22 June 2010

Technical Director
File Reference No. 1810-100,
Financial Accounting Standards Board,
401 Merritt 7,
PO Box 5116,
Norwalk,
CT 06856-5116,
USA

Dear Sir or Madam,

SUBMISSION WITH REGARDS TO “Exposure Draft on Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities”

The IASB have asked their constituents to submit comments on the above Exposure Draft of the proposed Accounting Standards Update, which the IASB and the FASB will use as part of their global convergence project.

The Australian Listed Investment Companies Association (“ALICA”) welcomes the opportunity to do so, and is grateful to the FASB for being receptive to comments from organisations other than their own constituents.

ALICA represents amongst its members over 200,000 retail shareholders. Listed Investment Companies are entities that are publicly quoted on the Australian Securities Exchange and provide, like US mutual funds, a cheap and efficient way for retail shareholders to obtain a broad exposure to equity investments. They have a long history in Australia, in some case stretching back over 80 years, and are well-recognised as an investment vehicle in the local market. As publicly-listed companies, they have the same accounting and reporting requirements as all other Companies, and therefore any changes to IASB standards, whose use is mandated in Australia, have a direct impact on their reporting and communication to stakeholders. Due to the global convergence project between IASB and FASB, ALICA are aware that any proposed changes by the FASB to their Accounting Standards may influence future IASB standards and consequently Australian Accounting Standards.

It is important to note that the member organisations of ALICA would not qualify as ‘investment companies’ under the FASB definitions, as they do not have a pre-determined exit point for their investments. They take a ‘buy-and-hold’ approach and are essentially long-only equity investors rather than private equity companies who purchase businesses or stakes in businesses for the purpose of restructuring and/or selling at a profit in the near to mid-term. They also report ‘Other Comprehensive Income’ as part of their financial statements, unlike FASB-denominated ‘investment companies’.

ALICA, and its constituent members, participated in the discussion leading up to the release of IFRS 9 Financial Instruments both directly with the IASB and through the Australian Accounting Standards Board.
On the whole, ALICA was pleased with the final version of the Standard, which addressed many of the issues that ALICA, and others, had with the exposure draft concerning the accounting treatment for equity investments.

As ALICA and its member companies are not constituents of the FASB, we have confined our comments only to the areas that are of greatest interest, and possibly greatest impact, to it.

Question 23 – The proposed guidance would establish fair value with all changes in fair value recognised in net income as the default classification and measurement category for financial instruments ……

Paragraph 20 states that ‘An entity shall include in net income for the current period all changes in the fair value of its financial instruments ….. For example, an entity shall report in net income all changes in the fair value of equity instruments held …’

The investments that ALICA members make are predominantly based on a business strategy to invest in certain companies for the long-term, to hold the investments and collect the cash-flows that are distributed by the companies in which they invest.

Appendix A “Comparison of the FASB’s and the IASB’s Proposed Models for Financial Instruments” notes the difference with IFRS 9 permitting companies to measure changes in fair value on such long-term equity investments through other comprehensive income.

ALICA would argue strongly in favour of the IASB’s treatment. As companies, ALICA members invest their capital in the (predominantly) equity instruments of other companies. They use this capital to derive an income for their shareholders in the form of dividends and distributions. Any sales or disposals of these investments are considered part of the recycling of capital, and therefore realised gains on disposals are also measured in other comprehensive income rather than being recycled through net income.

The FASB’s treatment would therefore force a distinction in treatment between companies that use their capital to invest in other companies from companies that use their capital to invest in plant and machinery to derive an income.

The effect of having all of the ALICA member’s long-term investments fair value changes going through net income would lead to extreme volatility between periods. In ALICA’s view, this would give a misleading view of ‘net income’ to shareholders and other users, who would report the companies making a ‘loss’ when the market goes down or a profit when it goes up. These figures would have no relation to the level of income that has been generated by the company’s investments, and consequently no relation to the dividends that an ALICA member’s shareholder might expect.

As noted, ALICA member companies do report other comprehensive income, and in addition report the effective fair value of their investments through a monthly release to the market. Consequently, shareholders and users of the accounts have access to the movement in the value of the investments without such information having to be recycled through net income.

ALICA would suggest that the exceptions noted in paragraph 21 b. whereby changes in the fair value for instruments that are held when ‘the entity’s business strategy for the instrument is to collect … the related [contractual] cash-flows rather than to sell the financial asset ..’ be extended to equity instruments rather than as currently suggested just applying to debt instruments. This reflects the business strategy of ALICA’s members, which is to hold the investments and collect and distribute the dividends and distributions received as the income generated by its capital. If this were adopted, paragraph 21 a. would need to be changed to read “It is an equity instrument or a debt instrument held or issued….”

—— letter 2-1.docx
In some cases, ALICA members do have some securities that they purchase for 'trading'. In these instances, they act like any other trader and it is right that such securities are measured at fair value through net income.

**Question 11 – Do you agree that transaction fees and costs should be expensed immediately for financial instruments measured at fair value with all changes in fair value recognised in net income?**

Not if changes in fair value do not go through net income (as suggested above). Transaction fees and costs with regard to equity investments (i.e. brokerage) are part of the purchase (and disposal) price of investments, and should be capitalised as such. This is the current treatment under IFRS and is consistent with market practice in Australia. Expensing such items does not reflect the actual cost of the asset.

Obviously for securities with changes in fair value through net income, the effect is the same whenever there is actually a change in the fair value of an asset.

**Question 13 – Do you believe that the default measurement attribute for financial instruments should be fair value?**

Yes, but see comments above.

ALICA would once again like to thank the FASB for the opportunity to comment on the exposure draft, and would be happy to expand on any of the comments made at the FASB’s discretion.

Yours sincerely

[Signature]

Frank Gooch
Chairman