



Memorandum

To:	AASB members	Date:	24 March 2014
From:	Angus Thomson	Agenda Item:	15.1
Subject:	Superannuation Entities	File:	--

Action

Decide on suggested changes to Draft AASB 105X *Superannuation Entities* for fatal flaw review.

Staff consider that none of the suggested changes would require further due process.

The next step is for staff to finalise a ballot draft for voting by the Board, to be sent to members together with a Regulation Impact Statement.

Attachments

Formal submissions received on the Draft AASB 105X *Superannuation Entities* for fatal flaw review (Macquarie University, Actuaries Institute, Association of Superannuation Funds of Australia, and the Institute of Public Accountants) – agenda paper 15.2

Marked-up Draft AASB 105X *Superannuation Entities* (showing suggested changes and comments on items raised by commentators arising from the fatal flaw review process) – agenda paper 15.3

Background

When issued, the new Standard will replace AAS 25 *Financial Reporting by Superannuation Plans*.

In December 2013 the Board voted in favour of publishing Draft AASB 105X *Superannuation Entities* on the AASB's website for fatal flaw review for 60 days. The Draft was published on 20 December and the comment period closed on 28 February 2014.

In addition to the four formal comment letters received, staff were in contact with about 20 other constituents with an interest in the Draft. These constituents included industry associations, finance staff servicing various industry superannuation entities, consulting actuaries, most of the administrators/trustees of large public sector superannuation entities, administrative service providers to the superannuation industry, and a number of auditors of superannuation entity financial statements.

Comments

No 'fatal flaws' have been identified; however, commentators made suggestions for improvement, in particular, clarifications.

Most of those suggestions are noted in the attached marked-up Draft AASB 105X.

Four of the suggestions (regarding disclosures of insurance premiums and claims, definitions and defined benefit liability measurement) are dealt with below, because staff consider the Board should have more background information on these issues than can be comfortably addressed in notes in the attached marked-up Draft AASB 105X.

Table of suggested changes to Draft AASB 105X

Balloon comment	Page and paragraph (¶)	Explanation
1	p5	Template change
2	p6	Reference made to ‘large’ superannuation entities for clarity
3, 19 & 22	pp10, 29 & 35, ¶10 & ¶AG45	Refer to issue 1 below
4	p10, ¶11	Added reference to ‘beneficiaries’ for clarity
5	p12, ¶25	Editorial change
6	p12, ¶25	Added reference to information potentially being qualitative for clarity
7	p15, ¶36	Added reference to information potentially being quantitative or qualitative for clarity
8	p16, App A	Refer to issue 2 below
9, 10 & 20	pp16 & 17, App A, p31	Refer to issue 3 below
11	p18, ¶AG1	Refer to issue 3 below
12	p21, ¶AG18	Added paragraph clarifying the intended content of line items in the statement of changes in member benefits, including employer contributions, net benefits allocated to defined contribution members and net changes to defined benefit members
13	p22, ¶AG19	Added paragraph acknowledging the potential use of defined benefit plan surplus to fund employer contributions to defined contribution members
14	p23, ¶AG25	Clarifying that the defined benefit liability measure is a present value
15	p23, ¶AG25	Deleting reference to ‘margin for uncertainty’ to avoid potential confusion
16	p23, ¶AG25	Editorial change regarding relationship between actual and ‘ideal’ investment portfolios
17	p24, ¶AG25	Refer to issue 4 below
18	p24, ¶AG25	Clarifying that there is not a vested benefit ‘floor’ for defined benefit member liabilities
21	P32, Differences	Editorial change
23, 25 & 26	pp44, 46 & 49, Examples	References to ‘foregone benefits reserves’ deleted
24	P45, Examples	Editorial change
27	p55 & 56, ¶BC22	Additional background to acknowledge the fatal flaw comment process
28	p56, ¶BC26	Acknowledging views of some that SMSFs might be reporting entities
29	p74, ¶BC97	Changed text and added footnote to help clarify status of the superannuation surcharge
30	p88, ¶BC140	Noting why Standard doesn’t specifically address receivables for ‘normal’ accruals
31	p96, ¶BC164	Additional background on including in financial statements the impact of the cash flows related to insurance arrangements superannuation entities provide to members in the capacity of an agent

Page and paragraph references are to the marked-up page and paragraph numbers in agenda paper 15.3

Issue 1. Disclosures when superannuation entities are acting in the capacity of insurers

The following paragraphs appear in Draft AASB 105X.

