Returns from Fiji National Provident Fund: Accounting Myth vs. Economic Reality

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Abstract

This paper reviews the accounting practices employed by the Fiji National Provident Fund in reporting its investment interests in Amalgamated Telecom Holdings Fiji Limited. It demonstrates that the FNPF initially failed to observe financial reporting regulations and by so doing reflected a higher return on the investment then would have been the case under generally accepted accounting practices. FNPF changed its accounting practices only when conformity with regulations allowed it to report superior returns than the non-compliant approach initially adopted. The paper demonstrates that FNPF's opportunistic reporting practices have served to benefit those who have recently taken a pension, or are about to do so and those who have recently or will shortly leave fund membership. Conversely newer members and those about to join have been disadvantaged. The paper also considers developments in the regulation of financial reporting, which are due to be adopted in Fiji in 2006 that will impact on the returns the FNPF reports and the consequences for fund members' accounts.

The Past and Present: A Failure of Compliance

In 1999 the Fiji government set up Amalgamated Telecom Holdings Ltd (ATH), as a corporation holding all the Government's equity in the

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various companies operating in the state owned telecommunication industry. It did so with the intent to sell off initially 49% of its interest to a private investor. While it has been argued that the decision was taken to enable the government to meet the shortfall in its finances created by the National Bank of Fiji (NBF) fiasco (Grynberg, et al 2002), it was expected that the equity would be sold to a strategic partner, which would facilitate the development of Fiji's telecommunication's industry. The initiative attracted only two bids from entities established in the telecommunications industry, Cable and Wireless and French Telecom, both of which placed a low, and probably unrealistically low, valuation on the equity offered for sale. Had either bid been successful the government would have undoubtedly passed over control of ATH operations to the strategic partner, which would, under financial reporting regulations, have been obliged to consolidate ATH's profits and net assets in its financial reports, control rather than shareholding being the key determinant in making consolidations (*International Accounting Standard* (IAS) 27, and its Fiji equivalent, paragraph 12).

The government financial target for the sale of ATH's equity was met by the bid of the Fiji National Provident Fund (FNPF). The bid was controversial on two counts. First, and obviously, the FNPF had no expertise in running a telecommunications organisation. It scarcely filled the role of a strategic partner. Second, while ATH was undoubtedly financially sound, FNPF's bid of over $254 millions was, and is, considered by many to be way too high.

The FNPF can undoubtedly argue that limited alternative investment opportunities made the initial acquisition a sensible one. A 49% holding, prima facie, does not represent control and there is no reason to expect the government as majority shareholder to pass control of a telecommunications company to a pension fund. However, FNPF subsequently acquired an additional 2% of equity in ATH in 2000. The additional purchase was made for just over $9 million, a discount of 13% on the price per share for the initial acquisition, but still at a price regarded by many as well in excess of the equity's fair value. Such behaviour was that of an investor seeking control over the investee, although FNPF made no such claim at the time of the purchase or in its annual reports for the year ended 30th June 2000. However, FNPF has nominated the majority of the directors to the ATH board since 2000 (ATH, 2000, 2001, 2002, 2003, 2004), further evidence that control exists. The FNPF first stated that it controlled ATH in its annual report for the year ended 30th June 2001. FNPF's annual report for the year ended 30th June 2002 stated that the fund does control ATH, but stipulates that such control is intended to be temporary and does not consolidate ATH in its annual financial reports.

On what grounds could FNPF justify non-consolidation? Notwithstanding *IAS27 Consolidated Financial Statements and Accounting for Investments in Subsidiaries* paragraph 14, which states that entities should consolidate irrespective of the fact that holding companies and subsidiaries operate in fundamentally different industries, financial institutions around the world have avoided consolidation of subsidiaries precisely on this ground. The investor justifies the non-consolidation by claiming that even where control exists it is deemed passive as the financial institution does not have the expertise to direct that subsidiary. Such direction, de facto, lies with the management of the subsidiaries. This is clearly a dangerous view to adopt. Members of pension funds, unit trusts, etc., would clearly be concerned if such investments were not kept under strategic control, particularly given the instances of management misappropriation and greed that have surfaced recently, particularly in the United States of America, and the consequences of such behaviour for investors (Financial Times, 2003). The concern of the International Accounting Standards Board (IASB) over this issue was reflected by the introduction of a new provision in 2003. This was incorporated into paragraph 19, to IAS27, which reads as follows: 'a subsidiary is not excluded from consolidation simply because the investor is a venture capital organisation, mutual fund, unit trust or similar entity.'

