Presentation of a Statement of Changes in Reserves/Equity by superannuation entities

The purpose of this paper is to provide relevant information for the Board to decide on whether to proceed with requiring the presentation of a statement of changes in reserves/equity and, if so, the type of guidance that might be provided in a superannuation entity context.

1. Background

1.1 ED 223 *Superannuation Entities* (December 2011) proposed that superannuation entities present up to five financial statements:

* a statement of financial position
* an income statement
* a statement of changes in equity, **where relevant**
* a statement of cash flows
* a statement of changes in member benefits.

1.2 Accordingly, the Board envisaged that a superannuation entity would not need to present a statement of changes in equity if it were not relevant to the entity's situation.

1.3 ED 179 *Superannuation Plans and Approved Deposit Funds* (May 2009) proposed essentially the same financial statements and also contemplated that a statement of changes in equity may not be relevant to the circumstances of the entity.

1.4 AAS 25 *Financial Reporting by Superannuation Plans* does not require the presentation of a statement of changes in equity. AAS 25 requires a defined contribution plan, and permits a defined benefit plan, to present a statement of financial position, operating statement, and statement of cash flows. Alternatively, defined benefit plans can present a statement of net assets and a statement of changes in net assets.

1.5 There are two sets of Illustrative Examples in ED 223 – one for a superannuation entity that provides defined contribution entitlements only, and one for a (hybrid) superannuation entity that provides both defined contribution and defined benefit entitlements.

1.6 The relevant parts of those examples are shown on the next page.

Consolidated Statement of Changes in Equity for Defined Contribution Superannuation Plan for the year ended 30 June 20XX

	Unallocated surplus/ (deficiency) $000	Invest-ment reserve* $000	Admin reserve+ $000	Non-controlling interests $000	Total equity $000
Opening balance	**--**	**3,330**	**12,370**	**49**	**15,749**
Profit/(Loss) for period	(3,016)			57	(2,959)
Dividends paid				(5)	(5)
Transfers to/from reserves	3,016	(1,675)	(1,341)		--
Closing balance	**--**	**1,655**	**11,029**	**101**	**12,785**

* The investment reserve comprises the difference between the cumulative amount of investment income (net of investment expenses) allocated to members' accounts compared to the cumulative investment income (net of investment expenses) earned.

\+ The administration reserve comprises the difference between the cumulative amount of administration fees charged to members' accounts compared to cumulative actual administration costs.

Statement of Changes in Equity for Hybrid Superannuation Plan for the year ended 30 June 20XX

	Forgone benefits reserve $000	Invest-ment reserve* $000	Admin reserve+ $000	Unallocated surplus/ (deficiency) $000	Total equity $000
Opening balance	**3,686**	**4,219**	**3,213**	**22,671**	**33,789**
Benefits forgone by exiting defined benefit members	795				795
Transfers to defined benefit members' accrued benefits as allocations to members	(823)				(823)
Transfers from reserves to vested benefits of defined contribution members		(1,239)	(1,213)		(2,452)
Operating result for the period				(72,252)	(72,252)
Closing balance	**3,658**	**2,980**	**2,000**	**(49,581)**	**(40,943)**

* The Investment reserve comprises the difference between the cumulative amount of investment income (net of investment expenses) allocated to members' accounts compared to the cumulative investment income (net of investment expenses) earned.

\+ The Administration reserve comprises the difference between the cumulative amount of administration fees charged to members' accounts compared to cumulative actual administration costs.

1.7 In the Defined Contribution example, some might regard the non-controlling interests as the only 'genuine' equity item. Staff observe that, depending on the outcome of the Board's deliberations on ED 233 *Australian Additional Disclosures – Investment Entities* (for comment by 29 March 2013), and depending on how that outcome affects superannuation entities, there may be no cases of recognised non-controlling interests.

