'Receivables'[1] relating to Defined Benefit Liabilities of superannuation entities

The purpose of this paper is to provide relevant information for the Board to finalise the principles underpinning the recognition of receivables by superannuation entities with insufficient investment assets to meet their defined benefit liabilities, to be incorporated in replacement standard for AAS 25 *Financial Reporting by Superannuation Plans*.

1. Background

1.1 The issue of whether superannuation entities might have recognisable receivables from employer sponsors in particular circumstances is not addressed in AAS 25. The issue is raised in paragraph BC64 of the Basis for Conclusions to ED 223 *Superannuation Entities*, which explains:

> Where net assets attributable to defined benefit members is less than defined benefit members' accrued benefits, the AASB noted, unless there is a specific contractual agreement between the entity and employer sponsor, the deficiency would not in itself give rise to a receivable controlled by the entity. This is because, in the absence of a contract, the payment of any future contributions by the employer sponsor to address the deficiency:
>
> (a) would not meet the definition of a financial instrument under AASB 132 *Financial Instruments*: *Presentation*; and
>
> (b) would not be virtually certain to be received, as required to recognise a 'reimbursement' under AASB 137 *Provisions*, *Contingent Liabilities and Contingent Assets*.

1.2 One respondent to ED 223 specifically commented that: "To reflect the reality of the situation, the employer's liability [for] the deficit could be shown as a receivable in the fund's financial statements. Such an approach would mean that the accrued liabilities less the employer receivable would be matched by the fund assets, with no resulting negative equity.".[2] The context of the comment is the respondent's view that the defined benefit liability of the superannuation entity is only responsible for paying benefits up to the amount of the assets it holds, and that the recognition by a superannuation entity of a defined benefit deficit would be double counting the liability recognised by employer sponsors applying AASB 119 *Employee Benefits*.

1.3 The Board has already rejected the view that the recognition by a superannuation entity of a defined benefit deficit would be double counting, because the superannuation plan has an obligation to its members to meet their benefits when they fall due. The recognition of defined benefit obligations under AASB 119 *Employee Benefits* is a separate matter.

---

1 The circumstances of superannuation entities that have legislative or other enforceable arrangements to obtain funds to meet member benefits differ. For ease of reference, the term 'receivables' is used in this paper to describe the rights that superannuation entities might possess to either obtain cash/investment inflows to meet immediate member benefit payments or obtain cash/investment inflows in advance of meeting member benefit payments.

2 Comment letter from Mercer Superannuation (Australia) Limited dated 30 April 2012, page 6.

1.4 It would be fair to say that the Board's conclusions (reflected in ED 223, paragraph BC64) were reached largely in the context of private sector superannuation entities. At the Board's October-November 2012 meeting, the Board discussed the situation in the public sector, including cases where governments hold assets outside the superannuation entity that are intended for use in meeting defined benefit liabilities and legislative guarantees to meet defined benefit payments.

1.5 At its October-November 2012 meeting, the Board generally agreed that, where there is a legislative guarantee of future contributions to meet accrued defined benefit liabilities, there is a receivable that meets the definition and recognition criteria for an asset in the *Framework for the Preparation and Presentation of Financial Statements*.

1.6 The Board also agreed that the source of funds in relation to a legislative guarantee (whether a designated pool of assets outside the superannuation entity or future government revenue) is not a distinguishing factor for accounting purposes. The Board also tentatively decided that:

(a) legislative guarantees of future contributions to meet accrued defined benefit liabilities do not explicitly fall within the scopes of any specific standards;[3] and

(b) in the context of the hierarchy (in AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*) used to determine accounting policies in the absence of a specifically applicable standard, legislative guarantees should be accounted for, by analogy, as financial assets under relevant financial instruments Standards.

1.7 However, the Board also considered it required further information on receivables from employer-sponsors, particularly since the response to ED 223 from public sector entities had been limited. Accordingly, the Board asked staff to undertake targeted consultation on the issue, particularly with public sector superannuation entities.

1.8 Staff also note that, at its April 2010 meeting, the Board "… confirmed its view that AASB 136 *Impairment of Assets* (rather than AASB 139 *Financial Instruments: Recognition and Measurement*) applies to the impairment of statutory receivables because of the non-contractual nature of such receivables".

2. Consultation

2.1 Staff undertook targeted consultation in late 2012 and early 2013, which included discussions with the administrators and/or trustees of the Commonwealth and most State defined benefit plans and representatives of a number of private sector corporate master trusts.

2.2 In terms of the private sector, all of those we contacted were of the view that it is highly unlikely there are contracts or other types of enforceable arrangements between

3 A number of possibilities were considered, including: AASB 132 *Financial Instruments: Presentation*; AASB 9 *Financial Instruments*; AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* (as a reimbursement); AASB 138 *Intangible Assets*.

superannuation entities and employer-sponsors for the latter to make contributions to meet a plan deficiency. Accordingly, for the purposes of discussion in this paper, the matter is treated essentially as a public sector phenomenon relating to statutory guarantees.

2.3 In the public sector, there are essentially four types of arrangements, which all involve legislation guaranteeing that members' defined benefits will be met.