This serves to make explicit a requirement, which was already embedded in the regulation.

IAS27 permits non-consolidation of controlled subsidiaries where control is temporary as claimed by FNPF (paragraph 13). The FNPF's claim requires testing. In view of the FNPF's acquisition policy the intent is difficult to accept. Why acquire the critical 2% of equity to move the holding from 49% to 51%, if it was not to acquire control? If control is intended to be temporary why acquire a further 7.2% of equity when a public offering was made? Surely the FNPF would be looking to reduce its holdings, or look for another institution, which has the expertise to provide strategic direction for ATH to take over the entire investment, or at least the greater part of it. Neither option appears viable. The total value of all share trades on the South Pacific Stock Exchange in all listed companies in the year following ATH's listing in 2002 amounted to less than $10million (Chand, 2003). Trading activity in 2003 was even lower, with the total value of trades being under $5 million, rising to nearly $13 million in 2004 (South Pacific Stock Exchange, 2005). Comparing this with FNPF's total investment in ATH as at 30th June 2002 of $295million, it is clear that FNPF does not have the scope to sell down its holding to below 50% without drastically reducing the market price of the shares and in consequence reporting a substantial loss. Indeed, even if it were to do so it would remain the largest single shareholder by far and therefore retain de facto control. To relinquish control it may well have to sell down its holding to below the 35% still held by the government.

Can FNPF sell off its entire holding to another telecommunications company? In view of the disinterest shown by established operations in 1999, it seems unlikely that the FNPF would have any more success now. Deregulation of the telecommunication industry was set to start in 2004. While this has been delayed, deferral may be of little help. As early as 2003 Telpac attempted to break into the Fiji telecommunications market. At the same time the Fiji Electricity Authority began exploring the possibility of using power lines for telecommunications (Tabureguci, 2003). In 2005 Pacific Connex sought a license to provide mobile telephony services. The company justified the application on the grounds that they use a technology not covered by the exclusivity provisions of the license granted to Vodafone (Baselala, 2005). Thus, even if regulation is retained indefinitely ATH's monopoly and associated monopoly profits cannot be expected to continue indefinitely. Any sale of the entire investment will, therefore, only come at a considerable loss.

Irrespective of the intent, the economic reality would appear to be that FNPF's control of ATH, which almost certainly existed in 2000 and certainly in 2001, was not temporary. As such generally accepted accounting practice required FNPF to consolidate ATH's performance in its financial reports for those years.

If FNPF had reported its investment in ATH in line with regulatory requirements, how would it have impacted on the returns FNPF would have reported as earnings for its members? Under the procedures FNPF employed up to 2002 it recognised the dividends earned from ATH and the gains/losses owing to movements in the market price of the investment as income. This is consistent with accounting regulation relating to the reporting of income from investments, where the conditions that require consolidation of the investees profits are not met. Gains/losses on the movements in the market price of the shares were only recognised in 2002 when ATH was listed on the South Pacific Stock Exchange (SPSE). The incomes on the investment actually reported were as in Table 1

Had ATH been consolidated, FNPF would take the proportion of ATH's profits corresponding to its shareholding and then allow for the effect of inter entity adjustments. The only material adjustment necessary will be for the amortisation of goodwill and the management rights ATH exercises over Fiji International Telecommunications Ltd (FINTEL). That is to say, the premium paid over and above the value of the percentage of the assets FNPF acquired in ATH. This premium can be derived from FNPF's annual reports as being a little over $198 million on the initial purchase of shares in 2000, with an additional $28 million with the subsequent share purchase in 2002.

Table 1: ATH's Contribution to FNPF's Income as Reported by the FNPF (Years ending: 30th June)

	2000 ($000)	2001 ($000)	2002 ($000)
Dividend income	9,849	8,536	6,317
Loss on market movements			15,000
Net income (loss)	9,849	8,536	(8,683)
Percentage return on cost of investment	3.7	3.2	(2.9)

Source: FNPF annual reports for the years ending 30th June.

The income the ATH group would have contributed to FNPF for the three years, had consolidation taken place, can now be calculated. In doing so it must be borne in mind that accounting regulation in Fiji on this point as stated in Fiji Accounting Standard, FAS22 Business Combinations, required a benchmark amortisation rate of 20% per annum to be applied on goodwill for reporting periods ending on or before 30th June 2002. This benchmark rate was to be used when it was not possible to estimate the duration of the goodwill benefit with any accuracy, but with the limitation that a lower rate could not be applied.

