MMC
FUND ADMINISTRATION

The Chairman
Australian Accounting Standards Board
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AUSTRALIA

Email: standard@aasb.gov.au

19 February 2013

Dear Sir,

Australian Additional Disclosures – Investment Entities (proposed amendments to AASB 1054)

MMC Limited ("MMC") is pleased to make a submission on the Australian Accounting Standards Board (AASB) Exposure Draft 233 (ED 233), Australian Additional Disclosures – Investment Entities.

This submission focuses on the impact to our business of the existing International Financial Reporting Standards (IFRS) and the changes proposed by the International Accounting Standards Board (IASB) through amendments to IFRS 10, IFRS 12 and IAS 27.

MMC strongly supports the IASB proposal to exempt investment entities from consolidating entities; instead allowing those qualifying entities to fair value them. The new IASB proposal will in our view, make financial reporting more useful for decision making purposes than consolidated accounts.

If you would like to clarify any point made in the submission, please do not hesitate to contact Paul Bishop on +64 9 307 9911.

Yours sincerely,

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Introduction

1.1 MMC Limited is an outsourced service provider of fund administration services to New Zealand Investment Managers.

1.2 MMC provides services to 30 clients with funds under management of in excess of $10bn and spanning more than 300 investment funds. Currently, MMC produces approximately 150 sets of financial statements each year.

1.3 New Zealand's Financial Reporting Standard 44 (FRS 44) - New Zealand Additional Disclosures, sets out New Zealand specific disclosures for entities that have adopted New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) and **supports the objective of harmonising financial reporting standards in Australia and New Zealand**.

1.4 Therefore, as preparers of financial statements that comply with NZ IFRS, MMC has an active interest in the standard setting in Australia and its likely impact on our own financial reporting regime – particularly those standards impacting investment entities.

1.5 The following are submissions for the AASB ED 233, Australian Additional Disclosures – Investment Entities.

- **Appropriateness of the proposed Australian additional disclosures**

2.1 The AASB has asked for comment on the appropriateness of the proposed disclosures – that is the disclosure of consolidated financial statements comprising:

- a consolidated financial statement of profit or loss and other comprehensive income
- a consolidated statement of financial position
- a consolidated statement of changes in equity
- a consolidated statement of cash flows.

2.2 In our experience the vast majority of investment entities that we deal with are unit trusts or superannuation schemes. This means that their objectives are simple – to pool investors' money, make investments in order to provide capital appreciation and investment income and measure and evaluate performance on a fair value basis.

2.3 We believe that including consolidated financial statements hampers and does not help user's ability to make financial decisions for the following reasons:

- The definition of control is somewhat theoretical in the investment funds industry particularly where control can change daily where investments in an open ended investment funds are concerned.

- Where an investment fund invests into multiple open ended investment funds, there may be inconsistency of accounting treatment whereby some underlying investments are fair valued while others are consolidated.

- Information is presented of investees rather than the investment fund itself.

- Information flowing from investees is often slow and unreliable thus impacting the usefulness of financial information in terms of timeliness and reliability.

2.4 Control:

Currently, MMC consolidates investment fund investees where the ownership interest exceeds 75%. This threshold is based on the Unit Trust Act which allows unit holders to have the power by resolution at a meeting of unit holders to direct the trustee as they think proper, provided that not less than three quarters of the interests in the unit trust agree to it.

As fund administrators to numerous investment funds, MMC observes changes in control of underlying funds by virtue of ownership thresholds changing on a regular, if not daily basis. This is mainly seen where investments are made in other open ended investment funds whose offering documents permit the daily buying and selling of units. At its extreme, investment funds may control an underlying investment fund one day, lose it the next and regain it again a day or so later. This is all possible because other investors may buy and sell at their own notion without any consultation or restriction.

The flow on impact to the financial statements is that an entity may control underlying investments for part periods. How is it possible for an investor to understand the financial position and financial performance of an investment which is consolidated one day and not the next, all through the actions of other unit holders?

2.5 Inconsistency:

MMC has a number of fund of funds investments – an investment mechanism whereby investment funds invest into other investment funds. The fund of fund structure has not been established as a method of control but to gain efficiencies primarily for the benefit of unit holders. Efficiencies exist whereby direct investments can be held in 5-6 single sector funds, rather than each and every investment fund holding its own portfolio of direct investments covering a wide range of investment options. Administration and compliance costs are reduced, thus saving money for investors.