- 10 When a superannuation entity acts in the capacity of an insurer, the income statement or notes to the financial statements shall separately present insurance premiums, claim expenses, reinsurance expenses, reinsurance recoveries, and the net result from insurance activities.
- AG42¹ When a superannuation entity is taking on the role of an insurer, the impacts on the financial statements could include:
- (a) insurance contract revenue, incurred claims expense, reinsurance expense and reinsurance recoveries recognised in the income statement;
 - (b) insurance contract liabilities and reinsurance contract assets recognised in the statement of financial position; and
 - (c) insurance contract cash inflows, reinsurance contract cash outflows, claims cash outflows and reinsurance recoveries cash inflows recognised in the statement of cash flows.

Some superannuation entities act in the capacity of an insurer and, in turn, reinsure with an outside insurer. In such cases, there are usually explicit premium revenues, claim expenses and reinsurance premiums and recoveries.

Other superannuation entities acting in the capacity of an insurer, particularly in respect of defined benefit members, may effectively be ‘self-insuring’. There are no explicit premiums being paid by the entity, the members or employer-sponsors, and no outside reinsurer is involved – so the affected entities would need to impute amounts in relation to their insurance activities. In the private sector, this is routinely done in respect of premiums because the notional premium for bearing the insurance risk is tax deductible to the entity. However, typically, public sector entities that are not subject to tax do not currently identify these notional amounts.

In cases where there are no explicit amounts, some commentators were unsure as to whether paragraph 10 would be applicable. Other commentators read paragraph 10 as requiring entities to impute amounts where they are not explicit, but consider that this would not be a cost-beneficial requirement, particularly for those entities that currently have no need to impute notional amounts.

Staff also note the following paragraphs from Draft AASB 105X.

- 35 **A superannuation entity that recognises liabilities and assets in respect of insurance arrangements it provides to its members shall disclose information that provides a basis for understanding the amount, timing and uncertainty of future cash flows arising from those arrangements.**
- 36 To meet the objective in paragraph 35, the disclosures would include quantitative or qualitative information in relation to:
- (a) key assumptions used in measuring liabilities arising from insurance arrangements the superannuation entity provides to its members;
 - (b) any uncertainties surrounding those key assumptions; and
 - (c) any uncertainties surrounding reinsurance assets.
- AG43² Consistent with the presentation approach under AASB 119, liabilities arising from insurance arrangements a superannuation entity provides to defined benefit members need not be presented separately from the entity’s liabilities for such members’ benefits in the statement of financial position.

On balance, staff consider that, in view of the requirements in paragraphs 35 and 36, and given the approach to insurance liability presentation in paragraph AG43 relating to defined benefit members, it would be reasonable to not require that insurance revenues and expenses (notional or otherwise) be separately presented in relation to insurance arrangements for defined benefit members.

1 Paragraph AG44 in marked-up version of Draft AASB 105X – agenda paper 15.3

2 Paragraph AG45 in marked-up version of Draft AASB 105X – agenda paper 15.3

Staff recommend that paragraphs 10 and AG42 should be narrowed to apply only in the case of defined contribution members and paragraph AG43 (now paragraph AG45) should include a further sentence, as follows:

10 When a superannuation entity acts in the capacity of an insurer in respect of defined contribution members, the income statement or notes to the financial statements shall separately present insurance premiums, claim expenses, reinsurance expenses, reinsurance recoveries, and the net result from insurance activities

AG45 Consistent ... position. Furthermore, revenues and expenses that might explicitly or notionally arise from insurance arrangements a superannuation entity provides to defined benefit members need not be presented separately in the income statement or statement of changes in member benefits.

