

**AUSTRALIAN
FOUNDATION
INVESTMENT
COMPANY**

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18 November 2011

The Chairman,
Australian Accounting Standards Board,
PO Box 204,
Collins Street West,
Victoria 8007

via e:mail

Dear Sir,

AASB Exposure Draft ED 220 - Investment Entities

As you are aware, Australian Foundation Investment Company Ltd ("AFIC") is a Listed Investment Company as defined by the ITAA 1997. Listed on the ASX it is responsible for the investments of over 93,000 predominantly retail shareholders in Australia and New Zealand.

As such, it is clear that AFIC would fall within the definition of an 'investment entity' and as such is making a submission on the Exposure Draft.

Question 1 – Do you agree that there is a class of entities, commonly thought of as an investment entity in nature, that should not consolidate controlled entities and instead measure them at fair value through profit or loss? Why or why not?

It is unclear why investment entities should be subject to a separate Accounting Standard, as this would seem to invalidate the precepts of 'comparability' that are included in para. 39 of the AASB Framework – "the measurement and display of the financial effect of like transactions and other events must be carried out in a consistent way for different entities."

By making one section of 'preparers' subject to a different accounting standard than others, it is not clear that comparability for users is necessarily enhanced.

AFIC notes, and agrees with, the comments from the three dissenting members of the IASB that should fair value information for entities that have been consolidated be required, if such investments are held in accordance with the paras 2 and B6 then fair value information disclosed in the notes should provide the necessary information.

However, should it be determined that a separate accounting standard be necessary for investment entities, then AFIC would ask that other issues be addressed which would make the financial statements more useful.

For instance, AFIC and many other investment companies manage their long-term investment portfolio on a consistent basis and under AASB 9, account for the changes in the fair value of the investments that are defined as 'equity' through Other Comprehensive Income.

However, there are other investments that are held which may be quoted in a liquid market but are not eligible for 'equity' treatment – e.g. convertible notes, puttable instruments (where the 'put' can only be exercised if the security is delisted). It would be more consistent with the Company's approach to investing if these non-controlled investments were eligible for the same treatment as the other 'equity' investments.

The new ED therefore introduces a further anomaly into the reporting for investment entities – investments in equity instruments that represent a minority shareholding may be fair valued through Other Comprehensive Income ("OCI") whilst investments in equity instruments that represent 'control' must be measured at fair value through profit or loss.

However, this is strongly preferable to the alternative as it is very important that the ability for investment entities to use AASB 9 at least for their minority equity investments continues. AFIC and the LIC industry body, ALICA, strongly supported the provisions of AASB 9 that allowed their minority equity investments to be fair valued through OCI.

It is therefore extremely important that the current requirements proposed in the ED (namely, that it applies only to entities that the investment entity 'controls' – para. 6) be maintained and not extended to all investments.

Question 2 - Do you agree that the criteria in this exposure draft are appropriate to identify entities that should be required to measure their investments in controlled entities at fair value through profit or loss? If not, what alternative criteria would you propose, and why are those criteria more appropriate?

No comment other than to reiterate the importance that AFIC attaches to the ED only being relevant to investments that are controlled.

Question 3 - Should an entity still be eligible to qualify as an investment entity if it provides (or holds an investment in an entity that provides) services that relate to:

(a) its own investment activities?

(b) the investment activities of entities other than the reporting entity?

Entities do control subsidiaries that either hold necessary licenses and/or act as the employer for the entities investment management and operational staff. To therefore exclude such entities from the definition of an investment entity would remove many entities that the ED appears designed to apply to. In fact, should such an exclusion be made, it could well lead to entities that do not wish to fair value their investments through Profit or Loss creating such subsidiaries.

A question arises as to whether the ED should only apply to investments that are being specifically held for the purposes mentioned in paragraph 2 (a), rather than seek to

exempt only an investee 'that provides services that relate only to the entity's own investment activities.'

This would remove the issue that arises, as noted in Question 3 (b) when an investment company has a subsidiary that provides services not only for its own investment activities, but also to other investment entities. The issue remains as to what extent these activities are 'substantive'. An entity, for instance, that is formed primarily in order to provide services to investment entities but also has some incidental investments should not, for instance, be considered an investment entity, but an entity whose stated goals are as set out in para 2 (b) but also has a subsidiary that provides investment services to itself and to other entities in pursuit of that goal should be so considered.