The FNPF board had considered consolidating ATH in the annual financial report for each of the three years and chose not to. In view of the outcomes given in Table 2 the decision is scarcely surprising.

Table 2: ATH's Contribution to FNPF's Income had Initial Reporting Regulations been Applied (for Years Ending 30th June)

	2000 ($000)	2001 ($000)	2002 ($000)
ATH Group Profit	27,947	30,144	32,910
51% Accruing to FNPF	14,253	15,373	
58.2% Accruing to FNPF			19,154
Amortisation of Intangibles	(39,679)	(39,679)	(45,280)
Loss	(25,426)	(23,706)	(26,126)

Source: ATH and FNPF annual reports for the years ending 31 March and 30th June respectively.

The figures hardly make happy reading from the perspective of fund members and may well have created an uproar among members had

FNPF consolidated and reported these losses. However Fiji's generally accepted accounting practices changed with effect from 1st July 2002, bringing regulation in Fiji into line with the provisions of the International Standard as they stood at that time. One important effect of this change in regulation was to adjust the minimum benchmark amortisation rate on goodwill to only 5% of cost per annum. Further, International Accounting Standard No.8, *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies* (1993), and its Fiji equivalent, require retrospective adjustments to financial reports with a change in accounting policy. The contribution of ATH group profits to FNPF income could be and was, therefore, restated as in Table 3.

Table 3: ATH's Contribution to FNPF's Income for Years Ending 30th June had Current Accounting Regulations been Applied

	2000 ($000)	2001 ($000)	2002 ($000)	2003 ($000)	2004[2] ($000)
ATH Group Profit accruing to FNPF prior to amortisation of Intangibles	14,253	15,373	19,154	24,502	26,780
Amortisation	(9,920)	(9,920)	11,320)	11,320)	11,320)
Gain	4,333	5,433	7,834	13,182	15,460
Return on investment	1.5%	2.1%	2.4%	4.6%	5.4%

Source: Figures have been derived from the ATH and FNPF annual reports for the years ending 31st March and 30th June respectively, save for the 2004 figures, which have been estimated by way of an extrapolation from the ATH interim financial report for the six month period ending 30th September.

These figures look somewhat healthier, although they represent an entirely unsatisfactory return on FNPF members' funds. In view of the continuing decline in the market price of ATH shares from a peak of $1.17 experienced in 2003, which would have precipitated another loss under the accounting policy initially employed, it is hardly surprising that FNPF chose to consolidate in its financial report for the year ended 30th June 2003. FNPF in its annual financial report for the year ended 30th

[2] ATH reported a 9.3% increase in profits after tax for the six months ended 30th September 2004 as compared with the comparable period for 2003. It is assumed here and throughout the paper that this increase will be sustained through the full year. On 30th June 2005 ATH announced profits for the year ended 31st March 2005 of only $40 million, a fall of 26% on the previous year. However this was due to one off write downs in the value of investments made by subsidiaries and the costs of redundancy packages incurred through a restructuring process. The underlying operating profit is broadly in line with the projections used in this paper.

June 2003 justified this change in accounting policy owing to a change in its investment strategy, with the investment in ATH no longer regarded as being temporary. However, in view of the impact the change in policy has on the reported performance on the ATH investment, the reader and FNPF members might have reason for viewing the timing of the change in policy with some cynicism. Without the policy change, FNPF would have reported a loss of $8.4 million on the investment in 2003.

While FNPF can now claim to be complying with accounting regulation, it would be wrong to simply accept the revised set of calculations as truly reflecting the contribution that the ATH investment makes to FNPF members' retirement benefits. Before applying the 5% amortisation rate the relevant accounting standard at that time, IAS22 Business Combinations (1998) and its Fiji equivalent, stipulated that 'the amortisation period and the amortisation method should be reviewed at least at every financial year end. If the estimated useful life of goodwill is significantly different from previous estimates, the amortisation period should change accordingly' (para 54). This is eminently reasonable. There is no reason to presume that goodwill will invariably last for 20 years (amortisation of 5% per annum), or for that matter, for 5 years (amortisation at 20% per annum).

