Institute of Actuaries of Australia

30 September 2009

The Chairman
Australian Accounting Standards Board
PO Box 204
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AUSTRALIA

E-mail: standard@aasb.gov.au

Dear Mr Stevenson

**AASB Exposure Draft 179 - Proposed changes to financial reporting by Superannuation Plans and approved deposit funds**

The Institute of Actuaries of Australia ("the Institute") is the sole professional body for actuaries in Australia. It represents the interests of over 1,400 fellows and 2,000 other members. Our members have had significant involvement in the development of insurance regulation, financial reporting and related practices in Australia over many years.

The Institute welcomes the opportunity to submit comments to the proposed changes to financial reporting by Superannuation Plans and approved deposit funds, as set out in the Australian Accounting Standards Board's (AASB) Exposure Draft, ED179. While the Specific Matters for Comment in ED179 are broad, the Institute has chosen to focus its submission on those Matters on which it feels it can most usefully provide comments, given its members' specialist skills and first hand experience.

***Introductory comments***

A recurring concern of the Institute is whether the information provided under ED179 will be useful (and not misleading) to users of the information, particularly in light of the wide range of (more detailed and extensive) information and reporting which is currently provided to each group of users. We believe that it would be helpful for the AASB to confirm that usefulness of information for users is the main objective for the proposals in the standard or to set out any other objectives.

By way of background, almost all Australian Defined Benefit Superannuation Plans have now been closed off to new members, and therefore the membership will fall. In our experience, the average expected future membership periods of such Superannuation Plans is typically 8-12 years.

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Turning to each potential "user of the information":

- A Superannuation Plan Trustee has full access to their appointed actuary, and is required to monitor the financial position of their Superannuation Plan on an ongoing basis. The prudential framework for such monitoring in Australia is extensive and a Superannuation Plan Trustee is required under the Superannuation Industry (Supervision) Legislation to obtain a detailed triennial Actuarial Review report (again, governed by actuarial professional standards) which already measures the Superannuation Plan's benefits using differing methodologies.

  This report already provides detailed information which is far more detailed than that provided under ED179 and the different measures of the Superannuation Plan obligations are carefully explained and contrasted in the triennial Actuarial Review report. Such information is specifically designed to ensure the Trustee is provided with differing short and long term solvency measures. The Superannuation Industry (Supervision) Legislation also imposes obligations on Auditors and Actuaries to report on specific solvency measures to the Trustee and/or Regulator.

- Members are most likely to relate to a "Vested Benefit" measure of the Superannuation Plan's benefit obligations (being the benefit paid out by the Superannuation Plan if the member voluntarily left service). This measure is already provided annually within existing AAS25 reporting, along with the actuaries' longer term measure of the last actuarial review results (provided as a disclosure note). It is the Institute's view that members are unlikely to understand the relevance of alternative measures of the benefit obligation.

  Note also that it is unlikely that a defined benefit member will become a defined benefit member of some other sponsoring employer's Superannuation Plan, given that almost all Australian defined benefit plans are closed to new members. Therefore, in reality, there is limited need for comparison by such members.

- The regulator of Australian superannuation plans, APRA, already has the ability to request any actuarial analysis provided for Superannuation Plans. Like the Trustee, they can therefore also access the Actuarial Report of the Superannuation Plan which includes short and long term measures of the liabilities.

- Auditors similarly have full access to the results of the triennial Actuarial Review, annual calculation of the Superannuation Plan's Vested Benefits, as well as any actuarial analysis prepared between triennial reviews.

- Investors already have access to AASB119 reporting disclosed in sponsoring employers' accounts (which provides a similar – but not identical – benefit obligation measurement to that drafted in ED179, plus prescribed information regarding cash contribution requirements).

Where these users have a need for information contained in the financial statements is in relation to the fair value of the Superannuation Plan's assets. Some of the issues which the superannuation industry is grappling with at the moment are in relation to the valuation of unlisted assets and the treatment of deferred tax assets. These are areas where the standard can provide assistance to users of Superannuation Plan financial statements.

To the extent that the standard pursues measures that are costly to produce and of limited value to users, we are concerned that they may be a detriment to the users (some of whom ultimately meet the costs of preparation) rather than a benefit.

## Executive Summary

The Appendix to this letter sets out the Institute's views on the Specific Matters for Comment in ED179. However, a summary of our key concerns are as follows:

***The Institute is concerned with the inclusion of a liability for members' benefits in a balance sheet for Superannuation Plans.***

Superannuation Plans are established for the benefit of their members. The members are the true owners of the Superannuation Plan and hence their interests are closest aligned to equity.

