Dynamic Investment Solutions

QIC

27 March 2013

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

Dear Mr Stevenson

Comments on *Exposure Draft 233 – Australian Additional Disclosures – Investment Entities*

Thank you for the opportunity to comment on Exposure Draft 233 ('ED 233'). This letter contains our overall response to the proposals outlined in ED 233, whilst the appendix to this letter contains our response in relation to the specific matters for which the Australian Accounting Standards Board ('AASB') has requested comments.

QIC is a Queensland government-owned corporation and one of the largest institutional investment managers in Australia, with 93 clients and more than $69 billion (at 31 December 2012) in funds under management.

We believe that the majority of the entities managed by QIC and its subsidiaries meet the definition of 'investment entities', as defined in the International Accounting Standards Board's ('IASB') recent amendments to International Financial Reporting Standard 10: *Consolidated Financial Statements* ('IFRS 10'). Accordingly, we have a significant interest in the proposals outlined in ED 233.

QIC does not support the proposals contained in ED 233.

We believe that fair value information is more valuable to the users of an investment entity's financial statements than consolidated information and that consolidated financial statements are not needed by investors for decision making. We therefore consider the IASB's amendments to IFRS 10 to be a desirable change to existing financial reporting requirements, as they would result in financial statements containing information that is more relevant and meaningful to users.

We also believe that the proposals outlined in ED 233 for additional disclosure of consolidated financial information would result in unnecessary cost and operational burden being incurred for the preparation of financial statements. It would also continue to limit the ability of investment entities to provide audited financial statements to users on a timely basis. This is clearly an undesirable outcome for Australian investment entities and would place them at a disadvantage when compared to their global competitors, particularly those in North America and Europe.

The proposals outlined in ED 233 will result in a divergence from IFRS 10. This is in direct conflict with the IASB's global harmonisation project and the AASB's stated policy of only modifying IFRS for not-for-profit entities.

We are also concerned that the proposals may prevent investment entities from stating continued compliance with IFRS. To insert significant new Australian-only disclosure requirements and to delay the adoption of an accounting standard passed by the IASB in October 2012 is an inappropriate outcome and damages the stable platform of IFRS compliant reporting that has been so successfully established.

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The outcomes summarised above could easily harm the global credibility of the Australian accounting profession and the Australian investment management industry.

In summary, we do not support the proposals outlined in ED 233 and strongly urge the AASB to immediately implement IFRS 10 unamended.

Should you have any questions regarding the contents of this letter and its Appendix, please do not hesitate to contact us.

Yours sincerely

CMBlake

Claire Blake
Chief Financial Officer

APPENDIX – Responses to specific matters for comment

1: Comment on the appropriateness of the proposed Australian additional disclosures and whether such disclosures are warranted.

QIC comment: Fair value information is most valuable to users of an investment entity's financial statements.

- We understand that one of the key motivations for retaining consolidated financial information, as outlined in ED 233's 'Alternative View 1', is that information prepared on a consolidated basis potentially provides more useful information to users than financial information that is prepared using fair value. However, this is inconsistent with the statement in 'Alternative View 2' that *'users have advised the IASB that they prefer fair value recognition of controlled investees rather than consolidation accounting for these entities'*.
- Our view is consistent with the general response to the IASB's consultation process: investors typically do not view investment entities as a consolidated group, but rather on a 'look through' basis as a portfolio of investments held at fair value. We believe that the measurement and disclosure of investments at fair value is more reflective of the substance of the arrangement and that fair value is the most relevant information for the purpose of making investment decisions and measuring performance, for both investment entities and their investors.
- This view is supported by market communication and the disclosures typically contained in product disclosure statements and information memoranda. QIC's investment entities are managed on a fair value basis and all internal reporting, whether to management, the Audit and Risk Committee or the Board of Directors, is on a fair value basis.

QIC comment: Information presented in consolidated financial statements by 'investment entities' is not used for decision-making by investors.