1.8 The ED 223 Basis for Conclusions includes the following:

> The AASB noted that, while superannuation entities have no equityholders as such, they often have equity, particularly in the form of reserves. The AASB also noted that an entity's reserving policy could have implications for the amounts credited to defined contribution members' accounts. … [paragraph BC91]
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> … , the AASB also noted there are no legal restrictions prohibiting a superannuation entity from holding a material amount of its net assets as reserves. The AASB concluded it should retain the proposal [from ED 179] with the understanding that entities would determine when a statement of changes in equity is appropriate by applying the principles and requirements in AASB 1031 *Materiality*. [paragraph BC93]

2. Feedback on ED 223 – written comments, December 2011 roundtables and subsequent consultation

2.1 Many constituents providing feedback on the proposal for a statement of changes in equity considered that it would not provide sufficient useful information to users in a superannuation context to justify the cost of preparation and audit. Some noted that the information that would otherwise be presented in a statement of changes in equity could be included in the statement of changes of member benefits because there would generally be few equity items in a superannuation context, many of which would normally be small (if not immaterial), and in most cases would comprise reserves that will ultimately be used for the benefit of members.

2.2 Many of those providing feedback made comments along the following lines:

* having a statement of changes in equity may be misleading and a note about the movements might be better; and
* the statement of changes in equity might be better labelled a statement of changes in reserves, which generally relate to the members and are more in the nature of liabilities. Alternatively, 'unallocated amounts' might be a better description than 'equity'.

2.3 Some of those providing feedback made more general comments about terminology, such as:

* the terms 'profit' and 'equity' are not particularly suitable in a member-based context. The terms surplus/deficiency would be better than 'profit'; and
* surpluses/deficits will give rise to equity/negative equity, yet there are no equity holders in superannuation entities – members would regard themselves as creditors.

2.4 Some constituents also commented that the reference to 'where relevant' is unhelpful because the circumstances in which it is not relevant might be unclear.

3. Stronger Super reforms

3.1 The Stronger Super reforms being introduced by the Australian Prudential Regulation Authority (APRA) include the *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Act 2012*. Section 52(8)(b) of that Act requires trustees to include a covenant in the rules of the registrable superannuation entity (RSE) "to maintain and manage in accordance with the prudential standards financial resources (whether capital of the trustee, a reserve of the entity or both) to cover the operational risk that relates to the entity".

3.2 Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. This includes legal risk but excludes strategic and reputational risk.

3.3 APRA is expecting that RSE licensees would typically have a target level for operational risk financial resources of at least 0.25 per cent of funds under management.

3.4 Those financial resources (reserves) are generally expected to be built up by charging a member fee or through a reduction in the returns allocated to members. The trustees might also contribute capital for this reserve. Constituents' comments to staff about these reserves have included:

* the reserve may come to represent a transfer of resources between generations of members; and
* the reserve seems to be more in the nature of a liability than an equity on the basis that the reserves are set aside for the ultimate benefit of members.

4. AASB 101 paragraphs on terminology and 'mutual' entities and on 'complete set of financial statements'

4.1 AASB 101 *Presentation of Financial Statements* includes the following commentary:

> AASB 101.5 This Standard uses terminology that is suitable for profit-oriented entities, including public sector business entities. If entities with not-for-profit activities in the private sector or the public sector apply this Standard, they may need to amend the descriptions used for particular line items in the financial statements and for the financial statements themselves.
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> AASB 101.6 Similarly, entities that do not have equity as defined in AASB 132 *Financial Instruments: Presentation* (e.g. some mutual funds) and entities whose share capital is not equity (e.g. some co-operative entities) may need to adapt the financial statement presentation of members' or unitholders' interests.

4.2 Superannuation entities are often characterised as being, in essence, profit-seeking but also mutual in nature. Arguably, the implications of paragraph 6 of AASB 101 is that a statement of changes in equity might include equity-like items.

4.3 AASB 101, paragraph 10 states the following:

> AASB 101.10 A complete set of financial statements comprises:
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> (a) a statement of financial position as at the end of the period;

(b) a statement of profit or loss and other comprehensive income for the period;

(c) a statement of changes in equity for the period;

(d) a statement of cash flows for the period;

(e) notes, comprising a summary of significant accounting policies and other explanatory information; and

(f) a statement of financial position as at the beginning of the earliest comparative period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements.

An entity may use titles for the statements other than those used in this Standard. For example, an entity may use the title 'statement of comprehensive income' instead of 'statement of profit or loss and other comprehensive income'.

5. Framework definition of 'equity'

5.1 The *Framework for the Preparation and Presentation of Financial Statements* defines 'equity' as a residual after recognising assets and liabilities (paragraph 49). It goes on to note that equity may be sub-classified and identifies various types of reserves that might be among those sub-classifications.