In some cases members' interests will fall within the definition of equity in International Financial Reporting Standards, whereas in other cases members' interests may arguably fall outside equity. Given the difficulty that different approaches to members' interests would create, we support one consistent treatment. However, it would be preferable if the treatment was aligned with the substance and purpose of Superannuation Plans.

We believe that substance and purpose of Superannuation Plans (to provide benefits for members) leads you to conclude that members' interests should be treated as equity by the Superannuation Plan. If members' interests are treated as equity we would of course continue to support the disclosure of information on members' interests in the disclosure notes.

***The Institute strongly recommends the use of "Vested Benefits" as the primary measure of a Superannuation Plan's defined benefit liability disclosed in any replacement to AAS25.***

A practical measure is needed, and Australia's (predominantly) lump sum environment readily provides a convenient, transparent and assumption-free measure of a Superannuation Plan's obligations.

The Vested Benefit measure will be:

- Understood by members.
- Consistent with the obligations shown on their benefit statement.
- Readily obtainable, without the significant time and costs of additional actuarial input. Cost is a key issue, given the closed (and running off) status of most of Australia's Defined Benefit Superannuation Plans.
- Available within the statutory reporting periods.
- Consistent with the legislative measurement of a Superannuation Plan's financial position. (It will avoid circumstances in which Trustees report that the Superannuation Plan is in a satisfactory financial position, but that the financial statements suggest a deficit using the proposed ED179 measure).
- Calculated without the use of assumptions for lump sum Superannuation Plans (the vast majority). Supplemental guidance can be issued for pension paying Superannuation Plans, which we would expect to involve calculations on a funding valuation basis (most likely the triennial valuation basis unless the actuary has reason to believe that those assumptions are no longer appropriate).

***The Institute does not recommend adopting the proposed ED179 Accrued Benefits measure, because:***

- It will introduce a fourth measure of a Superannuation Plan's benefit obligations, but provide limited additional useful information (when compared with what is already available to those users).
- It will value Accrued Benefits at a lower discount rate (either a risk free, or corporate bond rate) than that used by the Actuary for funding purposes (which is typically valued using discount rates based on the Superannuation Plan's expected future investment returns). Therefore, the ED179 Accrued Benefits measurement will be greater than the Accrued Benefits for funding purposes. Therefore:
    - If it were not for Vested Benefits, a Superannuation Plan will always be in deficit on an ED179 basis if assumptions are borne out in practice. This would be unnecessarily alarming to Defined Benefit members. We question the ability for members to obtain sufficient level of access to an actuary to obtain clear explanation of how any ED179 Accrued Benefits measure differs from other measures of the obligation (in the same way that Trustees and Finance Directors have tried to gain such an understanding since the implementation of AASB119).
    - A pragmatic compromise is the (potentially higher) Vested Benefit measurement.
    - A longer term measure of the benefit obligation would be an Accrued Benefit measure on the Funding (i.e. return on assets) basis. Trustees and actuaries typically target full asset coverage of this measure in the longer term.

***The "Comparison" purpose used to develop the AASB119 Accrued Benefits measure appears to be less important for users of ED179.***

We understand that the AASB119 calculation was intended to provide stock analysts / investors with consistent comparisons of AASB119 disclosure information within corporate accounts. However, there is no practical outcome of providing members with a measure of making a "consistent comparison" of their Superannuation Plan's financial position against others.

This is because almost all Australian Defined Benefit Superannuation Plans are closed to new members; there is virtually no opportunity for Defined Benefit members to join a different sponsoring employers' defined benefit Superannuation Plan (even if they did change employer).

***The proposed ED179 Accrued Benefit measure will provide no new useful information to Trustees and APRA.***

APRA, Trustees and Plan members already receive significant purpose-specific financial information which already measures Defined Benefit Superannuation Plan financial information using a variety of measures. Adding (and disclosing) a further measure will conflict with pre-existing information, add cost and may be challenging to complete within statutory reporting deadlines (without starting such work prior to balance date, and therefore using various approximation techniques).

***The ED179 Accrued Benefits measure may lead to poor decisions by Defined Benefit members.***

For example, a defined benefit member may note that the assets of their defined benefit Superannuation Plan are lower than the ED179 measured liability, and convert out of the Defined Benefit section of the Superannuation Plan. The conversion (more likely to a potentially less valuable Accumulation benefit) will be based out of perceived fear of the security of their benefit, and could ignore the possibility that:

- The Superannuation Plan's Vested Benefit (ie required funding) measure, and
- The Superannuation Plan actuary's longer term funding measure of the Accrued Benefits

may be both adequately funded.