- We believe that the primary reason for investors to invest in an investment entity is the belief that the investment manager will earn a better return on the investors' capital than the investors can themselves. We believe that investors make this decision using information that is provided in a prospectus, product disclosure statement, investment memorandum and similar documents, rather than the financial statements.
- Since there is typically a material delay between reporting date and the date that independently attested financial statements are available for investors' use, it is unlikely that investors make capital allocation decisions primarily based on information contained in financial statements, since that information is not timely, nor reflective of the current price at which the investment entity is trading.
- Accordingly, we believe that the preparation of consolidated financial information is of very little use to investors and other stakeholders and it certainly does not provide investors with the requisite information to enable them to determine where or how they best allocate their capital.
- We contend that it would be of more benefit to the users of an investment entity's financial statements to provide audited fair value information within a shorter timeframe than that which would occur if consolidated financial information was also required to be provided.

QIC comment: Consolidated financial information may be misleading.

- We believe that investment managers generate investment returns through acquiring, holding and disposing of investments, rather than through the management of the underlying assets and operations of those investments. Accordingly, the disclosure of the underlying assets and results of operations do not provide users with meaningful information on how well investment managers have managed their portfolio of investments. The measurement and reporting at fair value in financial statements more closely aligns the various sources of information provided to investors in investment entities.
- We are concerned that the provision of information that is superfluous to investors' interests, such as consolidated financial information, could be misinterpreted by the users of these financial statements. The performance of an investment entity, and the risks to which it may be exposed, may be overlooked or clouded by information not directly relevant to the user.
- We are also concerned that providing two sets of financial statements, one using fair value and one containing consolidated information, is likely to be more confusing than informative to users.
- Accordingly, we believe that removing the requirement to consolidate investee entities would produce clearer financial reports that more appropriately reflect the true nature of the activities being undertaken by investment managers.

QIC comment: ED 233 is inconsistent with the IASB's and AASB's commitment to harmonisation.

- We are highly concerned that the proposals outlined in ED 233 may prevent Australian investment entities from stating continued compliance with IFRS. This would result in financial statements for Australian investment entities being out-of-step with those prepared by international counterparts.
- Furthermore, Australia's divergence from IFRS 10 would reduce the global portability and comparability of Australian investment entity reporting. We consider this to be an unnecessary hurdle to global competitiveness, especially in relation to the practicalities of producing timely and relevant financial information for distribution to global investors and regulatory bodies. This would be an undesirable outcome for QIC and the Australian investment management industry in general.
- The proposed divergence from IFRS 10 is contrary to AASB's stated policy of only modifying IFRS for not-for-profit entities. It also conflicts with the principles of regional harmonisation projects, including the Australia and New Zealand harmonisation project.
- We believe that the views expressed in 'Alternative View 1' are essentially theoretical in nature and do not account for the practicalities associated with financial reporting for investment entities. We are concerned that Australia's potential divergence from an IASB standard, largely due to a theoretical argument, could adversely affect the international credibility of the Australian accounting profession.

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QIC comment: There are significant practical difficulties of preparing consolidated financial information.

- We note that the preparation of consolidated financial information, especially if subject to independent audit, is often dependent on other parties or processes that are outside of our control. For example, if we are required to prepare financial statements that consolidate other fund-of-fund structures, we will inevitably be dependent on other parties to obtain the relevant financial information for consolidation purposes. The underlying information will often only be made available once it has been audited and the respective responsible entities or trustees have approved the underlying financial statements for issue to investors. This creates significant pressure on the upstream investment entities and their service providers to produce consolidated financial information on a timely basis for audit, approval, lodgement (if required) and release to investors. The logistical pressures pertaining to the preparation of consolidated financial statements is further exacerbated when there are downstream delays, complications or other issues (such as audit qualifications or restatements) and this can extend the timeframe for financial reporting by investment entities to investors.

- This is clearly an untenable situation that puts increased cost and time pressure on service providers and responsible entities, especially as the industry continues to experience growth in financial products and increased complexity.

