

This Agenda Paper discusses a number of ‘sweep’ issues identified by staff in preparing the draft replacement Standard for AAS 25 *Financial Reporting by Superannuation Plans*

Background

1. From the Board's redeliberations on ED 179 *Superannuation Plans and Approved Deposit Funds*, staff have identified the following five 'sweep' issues that it considers should be addressed prior to a draft of the replacement Standard for AAS 25 *Financial Reporting by Superannuation Plans* is finalised.

Sweep Issue #1 – Disclosure of related party information in relation to superannuation trustees

2. ED 179 proposes that a superannuation plan or approved deposit fund (ADF) disclose related party information that is consistent with the types of information disclosed under AASB 124 *Related Party Disclosures*. In addition, ED 179 proposes that a plan or ADF need not disclose information in relation to any transaction during a reporting period or balance at the end of the reporting period between the entity and:
 - (a) an employer sponsor; or
 - (b) its trustee or trustees;that would be considered 'normal' in a superannuation context. Appendix A to this Agenda paper provides the main paragraphs in ED 179 dealing with related party disclosures.
3. As discussed in Agenda paper 6.2 to the Board's February 2010 meeting, four respondents to ED 179 expressed concerns with the manner in which the related party disclosures are dealt with in the ED, including:
 - (c) the proposals do not appear to include the materiality threshold that applies in relation to AASB 124; and
 - (d) the term 'normal' may be difficult to apply in some circumstances to determine whether a transaction and/or balance between a plan, its trustee or an employer sponsor should be subject to disclosure.
4. At its February 2010 meeting, the Board decided that the replacement Standard for AAS 25 *Financial Reporting by Superannuation Plans* should require a plan or ADF to apply, when appropriate, the principles and requirements in AASB 124. To this end, the Board noted that the definition of a related party in AASB 124 had been amended subsequent to the publication of ED 179 to confirm that a sponsoring employer of a post-employment benefit plan is a related party of the plan. Nevertheless, AASB 124 remains silent with respect to the related party status of trustees of plans and ADFs. Accordingly, in the absence of specific guidance in the replacement Standard for AAS 25, AASB 124 may not necessarily facilitate the disclosure of related party information in relation to the plan's or ADF's trustee, or entities that are related parties of the trustee.

Related party disclosures in relation to trustees and entities that are related parties of trustees

5. Paragraph 9(b) of AASB 124 states, in part, that:

“An entity is related to a reporting entity if any of the following conditions applies:

- (i) The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).
- (ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member)...

6. Trustees are not considered to control or significantly influence their plans or ADFs for reporting purposes. Nevertheless, they arguably have the ability to affect the financing and operating policies of their plans and ADFs. Consistent with this, some plans and ADFs currently disclose various relationships and transactions with trustees and entities related to trustees as related party information, including:

- (a) fees paid and payable in relation to services provided by the trustee;
- (b) investments with investment managers that are a part of the same economic group as the trustee; and
- (c) loans to the trustee from the plan or ADF.

7. While these disclosures are arguably not required under AASB 124, they are consistent with the guidance in AASB 1031 *Materiality*. Paragraph 12(b)(i) of AASB 1031 states, in part, that:

“In deciding whether an item or an aggregate of items is material, the size and nature of the omission or misstatement of the items usually need to be evaluated together. In particular circumstances, either the nature or the amount of an item or an aggregate of items could be the determining factor. For example:

...

- (b) it may be necessary to treat as material an item or an aggregate of items which would not be judged material on the basis of the amount involved, because of their nature. This may apply when:
 - (i) transactions occur between an entity and parties who have a fiduciary responsibility in relation to that entity, such as those transactions outlined in AASB 124 *Related Party Disclosures* and AASB 1046 *Director and Executive Disclosures by Disclosing Entities...*”

Staff view

The term ‘related party’ is currently being interpreted in practice by some plans and ADFs to encompass their trustees as well as related parties of their trustees. Nevertheless, staff consider that the replacement Standard for AAS 25 should clarify that a trustee of a plan or ADF, or a related party of a trustee of a plan or ADF, is a related party of the plan or ADF.

Sweep Issue #2 – Consistency between ED 195 *Defined Benefit Plans (proposed amendments to AASB 119)* and the replacement Standard for AAS 25 in respect of disclosure principles and requirements

8. The IASB published ED/2010/3 *Defined Benefit Plans – Proposed amendments to IAS 19* in April 2010 as a part of its project to improve the accounting for employee benefits. A summary of the proposals in ED/2010/3 is provided in Appendix A to Agenda paper #.2 to this (September 2010) meeting.
9. Consistent with the proposals in ED/2010/3, the AASB has decided that the replacement Standard for AAS 25 should require a plan to:
 - (a) recognise all gains and losses arising from any obligations for defined benefit members' accrued benefits in the period in which they occur; and
 - (b) disclose the main components of any remeasurement changes in its obligations for defined benefit members' accrued benefits, including benefit cost, interest cost and actuarial gains and losses.

In addition, most of the disclosures proposed in ED 179 for a plan with defined benefit members are either consistent with, or more extensive than, the equivalent disclosures proposed in ED/2010/3 for an employer sponsor of a defined benefit plan. Appendix B to this Agenda paper provides a comparison of the defined benefit disclosure proposed in ED/2010/3 and ED 179.

10. However, ED/2010/3 proposes that an employer sponsor of a defined benefit plan make a number of disclosures regarding their defined benefit obligations that a plan would not necessarily make in relation to defined benefit members under the proposals in ED 179. In particular, ED/2010/3 proposes that an employer sponsor disclose:
 - (a) the present value of defined benefit obligations, adjusted to exclude the effect of projected growth in salaries ('accumulated benefit obligation'); and
 - (b) sensitivity analyses in respect of the effect of a change to each significant assumption on:
 - (i) defined benefit obligations at the end of the reporting period; and
 - (ii) service (benefit) cost for the reporting period.

Disclosure of the accumulated benefit obligation

11. Appendix C to this Agenda paper contains email correspondence between AASB staff and IASB staff in relation to the proposal in ED/2010/3 to require an employer sponsor of a defined benefit plan to disclose the amount of the accumulated benefit obligation (ABO) in relation to its defined benefit obligation.
12. As noted in the email correspondence, AASB staff do not consider ABO information to be useful in an Australian context because it is arguably inconsistent with:
 - (a) the measurement approaches under IAS 19 and AASB 119, which presume that employers will honour their defined benefit obligations in full;
 - (b) the general practice among Australian employers to honour defined benefit obligations in full; and

- (c) current and proposed approaches for measuring similar liabilities, such as provisions and insurance obligations.
13. In addition, AASB staff note that:
- (a) the disclosure of ABO information is likely to be confusing to users and any attempt to overcome this confusion by disclosing additional information is likely to impose additional costs on entities that are arguably not justified on cost-benefit grounds; and
 - (b) if the intention of disclosing ABO information is to provide users with more detailed information about the minimum level of an employer's DBO, users are likely to be better served by plans disclosing their obligations for defined benefit members' vested benefits (as proposed in paragraph AG89(a) of ED 179).

Staff view

Staff consider that the replacement Standard for AAS 25 should not require a plan with defined benefit members to disclose the amount of its accumulated benefit obligation (ABO) in relation to such members.

Sensitivity analyses in respect of significant assumptions relating to obligations for defined benefit members' accrued benefits

14. At its August 2008 meeting, the Board decided that the replacement Standard for AAS 25 should require a plan that has defined benefit members to disclose information that provides users with a basis for understanding the uncertainties surrounding the key assumptions, including the amount and timing of benefit payments, rather than a sensitivity analysis in respect of each significant actuarial assumption (such as the approach required for medical costs under paragraph 120A(o) of AASB 119).
15. Agenda paper 3.5 to the Board's August meeting discussed the merits of requiring a plan to disclose information in relation to the sensitivity of its defined benefit members' accrued benefits to changes in actuarial assumptions and noted the following.
- (a) Actuarial assumptions, particularly assumptions regarding future salary levels, the inflation rate and the discount rate, are interrelated (as noted in paragraph 75 of AASB 119). Accordingly, requiring a plan to disclose the effect on defined benefit members' accrued benefits of, for instance, an increase or decrease of one percentage point in the discount rate, the disclosed information may mislead users, particularly members and beneficiaries.

In order to provide a meaningful portrayal of the impact on defined benefit members' accrued benefits of a change in an actuarial assumption, it would be necessary to consider how a change in one assumption would impact on other actuarial assumptions in order to quantify the overall impact on the defined benefit obligation. Nevertheless, it might be difficult for some users, particularly members and beneficiaries, to understand and evaluate the complex interrelationships that exist between actuarial assumptions, and the possibly opposing or reinforcing effects that different assumptions can have on an accrued benefits figure.

In addition, actuarial assumptions reflect the most likely outcomes with respect to demographic and financial factors. Accordingly, the disclosure of an outcome based on assumptions that are considered reasonably possible, but not sufficiently likely for the purpose calculating the liability for accrued benefits, may be difficult for some users to understand. Furthermore, the disclosure of an ‘alternative’ accrued benefits figure or information in relation to ‘alternative’ actuarial assumptions might undermine users’ confidence in the accrued benefits figure recognised in the financial statements.