To reasonably estimate the life of goodwill it is necessary first to consider its nature. The standard refers to goodwill as economic benefits arising from synergies, among other things (para 49). Such benefits may have accrued to Cable and Wireless, French Telecom, or any other telecommunications company, by linking the acquired network with their existing network. Clearly the possibility of deriving such synergistic benefits does not exist for FNPF. It should, therefore, amortise the premium payments of some $226 million directly or justify capitalisation on the basis that 'some other benefits' are enjoyed. Such benefits are clearly not obtained through inter entity trading activities, which, as might be expected, are minimal. The only other possibility would appear to be the benefit of the future monopoly profits, including those accruing through the management rights held in FINTEL.

While setting the 5% benchmark rate, accounting regulation states that 'Goodwill should be amortised on a systematic basis over its useful life. The amortisation period should reflect the best estimate of the period during which future economic benefits are expected to flow to the enterprise' (FAS 22 paragraph 44). The exclusive licenses enjoyed by ATH are due to expire at different dates, the last one expiring in 2014. By applying the benchmark rate of 5% on cost, i.e. over a period of twenty years, FNPF is clearly understating the true amortisation cost.

It is also necessary to consider accounting regulation, which seeks to prevent overvaluation in financial reports. IAS36 Impairment of Assets is the pertinent authority as the application of IAS 36 will become mandatory in Fiji from 2006. In a nutshell IAS36 requires a reporting entity to write down the amount an asset, or a group of assets, is valued at in the reporting entity's balance sheet (referred to as the carrying amount) to the present value of the cash flows that can be generated by that asset/group of assets, when the carrying amount exceeds that present value. This will clearly lead to more sensible accounting than the arbitrary benchmark set in IAS/FAS 22. ATH itself is a profitable entity. Its net profit of some $42.8 million for the year ended 31st March 2004 represented a return on net operating assets in the order of 25% (ATH, 2004). Its financial reports for the sixth months ending 30th September 2004 showed a 9.3% increase over the comparable period for 2003. The present value of its operating assets can clearly be taken to exceed these assets carrying amounts. Therefore, no write-downs are required. If FNPF is earning an unsatisfactory return on its ATH investment this must be due to the excessive carrying amount of the goodwill. What write down, if any, is required?

Goodwill Writedown

The question might be tackled by first considering the acceptable long term return to the FNPF on the ATH investment, by taking the proportion of ATH income accruing to the FNPF without making any charge for goodwill amortisation. For the year ending 31st March 2004 the return earned can be determined as 8.4% ($25 million on an outlay of $295,468,000). A return for the year ended 31st March 2005 can be projected as being 9.2%. Such a return can at best be regarded as barely satisfactory. The bulk of the investment portfolio is held in fixed interest securities, loans and term deposits. This element of the portfolio earned a return of 5.2% in the year in question (interest of $116,321,000 on a total investment of $2,248,376,000.) Part of these assets earned very low interest income on deposit with banks. The return on long term securities would, therefore, be of the order of 6% or possibly more. The bulk of the securities is issued by the government and would be regarded as risk free. ATH itself offers a 6% return to its own loan creditors, save for FNPF, which only receives 5% (ATH, 2004). Clearly the ATH investment carrying an equity risk should be earning a higher rate of return. How much higher is difficult to assess.

Reference to Fiji's capital market provides some insights, but these obviously need to be applied with caution. ATH market share price for the year ending 30th June 2004 has moved in the range of $1.04 to $1.07. During this period FNPF bought some small blocks of shares placed on the market (FNPF, 2004), which may have had a stabilising influence on the price. Since June 2004 ATH's market price rose briefly to $1.09 before falling to $1.00 by 31st March 2005, its own financial year end and $0.90 two months later. The increase in volatility in the market movements will itself create an element of increased risk for the investor. Assuming that the profits growth ATH achieved in the first half of the financial year ending 31st March 2005 is also secured in the second six months, the group's Price/Earnings ratio will be 9, giving an implied market capitalization rate of 11.1%. This represents a rise from 9.4% as at 31st March 2004. The subsequent decline in the market value of ATH's shares has pushed the Price/Earnings ratio down to 8.1 and the implied market capitalization rate out to 12.3. Given the highly imperfect nature of Fiji's capital market, this can only be seen as an approximation of the true return required. This is almost certainly the result of the Commerce Commission's determination on tariffs to be applied by the ATH group. Fiji's Commerce Commission has taken the view that a 12% return on equity is appropriate for Fiji's telecommunication industry (Commerce Commission, 2005). There is also a growing expectation in the market that ATH's monopoly position will be eroded sooner rather than later. In the absence of any further clues from the market we can consider the implications of valuing FNPF's investment in ATH with a required rate of return in the range of 9% to 13%.