QIC comment: cost concerns

- We note that it is quite common for investment entities to vary their holdings in underlying investments based on investor cash flows, investment strategy and market movements. Where the underlying investment is in a controlled entity, this can result in multiple consolidation ownership percentages within a short space of time. This makes the preparation of consolidated financial information very unwieldy and inefficient. The requirement to undertake consolidated financial reporting therefore adds to the cost incurred by investment entities and potentially reduces investor returns. This will result in Australian investment entities having a cost disadvantage relative to international counterparts, which is clearly an undesirable outcome.

2: Comment on whether there are any alternative approaches/disclosure strategies that can be employed to minimise the adverse impact on decision-making of the loss of consolidation information.

- As previously outlined in our response to item 1, we do not believe there to be an adverse impact on decision-making should consolidated financial information not be provided to the users of an investment entity's financial statements. We argue that an absence of consolidation information will enhance the readability of financial statements.
- We note that investment entities could voluntarily prepare consolidated financial information in addition to fair value information. Users could request such additional financial statement disclosures, if desired. This would be determined on a case-by-case basis by the responsible entity/trustee and investment manager. If consolidated financial information was considered relevant, a resulting market practice would develop, as has been the case for the reporting of fair value information and other information not required by financial reporting standards (for example, unit pricing and performance reporting).
- We believe that the broader investment management market will ultimately determine industry practice. Investors will decide whether the additional information provided by consolidating investee entities is more transparent and valuable to them than fair valuing those entities and, if so, will demand that investment entities provide consolidated information (in addition to the fair value disclosures that would be provided under the IFRS 10 amendments). If the responsible entity, trustee or manager of an investment entity resists these demands, the investor has the option of transferring their capital to another investment entity that does prepare consolidated financial information.

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3: If the AASB's proposals proceed, comment on whether you agree with not providing relief to Tier 2 entities from any of the proposed Australian additional disclosure requirements.

- For the reasons outlined previously in this document, we believe that, in the unwelcome scenario that the AASB mandates consolidated information disclosures, relief should be provided to Tier 2 entities under the AASB's 'Reduced Disclosure Regime' ('RDR').
- We understand that the AASB's objective in developing the RDR was to reduce the reporting burden for eligible entities whilst providing sufficient and relevant information to users on a timely basis. Accordingly, we don't believe that the preparation of consolidated financial information by investment entities would meet the objective of the RDR.

4: Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to (a) not-for-profit entities, and (b) public sector entities.

- We are not aware of any Australian regulatory requirements to include additional consolidation disclosures in the financial statements of investment entities. Accordingly, we believe that the full adoption of the IFRS 10 amendments would not have any adverse impacts.

5: Comment on whether, overall, the proposals would result in financial statements that would be relevant to users.

- As previously outlined in this Appendix, we believe that:
  - The additional disclosures proposed in ED 233 would not be useful to users and would therefore provide no benefit to their decision-making. The AASB's full adoption of the IFRS 10 amendments would result in the financial statements of investment entities being more relevant to their users.
  - The provision of consolidated financial information does not provide meaningful information to the users of the financial statements of investment entities because fair value measurement is considered to be an appropriate representation of the manner in which investment entities are managed, marketed and reported to investors from a product perspective (for example, in product disclosure statements, information memoranda, performance reporting and unit pricing). Accordingly, fair value is the predominant basis upon which the users of financial statements of investment entities make their economic decisions.