- (b) The discount rate is generally regarded as an important actuarial assumption because a relatively small change in the discount rate can have a significant impact on the amount of the obligation. Accordingly, requiring a plan to disclose that its obligation for defined benefit members’ accrued benefits would, for instance, change by 10% as a consequence of a one percentage point change in its discount rate is arguably not relevant or reliable information for users if such a change in the discount rate is considered unlikely to occur in the first place.
- (c) Defined benefit entitlements tend to accrue gradually over time and are not generally prone to significant changes in the short term. In contrast, the value of a plan’s assets can change dramatically over a relatively short period of time. Accordingly, disclosures in relation to a plan’s assets, such as those required under AASB 7 *Financial Instruments: Disclosures*, are likely to be more useful to users than information in relation to the sensitivity of defined benefit members’ accrued benefit figures to changes in actuarial assumptions. Such information would be useful, for instance, when users are interested in evaluating the capacity of a plan to pay members’ benefits as and when they fall due.

16. Consistent with the Board’s August 2008 decision, paragraph AG89(g)(ii) of ED 179 proposes that:

“...a superannuation plan or approved deposit fund discloses, as a minimum when relevant, the following:

...

- (g) information in relation to the actuarial assumptions used in measuring defined benefit members’ accrued benefits, including:

...

- (ii) any uncertainties surrounding the key actuarial assumptions used to measure members’ accrued benefits at the end of the reporting period, including the amount and timing of benefit payments...”

17. As noted in Agenda paper 6.2 to the Board’s December 2009 meeting, fourteen of the twenty respondents to ED 179 provided comments on the proposed disclosure principles in paragraphs 32-50 of the ED. Eight of the fourteen respondents that commented on the disclosure proposals expressed overall agreement with the proposed disclosure principles. In addition, none of the respondents expressed concerns with the disclosure proposals in paragraph AG89(g)(ii) of ED 179.

Staff view

Consistent with the proposals in ED 179, staff consider that the replacement Standard for AAS 25 should require a plan that has defined benefit members to disclose information that provides users with a basis for understanding the uncertainties surrounding the key assumptions, including the amount and timing of benefit payments, rather than a sensitivity analysis in respect of each significant actuarial assumption.

Sweep Issue #3 – Towers Watson’s supplementary submission

18. In the Agenda papers to the Board’s June 2010 meeting, Board members received a copy of a supplementary submission from Towers Watson (submission #21).¹ The submission discusses issues in relation to the measurement of obligations for defined benefit members’ benefits and the measurement of insurance obligations. Appendix D to this Agenda paper provides a copy of Towers Watson’s supplementary submission.

Measurement of obligations for defined benefit members’ benefits

19. Towers Watson’s submission discusses the following three issues in relation to the measurement of accrued benefits in accordance with the approach in AASB 119 for defined benefit obligations.

Measuring defined benefit members’ accrued benefits within the required reporting timeframe

20. Towers Watson’s submission contends that requiring obligations for defined benefit members’ accrued benefits to be measured in accordance with the approach in AASB 119 for defined benefit obligations and within the reporting timeframe required by APRA (within four months of the end of the reporting period) will pose significant challenges for most plans with defined benefit members.
21. Towers Watson notes that AASB 119 assists employer sponsors in meeting their reporting deadlines by permitting them to use estimates, averages and computational shortcuts to measure their defined benefit obligations. Employer sponsors are also assisted to this end by their defined benefit obligations generally being small relative to other balance sheet items, which ensures that any estimation differences arising from the use of estimates, averages and computational shortcuts tend to be immaterial.
22. In contrast, defined benefit members’ accrued benefits are the largest obligations of many plans. This means the types of shortcuts used by employer sponsors to measure defined benefit obligations under AASB 119 are unlikely to be of assistance to plans in meeting their reporting deadlines because most estimation differences are likely to be material for plans. Accordingly, Towers Watson recommends that special guidance on materiality guidelines should be provided in respect of superannuation plans.

¹ Watson Wyatt made a submission on ED 179 (submission # 8). Subsequent to the submission being received, Watson Wyatt and Towers Perrin merged globally and became Towers Watson.

Staff view

While staff acknowledge that plans will face some initial practical difficulties in applying the proposed recognition and measurement requirements for defined benefit members' accrued benefits, staff do not consider that special guidance on materiality guidelines should be provided in respect of plans because:

- (a) it would be contrary to the Board's transaction-neutrality policy; and
- (b) any special guidance on materiality for superannuation plans would arguably need to be rules-based, which is contrary to the approach in AASB 1031 *Materiality*.

In addition, staff note that:

- (a) AASB 119 does not require an entity use particular estimates, averages or computational shortcuts in measuring its defined benefit obligations. Accordingly, under the replacement Standard for AAS 25, a plan would be permitted to use any shortcuts it (and its auditor) considers appropriate (including, but not limited to, the shortcuts used by employer sponsors) in meeting the plan's financial reporting obligations; and
- (b) the issues discussed in paragraphs 20-22 of this Agenda paper may be relevant to the Board's deliberations on transitional arrangements for the replacement Standard for AAS 25 (see Agenda paper #.2 to this meeting).

Implications of a plan recognising its obligations for defined benefit members' accrued benefits

23. Towers Watson highlights a number of issues arising from the proposal for a plan to recognise its defined benefit members' accrued benefits as a liability, including:
- (a) the AASB 119 approach is likely to give rise to an accrued benefits figure which is generally larger than the accrued benefits figure the plan uses for monitoring and funding purposes. Accordingly, most plans with defined benefit members will recognise defined benefit 'deficiencies', notwithstanding that they will generally be in a satisfactory financial position for funding purposes; and
 - (b) users of the financial statements of a plan with defined benefit members are likely to be misled by any defined benefit 'deficiencies' reported as a consequence of the plan applying the approach in AASB 119 for defined benefit obligations.

Staff view

The issues raised by Towers Watson in relation to a plan recognising its defined benefit members' accrued benefits as a liability were discussed at the Board's December 2009 and February 2010 meetings. Accordingly, staff do not consider that the issues raised by Towers Watson warrant further discussion by the Board.

Lack of consistency in the determination of discount rates and the treatment of taxes

24. Towers Watson notes that there is currently some diversity in practice regarding how:
- (a) discount rates are calculated; and
 - (b) how investment and contributions taxes are treated;
- for determining defined benefit obligations under AASB 119, and that this diversity undermines the comparability of financial statements between entities and over time.

Staff view

Staff acknowledge that any diversity in practice in determining discount rates for defined benefit obligations would undermine the comparability of financial statements between plans and over time. However, any attempts by the Board to limit any such diversity in practice would potentially create a difference between the measurement approach under AASB 119 and the measurement approach under the replacement Standard for AAS 25 for measuring defined benefit obligations, and this would be inconsistent with the Board's reasons for adopting the approach in AASB 119 for defined benefit obligations.

With respect to Towers Watson's concerns regarding the treatment of investment and contributions tax, staff note that:

- (a) ED 195 *Defined Benefit Plans* proposes amendments to the definition of 'return on plan assets' and to paragraph 73(b)(iv) which arguably clarify the treatment of superannuation contributions tax (see Agenda paper #.2 to this meeting); and
- (b) the amendments to AASB 119 arising from the proposals in ED 195 would apply to plans under a replacement Standard for AAS 25.

Accordingly, staff do not consider that the issues raised by Towers Watson warrant future discussion by the Board in the context of the replacement Standard for AAS 25.

Measurement of insurance obligations

25. While the Board did not specifically discuss Towers Watson's submission at its June or July 2010 meetings, the Board's decisions at these meetings address the issues raised by Towers Watson in relation to the measurement proposals for obligations arising from insurance arrangements provided to defined benefit members.
26. Towers Watson suggests that:
- (a) the best estimate of the cost of insurance for defined contribution members is the cash insurance premiums paid because the policies underwriting such members are:
 - (i) annual renewable policies; and
 - (ii) priced (by the reinsurer) to reflect the risks typically associated with annual life insurance policies. Therefore, the cash insurance premium is arguably a more reliable measure of the plan's annual insurance cost than the amount the trustee or its advisors might otherwise calculate; and
 - (b) in the event that a plan's obligation for defined contribution members' insurance benefits extends beyond the term of the policy as a consequence of, for instance,

claims in process or claims incurred but not reported (IBNR), it is unlikely that the trustee or its advisors could reliably measure the liability and/or the liability would be immaterial.

27. At its July 2010 meeting, the Board decided that, to facilitate consistency with the treatment of insurance obligations to defined benefit members, the replacement Standard for AAS 25 should require insurance obligations to defined contribution members to be measured in accordance with the approach in AASB 119 for defined benefit obligations. Towers Watson's proposals would arguably not facilitate consistency in the treatment of insurance obligations in relation to defined contribution and defined benefit members. This is because a cash premiums basis would not require plans that are 'on risk' for defined contribution members' insurance benefits and/or with material defined contribution IBNR provisions to recognise any obligations in respect of insurance benefits. However, staff acknowledge that a cash premiums basis for measuring the cost of insurance obligations in relation to defined contribution members may be justified when:
- (a) the insurance arrangements are written on a 'claims made' basis and the plan is not 'on risk' for future reporting periods; and
 - (b) the insurance policy period coincides with the plan's reporting period.