Issue 2. Definitions – ‘defined benefit member’ and ‘defined contribution member’

The existing Standard (AAS 25) includes definitions for ‘defined benefit plan’ and ‘defined contribution plan’ and has different reporting requirements for the different plans.

The replacement Standard will change the focus from different types of plans to different types of members within each entity. This is because there are many ‘hybrid’ superannuation entities (that have both defined benefit members and defined contribution members). Accordingly, Draft AASB 105X includes definitions for ‘defined benefit member’ and ‘defined contribution member’, which were modelled on the AAS 25 definitions relating to the different types of plans.

Some commentators consider that the Standard should not have its own definitions for ‘defined benefit member’ and ‘defined contribution member’, but should instead make use of the ‘defined benefit member’ definition in the *Superannuation Industry (Supervision) Regulations 1994* – Reg 1.03. They are also concerned that a defined contribution member with salary-based insurance would arguably fall within the defined benefit member definition. In particular, please refer to page 3 of the letter from the Actuaries Institute. They argue that, otherwise, it might be assumed that the different definitions in the Standard and the Regulations have different meanings, which is not the intention. The Reg 1.03 definition is:

“defined benefit member” means a member who is entitled, on retirement or termination of employment, to be paid a benefit defined wholly or in part by reference to:

- (a) the member’s salary on retirement, termination of employment or an earlier date; or
- (b) the member’s salary averaged over a period before retirement; or
- (c) both (a) and (b); or
- (d) a specified amount.

Although the SIS Act does not apply directly to public sector superannuation entities, staff believe that the SIS Act definition will function in the public sector context. Staff also note that the Draft Standard’s definitions for ‘approved deposit fund’ and ‘superannuation plan’ already rely wholly, or in part, on the definitions in the *Superannuation Industry (Supervision) Act 1993* (SIS Act).

Staff recommend that the following changes be made:

defined benefit member	A defined benefit member as defined in the <i>Superannuation Industry (Supervision) Regulations 1994</i> whose benefits are specified, or are determined, at least in part, by reference to a formula based on their years of membership and/or salary level.
defined contribution member	A member other than a defined benefit member whose benefits are determined by reference to accumulated contributions made on their behalf and by them, together with investment earnings thereon.

Issue 3. Definition – ‘superannuation entity’

Some commentators consider that it is potentially confusing to use the term ‘superannuation entity’ with a different meaning from the meaning it has under the SIS Act. In particular, please refer to page 2 of the letter from the Actuaries Institute. Those commentators acknowledge that the Draft Standard intentionally has a different meaning – it is both wider, because it includes public sector superannuation entities, and narrower, because it does not include pooled superannuation trusts.

The relevant definitions in the Draft Standard are:

superannuation entity	An entity that constitutes one or more superannuation plan(s) or an <i>approved deposit fund</i> .
superannuation plan	<p>An entity that is:</p> <ul style="list-style-type: none"> (a) regulated under the <i>Superannuation Industry (Supervision) Act 1993</i>, or similar legislative requirements in the case of an exempt public sector superannuation plan; and (b) established and maintained: <ul style="list-style-type: none"> (i) in order to receive superannuation contributions; and (ii) for the primary purpose of providing benefits to members upon their retirement, death, disablement or other event that qualifies as a condition of release for member benefits. <p><i>Superannuation plans may be constituted as separate entities or as a number of separate entities established to administer aspects of the plan (such as when one entity administers contributions and another administers benefit payments).</i></p>

The SIS Act (section 10) definition is:

“*superannuation entity*” means:

- (a) a regulated superannuation fund; or
- (b) an approved deposit fund; or
- (c) a pooled superannuation trust.