5.2 In discussing the nature of equity, paragraph 66 of the *Framework* comments:

> The creation of reserves is sometimes required by statute or other law in order to give the entity and its creditors an added measure of protection from the effects of losses. …

5.3 The risk reserves required under the Stronger Super reforms are likely to fluctuate as assets under management fluctuate. Accordingly, the reserves are not a residual and, therefore, not equity under the *Framework*. However, they are in the nature of the equity-type reserves discussed in the *Framework*.

6. Staff comments and recommendations

6.1 Consistent with the Board's broad approach to date in reviewing AAS 25, staff consider there to be three main approaches that the Board should consider:

A. refer superannuation entities to the requirements for financial statements in AASB 101 and leave it to them to interpret paragraphs 5 and 6 of AASB 101 (quoted in section 4 above) in a manner that best suits each entity;

B. not require a statement of changes in equity and require the information that would otherwise be presented in such a statement to be included in the statement of changes in member benefits; and

C. specify the statements required, including a statement of changes in equity, (as proposed in ED 223) and include wording in the replacement standard for AAS 25 along the lines of the comments in paragraph 6 of AASB 101 and relevant Illustrative Examples.

Approach A – refer to AASB 101

6.2 Although the Board has generally favoured relying on the other standards where feasible, staff consider that relying on AASB 101 is not practical in relation to this issue on the basis that AASB 101 is expressed in terms of identifying a 'complete set of financial statements' and that set does not include the statement of changes in member benefits that the Board has decided superannuation entities must present.

6.3 Furthermore, AASB 101 requires presentation of 'a statement of profit or loss and other comprehensive income', whereas the notion of other comprehensive income is not relevant to a superannuation entity. The following comments in the Basis for Conclusions to ED 223 are relevant in this respect.

> ED 223.BC69 The AASB considered whether superannuation entities should present single statements of comprehensive income or comprehensive statements of income in accordance with AASB 101 and concluded neither would be appropriate in a superannuation context because:
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> (a) all remeasurement changes in assets and liabilities, other than tax items credited or charged directly to member benefits, should be recognised in an income statement in the period they occur; and
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> (b) 'comprehensive income' encompasses items that would not be recognised in equity in a superannuation context and, accordingly, requiring a statement of comprehensive income may be misleading.

Approach B – include 'equity' changes in statement of changes in member benefits

6.4 The application guidance of ED 223 notes that:

> ED 223.AG17 A statement of changes in member benefits shows information in relation to items such as contributions, transfers and benefit payments. This information provides a basis for making assessments about any change in a superannuation entity's obligations for its defined contribution members' vested benefits and defined benefit members' accrued benefits during the period.

6.5 The statement of changes in member benefits includes items such as the investment earnings allocated to defined contribution member accounts. If the movements in reserves that have not been allocated to members (that would otherwise be included in the statement of changes in equity) are included in statement of changes in member benefits it might lead to confusion about the nature of that statement.

6.6 It might be argued that the statement of changes in member benefits could be presented in two sections – 'allocated benefits' and 'unallocated benefits'. It might be functional to have that presentation in respect of entities with only defined contribution members where the benefits relate to the allocation of actual investment earnings are allocated to members. However, it probably would not be appropriate for entities that have defined benefit members. This is because such benefits are determined through the application of a formula and changes in those benefits almost inevitably arise each period as a result of actual experience differing from the assumptions underlying the determination of accrued benefits.

Approach C – specify statement in superannuation standard

6.7 Staff recommend approach C because specifically identifying the statements required for superannuation entities provides the opportunity to make the requirements clear and put them in an appropriate context. Staff consider that, where material, a separate statement is warranted because there are likely to be material reserve-type balances and movements for many superannuation entities, particularly in light of the Stronger Super reforms that introduce the need to have risk reserves.

6.8 The requirements of the replacement standard for AAS 25 could specify 'a statement of changes in equity' and commentary along the lines of that in AASB 101 about using appropriate terminology for the entity could also be included.

6.9 The Illustrative Examples could also use terminology such as 'statement of changes in reserves' to demonstrate the overall intention behind the requirements and related commentary.

6.10 Finally, staff consider the reference to 'where relevant' in relation to the statement of changes in equity should be dropped in favour of additional application guidance that explains the statement might not be material in some cases. This would be consistent with the reference to materiality in ED 223, paragraph BC93 (quoted at the end of in section 1 of this paper).

Board members are asked to identify their views on the staff comments and recommendations and which approach they would support.