Staff view

Staff do not consider that a cash premiums basis would facilitate plans that are 'on risk' in respect to the insurance arrangements they provide to their members disclosing sufficient or adequate information regarding their insurance obligations. However, staff do consider that a cash premiums basis may represent a cost-beneficial method for measuring the cost of insurance obligations in certain circumstances. Accordingly, consideration could be given to permitting a cash premiums basis as a short-cut approach to accounting for particularly types of insurance arrangements provided by superannuation plans.

Sweep Issue #4 – Implications of the Cooper Review findings for financial reporting

28. Tabled Agenda paper 12.5 to the Board's July 2010 meeting provided an update on the Review of the Governance, Efficiency, Structure and Operation of Australia's Superannuation System (Cooper Review).
29. As a part of its terms of reference, the Cooper Review considered issues in relation to the fees, costs and investment returns of superannuation entities, and how to improve transparency around these items through more meaningful reporting to advisers, researchers, analysts, regulators and members.
30. The Review Panel concluded that the superannuation system currently lacks transparency, comparability and accountability in relation to costs, fees and investment returns as a consequence of a number of factors, including:
- (a) insufficiently strong incentives for trustees to be transparent about outcomes;
 - (b) a high degree of outsourcing of services, including administration and investment management; and

- (c) cultural and attitudinal barriers to effective disclosures in relation to costs, fees and risks.
31. To address this perceived lack of transparency, the Review Panel recommends the development of ‘outcomes reporting standards’ by APRA in consultation with ASIC, the superannuation industry and other relevant stakeholders. The Review Panel notes that outcomes reporting standards:
- (a) would require trustees to calculate and disclose items such as fees, costs and performance, at MySuper and investment option level, according to a standardised methodology tailored to the contemporary needs of the industry; and
 - (b) would operate as an overlay to existing (and unsatisfactory) accounting standards AAS 25 and ED 179.

Appendix E to this Agenda paper provides an extract from the final report of the Cooper Review discussing the Review Panel’s findings in relation to outcomes reporting standards and their relationship to accounting standards.

Staff analysis

32. With respect to the Review Panel’s conclusions regarding financial reporting information (refer to pages 34-35 of this Agenda paper), staff note the following:
- (a) the discussion in sections 4 and 4.1 of the Cooper Review’s final report appears to conflate information reported in a plan’s financial statements with the ‘abridged financial information’ and other financial information reported in annual reports to members of superannuation entities;
 - (b) as noted by the Review Panel, most plans receive few, if any, requests from members for their financial statements. Accordingly, this could be taken to mean that members do not consider the information provided in financial statements is useful for their specific decision-making needs. However, relatively few plans and ADFs make their financial statements readily available through publicly accessible media. Moreover, some plans and ADFs only make their financial statements available to current members. Therefore, the level of demand may not be a reliable basis for determining the usefulness of financial statements;
 - (c) paragraph 12 of the *Framework* states that:
 - “The objective of financial reports is to provide information about the financial position, financial performance and cash flows of an **entity** that is useful to a wide range of users in making economic decisions” (emphasis added).
- Accordingly, the criticism that a plan’s financial statements do not provide a member with information regarding their particular interest in the plan could similarly be levelled at the financial statements of other investment-type entities, such as managed investment schemes (MISs). Nevertheless, it is unlikely that members of plans (or investors in MISs) would agree with the suggestion that plans and ADFs should be relieved of their obligations to prepare general purpose financial statements and have such statements audited;
- (d) as noted in (f) under the heading 4.1 Accounting standards (refer to page 34 of this Agenda paper), paragraph 66 of AAS 25 relieves a plan whose only assets

(other than temporary deposits at call with a bank) are endowment, whole of life or other long-term insurance policies which match and fully guarantee the benefits to be paid to individual members from complying with a number of presentation and disclosure requirements in AAS 25. However, from discussions with constituents, staff understand that few, if any, of these type of plans are currently in existence. Furthermore, this reporting relief was not proposed in ED 179;

- (e) notwithstanding that general purpose financial statements do not provide information about each member's particular interest in a plan or ADF, such statements do provide 'whole-of-plan' information which is useful to members and other users in their decision making.

As demonstrated during the Global Financial Crisis, a member of a plan can be affected by factors that impact on the plan as a whole. For instance, as noted in the Cooper Review's Final Report (page 173):

“...during the GFC, previously liquid assets held by some superannuation funds became illiquid due to capital freezes in mortgage, cash management and property trusts. In order to meet portability, switching and capital drawdown requests, some trustees were forced to sell equities into a depressed market, while trustees who were unable to meet these requests applied to APRA for a variation or suspension of portability requirements.”

Under AASB 7, plans and ADFs are required to disclose liquidity risk information. In addition, ED 179 proposes that a plan or ADF disclose liquidity risk information at a 'whole of plan' level and the Board subsequently decided that a plan or ADF should provide information that is consistent with the types of liquidity risk information disclosed under AASB 7 with respect to non-financial liabilities. Accordingly, financial statements of a plan or ADF are arguably an important source of information for members and other users of the entity's financial statements; and

- (f) within the current regulatory arrangements, financial statements play an important role in providing a basis for the information reported in annual reports to members and members' individual benefit statements. Consequently, financial statements are the primary medium through which trustees discharge their fiduciary duties.

Staff view

Staff do not concur with the Review Panel's suggestion that the current lack of demand among members for financial statements proves that such statements provide no useful information for decision making in a superannuation context, or that the replacement Standard for AAS 25 will not facilitate a material improvement in the quality of information provided to users. Accordingly, staff do not recommend that the Board redeliberate the proposals in ED 179 in light of the Review Panel's conclusions. Nevertheless, staff consider that it may be appropriate for the Basis for Conclusions to the replacement Standard for AAS 25 to discuss in more detail the objectives and potential limitations of general purpose financial statements in a superannuation context.

Sweep Issue #5 – Transition arrangements and application date for the replacement Standard for AAS 25

33. There are two main ways in which the transition to a new accounting standard that involves changes in accounting policies could be facilitated under AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*. These are:
- (a) *prospective application*, whereby the new accounting policies are applied to transactions, other events and conditions occurring after the date as at which the policy is changed; and
 - (b) *retrospective application*, whereby the new accounting policies are applied to transactions, other events and conditions as if that policy had always been applied.
34. Consistent with the approach adopted on the transition to IFRSs, staff consider that superannuation entities should be required to apply the replacement Standard for AAS 25 retrospectively. Accordingly, the comparative information provided for a plan's or ADF's first reporting period under the replacement Standard would be prepared and presented as if the replacement Standard had always been applied.
35. Staff consider that some of the proposals in ED 179 and the Board's decisions in relation to these proposals are likely to require some superannuation entities, especially those with defined benefit members and insurance obligations, to make changes to their accounting systems. However, based on discussions with constituents, staff do not consider that these changes would be unduly onerous, provided superannuation entities are given sufficient time to transition to the new reporting requirements.
36. It is relevant to note that paragraph 23 of AASB 108 states that:
- “When retrospective application is required by paragraph 19(a) [required by the transitional provisions of the Australian Accounting Standard] or (b) [where the Australian Accounting Standard does not include specific transitional provisions or the change is voluntary], a change in accounting policy shall be applied retrospectively except to the extent that it is impracticable to determine either the period specific effects or the cumulative effect of the change.”
37. Paragraph 5 of AASB 108 states that:
- “...applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so. For a particular prior period, it is impracticable to apply a change in an accounting policy retrospectively or to make a retrospective restatement to correct an error if:
- (a) the effects of the retrospective application or retrospective restatement are not determinable;
 - (b) the retrospective application or retrospective restatement requires assumptions about what management's intent would have been in that period; or

- (c) retrospective application or retrospective restatement requires significant estimates of amounts and it is impossible to distinguish objectively information about those estimates that:
 - (i) provides evidence of circumstances that existed on the date(s) as at which those amounts are to be recognised, measured or disclosed; and
 - (ii) would have been available when the financial report for that period were authorised for issue;from other information.”

- 38. Staff have reviewed the Board’s decisions in relation to ED 179 and consider that few, if any, plans or ADFs would find them impracticable to apply.
- 39. It is relevant to note that ED 179 proposes that early adoption of the replacement Standard be permitted. While the ED did not specifically ask for comment on this proposal, none of responses to ED 179 expressed disagreement with the proposal. In addition, staff are not aware of any concerns among constituents regarding this proposal.

Staff views

Staff consider that, consistent with the approach adopted on the transition to IFRSs, superannuation entities should be required to apply the replacement Standard for AAS 25 retrospectively.

Staff have held discussions with some constituents on the potential implications of this approach, and intend to speak to more constituents prior to the Board’s September 2010 meeting.

With respect to an application date for the replacement Standard for AAS 25, staff consider that this should be subject to the Board’s decisions regarding whether to re-expose for public comment some or all of its revisions to the ED 179 proposals (see Agenda paper 3.4 to this meeting).

If the Board decides not to re-expose some or all of its revisions to the ED 179 proposals, the replacement Standard would be issued some time before 30 June 2011, in which case staff would recommend the replacement Standard apply, at the earliest, to reporting periods beginning on or after 1 January 2012.

Alternatively, if the Board decides to re-expose some or all of its revisions to the ED 179 proposals, it is likely that the replacement Standard will be issued around 30 June 2011, in which case staff would recommend the replacement Standard apply, at the earliest, to reporting periods beginning on or after 1 January 2013.