(a) The plan is responsible for paying member benefits and receives them from the employer-sponsor on a pay-as-you-go basis (as the cash is needed).

(b) The plan holds and manages some investment assets from which it pays member benefits and, once those are exhausted, it will receive funds from the employer-sponsor on a pay-as-you-go basis (as the cash is needed) to pay member benefits.

(c) The plan is responsible for paying member benefits and generally receives sufficient funds from the employer-sponsor in advance to meet the benefit payments when they fall due. The plan is involved in managing those funds until they need to be paid. For example, at the time a member elects to take a pension on retirement, the plan receives funds that it calculates will meet the total pension obligation.

(d) The plan is responsible for advising government on how much government should pay members when their benefits are due. The plan may hold some funds for members and when payment is due for particular members, the plan forwards those funds to government, which in turn pays the members.

The Commonwealth

2.4 The arrangements in the Commonwealth are largely reflected in (d). The implications of these arrangements seem to be that the relevant Commonwealth plans do not have receivables relating to legislative guarantees from government, and nor do they have the defined benefit liabilities. The Commonwealth Government itself seems to be the sole party having a present obligation to pay member benefits.[4]

2.5 Based on staff consultation, those in the Commonwealth responsible for the administration and stewardship of the larger defined benefit plans are supportive of the idea that the only recognisable assets and liabilities of the plans relate to:

* the investment assets held to meet member benefits (which are typically only a fraction of the total needed to meet member benefits); and

4 The Board considered the situation of the Commonwealth at its September 2012 meeting and "… discussed whether the definition of 'superannuation plan' should incorporate some of the more general language about superannuation arrangements currently in AAS 25 *Financial Reporting by Superannuation Plans*, in particular, in the context of there being assets designated to meet unfunded defined benefit obligations that are not held directly by a superannuation entity. The Board decided to retain the ED 223 definition of 'superannuation plan' [which includes all 'exempt public sector plans'] on the basis that it covers all relevant plans for general financial reporting purposes under the current regulatory framework and has been accepted as an appropriate definition in the context of both ED 179 *Superannuation Plans and Approved Deposit Funds* and ED 223".

- * a liability to surrender those investment assets to the Commonwealth when relevant member benefits are due to be paid.

The States

2.6 The arrangements in the States are reflected in (a) and/or (b) and (c). Accordingly, the State superannuation entities potentially have receivables relating to legislative guarantees from State governments. Staff think the differences between (a), (b) and (c) are not relevant to an assessment of whether an asset exists, as those differences relate only to the timing of payments.

2.7 Based on staff consultation, some of those in the States responsible for the administration and stewardship of defined benefit plans are supportive of recognising an asset in respect of the legislative guarantees that they have. Others in the States responsible for the administration and stewardship of defined benefit plans are undecided. None expressed outright opposition to the idea.

3. Measuring the asset

3.1 Most of those consulted by staff had not yet considered the implications of the Board's tentative decision (October-November 2012 meeting) that, in the context of the hierarchy (in AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*) used to determine accounting policies in the absence of a specifically applicable standard, legislative guarantees should be accounted for, by analogy, as financial assets under relevant financial instruments Standards. However, their overwhelming view is that, if an asset is to be recognised, it should be the intrinsic or derived amount; namely: the difference between the superannuation entity's investment assets (at fair value) and the defined benefit liability.

3.2 If the Board were to proceed on the basis of its earlier decision to draw an analogy between a receivable relating to defined benefit liabilities and financial instruments, there are a number of issues relating to both initial and subsequent measurement. This paper considers the issues only in the context of AASB 9 *Financial Instruments*, not AASB 139 *Financial Instruments: Recognition and Measurement* (except to the extent AASB 9 refers to AASB 139), on the basis that the replacement standard for AAS 25 is likely to take effect when AASB 139 has been superseded.

3.3 The following paragraphs from AASB 9 on classification are relevant to the measurement discussion.

> **4.1.1 Unless paragraph 4.1.5 applies,[5] an entity shall classify financial assets as subsequently measured at either amortised cost or fair value on the basis of both:**
>
> **(a) the entity's business model for managing the financial assets; and**
>
> **(b) the contractual cash flow characteristics of the financial asset.**

5 Paragraph 4.1.5 provides the option to designate at fair value through profit or loss.

> **4.1.2 A financial asset shall be measured at amortised cost if both of the following conditions are met:**
>
> **(a) The asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows.**
>
> **(b) The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.**

3.4 It would be difficult to make the analogy between the type of instrument envisaged in paragraph 4.1.2 and the asset that is the subject of this paper, particularly because the latter does not involve cash flows due on specified dates. Accordingly, amortised cost would not appear to be relevant for the asset that is the subject of this paper.

3.5 The following paragraph from AASB 9 on initial recognition is relevant to the measurement discussion.

> **5.1.1 At initial recognition, an entity shall measure a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, *transaction costs* that are directly attributable to the acquisition or issue of the financial asset or financial liability.**

3.6 Since the asset is statutory in nature, it is difficult to identify a 'transaction' or 'acquisition' that could be used in initial measurement. By default that amount might be the intrinsic or derived amount; namely: the difference between the superannuation entity's investment assets (at fair value) and the defined benefit liability.