6: Comment on whether the proposals are in the best interests of the Australian economy

- As previously outlined in this Appendix, we believe that:
  - The requirement to prepare consolidated financial information will impose unnecessary costs on Australian investment entities, which will adversely impact returns to investors, in the event that these costs are borne by the investment entities, or fees earned by the responsible entity/trustee/investment manager, in the event that these costs are not passed on to the investment entities.
  - The delay in providing investors with audited financial statements, due to the practicalities involved in obtaining underlying financial information for the preparation and audit of consolidated financial information, will result in Australian investment managers becoming increasingly uncompetitive, when compared to North American and European competitors, who are not required to prepare audited consolidated financial information.
  - Prior to the IASB amending IFRS 10, Australian investment entities were on a level playing field with other jurisdictions preparing financial statements under IFRS. However, should the proposals contained in ED 233 be adopted, Australian investment entities will be out-of-step with global practice. This is of particular concern, since the amendments to IFRS 10 achieve closer alignment of financial reporting by investment entities under US Generally Accepted Accounting Practice. We believe that it is vital that Australian investment entities do not carry an undue financial reporting burden compared to their competitors in global markets.
- In addition, we believe that the requirement to prepare consolidated financial information could potentially give rise to modified auditor reporting (for example, qualified opinions) for Australian investment entities that are unable to obtain the appropriate underlying financial information for the preparation and audit of consolidated financial statements that incorporate foreign investment entities, for example, in the hedge fund industry.
- Conversely, if the information that is obtained for the purpose of preparing consolidated information is unaudited, preparers of financial statements could request their auditors to perform additional work to obtain the necessary assurance over the underlying financial information, which would only result in increased costs of financial reporting in Australia and further erode returns to investors or profits of responsible entities/trustees/investment managers. This would invariably lead to restricted economic growth by those parties.

7: Comment on the costs and benefits of the proposals relative to current requirements, whether quantitative (financial or non-financial) or qualitative.

- We have already outlined a number of cost considerations in the preceding items 1 to 6. In addition, we believe that the proposal contained in ED 233 would be cost neutral or more costly, due to the requirement to prepare and audit two sets of financial information. However, the adoption of IFRS 10 with no amendment would result in a significant cost reduction for investment entities and this is our preferred option.
- In considering the relative costs of producing fair value disclosures versus consolidated disclosures, it has been our experience that the majority of the information required to prepare fair value disclosures is already produced internally and therefore would not create any significant additional cost or burden on preparers. This is primarily due to investment entities typically being promoted, managed, performance-reported and unit-priced on a fair value basis.
- We reiterate our belief that consolidated information does not provide relevant information to the users, therefore does not provide any benefit for the significant cost that is incurred in preparing it. This includes consideration of the cost of time to obtain data required for disclosure of consolidated financial information, in particular from non-Australian jurisdictions, where such information is not necessarily obtained for local reporting purposes. Such time loss can also result in unnecessary delays in operational processes, such as unit pricing, distribution calculations and performance reporting. Users of financial statements will not benefit from additional unnecessary disclosures at the cost of delays in the availability of audited fair value information.
- We note that our view is consistent with 'Alternative View 2', which states that 'In our view, requiring Australian additional disclosures...only imposes significant additional costs on Australian investment entities relative to their international counterparts'.

[illegible] whether quantitative (financial or non-financial) or qualitative.

- We have already outlined a number of cost considerations in the preceding items 1 to 6. In addition, we believe that the proposal contained in ED 213 would be cost neutral or more costly due to [illegible]. However, the [illegible] with [illegible] would result in a significant cost reduction for [illegible] and this is our preferred option.

- In considering the relative costs of providing fair value disclosures versus cost-based disclosures, it has been our experience that [illegible] fair value disclosures [illegible] internally and [illegible] would not involve any significant additional cost [illegible] calculations.

- We reiterate our belief that consolidated information does not provide relevant information to the users and therefore does not provide any benefit for the significant cost that is incurred in preparing it. This requires consolidation of [illegible] required for disclosure of consolidated [illegible] information, in particular from [illegible] jurisdictions where such information is not [illegible] obtained for local reporting purposes. [illegible] processes, such as [illegible] and performance reporting. Users of financial statements will not benefit from additional [illegible] disclosures at the cost of [illegible] the availability of [illegible] fair value information.

- We note that our view is consistent with Alternative View [illegible], which states that [illegible] additional [illegible] disclosures [illegible] additional costs on Australian [illegible] relative to their international counterparts.