Appendix A – Selected paragraphs from ED 179 *Superannuation Plans and Approved Deposit Funds*

- 48 A superannuation plan or approved deposit fund shall disclose information that provides users with a basis for understanding:
- (a) the nature of any related party relationships during the reporting period; and
 - (b) the nature and amount of any:
 - (i) related party transactions during the reporting period; and
 - (ii) outstanding balances between the entity and a related party at the end of the reporting period.

...

AG97 To comply with paragraph 48 of this Standard, a superannuation plan or approved deposit fund that has a related party relationship or is involved in a related party transaction applies AASB 124. In addition to any relevant disclosures that might need to be made under AASB 124, a plan or fund discloses information needed by users to understand:

- (a) the nature of the entity's relationships with its:
 - (i) employer sponsors; and
 - (ii) trustee or trustees;during the reporting period; and
- (b) any transaction during the reporting period or balance at the end of the reporting period between the entity and:
 - (i) an employer sponsor; or
 - (ii) its trustee or trustees;

that would be considered 'normal' in a superannuation context. For example, the recognition of contributions receivable by a plan would be regarded as 'normal' in a superannuation context, whereas the sale of assets by a plan to a trustee may not. Accordingly, normality should be judged on the basis of whether the information would affect a user's perception of the governance, financial performance or financial position of a plan or fund.

...

Related parties

BC130 While the disclosure principles and requirements of AASB 124 *Related Party Disclosures* would apply to most of the related party relationships and transactions that a superannuation plan or approved deposit fund would be involved in, it may not facilitate consistent disclosures across all superannuation plans and approved deposit funds.

BC131 The definition of a related party in AASB 124 focuses predominantly upon relationships premised on control, joint control or significant influence. However, in a superannuation context:

- (a) trustees are not considered to control or significantly influence their superannuation plans or approved deposit funds; and

- (b) employer sponsors are not considered to control or significantly influence trustees, superannuation plans or approved deposit funds.

BC132 However, the AASB concluded that trustees and employer sponsors are, in essence, related parties of superannuation plans and approved deposit funds because they can affect their plan's or fund's financing and operating policies. For example, by having surplus assets paid to it, an employer sponsor could affect their plan's financing policies. In addition, a trustee could alter their plan's operating policies by deciding to outsource the administration of members' accounts.

BC133 At the time of its deliberations on the disclosure of related party information by a superannuation plan or approved deposit fund, the AASB noted that the IASB had proposed that IAS 24 *Related Party Disclosures* be amended to clarify that a sponsoring employer is a related party of a post-employment benefit plan. However, the AASB concluded that, to facilitate the disclosure of useful related party information, ED 179 should propose that a superannuation plan or approved deposit fund only disclose related party information about its relationships with its trustees and employer sponsors, any transactions with trustees or employer sponsors during the reporting period, and any outstanding balances with trustees and employer sponsors at the end of the reporting period, if the nature of these relationships, transactions or balances were not considered 'normal' in a superannuation context. Consistent with the principles in AASB 124, normality would be judged according to whether information in relation to the relationship, transaction or balance was likely to affect a user's perception of the governance, financial performance or financial position of the entity. The AASB also concluded that the related party disclosure principles and requirements in any replacement Standard for AAS 25 should reflect the status of AASB 124 at that time.

**Appendix B – A comparison of the disclosures proposals in relation to defined benefit obligations
in ED/2010/3 and ED 179**

Amended AASB 119 paragraph number	Amended disclosure requirements for DB obligations under AASB 119 <i>Employee Benefits</i>	Equivalent ED 179 paragraph number	Proposed disclosure requirements under ED 179 for a plan with obligations for DB members' benefits
125A	An entity shall disclose information that: (a) explains the characteristics of its defined benefit plans (see paragraph 125C);	32(a)	“A superannuation plan or approved deposit fund shall disclose information that provides users with a basis for understanding: (a) the nature of the entity and the nature of the benefits it provides to its members...” See also paragraph AG52 of Appendix B to ED 179 below.
125A	(b) identifies and explains the amounts in its financial statements arising from its defined benefit plans (see paragraphs 125D-125H); and	42	“A superannuation plan or approved deposit fund shall disclose information that provides users with a basis for understanding the entity’s obligations for members’ benefits.” See also paragraph AG89 of Appendix B to ED 179 below.
125A	(c) describes how its defined benefit plans may affect the amount, timing and uncertainty of the entity’s future cash flows (see paragraphs 125I-125K).	42 34 44	See also paragraph AG89 of Appendix B to ED 179 below. A superannuation plan or approved deposit fund shall disclose information that provides users with a basis for understanding: (a) the nature and extent of the financial risks to which the entity is exposed during the reporting period and at the end of the reporting period; and (b) how the entity manages those risks. See also paragraphs AG61-AG76 of Appendix B to ED 179. It is relevant to note that at its April 2010 meeting the Board decided that, contrary to the approach in ED 179, a plan or ADF should apply the principles and requirements in AASB 7, as appropriate. “Where the amount of net assets attributable to defined benefit members does not equal defined benefit members’ accrued benefits, the superannuation plan shall disclose information

Amended AASB 119 paragraph number	Amended disclosure requirements for DB obligations under AASB 119 <i>Employee Benefits</i>	Equivalent ED 179 paragraph number	Proposed disclosure requirements under ED 179 for a plan with obligations for DB members' benefits
			<p>that provides users with a basis for understanding the size, nature, causes of and any strategies for addressing the difference between the two amounts.”</p> <p>See also paragraph AG90 of Appendix B to ED 179 below.</p>
125B	<p>An entity shall assess whether all or some disclosures should be disaggregated to distinguish plans or groups of plans with materially different risks. For example, an entity could disaggregate disclosure about plans showing one or more of the following features:</p> <ul style="list-style-type: none"> (a) different geographical locations; (b) different characteristics such as flat salary pension plans, final salary pension plans, post-employment medical plans, long-service leave or long-term disability benefits; (c) different regulatory environments; or (d) different funding arrangements, ie wholly unfunded, wholly or partly funded. 	<p>36</p> <p>40</p>	<p>A superannuation plan or approved deposit fund shall disclose information that provides users with a basis for understanding how the plan or fund arranges and manages assets attributable to different groups of members, and the related obligations to those members.</p> <p>Where a superannuation plan or approved deposit fund manages its assets on a segregated basis, the plan or fund shall disclose information that provides users with a basis for understanding:</p> <ul style="list-style-type: none"> (a) the type and nature of the assets within each segregated group of assets; (b) the financial performance and financial position of each segregated group of assets; and (c) the significant financial risks to which each segregated group of assets is exposed when the levels of such risks differ materially from the levels of the corresponding risks at the entity level. <p>It is relevant to note that the operations of Australian plans and ADFs are generally considered to reside within Australia. In addition, all private sector plans and ADFs operate within the same regulatory environments. Exempt public sector plans are the only types of plans permitted to be partly or wholly unfunded.</p>

Amended AASB 119 paragraph number	Amended disclosure requirements for DB obligations under AASB 119 <i>Employee Benefits</i>	Equivalent ED 179 paragraph number	Proposed disclosure requirements under ED 179 for a plan with obligations for DB members' benefits
125C	<p>An entity shall disclose:</p> <p>(a) information about the characteristics of its defined benefit plans, including:</p> <p>(i) the nature of the benefits provided by the plan (eg final salary defined benefit plan or contribution-based plan with guarantee).</p> <p>(ii) the effect of the regulatory framework in which the plan operates, for example the effect of any minimum funding requirements.</p> <p>(iii) a description of any other entity's responsibilities for the governance of the plan, for example responsibilities of trustees.</p>	AG52	<p>Information that would provide users with a basis for understanding the nature of the superannuation plan or approved deposit fund, and the nature of the benefits it provides to its members, would include the following:</p> <p>(a) a description of the entity, including:</p> <p>(i) the type of entity;</p> <p>(ii) the name of its trustee or trustees;</p> <p>(iii) an outline of the entity's registration with the Australian Prudential Regulation Authority (APRA); and</p> <p>(iv) an outline of the trustee's or trustees' Regulated Superannuation Entity (RSE) Licence; and</p> <p>(b) a description of the nature of the entity's members and beneficiaries, including:</p> <p>(i) the types of benefits provided;</p> <p>(ii) the numbers of members and beneficiaries holding each type of benefit;</p> <p>(iii) the numbers of members and beneficiaries classified as active, deferred or pensioner by type of benefit; and</p> <p>(iv) whether the entity can accept new defined benefit members.</p> <p>It is relevant to note that minimum funding requirements (apart from SG) do not apply to employers contributing to Australian plans.</p>
125C	<p>(iv) any restrictions on the amount recognised as a net defined benefit asset in accordance with paragraph 115B. An entity shall also disclose how it determined</p>	N/A	<p>The limit in paragraph 115B of AASB 119 would not apply to a plan under the proposals in ED 179. Under ED 179, a plan would present any surplus or deficiency (paragraph 26) and</p>

