

## AUSTRALIAN LISTED INVESTMENT COMPANIES ASSOCIATION

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14 August 2009

The Chairman  
Australian Accounting Standards Board  
Level 7  
600 Bourke Street  
Melbourne Vic 3000

Dear Sir,

This submission on ED /2009/7 is made by the Australian Listed Investment Companies Association ("ALICA").

The members of the Association (membership list attached) are all ASX listed investment companies (LIC's) who invest predominantly in dividend paying companies listed on the ASX, and hold such investments for the very long term. Their long term investment portfolios are not traded; sales of holdings are made infrequently.

Their principal purpose is to hold investments on capital account for the long term, collect dividends and, after deducting very modest internal management expenses (MER's are typically 0.1-0.2%), distribute the balance as dividends to their shareholders. Realised capital gains and the fluctuations in investment values are not taken into account when considering the amount proposed to be paid out in dividends.

The members of ALICA provide their shareholders with a recurring stream of dividends and an exposure to the listed equity market.

*The Association of Investment Companies in the UK is comprised of similar entities. In their Statement of Recommended Practice released in January 2009 they describe themselves as follows:*

*"LICs are fundamentally different from other companies in that, with respect to their primary business, they do not provide goods or services and have no customers other than their shareholders. Rather they function as investment vehicles for their investors."*

Members revalue their portfolios continuously to market price such that the Balance Sheet net asset backing per share always reflects current portfolio values. The change in value, after providing for tax on unrealised capital gains, is recognized in a revaluation reserve. Fluctuations in the underlying investment capital are not considered part of the operating income, unlike investors that operate as traders

Our shareholders and the markets are principally interested in:

1. Net Asset backing per share, which is announced by each member to the ASX within 14 days of month end. This is evidenced by the fact that the share price of the member LICs tends to trade in line with their net asset backing.
2. Dividends paid by the LIC.
3. Operating profit which excludes realised and unrealised capital gains. LIC shareholders are most interested in this measure of operating profit (recurring dividend income net of expenses) as this is the amount which is available for distribution as dividends.

Our shareholders, are themselves typically long term investors in the share market mostly as individuals, self managed superannuation funds and self funded retirees. They are familiar with, and prefer, this distinction between capital and recurring income yield.

Most of the ALICA members have operated in this style for between 60-80 years.

Accordingly we make the following submissions regarding the ED:

1. We **do not** support the adoption of valuing long term equity investments at fair value through the profit and loss account as this would not arrive at operating profit available for distribution to shareholders as described above. It would lead to large fluctuations in our reported profit and loss and be of no relevance to shareholders or the market.

Further, were unrealised losses in a year to exceed all other net income, we could be prevented from distributing as dividends all of our operating profit for that year to shareholders as there would be not be a "Profit" under Australian Corporations Law from which to pay dividends.

2. Question 10. Do you believe that presenting fair value changes (and dividends) for particular investments in equity instruments in other comprehensive income would improve financial reporting ?
  - (a) We **support** the proposition that fair value movements in equity investments should be recorded in OCI.
  - (b) We **do not** support the proposal that associated dividend income should also be recorded in OCI as dividends are a form of recurring income that is derived from long term capital investments.

We strongly submit that recurring dividend income should be recorded in the profit and loss account and note that this concept is supported by other accounting concepts:

- Matching of expenses and income;
- Property rental recognized as income;
- Recognition of pre acquisition dividends as income (rather than as a change in the fair value of the acquisition)
- Interest income on investments in term deposits and other deposit investments is recognized as income.
- Bank bill discount is recognized as income.

**It is our view that the standard should recognize that, where equity investments are held primarily to harvest the dividends, the recurring income thereon should be recorded in the Profit & Loss. Any long term capital growth or decline should be recorded through Other Comprehensive Income.**

If the standard remains as currently drafted and assets were marked to market through OCI, and dividends were also taken directly to OCI, then our reported 'profit' would only consist of modest interest income and expenses, and may likely be a loss, which would not only be meaningless to the market and our shareholders but also quite misleading. It could also affect the ability of the LICs to pass on the dividends to their shareholders.

Collectively ALICA members have around 200,000 shareholders who understand:

- that the net asset backing per share fluctuates and reflects the underlying value of our long term investment portfolio;
- that the share price of a LIC follows its NTA;
- the concept of distributable profit derived from recurring income net of expenses and look forward to the receipt of a dividend paid out of this distributable profit;
- the concept of not distributing realised capital profits and hence maintaining capital for long term growth, and, most importantly
- **They do not regard the total movement in balance sheet values as a measure of "profit".**

Yours sincerely,



A J Hancock  
Secretary

**AUSTRALIAN LISTED INVESTMENT COMPANIES ASSOCIATION**

**LIST OF MEMBERS**

**AS AT 17 AUGUST 2009**

**Australian Foundation Investment Company Limited**

**Contact:** Mr Ross Barker  
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**Australian United Investment Company Limited & Diversified United Investment Limited**

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**Milton Corporation Limited**

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**Whitefield Limited & Sylvastate Limited**

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**Brickworks Investment Company Limited**

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