

21 June 2010

AASB 1-2 September 2010
Agenda paper 17.4

Ms Joanna Perry,
Financial Reporting Standards Board NZ,
c/o Australian Accounting Standards Board,
Level 7,
600 Bourke Street,
Melbourne,
Victoria

via e:mail

Dear Ms Perry,

Basis for Conclusions on IFRS 9 Financial Instruments - Puttable Instruments, AASB 132/IAS 32 and AASB 9/IFRS 9

We are writing as the CEO and CFO of Australia's largest Listed Investment Company ("LIC"), representing over 92,000 retail shareholders in Australia and New Zealand, and as an Australian company listed on the ASX, a user of the International Financial Reporting Standards.

As a Company, and as a member of the Australian Listed Investment Companies Association (ALICA), we contributed to the discussion regarding the proposed AASB 9/IFRS 9 both directly to the IASB and through the Australian Accounting Standards Board, and were appreciative of the opportunity to do so.

We were pleased with the outcome of AASB 9/IFRS 9, as we believed strongly that to show the movement in fair value of our investments as part of Other Comprehensive Income, rather than as profit, whilst retaining the dividends earned on our capital employed as profit, was the best solution for our shareholders and other users of our accounts. Such an outcome also best reflected Management's view of the operations of the Company, and therefore AFIC, along with many other LICs, have early adopted AASB 9/IFRS 9.

However, we are concerned to note the last sentence in paragraph BC82, which has only just been brought to our attention, in the Basis for Conclusions for IFRS 9 which discussed puttable instruments that under paragraph 16A of AASB 132/IAS32 can be 'classified as an equity instrument'. This sentence reads that for the purposes of AASB 9/IFRS 9 "... the Board noted that such instruments do not meet the definition of an equity instrument."

The issue has relevance for us in respect of our holdings in one specific investment, Hastings Diversified Utility Fund (“HDF”). This investment is listed on the ASX, and the accounts of the fund note under Net Assets attributable to unitholders that ‘net assets attributable to unitholders comprise the residual interest in the assets of the Group after deducting its liabilities. It is represented by issued ordinary units and undistributed profit/(loss) attributable to unitholders.’ This is in accordance with the definition of “equity instrument” in AASB 132/IAS 32.

In all other respects, the investment is treated as equity and is regarded as an ownership interest of the underlying assets by those who invest in it.

HDF does, however, have an unusual clause in its trust deed. This states that should the entity cease to be quoted, and is still liquid, then and only then do unitholders have the right to ‘put’ the option for a share of net assets. This has led HDF to classify their ‘equity’ as a liability, and thus the net assets after the deduction of these liabilities would be nil.

Unlike a Managed Investment Trust or co-operative, HDF is a closed-end fund. Currently, the ‘equity’ owners can only realise value by selling the security in a liquid market – the ASX. Redemption is not possible whilst the security remains listed.

Unlike European-style options, there is no specified date when such an option can be exercised – it is merely a condition precedent which appears to have been inserted as a ‘poison pill’ defence.

Therefore, as an investor in securities listed on the ASX, it is not possible now or in the foreseeable future for this investment to be ‘put’. It is regarded as equity and functions as equity, and we would argue should be treated as equity for the purposes of IFRS9.

With regards to the issue of materiality, this would depend upon the size of the investment and the size of the market move by HDF. For instance, one company with which we are associated has HDF as their largest investment. Should this investment not be granted the same accounting treatment as other equity investments, the unrealised gain in this one investment could account, on current estimates, for 35% of the ‘profit’ for the year, whilst all other fair value movements on the remainder of their investments are valued through Other Comprehensive Income. Such a distortion would ensure large-scale earnings volatility whilst, we would argue, undoing the work of AASB 9/IFRS 9 and rendering the accounts seriously misleading to their users.

Such movements should, for an investment company like ours, be recorded the same way as all our other long-term equity investments – through Other Comprehensive Income.

A solution may be that for companies that invest in long-term securities that meet the classification of equity under AASB 132/IAS 32, puttable instruments that meet the classification of equity should only become ineligible for the treatment allowed for equity instruments when either a date is specified for their exercise or they meet any other condition precedent for their exercise – in this case, when they cease to be quoted.

We believe that this would result in an accounting treatment that would reflect the real underlying nature of our investments and our business, and provide shareholders and other users of our accounts with more relevant information.

As we will be releasing our results for the year ended 30 June 2010 to the market in early July, we would appreciate your urgent attention to this matter.

We would be grateful if you could bring this matter to the attention of IFRIC. We are happy to answer any questions that you may have, and are grateful for the open communication channels between the AASB, IFRIC, the IASB and their constituents.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ross Barker', with a long horizontal flourish extending to the right.

Ross Barker
Managing Director

A handwritten signature in black ink, appearing to read 'Andrew Porter', with a large 'A' and a 'P' that are stylized and connected.

Andrew Porter
Chief Financial Officer

cc: Kevin Stephenson, AASB Chairman