Amended AASB 119 paragraph number	Amended disclosure requirements for DB obligations under AASB 119 <i>Employee Benefits</i>	Equivalent ED 179 paragraph number	Proposed disclosure requirements under ED 179 for a plan with obligations for DB members' benefits
	the maximum economic benefit available, ie whether those benefits would be in the form of refunds, reductions in future contributions or combinations of both.		provide an explanation of any defined benefit surplus (paragraph 44 and AG90). In addition, paragraphs BC64-BC69 of the Basis for Conclusions to ED 179 provide an explanation of the circumstances in which a plan would treat a defined benefit deficit as a receivable from an employer sponsor.
125C	(b) a narrative description of the extent of the risks to which the plan exposes the entity and of any concentrations of risk. For example, if plan assets are invested primarily in one class of investments, eg property, the plan may expose the entity to a concentration of property market risk.	34	A superannuation plan or approved deposit fund shall disclose information that provides users with a basis for understanding: (a) the nature and extent of the financial risks to which the entity is exposed during the reporting period and at the end of the reporting period; and (b) how the entity manages those risks. See also paragraphs AG61-AG76 of Appendix B to ED 179. It is relevant to note that at its April 2010 meeting the Board decided that, contrary to the approach in ED 179, a plan or ADF should apply the principles and requirements in AASB 7, as appropriate.
125C	(c) a narrative description of any plan amendments, curtailments and non-routine settlements.	32(a)	"A superannuation plan or approved deposit fund shall disclose information that provides users with a basis for understanding: (a) the nature of the entity and the nature of the benefits it provides to its members..." See also paragraph AG52. In addition, paragraph 46 of ED 179 proposes that a plan disclose in the notes any gains or losses on settlements.
125D	An entity shall provide a reconciliation from the opening balance to the closing balance for each of the following, if applicable:	25	"A superannuation plan or approved deposit fund shall present: ... (c) a statement of changes in member benefits..."

Amended AASB 119 paragraph number	Amended disclosure requirements for DB obligations under AASB 119 <i>Employee Benefits</i>	Equivalent ED 179 paragraph number	Proposed disclosure requirements under ED 179 for a plan with obligations for DB members' benefits
125D	(a) the net defined benefit liability (asset), showing separate reconciliations for: (i) plan assets. (ii) the present value of the defined benefit obligation. (iii) the effect of the limit in paragraph 115B.		Example C in Appendix B to ED 179 demonstrates how a plan could present a statement of changes in defined benefit members' accrued benefits, including a reconciliation of the opening and closing balances of DB members' benefits. The Board has decided to retain illustrative example financial statements in the replacement Standard. As noted above, the limit in paragraph 115B of AASB 119 would not apply to a plan under the proposals in ED 179.
125D	(b) any reimbursement rights. An entity shall also describe the relationship between any reimbursement right and the related obligation.	AG89(d)	... a superannuation plan or approved deposit fund discloses, as a minimum when relevant, the following: ... (d) details of any guarantees provided in relation to members' or their beneficiaries' benefits, including: (i) the identity of the guarantor; (ii) the nature of the guarantee, including the benefit type and the number of members or beneficiaries to which the guarantee applies; and (iii) the amount of vested benefits and the amount of accrued benefits subject to the guarantee.. In addition, paragraphs BC64-BC69 of the Basis for Conclusions to ED 179 provide an explanation of the circumstances in which a plan would treat a defined benefit deficit as a receivable from an employer sponsor.
125E	Each reconciliation listed in paragraph 125D shall show each of the following, if applicable: (a) service cost, showing current and past service cost separately. (b) interest income or expense (see paragraphs 119B and	46	"A superannuation plan shall disclose in the notes the following items in respect of remeasurement changes in its obligations for defined benefit members' accrued benefits for the reporting period: (a) benefit cost;

Amended AASB 119 paragraph number	Amended disclosure requirements for DB obligations under AASB 119 <i>Employee Benefits</i>	Equivalent ED 179 paragraph number	Proposed disclosure requirements under ED 179 for a plan with obligations for DB members' benefits
125F	<p>quoted market price in an active market and those that do not:</p> <ul style="list-style-type: none"> (a) property. (b) government debt instruments. (c) other debt instruments. (d) own equity instruments. (e) other equity instruments. 		<p>(b) how the entity manages those risks.</p> <p>See also paragraphs AG61-AG76 of Appendix B to ED 179.</p> <p>It is relevant to note that at its April 2010 meeting the Board decided that, contrary to the approach in ED 179, a plan or ADF should apply the principles and requirements in AASB 7, as appropriate.</p>
125G	<p>An entity shall disclose:</p> <ul style="list-style-type: none"> (a) Quantitative information about actuarial assumptions used to determine the defined benefit obligation (see paragraph 73). Such disclosure shall be in absolute terms (eg as an absolute percentage, and not just as a margin between different percentages and other variables). When an entity provides disclosures in total for a grouping of plans, it shall provide such disclosures in the form of weighted averages or relatively narrow ranges. (b) A brief description of the process used to determine demographic actuarial assumptions to supplement the disclosures provided in accordance with (a). 	AG89(g)(i)	<p>“...a superannuation plan or approved deposit fund discloses, as a minimum when relevant, the following:</p> <p>...</p> <ul style="list-style-type: none"> (g) information in relation to the actuarial assumptions used in measuring defined benefit members' accrued benefits, including: <ul style="list-style-type: none"> (i) the key actuarial assumptions used to measure members' accrued benefits at the end of the reporting period...”
125H	<p>An entity shall disclose the present value of the defined benefit obligation, adjusted to exclude the effect of projected growth in salaries.</p>	No equivalent disclosure proposals	<p>IASB staff raised the prospect of the amended IAS 19 requiring an employer sponsor to disclose the accrued benefit obligation (ABO) in an email to AASB staff.</p> <p>See Appendix C to this Agenda paper.</p>
125I	<p>An entity shall disclose:</p> <ul style="list-style-type: none"> (a) how the effect of a change to each significant actuarial assumption that: <ul style="list-style-type: none"> (i) is reasonably possible at the end of the reporting period would have affected the defined benefit obligation at the 	No equivalent disclosure proposals	<p>It is relevant to note that paragraph AG89(g)(ii) of Appendix B to ED 179 proposes that:</p> <p>“...a superannuation plan or approved deposit fund discloses, as a minimum when relevant, the following:</p> <p>...</p>

Amended AASB 119 paragraph number	Amended disclosure requirements for DB obligations under AASB 119 <i>Employee Benefits</i>	Equivalent ED 179 paragraph number	Proposed disclosure requirements under ED 179 for a plan with obligations for DB members' benefits
125I	<p>end of the reporting period; and</p> <p>(ii) was reasonably possible at the beginning of the reporting period would have affected current service cost that was determined at the beginning of the reporting period</p> <p>(b) the methods and assumptions used in preparing the sensitivity analyses required by (a) and the limitations of those methods.</p> <p>(c) changes from the previous period in the methods and assumptions used in preparing the sensitivity analyses, and the reasons for such changes.</p>		<p>(g) information in relation to the actuarial assumptions used in measuring defined benefit members' accrued benefits, including:</p> <p>...</p> <p>(ii) any uncertainties surrounding the key actuarial assumptions used to measure members' accrued benefits at the end of the reporting period, including the amount and timing of benefit payments;</p> <p>(iii) the key actuarial assumptions used to measure members' accrued benefits at the end of the last annual reporting period;</p> <p>(iv) how, if at all, the key assumptions used to measure members' accrued benefits at the end of the reporting period differ from the corresponding key assumptions used to measure members' accrued benefits at the end of the last annual reporting period; and</p> <p>(v) whether the key assumptions used to measure defined benefit members' accrued benefits at the end of the last annual reporting period have been consistent with experience in the current reporting period."</p>
125J	<p>An entity shall disclose details of any asset-liability matching strategies used by the plan, including the use of annuities and other techniques, such as longevity swaps, to manage longevity risk.</p>	<p>34 and AG61-AG76 (see above)</p>	<p>It is relevant to note that longevity risk is not a significant risk for Australian plans because:</p> <p>(a) most DB entitlements, particularly in the private for-profit sector, are paid as a lump sum rather than as a lifetime annuity; and</p> <p>(b) those plans that do pay DB members annuities either purchase a defined period annuity from another entity and act as an 'agent' with respect to annuity payments or are</p>

Amended AASB 119 paragraph number	Amended disclosure requirements for DB obligations under AASB 119 <i>Employee Benefits</i>	Equivalent ED 179 paragraph number	Proposed disclosure requirements under ED 179 for a plan with obligations for DB members' benefits
			public sector plans that provide annuities that are ultimately backed by the government sponsor.
125K	An entity shall provide a narrative discussion of factors that could cause contributions over the next five years to differ significantly from current service cost over that period. For example, an entity shall disclose how it expects any surplus or deficit to affect the level and timing of its contributions over the next five years, and the period over which it expects the surplus or deficit to disappear.	AG89(f) AG90	<p>“...a superannuation plan or approved deposit fund discloses, as a minimum when relevant, the following:</p> <p>...</p> <p>(f) the actuary’s recommended level of contributions in respect of defined benefit members for the next reporting period...”</p> <p>“...a superannuation plan or approved deposit fund discloses, as a minimum when relevant, the following:</p> <p>(a) where the net assets attributable to defined benefit members is greater than such members’ accrued benefits, information that enables users to evaluate the size, nature, causes of and implications of the ‘surplus’, including:</p> <p>(i) whether the ‘surplus’ has arisen, in part or whole, as a consequence of applying different assumptions for the purposes of determining funding levels and measuring defined benefit members’ accrued benefits. If so, the plan would disclose, as a minimum, the nature of the differences between the two sets of assumptions; and</p> <p>(ii) whether the trustee is aware of any decisions by the employer sponsor to seek to be paid some or all of the surplus or to reduce the level of its contributions in the future; or</p> <p>(b) where the net assets attributable to defined benefit members is less than such members’ accrued benefits, information that enables users to evaluate the size, nature, causes of and implications of the ‘deficiency’, including:</p>