It is difficult to assess the ultimate impact of the Commerce Commission's determination on ATH's profits. FINTEL's legal challenge to the determination has led to a deferral and a possible revision of the tariff changes. Difficulties also exist, partly because of acknowledged methodological limitations underlying the determination (Commerce Commission, 2005), partly because the extent of inter company transactions is not known and partly because only FINTEL out of all the companies in the ATH group places its financial reports in the public domain. Assuming that the Commission's determination is eventually implemented with no substantial changes, it will apply significant cuts in the tariffs of Interconnect Fiji Ltd, FINTEL and Vodafone. (The immediate impact on Telecom Fiji Ltd would appear to be broadly revenue neutral.) The overall impact in income accruing to FNPF, as a worst-case scenario would appear to be in the region of $6 million in the first year it is applied.[3] It

[3] Interconnect is a wholly owned subsidiary of ATH. Interconnect's revenue will be cut by some $3 million by the tariff adjustment unless traffic increases. The

would, therefore, seem appropriate to consider the value of FNPF's investment in ATH over the range of possible required returns to investors (9-13%) and reductions in current profits that might be expected from the tariff reductions. The book value of FNPF's investment can be estimated to be $315,549,000. This will comprise the tangible assets projected as being held by ATH at 31st March 2005 and the intangibles as reported by the FNPF as at 30th June 2004. An indication of the appropriate write down of the intangibles can be drawn from Tables 4a and 4b.

Table 4a: Possible Values of FNPF's Investment in ATH ($000)

Required Return	$0	$2	$4	$6
9%	302,511	280,333	258,111	235,889
10%	272,260	252,300	232,300	212,300
11%	247,508	229,364	211,182	193,000
12%	226,882	210,250	193,583	176,917
13%	209,432	194,028	178,663.	163,278

Table 4b: Write-Offs Required in Goodwill Arising from the Valuations, $000

	Loss in income arising out of the Commerce Commission's Tariff Determination ($000)				
Required Return	$0	$2	$4	$6	$8
9%	13,038	35,216	57,438	76,660	101,882
10%	43,289	63,249	83,245	103,245	123,249
11%	68,041	86,185	104,367	122,545	140,731
12%	88,607	105,229	121,966	138,632	155,299
13%	106,117	121,451	136,841	152,271	167,655

Note: The appropriate loss would have to be written off in place of the amortisation charge currently being applied of $11,320,000.

Any write down necessary will be made against the fund's invest-

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reduction in profits after tax will be about $2 million. As this will make Interconnect unprofitable it is possible that cuts in tariffs made elsewhere will reduce Interconnects costs. To the extent that these cannot be determined the potential loss of Interconnect is overstated. ATH has a 51% ownership of Vodafone. The tariff adjustment will cut Vodafone's revenues by some $20 million and profits after tax by some $14 million assuming no consequent increase in traffic. The Fiji government has a 51% holding in FINTEL. ATH receives 80% of the dividend from FINTEL that accrues on the Government shareholding, by virtue of holding the management rights. The collective adjustments to FINTEL's tariffs would seem to reduce its after tax profits by the order of $6 million, although FINTEL claim that the loss in profits will be more substantial.

ment income. The FNPF secured an income from investments of $166,321,000 for the year ending 30th June 2004. It is, therefore, possible that the fund's investment income for one year will be drastically reduced or eliminated in totality, if a write down of over valued intangibles is made.

The one-off negative return that the FNPF may well have to post if it were to recognise the impairment of goodwill in its 2005 financial report, is based on ATH's privileged market position. As the telecommunication industry is progressively deregulated, ATH will experience some loss of market share. Consequently further write-downs in the investment will almost certainly be required, owing to both the reduced revenue stream and the increased uncertainty associated with it.

It must be accepted that the discussion provided has not explicitly considered the opportunities for growth in the telecommunications industry in Fiji. The industry has certainly grown tremendously in the recent past. The 28% growth enjoyed in the financial year ended 31st March 2003 reflects this. However, growth for the following year was minimal and the projected growth for the year ended 31st March 2005 is less than 10%. Future growth potential is likely to be limited. ATH's annual report for the year ended 31st March 2004 states that the telephone line penetration rate stood at 123 per 1000 of population, just a little below the 127 per 1000 of population for countries at a comparable state of economic development. Potential future growth in Vodafone is less clear. Connections as at 31st March 2004 stood at 113,719, a 25% increase over the year (ATH, 2004). Growth continues to be impressive but it is inevitably slowing. Vodafone's investment in technology to provide capacity for 380,000 subscribers (ATH 2002), seems over optimistic to say the least. Fiji has a population of a little over 800,000 of which only 112,000 are active in the formal sector of the economy (Reserve Bank of Fiji, 2004). How many more subscriptions can such a population support?