3.7 Based on paragraphs 4.2.1, 4.2.2 and 5.3.1 of AASB 9, subsequent measurement would be fair value through profit or loss. Given that there is no market for the asset that is the subject of this paper, the fair value would need to be modelled and would include factoring in the potential for the government not meeting the legislative guarantee. Accordingly, the measurement would include all of the problems associated with trying to measure a defined benefit liability at fair value, and which were a reason for the Board rejecting fair value measurement of that liability. Those problems are outlined in paragraphs BC129 to BC131 of ED 233, included as Appendix A to this paper.

4 Staff comments and recommendations

4.1 Staff recommend that rights to claim resources to meet defined benefit payments that fall within the *Framework* definition of an asset and meet the *Framework* recognition criteria should be required to be recognised as assets in the financial statements of a superannuation entity.

4.2 Staff recommend that application guidance should discuss the example of legislative guarantees to meet defined benefit payments as potentially giving rise to recognisable assets.

4.3 Staff consider that measurement of any such recognisable assets should not be by analogy to financial instruments. Instead, staff recommend that any such recognisable assets should be measured at their intrinsic amount; namely, the gap between the defined benefit liability and the fair value of any investment assets held by the superannuation entity to meet those benefits. This is effectively equivalent to requiring measurement on the same basis as the defined benefit liability. Staff consider this approach can be justified on the basis that the notion of a fulfilment value underpinning the defined benefit liability measurement requirements is equally relevant to the associated asset and because there is no relevant alternative in the existing suite of standards.

4.4 Staff consider the Basis for Conclusions should continue to include the thinking in ED 223 (and quoted in paragraph 1.1 of this paper) around contracts between employer-sponsors and superannuation entities in relation to receivables. Staff consider the Basis for Conclusions should also note:

(a) the consultation performed on the receivables issue, particularly in the public sector;

(b) the Board's deliberations on the receivables issue in the context of the *Framework*; and

(c) the Board's deliberations on the various standards that might apply to the recognition and measurement of the receivables, including in particular the measurement of the receivables in the context of the financial instruments standards.

4.5 In respect of the matters raised in paragraphs 2.3(d), 2.4 and 2.5 of this paper (regarding the Commonwealth), staff consider that the guidance associated with the requirements relating to the recognition and measurement of defined benefit liabilities would need to acknowledge the existence of arrangements under which the liability is limited to the assets available to meet them.

Board members are asked to identify their views on the staff comments and recommendations in section 4.

Appendix A – extracts from the Basis for Conclusions to ED 223

BC129 In developing ED 179, the AASB considered a number of bases for measuring defined benefit members' accrued benefits, including:

(a) at fair value consistent with the IASB Discussion Paper proposals that have now led to AASB 13;

(b) at current exit value consistent with a model in the IASB's Discussion Paper *Preliminary Views on Insurance Contracts*;

(c) at present value of the expected future benefit payments consistent with the requirements of AAS 25; and

(d) at present value of the expected future benefit payments consistent with AASB 119 for defined benefit obligations.

BC130 With respect to measuring defined benefit members' accrued benefits, the AASB noted:

(a) a fair value or current exit value could potentially:

(i) provide useful information to users, particularly in relation to the amount, timing and uncertainty of future benefit payments; and

(ii) facilitate consistency of reporting (with most assets being measured at fair value);[6]

(b) defined benefit obligations are not traded as stand-alone items and are generally extinguished in the normal course of business. While the absence of an active market for defined benefit obligations does not preclude such fair value measurement, the issues that would need to be addressed to achieve consistency across superannuation entities would be potentially insurmountable. The issues include estimating risk margins, service margins and costs of capital, and putting a price on the 'moral hazard' implications of an employer sponsor transferring its defined benefit obligations to a third party and potentially avoiding the full consequences of its decisions regarding employees' salaries; and

(c) fair value or current exit value would be inconsistent with:

(i) achieving closer alignment between the treatment of defined benefit obligations recognised by employer sponsors and superannuation entities;

(ii) thinking included in the IASB Exposure Draft of proposed amendments to IAS 37 *Provisions*, *Contingent Liabilities and Contingent Assets* and IAS 19 *Employee Benefits*, that the amount an entity would rationally pay to extinguish a liability is the lower of its settlement or transfer amounts; and

(iii) the reasoning behind the proposals in the AASB's ED 201 *Insurance Contracts*, which incorporates the IASB's ED/2010/8 *Insurance Contracts*.

BC131 Due to the relative weight of argument, the AASB concluded against proposing that defined benefit members' accrued benefits be measured at fair value or current exit value.

6 Asymmetries sometimes arise under AASB 119 because it requires plan assets to be measured at fair value and defined benefit obligations to be discounted at a rate determined by reference to market yields on high quality corporate bonds. When a plan's assets are invested to achieve higher returns than high quality corporate bonds, the employer sponsor may show a 'structural deficit', despite the plan being fully funded on an actuarial basis.