Amended AASB 119 paragraph number	Amended disclosure requirements for DB obligations under AASB 119 <i>Employee Benefits</i>	Equivalent ED 179 paragraph number	Proposed disclosure requirements under ED 179 for a plan with obligations for DB members' benefits
125K		AG90(b)	<ul style="list-style-type: none"> (i) whether the 'deficiency' has arisen, in part or whole, as a consequence of applying different assumptions for the purposes of determining funding levels and measuring defined benefit members' accrued benefits. If so, the plan would disclose, as a minimum, the nature of the differences between the two sets of assumptions; (ii) to the extent that the 'deficiency' is not explained by (i), the entity's strategy for addressing the 'deficiency' and the anticipated timeframe over which the 'deficiency' will be eliminated; and (iii) if there is a specific contractual agreement in place between the trustee and the relevant employer sponsor in relation to funding the 'deficiency', the main features of the agreement; or (iv) if there is no specific contractual agreement in place between the trustee and the relevant employer sponsor, how the trustee monitors and manages the 'deficiency'.

Appendix C – Email correspondence with IASB staff in relation to accumulated benefit obligation (ABO) disclosure proposals for employer sponsors

Dear Chairman

The IASB would appreciate feedback from national standard setters on whether the information about the Accumulated Benefit Obligation (ABO) could be readily estimated for disclosure purposes in your jurisdiction.

The ABO is the present value of the defined benefit obligation, measured under IAS 19 *Employee Benefits*, modified to exclude the effect of projected salary growth. The current measurement of the defined benefit obligation required by IAS 19 is referred to as the Projected Benefit Obligation (PBO).

At the July 2009 meeting, the IASB tentatively decided that the ABO amount should be disclosed in the notes as a part of the proposals in the forthcoming exposure draft of proposed amendments to IAS 19. It was noted that users of financial statements would like disclosure of the ABO amount disaggregated from the currently disclosed defined benefit obligation amount. Some believe that the ABO could easily be calculated by merely nullifying the assumption on the future salary increase in the calculation of the PBO.

However, some are concerned that requiring the disclosure of the ABO may be difficult in certain jurisdictions. The IASB would like further information on the costs, if any, and relative ease of disaggregating the ABO amount from the defined benefit obligation for disclosure purposes.

Your assistance in answering the following questions is most appreciated. We would appreciate responses by the **30 September 2009**.

Questions

1. In your jurisdiction, is the entity required to measure the defined benefit obligation on the actuarial basis, for example in accordance with IAS 19?
2. If so, is the entity required or encouraged to disclose the ABO amount either for financial reporting, regulatory purposes or any other purposes?
3. Assuming that the entity is required to disclose the ABO amount in your jurisdiction, how costly would it be to estimate the ABO amount?

We realise that it is currently a busy period for you. Your assistance on this matter is greatly appreciated.

Thank you and kind regards

Jae Ho

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Dear Mr Kim,

Please find attached responses to your questions below from an Australian perspective.

Please note that the "Other Comments" provided in the attached document are the views of AASB staff and do not necessarily coincide with the views of AASB Board members.

Regards

Dean Ardern | Project Manager

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IASB Post-employment Benefits Project

Feedback on information about the Accumulated Benefit Obligation (ABO)

Question 1 – In your jurisdiction, is the entity required to measure the defined benefit obligation on the actuarial basis, for example in accordance with IAS 19 *Employee Benefits*?

Yes. A for-profit entity applying Australian Accounting Standards is required to measure any defined benefit obligation (DBO) it has on an actuarial basis (specifically, the projected unit of credit method) in accordance with AASB 119 *Employee Benefits*, which is the Australian adoption of IAS 19. A not-for-profit entity applying Australian Accounting Standards is required to measure any DBO it has on the same actuarial basis as a for-profit entity. However, a not-for-profit entity reporting under AASB 119 is required to discount any DBO obligation by reference to market yields on government bonds.

Question 2 – If so, is the entity required or encouraged to disclose the ABO amount either for financial reporting, regulatory or any other purposes?

An entity reporting under Australian Accounting Standards is neither required nor encouraged to disclose the ABO of any DBO for domestic financial reporting, regulatory or other purposes. Furthermore, we are not aware of any entities reporting under Australian Accounting Standards disclosing ABO figures. Nevertheless, some entities operating in Australia, particularly subsidiaries of US parent companies, would need to calculate the ABOs of any DBOs to facilitate the preparation of their parent's financial statements under US GAAP.

Question 3 – Assuming that the entity is required to disclose the ABO amount in your jurisdiction, how costly would it be to estimate the ABO amount?

As technical staff of the AASB, we do not consider it would be appropriate for us to speculate on how costly it would be for an entity reporting under Australian Accounting Standards to estimate the ABO of a DBO. Accordingly, we recommend you consult with industry participants with relevant experience, such as actuaries specialising in the

measurement of DBOs in Australia. Nevertheless, from discussions with constituents we understand that those entities not currently calculating the ABOs of their DBOs would probably incur some initial implementation costs (probably in the range of 10%-20% of their current actuarial fees) and some additional on-going costs, although these on-going costs would be smaller relative to the initial implementation costs. For those entities that currently calculate ABOs for their DBOs, there would presumably be no implementation or on-going costs, provided that the IASB's definition of ABO is the same as the definition of ABO in US GAAP.

Other Comments

We consider that few, if any, Australian users of financial statement would regard the ABO as useful information because measuring a DBO on the basis that there will be no future salary growth is arguably inconsistent with:

- (a) paragraphs 52-53 of IAS 19/AASB 119, which presume that employers will honour their DBOs;
- (b) the general practice among Australian employers to honour DBOs in full; and
- (c) current and proposed approaches for measuring similar liabilities, such as provisions and insurance obligations.

In addition, we consider the disclosure of alternative measures of a DBO, such as the ABO, would be confusing to users. To overcome this confusion, entities would need to provide enhanced disclosures to explain the relationship between the amount of the DBO presented in the financial statements and the alternative measure(s) disclosed in the notes. Such enhanced disclosures are likely to impose costs on entities and arguably make their financial statements more complex than they need to be.

If the IASB's intention in considering the disclosure of the ABO is to provide users with more detailed information about the minimum level of an employer's DBO, we suggest that the Vested Benefit Obligation would be more useful to users.

In the Australian context, the vested benefit obligation is the amount of benefits to which members (or their beneficiaries) would be entitled to if they were to resign from their employer and/or withdraw from their superannuation plan. Accordingly, in the Australian context, the vested benefit obligation is arguably useful information to users because:

- (a) items that may be regarded as equivalent to vested benefits are reported by other entities. For instance, 'demand deposits' are reported by banks and other deposit-taking entities; and
- (b) vested benefits may be regarded as akin to the current portion of an employer's DBO, and are generally calculated at present in order to determine the current/non-current classification required under AASB 101 *Presentation of Financial Statements* (IAS 1).

Appendix D – Submission #21 on ED 179 from Towers Watson, dated 18 May 2010

18 May 2010

The Chairman
Australian Accounting Standards Board
PO Box 204
COLLINS STREET WEST VIC 8007

Dear Sir

This letter is intended to provide the AASB with:

- Some important practical considerations associated with the proposed measurement of accrued benefits under ED179 (as decided in the AASB's meeting on 9-10 December 2009). We strongly believe these issues require the consideration of the AASB prior to implementation of a AASB 119 based measure for accrued benefits; and
- A review of the proposed assessment of insurance obligations under ED179, namely those that cross refer to the existing AASB1038 accounting standard for insurers.

Issues relating to the proposed measurement of accrued benefits

Prior to industry adopting the new measurement approach, we strongly recommend the AASB address the issues below:

- Calculating the required value of accrued benefits for accounting disclosures within the regulator's reporting timeframe will require computational shortcuts. Whilst such shortcuts are used to meet tight *corporate* reporting deadlines, special guidance on materiality guidelines will be required to allow similar shortcuts for *fund* reporting.

Currently, the AASB119 liabilities disclosed by companies for *corporate financial disclosures* commonly use data from a pre-balance date, which is then rolled forward in order to meet the *corporate* reporting deadlines. Such computational shortcuts have been acceptable for AASB119 on materiality grounds. This is because any level of estimation differences arising from such shortcuts on the AASB 119 measure are extremely unlikely to be material when compared to the sponsoring employer's corporate balance sheet as a whole.

APRA requires financial reporting to be completed and audited within four months of the end of each plan year. Typically, final membership and vested benefit data only becomes available at the very end of a year-end annual administration review cycle and actuarial valuations normally need this data as a starting point for the accrued benefits calculation. Therefore, calculating the value of accrued benefits accurately *before* the end of the 4 months annual return reporting deadline, using year end data, for all funds will be impossible. (Currently, the vested benefits figure is usually one of the final figures to be inserted in draft financial statements.) In order to meet the four month APRA reporting deadline, earlier dated membership data will need to be used.

