Property. Rather, the Panel looked to what had been purchased. The evidence being, for example, a contract to acquire a hotel/club demonstrated that Fund acquired Property that included all fixtures and fittings and existing licence arrangements.

Fund’s approach is supported by guidance in AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*. Clause 10 states:

“In the absence of an Australian Accounting Standard that specifically applies to a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is:

- (a) relevant to the economic decision-making needs of users; and
- (b) reliable, in that the financial statements:
 - (i) represent faithfully the financial position, financial performance and cash flows of the entity;
 - (ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form;
 - (iii) are neutral, that is, free from bias;
 - (iv) are prudent; and

- (v) are complete in all material respects.

Further to this, Fund's approach is consistent with the *Framework for the Preparation and Presentation of Financial Statements*.

Clause 35 *Substance Over Form* states:

"If information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form....."

The Framework sets out the definition of an asset in clause 49 (a) as:

"An asset is a resource controlled by the entity arising from past events and from which future economic benefits are expected to flow to the entity."

These criteria led the Panel to an acceptance that the Fund's Investment Property, in its entirety, meets this definition. The composite asset satisfies the criteria. It is the only asset that satisfies all of the criteria. So long as the Fund leases out its Investment Property to a tenant, the Fund does not control the individual components underlying the Investment Property. Nor, do the underlying assets derive benefits for Fund individually.

3.2 Does AASB 138 prevail over AASB 140 in terms of having to separately identify and record intangibles that are integral to an Investment Property?

AASB 138 *Intangible Assets* clearly states within its Scope Clause 2 (a):

"This Standard shall be applied in accounting for intangible assets, except:

- (a) intangible assets that are within the scope of another Australian Accounting Standard;"

ASIC has interpreted this to mean that a Standard other than AASB 138 should only be applied to an intangible asset if that standard prescribes the accounting for that specific type of intangible asset. Since AASB 140 does not specifically prescribe accounting for any intangible assets, ASIC argues that AASB 138 applies to licences acquired within an investment property.

The Panel notes that paragraph 3 of AASB 138 explains the intended application of the exclusion clause by identifying nine types of intangibles to which AASB 138 does not apply because of the existence of other applicable Standards. It is relevant that with one exception, goodwill acquired in a business combination, none of the intangibles is mentioned or otherwise prescribed in the scope of those other Standards.

Therefore, the Panel believes that the absence from AASB 140 of any reference to intangible assets in no way precludes that Standard from applying to intangible assets such as licences.

Accordingly, the Panel considers that any intangibles such as Licences that form part of an Investment Property are within the Scope of AASB 140 *Investment Property*.

It is noted that no specific reference to Intangibles is contained within AASB 116 *Property, Plant and Equipment*. The Panel disagrees that the reference to AASB 116 as set out in AASB 138 *Intangible Assets* at clause 4 as inferring that a specific reference to AASB 140 *Investment Property* is essential to applying AASB 140 under the circumstances found here.

3.3 Is the disclosure in the notes to the accounts adequate in terms of setting out the accounting policy applied?

Note to the Financial Statements 1 (n) for the year ended 30 June 2009 does not explicitly refer to gaming and liquor licences. It states:

“Land and buildings have the function of an investment and are regarded as composite assets.”

The Panel would recommend that the Fund consider explicitly informing users of the Financial Report that Investment Property is composed of land and buildings leased out to tenants and includes plant and equipment, fixtures and fittings and certain intangible assets such as liquor and gaming licences.

Such additional disclosure would assist readers of the Financial Report.