Paragraph 7 (a) could then read :

"If an investment entity controls an investee that is not held for capital appreciation, investment income or both, it shall consolidate that investee ..."

Should this not be considered appropriate, the Board may wish to consider amending paragraph 7 (a) to read :

"If an investment entity controls an investment that provides services that relate only to the entity's own investment activities, or to other investment entities' activities, and is held for operational reasons rather than for capital appreciation, investment income or both, it shall consolidate that investee ..."

**Question 4 - (a) Should an entity with a single investor unrelated to the fund manager be eligible to qualify as an investment entity? Why or why not?
(b) If yes, please describe any structures/examples that in your view should meet this criterion and how you would propose to address the concerns raised by the Board in paragraph BC16.**

As AFIC is a public company, it has no comment to make on this question.

Question 5 - Do you agree that investment entities that hold investment properties should be required to apply the fair value model in IAS 40, and do you agree that the measurement guidance otherwise proposed in the exposure draft need apply only to financial assets, as defined in IFRS 9 and IAS 39 Financial Instruments: Recognition and Measurement? Why or why not?

AFIC as an investor in financial assets only has no comment other than to note that entities that hold other types of investments that might not be considered financial assets (e.g. almond trees held under Managed Investment Scheme) might be considered by users to be investment entities.

Question 6 - Do you agree that the parent of an investment entity that is not itself an investment entity should be required to consolidate all of its controlled entities including those it holds through subsidiaries that are investment entities? If not, why not and how would you propose to address the Board's concerns?

Not relevant for AFIC, therefore no comment.

Question 7 - (a) Do you agree that it is appropriate to use this disclosure objective for investment entities rather than including additional specific disclosure requirements?

(b) Do you agree with the proposed application guidance on information that could satisfy the disclosure objective? If not, why not and what would you propose instead?

The disclosures required under para 9 and suggested under paras B19 and B20 would, if included in the Notes as noted in the answer to Question 1, appear sufficient to give users a full picture of the entities investment activities without requiring that all controlled investments be fair valued through Profit or Loss.

An objective accompanied by 'guidance' is, in most cases, preferable to specific disclosure requirements as it gives reporting entities the flexibility to report the relevant information in a manner that is most appropriate to its activities.

Question 8 - Do you agree with applying the proposals prospectively and the related proposed transition requirements? If not, why not? What transition requirements would you propose instead and why?

In AFIC's view, it is usually preferable to have accounting standards introduced prospectively and this is no exception.

Question 9 - (a) Do you agree that IAS 28 should be amended so that the mandatory measurement exemption would apply only to investment entities as defined in the exposure draft? If not, why not?

(b) As an alternative, would you agree with an amendment to IAS 28 that would make the measurement exemption mandatory for investment entities as defined in the exposure draft and voluntary for other venture capital organisations, mutual funds, unit trusts and similar entities, including investment-linked insurance funds? Why or why not?

This question is predicated on the assumption that there should be a specific ED for investment entities.

To mandate that only investment entities can fair value associates and joint ventures through Profit or Loss would restrict the ability of other entities that currently use such an election from so doing, as the Board has noted. This restriction would appear unnecessary bearing in mind that presumably such an election had been made because it more accurately reflected the business and management view of the relevant entity.

An alternative may be to amend AASB 128 and 131 to allow all entities, including investment entities as defined in the current ED, rather than just the non-investment entities mentioned, the option to irrevocably elect to measure investments in associates and joint ventures at FV through Profit or Loss, depending on which method best reflects the business of the entity. This could be then combined with enhanced disclosure requirements in AASB 12, possibly with specific disclosures for investment entities.

A further possibility may be to extend the principle of irrevocable election to all investments by an investment entity (including the entities that it controls). An investment entity could not elect just to FV associates through Profit or Loss but not subsidiaries – it would have to either FV all through Profit or Loss or none.

Whilst accepting that this would lessen the degree of 'comparability' between investment entities, this would provide investment entities the maximum flexibility to utilise whichever method (FV through profit or loss or consolidation/equity accounting) would better reflect their business. Enhanced disclosure as noted in answer to Questions 1 and 7 would help with regards to comparability if such disclosures were required regardless of which election was made.

I would be happy to discuss the above with you in more detail at your convenience, should it be required.

Yours sincerely

A handwritten signature in black ink, appearing to be 'A. Porter' with a stylized flourish at the end.

Andrew Porter
Chief Financial Officer