However, the ED179 Accrued Benefits measure will represent virtually all of the full value of the Fund's obligations. From this reporting entity's perspective (i.e. the Fund itself) the difference may therefore be material. In summary, different materiality thresholds for corporate versus fund disclosures will mean different calculation approaches and hence the disclosed liabilities will differ. Therefore, the AASB will need to provide specific clarification on such materiality thresholds in order for this work to be undertaken within 7 APRA timeframes.

- As highlighted in our earlier submission on ED179, the AASB119 measure will often record a liability measure that is *greater* than net assets, even though the financial position (as monitored by APRA, as well as that used for funding purposes by the Trustee and actuary) shows the Fund to be in a *satisfactory* financial position i.e. vested benefits are *less* than net assets. Similarly, the actuarial value of past service benefits used by the Trustee and actuary to guide cash funding decisions may also be a lower figure than the AASB 119 figure for such benefits.

Therefore, Trustee communications to members will become critical, if members are not to be misled about the actual financial position of the Fund. For example, Trustees may consider it necessary to

caution members that the measurement of the benefits for accounting purposes is different to the benefits they actually receive and different to the measurement basis applied by the Fund actuary, Trustees and APRA in monitoring the financial strength of the Fund (as well as the long term basis on which the plan is funded). In this respect, Trustees will need to caution users of the financial statements to seek advice on the disclosed measurement (advice which requires an accurate understanding of this issues which may not be reliably available from financial planners).

Would such Trustee disclaimers and reliance on financial planners to clarify the differing measure of the obligation be of concern to the AASB?

- A current lack of consistency in discount rate selection and methodology in Australia still requires AASB guidance if the accounting objective of "comparability" between superannuation funds is to be met.

The requirements of measuring an AASB119 obligation will depend on assumptions and actuarial methodologies (as opposed to a vested benefit measurement which typically requires no assumptions or methodologies to determine, except in relation to the value of pensions in payment). However, Australian Funds have retained significant differences in the recognition of future obligations for investment and contribution taxes in their sponsoring employers' AASB119 measurement. Whilst such inconsistencies may not have been addressed for corporate reporting purposes in the past (again, largely due to the materiality of such results in the corporate context) this will be a more important issue given that the accrued liability measurement represents broadly the full obligation of the Fund. Trustees may also have a different view of these issues to that of the Fund's sponsoring employer. The treatment of taxes therefore becomes areas of primary concern rather than a matter of detail.

We understand that the AASB does not usually wish to become involved in preparing detailed implementation guidance. However, given the significant investment of time required in rewriting this accounting standard, will the AASB work with the industry to develop a "safe harbour" interpretation of the new requirements particularly in relation to the application of taxes. AASB involvement is required to clearly articulate its expectations for reporting.

Review of insurance provisions within ED179

In our view, the measurement approach set out under AASB1038 is complex compared with what is actually needed (and currently used) in measuring the death and disability obligations of a superannuation plan. Furthermore, most fund trustees (and their advisors) are unlikely to be able to reliably assess the claims provisioning etc on any other basis than what is already priced into either the AASB119 calculations (if a defined benefit fund) or cash insurance premiums (if a defined contribution fund).

The complexities of AASB1038 are required to control the timing of a life office's recognition of profits and losses over the expected life of their policy contracts. By way of example, many traditional life insurance policies typically charge *level* premiums across the life of an individual (despite the underlying risks actually increasing over the age of the individual being insured). Also, the base premiums are somewhat loaded in initial years to recover the cost of provisioning and upfront commissions. An AASB1038 provision is therefore calculated as the present value of all future death and disability claim amounts, less the present value of all future insurance premiums paid.

By contrast, the measurement of obligations of superannuation funds can be more simply captured.

Insured defined contribution funds:

For these funds, the best estimate of the cost of insurance is most objectively and reliably priced by setting this equal to the cash insurance premiums paid.

- Insurance policies held by superannuation funds are annual renewable policies, rather than long term contracts. For this reason:
 - policy premiums depend on the fund's actual age profile in that year; and therefore
 - the cash premiums paid are the best estimate of the value of the insured risk that year (we would not expect the Trustee to have access to more credible data about the value of the insured risk than those already implicitly built into the insurance premiums paid).

Therefore, expensing the cost of insurance on any other basis than the cash insurance premiums on most private sector superannuation funds would be spurious at best.

Note: In our view, a fund might need over (say) 30,000 members to begin to place any reasonably credible statistical estimate of mortality and morbidity rates (and even then, rates at many ages would be based on relatively small experience). Even if this was the case, it is difficult to argue that a trustee or its actuarial advisor would be able to price such risks more reliably than its insurer - whose pool of experience will still be multiple times as great as that of the individual fund.

- The insurance premiums paid on group life policies already include the expense of various outstanding claims provisions (e.g. incurred but not yet reported claims) required at the end of each policy. This is because the policy is renewable annually; the insurer must therefore price such premiums to fully cover the costs of any such unknown claims. Again, life insurers are best positioned to estimate such provisions based on claims emergence data from their larger pool of experience.
- Such premiums are generally also competitively tendered by the trustees every few years.

We have considered some elements that could *potentially* have an attaching balance sheet provision. But generally, we would not expect that such provisions could be reliably priced by trustees (and if that were possible, we would not expect it to be material):

- Claims reported and approved by the Trustee, but not yet paid. We would expect that such claims would already be included under existing financial disclosures, as part of Benefits Payable.
- Claims approved by the Trustee, but for which the insurer has declined to approve a claim on the policy. Again, we would expect the financial cost of such claims would already have been included as part of Benefits Payable as and when such claims are approved. In practice, trustees would seldom grant such benefits and/or trust deeds will (or could be amended to) amend the member's rights if the insurer refuses to payout a claim.
- Claims approved, but for which the insurer is yet to determine whether to approve a claim on the policy. In practice, we would not expect trustees to approve any such benefits prior to knowing the outcome of the Insurer's assessment.
- Claims incurred but not yet reported. As highlighted above, the insurance premiums paid would already factor in the expense of such unknown claims (and far more credibly than any estimate that a trustee could determine based on their own fund's limited experience).
- Prepaid insurance premiums (e.g. if the insurance policy period does not coincide with the Fund's reporting period). This would be uncommon, but we believe that simply accruing such provisions based on a simple calendar based proportion would be materially the same at the Fund level, as applying life office methodologies for valuing premiums received but not yet earned.

Defined benefit plans (insured or self insured)

An AASB119 measurement already includes:

- The past service component of any death and disability benefits, within the AASB 119 past service liability. The actuary may have used mortality and morbidity tables based on some pool of comparable experience, or the rates implied by the insurance premiums actually paid by the Fund; and
- The expected one year cost of the insurance component (whether self-insured or otherwise), within the Service Cost calculation (again, based on the actuary's chosen mortality and morbidity tables).

We would not expect the AASB119 past service provision to differ materially from the AASB1038 obligation. We therefore do not recommend "overwriting" the measurement of death and disability benefits under AASB119 by replacing this element of the costs with AASB1038 requirements. Importantly, to do so would also create yet another actuarial measure of the benefit obligation and difference from the AASB119 measurement.

Conclusion

We strongly urge the AASB to:

- Address the implementation issues caused by the AASB119-based measure for accrued benefits under ED179, prior to its introduction.
- Remove the proposed assessment of insurance obligations under ED179, namely those referencing AASB1038, and instead:

1. For insured defined contribution superannuation funds, we recommend expensing based on insurance premiums paid (if necessary, accrued based on a proportion of the remaining calendar year). We do not consider the other claims provisions can be reliably estimated by the Trustees, nor would we expect these to be material for most remaining Australian superannuation funds, even if such valuation was possible.
2. For defined benefit or self-insured superannuation Funds, we recommend expensing and provisioning based on (unadjusted) AASB119 methodologies (as described above).

Yours sincerely

Andrew Boal
Managing Director

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Director

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APPENDIX E – Extract from the Report of the Cooper Review (pp. 101-105)

2 OUTCOMES REPORTING STANDARDS

The Panel believes that the lack of transparency of outcomes in Australian superannuation can be resolved through a new tool: ‘outcomes reporting standards’ to be developed by APRA in consultation with ASIC, the industry and other relevant stakeholders. The standards would be developed by APRA under a new standards-making power that the Panel has recommended be given to APRA, as discussed in greater detail in chapter 10.

Improving transparency and outcomes reporting within Australia’s complex super system requires fine adjustments. The Panel sees these standards as the best way of achieving tailored solutions to many of the measurement, disclosure and comparability issues affecting the industry. The Panel believes that outcomes reporting standards have the potential to resolve the vast majority of problems identified in this chapter in a way that best suits the needs of stakeholders. They can be the subject of comprehensive consultation and have the flexibility to provide innovative solutions, such as effectively overlaying existing (and unsatisfactory) accounting standards. This is discussed later in section 4.1.