This is not the first time the issue has been raised and staff consider that ‘superannuation entity’ remains the best term for us to use compared with the alternatives. The Board has previously rejected using the terms ‘superannuation plan’ or ‘superannuation fund’ as the primary definition because there may be multiple plans or funds within the one entity.

Staff recommend continuing to use ‘superannuation entity’ as the primary definition. Staff also recommend amending the ‘superannuation plan’ definition to more clearly line up with the SIS Act and including a comment in the Application Guidance along the following lines to help avoid confusion.

superannuation plan	<p>An entity that is:</p> <ul style="list-style-type: none"> (a) <u>a regulated superannuation fund</u> under the <i>Superannuation Industry (Supervision) Act 1993</i>, or similar legislative requirements in the case of an exempt public sector superannuation plan; and (b) ...
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AG1 This Standard applies to the general purpose financial statements of superannuation entities, as defined in Appendix A. The definition of ‘superannuation entity’ ~~would include~~ includes ~~regulated~~ registrable superannuation ~~funds~~ entities ~~regulated~~ under the *Superannuation Industry (Supervision) Act 1993* (SIS Act). It also includes ~~and~~ various public sector superannuation arrangements, but does not include pooled superannuation trusts. Accordingly the term has a different meaning in this Standard from its meaning in the SIS Act.

Issue 4. Measurement of defined benefit member liability

Some commentators expressed the view that the Draft Standard is not clear on whether the portfolio of investments referred to in paragraph 17 would be of assets that would yield contractual cash flows that meet the benefits when they fall due or a portfolio that might be described more as a 'hedge' against the obligation.

Paragraph 17 states:

- 17 Defined benefit member liabilities shall be measured as the amount of a portfolio of investments that would be needed as at the reporting date to yield future net cash inflows that would be sufficient to meet accrued benefits at that date when they are expected to fall due**

Staff note that an amount determined by reference to a portfolio that would yield contractual cash flows that meet the benefits when they fall due would generally be equivalent to the purchase price of an annuity that effectively eliminates the investment risk and the liquidity risk associated with the liability.

Staff believe it was the Board's intention to not limit the portfolio to one that would be expected to yield matching contractual cash flows over the expected life of the liability. This is because the Board has acknowledged in paragraph BC127 that the portfolio is one that is judged by the trustees to be the optimal way to generate the net cash flows required; and because, in relation to defined benefit member liabilities, paragraph 25(d) requires a superannuation entity to disclose information about the manner in which it manages liquidity risk.

Staff recommend adding a sub-paragraph to paragraph AG25, as follows.

AG25 The amount of defined benefit member liabilities measured in accordance with paragraph 17 is based on a portfolio of investments estimated to yield future net cash inflows that would be sufficient to meet accrued benefit payments when they are expected to fall due. In this context:

...

- (e) the amount of a portfolio of investments that would be needed as at the reporting date to yield future net cash inflows that would be sufficient to meet accrued benefits at that date when they are expected to fall due could relate to investments that yield cash flows through income received and/or through disposal, and would not necessarily be those that would be expected to provide matching contractual cash flows over the expected life of the liability.

Regulation Impact Statement (RIS)

The Office of Best Practice Regulation (OBPR) considers that a RIS is needed to justify the replacement Standard. A particular process needs to be followed with by the OBPR to finalise the RIS before the Board can make the replacement Standard for AAS 25. Staff have prepared a draft RIS that has been reviewed by OBPR staff.

The OBPR is insisting on us applying the Business Cost Calculator (a quantitative cost-benefit analysis), which is to be included in the RIS. Despite making many attempts to obtain cost-benefit information from relevant constituents, staff have only been able to gather limited useful input, which includes considering the use of the Business Cost Calculator by other agencies such as the Australian Prudential Regulation Authority. Accordingly, in using the Business Cost Calculator, staff may need to undertake a number of iterations before being able to satisfy the new OBPR requirements.

The Board will receive the finalised RIS with the ballot draft Standard for voting.