

710/2 York Street  
Sydney NSW 2000

8 March 2013

The Chairman  
AASB  
PO Box 204  
Collins Street West VIC 8007*By email*

Dear Kevin

**Re: ED 233 Australian Additional Disclosures – Investment Entities**

Westworth Kemp Consultants value the opportunity to provide feedback into the consultative process surrounding the auditor's responsibilities relating to other information in documents containing or accompanying audited financial statements. We are a boutique consultancy specialising in financial reporting, assurance and compliance issues, particularly in the context of litigation and dispute resolution ([www.westworthkemp.com.au](http://www.westworthkemp.com.au)).

We are writing to express our grave concern with the tenor of this exposure draft. In 2002, the FRC decided that Australia should adopt IFRS, a decision that was implemented by the AASB issuing a "stable platform" of converged Australian standards in 2004, the application of which resulted in compliance with IFRS. At that point, Australia ceded its sovereignty in terms of standard-setting for publicly accountable private sector entities and the role of the AASB became the role of a commentator and lobbyist in an international forum. Shortly after the changeover to AIFRS took place, the few optional treatments permitted under IFRS were reinserted into the standards and many of the remaining Aus paragraphs were removed to ensure, as far as possible, complete convergence. Australian entities then had access to all the accounting treatments permitted under IFRS overseas. To insert significant new Australian disclosure requirements now and to delay the adoption of a standard that was passed by the IASB in October 2012 is in our view a retrograde step. Furthermore Australian investment entities are being prejudiced in an international context by being prevented from early-adopting the October 2012 amendments.

We understand that control based consolidation has been a key feature of Australian financial reporting for a long time and has stood Australia in good stead, but in our view there are circumstances where the nature of the investor relationship is better portrayed by accounting for the investment at fair value.

Furthermore, we object to the implicit encouragement in BC 19 of ED 233 to present the additional disclosures on the face of the primary financial statements. In our view, this treatment is potentially misleading as it would result in financial statements that appeared not to comply with IFRS and is also out of synchronisation with the views of ASIC presented in their paper on *Disclosing non-IFRS Financial Information*, RG 230. We note paragraph 35: "Any non-IFRS financial information necessary to give a true and fair view of the financial position and performance of the entity should be presented in accordance with the principles in this guide. In particular, it should not be presented in a manner that may mislead or deceive. For example, that information should not be given greater prominence than

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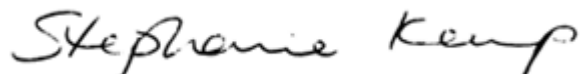
IFRS financial information and it should be clear that it has not been prepared in accordance with accounting standards.” These proposals advocate the insertion of non-IFRS financial information by an AASB standard, which is, in our view, an unsatisfactory situation.

We attach hereto our responses to the questions for specific comment. If you wish to discuss any of these matters further, please contact me at [chris@westworthkemp.com.au](mailto:chris@westworthkemp.com.au).

Yours faithfully



Chris Westworth, LLB, FCA, FAICD



Stephanie Kemp MA, FCA

## Appendix: the AASB's specific questions

The AASB would particularly value comments on the following:

*1 the appropriateness of the proposed Australian additional disclosures and whether such disclosures are warranted;*

As we noted in our covering letter, Australia effectively relinquished standard setting for publicly accountable private sector entities when the decision was made in 2002 to adopt IFRS and the loss of freedom to develop private sector standards was an accepted cost, which would be outweighed by the benefits of direct comparability, such as a lower cost of capital and lower costs for preparers, auditors and users of financial statements<sup>1</sup>.

The IASB conducts an extensive due process prior to issuing a standard and national standard setters can lobby for their preferred outcome. From time to time national interests come second to the benefits of global comparability. The IASB has concluded that, for investment entities, consolidation does not convey information that is useful for users. In our view, therefore, to then propose a standard that requires the inclusion of a consolidation is at odds with the requirements established by the IASB.

Because the proposals are so at odds with IFRS, they do not fall within the provisions of AASB 101 (IAS 1) paragraph 15 which allows the inclusion of additional information to allow fair presentation. To run that argument would be to argue that the standards set by the IASB, which specifically exempt investment entities from consolidating, do not give a fair presentation. Such a view undermines the whole principle of international harmonization, achieved by using IFRS as the basis for Australian financial reporting and is at odds with the powers of AASB set out in s227 of the ASIC Act.<sup>2</sup> Consequently, if ED 233 is issued as a standard, Australian companies complying with the standard would therefore not be able to make the unequivocal statement of compliance with IFRS required by AASB 101 (IAS 1) paragraph 16.

If the AASB proceeds with adding these extra disclosures, it is vital that the information be presented in the notes rather than on the face of the financial statements to ensure that readers do not mistake the additional disclosures for the primary IFRS compliant financial statements.

*2 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;*

The AASB appears to have concluded, without explicit justification, that the fair value information required by the IASB's *Investment Entities* amendments is inferior to

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<sup>1</sup> AASB presentation [http://www.aasb.gov.au/admin/file/content102/c3/IFRS\\_adoption\\_in\\_Australia\\_Sept\\_2009.pdf](http://www.aasb.gov.au/admin/file/content102/c3/IFRS_adoption_in_Australia_Sept_2009.pdf)

<sup>2</sup> S227(4) provides AASB with only limited powers to modify international standards "to the extent necessary to take account of the Australian legal or institutional environment and, in particular, to ensure that any disclosure and transparency provisions in the standard are appropriate to the Australian legal or institutional environment"

consolidated information and that its loss has an “adverse impact on decision making”. In our view, for the reasons outlined below, this is not the case for investment entities.