3 INFORMATION PROVIDED BY SUPER FUNDS

3.1 The users of super data

It is not the Panel’s position that the average member has a need for a large amount of data about superannuation, but there are a number of stakeholders who need different types of data for a variety of reasons. These stakeholders include:

APRA, which, as part of its prudential supervision of superannuation funds, needs to know that the fund is being operated soundly by the trustee in accordance with its risk management plans, its investment strategies and other trustee policies. APRA uses the data it collects to help risk-rate each fund. Major changes in trend data, or other indicators of increased risk, will lead to earlier and a more intensive on-site review of the trustee’s operations, and mitigate (though not eliminate) the risk of member losses due to mismanagement. APRA’s use of data in this way is of direct benefit to members. The Panel is now proposing that APRA be given a new mandate; to monitor and regulate the efficiency and outcomes of super funds. This is discussed in more detail in chapter 10.

Employers, who are generally required to choose a default fund for their employees, benefit from the ability to compare how efficiently different funds perform and manage a variety of costs.

Financial advisers, who need to make sound, evidence-based recommendations to their clients, whether individuals, or employers seeking a default fund for their employees.

Government and its policy advisers, who need reliable industry-wide data in order to assess the continuing soundness of policy settings and the need for any adjustments. Reliable data on fund performance after fees and taxes would also provide an essential degree of industry-wide accountability for the \$22 billion a year investment the government makes in the super industry by way of tax concessions.

Members, who might wish to compare the performance and cost of their fund (or investment

option) with others available to them.

Researchers and commentators, both in Australia and overseas, who use data to analyse the industry, help drive innovation and competition, and improve understanding.

Trustees, that might want to compare and benchmark their fund's performance with the performance of other funds locally and internationally.

3.2 Current sources of information

Trustees are required to provide information directly to members by way of periodic statements. These statements provide useful information on the performance of the member's own account, but form a very limited basis on which to make a comparison with other investment options or make a judgment about the whole of the fund. While members can request a copy of the audited financial statements for the fund, this report is highly aggregated and rarely requested. An annual fund report is also available to members. There are generic requirements for these annual fund reports to include the information that the trustee reasonably believes a member would reasonably need for purposes of understanding the management and financial condition and the investment performance of the fund, and a description of the investment strategy and objectives in respect of the fund.² Trustees also provide some financial information about the costs of investment options in PDSs. However, information on costs is often presented in ranges, which diminishes its usefulness. Trustees must also report to APRA and can voluntarily provide data to commercial research houses.

APRA collects data using its powers under the *Financial Sector (Collection of Data) Act 2001 (FS (CoD) Act)*. It uses this data principally for the purpose of its prudential supervision of the industry, but also to fulfil its mission to 'act as the national statistical agency for the Australian financial sector'³ and to provide data required by the Australian Bureau of Statistics (**ABS**) in preparing the national accounts. To meet the latter purpose, APRA also publishes available data from Exempt Public Sector Superannuation Schemes (**EPSSSs**) and data on SMSFs, which is provided by the ATO. APRA's publication of industry, sectoral and fund level data is therefore not designed, nor intended, to help members select funds, or investment options based on past performance data.

Commercial research houses⁴ collect and provide data on investment performance of individual investment options. These data are generally only available to paying subscribers. Additionally, the data suffer from several inherent limitations, such as:

- (a) selection bias as the data is submitted voluntarily by trustees. Trustees may avoid submitting data on poorly performing funds, or investment options, to avoid adverse comparisons. The data coverage is therefore incomplete and results are skewed towards better performing funds;
- (b) the submitted data on investment performance of individual investment options are calculated by the fund trustees and are unaudited;
- (c) data disclosed by trustees are inconsistent, and can require substantial adjustment by the agencies to enable reasonable comparability;⁵
- (d) naming of investment options differs across superannuation funds, so obscuring the underlying asset composition and making comparison difficult. Methodologies for performance comparisons also differ across research houses; and
- (e) the potential for conflicts of interest as commercial research houses might find it difficult to be objective about a poorly-performing fund that buys other services the research house provides.

4 DEFICIENCIES WITH EXISTING FINANCIAL REPORTING INFORMATION

“Financial reporting is a key governance mechanism by which superannuation fund trustees are accountable to fund members and other stakeholders. Apart from highly aggregated information contained in abridged financial reports, information disclosed to members in annual reports is unregulated and generally unaudited. This situation presents scope for trustees to manipulate disclosures, thus potentially misleading fund members and adversely affecting their decisions ... findings reveal a lack of transparency in superannuation fund reporting that limits the usefulness of disclosures as a fund governance mechanism.”⁶

The concern expressed in the quote by two prominent accounting academics is shared by the Panel. The current disclosure position is an inadequate compromise: members get quite complex and often unhelpful information and experts get aggregated and non-specific data.

4.1 Accounting standards

Financial disclosure should play a critical role as a governance mechanism and in improving transparency and comparability. However, despite its importance, the current accounting regime relating to the superannuation system leaves a great deal to be desired.

The accounting standard AAS 25 — Financial Reporting by Superannuation Plans (**AAS 25**) requires only aggregated or 'whole of fund' financial reporting, while the industry and super members are concerned about the performance of the investment option in which they are invested. This is the 'product' that the industry has created and which the members 'consume'. For this reason, financial statements at fund level are rarely used by analysts, researchers or members.

The disconnect between AAS 25 and the financial information that users require is demonstrated by the following examples:

- (a) the PDS for the fund must disclose the fees and returns at an investment option level;⁷
- (b) member periodic statements must contain information about the investment return applicable to each particular member;⁸
- (c) the annual report to members usually contains information relating to the investments, returns and management expense ratios for the various investment options offered by the fund;⁹
- (d) the potential for inconsistency of treatment of specific expenses such as the administration expenses — for example, some funds currently follow IFSA Standard 6.00 (which requires administration expenses to be deducted in arriving at net investment returns) while other funds do not;¹⁰
- (e) the potential for trustees to report returns and expense ratios selectively — a long-standing concern as identified in the 2002 Ramsay report to ASIC;¹¹ and
- (f) AAS 25 treats the investment return from a life company that wholly backs a superannuation fund as the proceeds of an insurance policy, and there is no need for the accounts to disclose underlying fees and costs or any other information. This is clearly unsatisfactory and creates a regulatory imbalance between super funds that have access to this structure and those that do not.

While management accounts are typically prepared at the investment option level to enable allocation of earnings and costs to members, it is only the fund financial statements prepared at the whole of fund level that are audited. Other investment vehicles, such as registered managed investment schemes, and even SMSFs, which are significantly smaller than the average investment option in a large APRA fund, require annual audits.

The Australian Accounting Standards Board (**AASB**) has issued an Exposure Draft 179 — Superannuation Plans and Approved Deposit Funds (**ED 179**) to replace AAS 25. While this will modernise an outdated accounting standard and improve whole of fund disclosure, the Panel does not believe that ED 179 will materially improve the information needed by users, in particular members.

4.2 The solution

In this context, the Panel therefore sees the need for outcomes reporting standards (discussed in section 2) that would require trustees to calculate and disclose items such as fees, cost and performance, at MySuper and investment option level, according to a standardised methodology and tailored to the contemporary needs of the industry. These standards would operate as an overlay to AAS 25 and ED 179 for large APRA funds.

The standard methodology would then be applied by trustees of all large APRA funds in the calculation of both investment performance and costs. This would provide interested parties with the ability to make the comparisons they believe are warranted. The regime would have the flexibility to deal with any number of the current transparency and comparability problems affecting the industry.

In its Second Phase One Preliminary Report on MySuper, the Panel said that MySuper would require separate audited financial statements to support transparency and comparability. The Panel's concluded view is that an outcomes reporting standard could produce a better outcome for all stakeholders, but still believes that a level of assurance by way of audit would still be required. The mechanism by which this would occur should be specifically addressed in the relevant outcomes reporting standard.

Recommendation 4.1

With an enhanced rule-making power, APRA, in consultation with ASIC and industry, should develop outcomes reporting standards as an overlay to the existing accounting standards AAS 25 and ED 179 to facilitate consistent and comparable reporting by large APRA funds of investment performance and costs at investment option level, including for MySuper products.

Endnotes

- 2 SIS Regulations 7.9.35 and 7.9.36, Corporations Regulations 2001.
- 3 APRA mission, <www.apra.gov.au/aboutapra/>
- 4 These include Chant West, Rainmaker and SuperRatings.
- 5 Chant West, Multi Manager Quarterly, V8, No. 1, March 2010
- 6 Gallery, Professor Natalie & Gerry, School of Accountancy, Queensland University of Technology: Accounting Impediments to Better Superannuation Fund Governance, Accounting, Accountability and Performance Vol 12, Number 2, 2006, p 33.
- 7 Item 205 of Schedule 10, Corporations Regulations 2001.
- 8 Compound 5 and 10 year investment return reporting requirements after 30 June 2010 - Regulations 7.9.20(1)(n) and 7.9.20AA(8), Corporations Regulations 2001.

- 9 An incentive to do so for the annual report to be one of the vehicles to provide members with the information on investment options necessary to support a member's investment direction as generally required by regulation 4.02 of the Superannuation Industry (Supervision) Regulations 1994.
- 10 IFSA is reversing this Standard as part of its Super Charter.
- 11 'Review of Current Australian Requirements and Options for Reform - Report to the Australian Securities and Investments Commission', published as ASIC Report 16, September 2002.