How much further growth will be enjoyed by ATH (and how much by its future competitors) is of course a moot point. If effective ongoing protection is given to ATH it may be able to exploit any remaining growth potential. Competitors, when they eventually enter the market, may then find it that much more difficult to offer an economically viable service if they have to attract customers away from ATH than where they can secure a portion of the untapped market.

In assessing future growth potential it must be born in mind that additional capacity sold is unlikely to carry as much traffic as capacity already in use. Those with the greatest need of telecommunications can be expected to already have access to them. To continue to factor in higher growth rates on mobile phone services in line with past high growth rates would seem overly optimistic. Competition in this area will require far less start up capital than that required to offer an alternative line service. To factor in growth potential on technologies yet to be introduced would be to move from the realm of estimation to speculation. By definition the use of technologies yet to be introduced and developed are not regulated. ATH, therefore, enjoys no operating advantage over would be competitors in these areas. The attempted incursions by Telpac and the FEA into the market and the possible entry of Pacific Connex, already demonstrates that ATH's privileged market position may not be defensible even if existing regulation was retained. ATH itself in its annual reports for the year ended 31st March 2003 and 2004 strike a cautionary note on these issues.

The tale of FNPF's accounting of its investment in ATH may well carry a further twist. Applying the impairment rule to value goodwill is clearly a conceptually superior approach to the application of an arbitrarily determined rate, be it 5%, 20%, or anything else. Universal application of such an arbitrary rate will lead to write downs that bear no relationship to a reporting entity's economic circumstances. There are, however, likely to be difficulties in applying the impairment approach. These have been acknowledged by the IASB (2004) itself. They stem from the fact that where businesses combine and by so doing identify synergistic benefits (goodwill), they will in all probability continue to generate such benefits in their operations, while exploiting those benefits created by the business combination. Generally accepted accounting practice recognises the synergistic benefits obtained through a transaction - the purchase of one entity by another - but does not recognise such benefits that are generated internally, as there is no transaction for the accountant to report. However, in assessing the value of synergistic benefits inherent in an entity, there is no practical means of distinguishing between goodwill born out of a combination of entities and goodwill generated subsequent to the combination. The IASB accepts that this constitutes a real operational problem and may inevitably lead to a substantial majority of reporting entities never amortising goodwill.

This paper takes the position that FNPF's acquisition of ATH gave rise to no synergistic benefits on combination. In view of the fundamental differences in the operations of the two entities' operations, no synergies could have been generated since 1999 when the initial investment was made. The goodwill relates to the monopolistic position ATH holds. As those benefits are exploited and ATH's monopoly rights are dismantled FNPF should write down the goodwill in ATH it carries on its balance sheet. However, given FNPF's initial failure to apply accounting regulation regarding its investment in ATH and its subsequent opportunistic application it would seem reasonable to monitor FNPF's reporting of goodwill in the future. Will it continue to present arguments that the goodwill is unimpaired and point to zero write downs of goodwill in other reporting entities, to demonstrate that it is merely applying de facto generally accepted accounting practice? Such a reporting strategy will ultimately shift the burden of carrying the write down of the goodwill from current members of FNPF to its members at some indeterminate point in the future, when the illusion of an unimpaired goodwill can no longer be maintained. It is surely conceivable that FNPF's auditors (KPMG since 1999), who did not qualify the fund's reports in regard to its failure to consolidate prior to 2002, or with regard to its failure to amortise goodwill at the appropriate rate from 2002 will acquiesce on this matter of inter generational inequity. Non compliance with mandatory regulations raises questions not only about the reliability of the FNPF's financial reports, but also of the propriety of KPMG's operations and by extension, that of the whole audit industry.

The Future: A Failure in Regulation?

Yet another regulatory development poses a challenge to the FNPF's method of financial reporting. Paragraph 32 of the IASB promulgated IAS 26 *Accounting and Reporting by Retirement Benefit Plans* (1998) states the following:

> Retirement benefit plan investments should be carried at fair value. In the case of marketable securities fair value is market value. Where plan investments are held for which an estimate of fair value is not possible disclosure should be made of the reason why fair value is not used.