The exposure draft contains no substantial argument to support an approach so significantly counter to the one established by IASB, other than a statement of belief that consolidated financial information is useful for users<sup>3</sup>. This does not address the significant arguments put by IASB in its bases for conclusion for the IFRS.

Nor are we convinced that there is empirical evidence to support the views expressed in Alternative View 1 and in particular AV1.3<sup>4</sup>. In our view fair value accounting for investments, while merging assets and liabilities into one fair valued figure, is not the same as off balance sheet accounting.

The IASB’s “Amendments to the Basis for Conclusions on IFRS 10 *Consolidated Financial Statements*”, which was excluded from the Australian republication in ED 233, sets out (inter alia at BC 215-235) the empiric work undertaken by IASB to consider whether an exception to consolidation was appropriate. In doing so IASB has determined the circumstances in which, for investment entities, the fair value of their investment provides the most relevant information to users in evaluating the investment entity’s financial position and operations.

The IASB’s approach was based on discussions with respondents and joint deliberations with the FASB, from which it formed the conclusion that fair value rather than consolidation most clearly reflects the purpose of the investment entity – the modus operandi of the investment entity is to buy and sell investments, deriving its benefits from investment income and capital appreciation, rather than from operating the underlying assets (inter alia BC238 in the proposed amendments to the IFRS 10 BC). Therefore the pertinent information is information about the performance of the investments as investments and this information is lost when the assets and liabilities of a variety of investee businesses are merged through a process of consolidation.

Our experience of the past practice of venture capital and private equity entities in Australia is that presenting information in the manner proposed in the IFRS Amendments most fully represents to investors in those entities the activities that formed the basis of their investment decisions namely:

- Because the purpose was to invest in (and develop for sale) discrete investments, the nature of those investments had more affinity with inventory than investments by other entities which are and should be consolidated. Such investments are generally bought at various times and sold at various times during an investment entities life. In such circumstances consolidation masks the value of the investments and their performance. By contrast reporting of the fair value of the investments during the period in which they are held measures the manner in which those assets are performing which in our experience is what investors need.

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<sup>3</sup> Paragraph 9 of the Basis for Conclusions in ED 233 expresses concern about the impact that “the loss of consolidation information could have on the decision-making of a wide range of users ... in order to make informed assessments of an entity’s financial position and financial performance.”

<sup>4</sup> “the exception to consolidation would require deconsolidation of controlled entities when Australia has been well-served by the control principle and has been relatively free of criticism of off-balance sheet accounting”.

- Circumstances can render the provision of consolidated information less useful.
  - Firstly as recognised by IASB in the Basis for Conclusion to the original IASB exposure draft at paragraph BC4, when the investment entity holds controlling stakes in some investments but not in others the quality of the information is further blurred. Without the IFRS Amendment, investments held for the same purpose would be either consolidated or held at fair value, as required by accounting standards, while the purpose of ownership is the same.
  - Secondly there are circumstances where an entity may inadvertently end up controlling an entity that it does not wish to control. This occurred through the operation of clauses in agreements triggered by the violent market movements of the past financial crisis. In such circumstances, for all practical purposes the investor entity will still not exercise control over the investee and seek to escape that position even though for a period it has the capacity to control the investee.

In conclusion, in our view, the decision as to whether investees should be consolidated or not should, as set out in the IASB's *Investment Entity* amendment, depend on the reasons why the investments are held. Investments held by investment entities are held as discrete investments with an ultimate plan for sale. Those that should be consolidated are in broad terms held as operating assets managed and operated more or else collectively.

This distinction between operating and investing assets has already been recognised within accounting standards with the split between operating, financing and investing in AASB 107 (IAS 7) *Cash Flow Statements*. Standard setters perceive a distinction between assets that are being actively managed to generate operating income and those that are being passively held. The use of an entity's business model to determine reporting is seen in AASB 8 (IFRS 8) *Segment Reporting*.

Consequently we do not view the IASB's approach as resulting in a loss of information that users need for decision making.

*3 if the AASB's proposals proceed, whether you agree with not providing relief to Tier 2 entities from any of the proposed Australian additional disclosure requirements;*

We disagree with the proposed additional disclosure in ED 233 and would therefore support relief for Tier 2 entities if the AASB proceeds with these proposals.

*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;*

If an entity satisfies the definition of an investment entity, it should be permitted to use these amendments regardless of the sector in which it operates. The IASB's

amendments would also be of use to superannuation funds and philanthropic foundations.

The AASB should avoid at all costs setting a standard that appears to conflict with IFRS.

We would also like to register our displeasure at the omission of pages 27 to 57 of the version of the IASB's *Investment Entities* standard that was included in ED 233. This omission deprives Australian constituents of the opportunity of considering fully the IASB's reasoning and undermines the AASB's due process.

*5 whether, overall, the proposals would result in financial statements that would be relevant to users;*

In our view, for the reasons explained at question 3, the preparation of consolidated information as proposed by investment entities would not result in financial statements that would be relevant to users.

*6 whether the proposals are in the best interests of the Australian economy; and*

The proposals in ED 233 are not in the best interests of the Australian economy.

They introduce unnecessary differences between Australian standards and IFRS and would result in a lack of comparability with entities overseas. At worst it could result in renewed confusion about the extent to which Australia has adopted IFRS.

*7 unless already provided in response to specific matters for comment 1 – 6 above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative]*

The proposals would result in increased costs to users as investment entities would have to provide two sets of financial information. Australian entities would face a higher cost of compliance than their overseas counterparts.

In addition, if the additional disclosures are shown on the face of the financial statements, the profit figure under consolidation would be different from that under fair value accounting, reducing comparability between Australian and overseas entities and thereby undermining the credibility of Australian financial information and potentially even contributing to an increased cost of capital.