When preparing financial statements for retail funds, underlying investments may include 5-6 single sector investment funds. It is common to observe such funds consolidating those underlying investment funds where ownership is greater than 75% but fair valuing other investments (for example less than 75% ownership). In our view this is confusing to investors as treatments differ depending on the level of ownership of an underlying investment, when in practice there is no real differentiation between the 5-6 investments especially if ownership levels vary by only for example 5% (the difference between say 75% and 70%).

2.6 Investee information:

Consolidated financial statements focus on the financial position, performance and cash flows of the whole group entity rather than the investment fund itself. With the growth of Kiwisaver in New Zealand, many Kiwisaver schemes offered to the New Zealand public are of such size now that underlying wholesale investment funds that are used as fund of fund vehicles are subject to consolidation rules. This means that regularly mum and dad investors are now presented with financial statements of a group rather than the single fund they invest in. Whilst it is important to explain the nature of investments and their objectives, it adds complexity to the way an investor reads and understands their investment.

For example, one Kiwisaver scheme invests into multiple wholesale funds, who in turn invest into multiple external and internal investment funds. The group presentation is very complex and time-consuming to prepare and understand and adds little to what readers need to evaluate their investment choice. In fact, without additional reconciliation's or disclosures, the net asset position of a consolidated entity in the financial statements, often bears little resemblance to a unit price struck at year end.

MMC believes that the focus of the accounting standards should be on what information is useful to users of the investment entities financial statements.

In our view some meaningful information to readers of the financial statements, which can be considered for disclosure are:

- name and country of incorporation of the controlled investment fund
- investment objectives, risks and types of securities held during the financial period
- size of the investment in relation to the size of the total investment portfolio;
- investment balance at year end and income derived for the period
- percentage holding held in the controlled investment fund by the investment entity; and
- the controlled entity's redemption restrictions.

Separate disclosure of the controlled subsidiary will provide the user with an understanding of the concentration of the investment in the unconsolidated entities in relation to the entity's overall investment portfolio. This will also provide an understanding of the significance of this investment in relation to the entity as a whole from a quantitative perspective.

The percentage holding will provide an indication to the user of the total size of the unconsolidated controlled entities as well as the level of influence the investment entity has over the unconsolidated subsidiary.

Further narrative disclosure will provide the user of the investment entity with an indication of the financial risks associated with the investment such as liquidity, geographic and industry risk including the potential risks associated with controlled entity's investment objectives.

In our view, the main focus of an investor in an investment will be the performance and position of the fund it invests into (that is the entity controlling the other investments) as well as any significant risks associated with its investments.

In regards to the Consolidated Statement of Cash Flows, the information presented provides little value to investors other than an indication of stock turnover and unit holder movements for the group entity. In our view the consolidated cash flows result will be even more meaningless as the users are not interested in the cash flow movements of an underlying investment entity.

2.7 Information flow

We currently experience consolidation issues around underlying investments which are managed and administered externally (including internationally) and that have different balance sheet dates. More often than not, the timing of information can be 4-5 months following the year end meaning that filing with regulators and communicating with investors occurs around 6 months after the year has finished.

Furthermore, where investments have differing balance sheet dates, the information used is based on management type accounts that usually relate back to the underlying funds unit price and not NZ IFRS compliant financial statements. This impacts investors by not having timely and in some cases reliable information for reporting purposes due to the current consolidation rules.

3 Summary

We agree that with the amendments made to NZ IFRS 10, there is a potential risk that some meaningful information might get lost in relation to investments in unconsolidated subsidiaries. We do not agree that consolidated financial statements need to be disclosed for investment entities. It is important that careful consideration should be given as to what essential additional information users of an investment entity's financial statements will be interested in with respect to investments in controlled entities that is not currently required under International Financial Reporting Standards.

These are:

- name and country of incorporation of the controlled investment fund
- investment objectives, risks and types of securities held during the financial period
- size of the investment in relation to the size of the total investment portfolio;
- investment balance at year end and income derived for the period
- percentage holding held in the controlled investment fund by the investment entity; and
- the controlled entity's redemption restrictions.