As at 30th June 2004 FNPF investment portfolio included Government and Reserve Bank of Fiji securities reported in its balance sheet at a little over $1.65 billion ($1.5 billion in 2003). Additionally it holds equity investments, most of which are marketable, reported at over $187 million, apart from its investment in ATH.

The FIA has yet to make application of IAS 26 mandatory, but it is another of the International Standards, which is to be introduced in Fiji in 2006.

This may have radical implications for members of the FNPF, if the fund complies with the Standard. The market for Government securities is inevitably a small one, confined effectively to the domestic economy.

This is demonstrated by comparing Fiji's gross domestic product with the FNPF's holding of government securities, as in Table 5.

How could the domestic economy absorb a sale of securities with a cost that amounts to some 36% of GDP?

Table 5: Fiji's GNP and FNPF's Investment in Government Securities A Comparison

Gross National Product 2003	$4,251.5m
Government Securities held by FNPF as at 30.6.03	$1,514.3

Source: RBF, Quarterly Review (December 2004), and FNPF Annual Report for the year ended 30th June 2003.

In reporting assets at their fair value, accountants typically make reference to prices ruling in the market and make a deduction for the transaction costs that would be expected if a sale is actually made. This approach is entirely reasonable where the entity owns an insignificant proportion of the securities issued. Such will be the case in large economies, where a considerable number of investors will seek to hold any security issued, particularly an issue by government. The approach scarcely applies in the case of FNPF's portfolio. A sale of this portfolio could clearly only raise a fraction of its cost, or the market value for a small number of units. Even if the accountant's assumption is applied to the FNPF's holding the impact on the fund's income could be dramatic. If the only adjustment required to the book value of FNPF's holding is a need to allow for transaction costs on the sale of the investments - and these can be taken to be 1% of book value as transaction costs may fall in the range of 1-2.5% of market value; the percentage is likely to be at, or close to, the minimum for large transactions - the impact on FNPF's investment income can be reflected as in Table 6

Table 6: Extracts from FNPF's Financial Report for the Year Ending 30th June 2004

	$000
Investment revenue	154 477
Notional reduction in value of government securities of 1%	16 716
Adjusted investment revenue	137 761

Thus a 1% reduction in the value of government securities will reduce FNPF's investment income by something in the order of 11%. The adoption of market-based accounting will mean that pension and/or lump sum entitlements will be dependent on the vagaries of the market at the time a member retires or withdraws from fund membership.

Is application of this regulatory provision necessary? Until March 2004 the FNPF could point to a provision in International Accounting Standard 39 *Financial Instruments: Recognition and Measurement* (2004), which allowed entities to report investments, which an entity intends to hold to maturity, at their cost adjusted for the proportion of any premium or discount vis-à-vis the redemption value at maturity that has accrued. This is precisely the method which the FNPF currently employs in reporting its government securities and some other investments. When IAS 26 is adopted as a Fiji Accounting Standard this approach is no longer available if FNPF is to comply with financial reporting regulation..

If application of this regulation will serve to better report the financial position of the fund the regulation should be applied, notwithstanding all the associated drawbacks. But will this regulation achieve this? It must be borne in mind that the FNPF is required by law to hold at least 50% of the total value of its portfolio in government securities. Of course, to ensure compliance the fund has to hold something in excess of 50% of its portfolio in government securities as any change in the value of the portfolio will impact on the proportion of funds held in government securities, possibly leaving FNPF in breach of the law. (As at 30th June 2004 FNPF's total investment portfolio stood at a little over $2.75 billion as compared with the reported value of the government securities of $1.65 billion.)

Any breach of the law in this regard will have a secondary effect. In order to bring the fund's portfolio back within legal requirements it would be obliged to sell off part of its non government investments in order to reduce the holding to below the 50% maximum permitted. Such a sale may well be made under distress conditions, with the fund being obliged to accept a loss on the sale.

FNPF might reasonably argue that it is not economically meaningful to report its assets at a market price when it cannot sell on the market. It might further point out that it provides it with an opportunity to rig its reported performance by its actions on the market. A purchase of securities made just before 30th June at an inflated price will enable the fund to report all the reported securities of that class held by the fund at that inflated price. The fund would, therefore, be able to report a market gain as part of its income, providing an opportunity to mask losses and inefficiencies in its operations overall. The regulation, at least in Fiji's context, would appear to be decidedly unhelpful!

Will the FNPF, therefore, choose not to comply with this regulation when it is eventually introduced? Given its earlier non-compliance with accounting regulation in regard to accounting for its investment in ATH, FNPF has already demonstrated its disposition to ignore regulation. In this instance FNPF would appear to have a good case to do so! But does this in itself pose a danger? Could FNPF at some time in the future point to its non-compliance with regulation regarding the valuation of government investments for good reason, to legitimise non-compliance with other regulatory requirements in the future?

Conclusion

Unless the analysis has taken an unwarranted pessimistic view of ATH's business prospects, however FNPF chooses to account for its investment in ATH, it will show unsatisfactory returns for existing fund members. Initial reporting practice gave a best accounting return of little more than 4% and in 2002 gave a return of 3% negative. Restating FNPF's accounts in line with current generally accepted accounting practices, without allowing for a write down of the excess goodwill is currently yielding accounting returns of the order of 5%. Accounting history is replete with examples of reporting entities applying reporting devices to manage the earnings figure that they report - as opposed to managing the earnings they actually achieve - in order to place a positive spin on their financial performance. Spectacular business failures such as Enron, World Com, Parmalat and on a more modest scale the NBF serve to demonstrate that the impact of these devices can be misleading in the extreme.

The extreme cases serve to show that such misleading financial reporting always has implications for stakeholders in a reporting entity. Senior managers in Enron, World Com and Parmalat enriched themselves at the expense of the outside shareholders and employees of these entities. When the NBF failed certain parties benefited from loans that went unrepaid while the burden of the losses were born by the taxpayers and arguably the pension fund members (Grynberg et al, op cit). The accounting techniques that the audit industry has endorsed, allowing misleading financial reports to be produced and their consequences has generated an extensive literature (see for example, Healy and Whalen 1999, and Cheng and Warfield, 2005). However, in most cases, as with those referred to outside Fiji, the stakeholder can choose to terminate her or his relationship with the reporting entity if he or she does not like the accounting policy. A shareholder who sees returns depressed by excessive provisioning can liquidate the investment. A customer who feels that the accounting system has led to overpricing can look to a new source of supply. An employee fearing that her/his employer is economically non viable can seek a new job, etc. However a resident of Fiji cannot avoid paying taxes, nor can a Fiji national employed in the formal sector of the economy quit FNPF membership before reaching the age of fifty five.

What are the implications of this? In the light of the Commerce Commission's determination on tariffs in the telecommunications industry, will FNPF write down goodwill substantially to acknowledge that it is grossly overvalued? The necessary write down is unlikely to see the end of the adjustment process that will be required. Deregulation of the telecommunications industry would almost certainly lead to the need for further write downs.

Consider the position from the viewpoint of a Fiji Islander about to enter the workforce, who is legally obliged to join FNPF. Unless ATH is able to achieve a dramatic improvement in its financial performance, she/he would expect to see modest returns on the ATH investment through her/his entire career. Yet the new member would rightly complain that the low returns were due to an investment decision made before she/he entered the fund, and that if she/he had the choice she/he would elect to join a fund that did not burden her/him with poor investments. The legitimate expectation would be that the consequences of the poor decision should be borne by those who were members when the bad decision was made.

Will FNPF take the moral high ground in financial reporting by writing down goodwill substantially in line with international regulation, which Fiji is poised to adopt? An immediate write down would allocate the cost of the overpriced investment to the accounts of the existing members of the fund, which is where the burden rightly belongs. Until the fund commits itself to making such an adjustment, together with subsequent adjustments necessary as ATH's monopoly position is eroded, recent entrants to the fund and those yet to enter will subsidise the pension rights of those who have recently retired and those who will do so in the near future.

This conclusion raises a further question. How can FNPF members be protected from bad investment decisions? Savenaca Siwatibau's (2003) observations regarding the governance of FNPF are pertinent. He suggested that an oversight committee of pensioners be established to audit FNPF's operations as a safeguard against malfeasance by FNPF officers and expropriations of fund assets. Of course no institutional check can guarantee that such unfortunate events will never occur, but Siwatibau's suggestion offers a constructive means of strengthening governance. Had such a committee been in place in 1999 it may well have challenged the investment made in ATH at the price paid. But why should the oversight committee represent only pensioners? The forgoing discussion demonstrates that it is fund members, past, present and future, who have an interest in such monitoring operations.

Properly informed, such a group, with agents appointed to represent future members, could also serve to make appropriate decisions regarding the implementation of reporting regulations and the application of appropriate reporting policies. It would certainly be expected to take a keen interest in the introduction of a regulation on the nature of financial reporting of retirement benefit plans and make appropriate representations to the Fiji Institute of Accountants on this matter.

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