***If the AASB does want to proceed with mandating such a measure, the Institute strongly recommends using a AASB119 measure by direct reference***

In practice there is unlikely to be much difference between the AASB 119 liability and the ED179 Accrued Benefit proposal in the majority of cases:

- Generally the AASB 119 liability will not include an allowance for expected administration costs anyway;
- Following the increased impact of Superannuation Guarantee minimum benefits on Defined Benefit designs, very few defined benefit plans have a benefit design that accrues materially higher levels of benefits as members approach retirement age; and
- The AASB 119 liability is currently calculated by discounting future benefit payments using a government bond yield, which is generally considered to be a risk-free rate. However we note that the International Accounting Standards Board (IASB) has proposed amendments which would change the basis of the discount rate from a government bond to high quality corporate bonds.

The Institute does not support a ED179 or AASB119 measure for this purpose. However, if such a measure is used, directly referencing AASB119 will at least eliminate any possibility of a fourth measure of Accrued Benefits emerging if any changes are made to AASB 119.

***We do not recommend changing requirements regarding the measurement or disclosure of those Superannuation Plans with a "higher of" benefit option.***

In practice, many actuaries already place a value on "higher of" benefits by deterministic projection techniques. Whilst the IASB's discussion paper on proposed amendments to IAS 19 suggested that a "higher of" benefit option be valued using option valuation techniques, the additional costs of making this theoretical measurement will almost certainly outweigh any additional value to the users of the information.

***We are concerned that the additional costs of some of these proposals outweigh the benefits.***

The Institute's view is that the changes in ED179 will only be in the interests of the Australian economy if the perceived value of the additional information received by users is greater than the associated increases in costs. It is not clear that the proposals provide benefits that outweigh the associated costs.

We address the specific matters for comment, in which the actuarial profession has particular expertise in the Appendix. We have not addressed some issues that we believe are outside the expertise of the actuarial profession.

We would be happy to discuss any of the matters raised in this letter.

Yours sincerely

Trevor Thompson
President

## Appendix: Specific Matters for Comment

*(a) the recognition principles in paragraph 10 of this Exposure Draft are appropriate for a superannuation plan or approved deposit fund;*

**IAAust Response**

We believe that the recognition of members' interests as liabilities and the issue of "equity" in superannuation plans is an important issue that requires further consideration.

We understand that the Framework for the Preparation and Presentation of Financial Statements defines equity to mean:

> *"Equity is the residual interest in the assets of the entity after deducting all its liabilities."*

That definition is further amended by AASB 132 which includes as equity certain puttable financial instruments. These instruments must have the following feature in order to be included in equity:

> *"(a) It entitles the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation. The entity's net assets are those assets that remain after deducting all other claims on its assets. A pro rata share is determined by:*
>
> > *(i) dividing the entity's net assets on liquidation into units of equal amount; and*
> >
> > *(ii) multiplying that amount by the number of the units held by the financial instrument holder.*
>
> *(b) The instrument is in the class of instruments that is subordinate to all other classes of instruments. To be in such a class the instrument:*
>
> > *(i) has no priority over other claims to the assets of the entity on liquidation; and*
> >
> > *(ii) does not need to be converted into another instrument before it is in the class of instruments that is subordinate to all other classes of instruments.*
>
> *(c) All financial instruments in the class of instruments that is subordinate to all other classes of instruments have identical features. For example, they must all be puttable, and the formula or other method used to calculate the repurchase or redemption price is the same for all instruments in that class.*
>
> *(d) Apart from the contractual obligation for the issuer to repurchase or redeem the instrument for cash or another financial asset, the instrument does not include any contractual obligation to deliver cash or another financial asset to another entity, or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity, and it is not a contract that will or may be settled in the entity's own equity instruments as set out in subparagraph (b) of the definition of a financial liability.*

*(e) The total expected cash flows attributable to the instrument over the life of the instrument are based substantially on the profit or loss, the change in the recognised net assets or the change in the fair value of the recognised and unrecognised net assets of the entity over the life of the instrument (excluding any effects of the instrument)."*

In line with the approach taken by the AASB in considering this issue in paragraph BC 41 we also believe that the provisions above, together with the different nature of superannuation plans leads you to consider different types of superannuation plans separately. We address each of those in turn below:

- **Defined contribution plans with no reserves and no member investment choice.** For a superannuation plan in these circumstances, there is no difference between members' account balances and plan assets. It would therefore appear that members' balances meet the definition of equity as there is no lower priority claim and members will receive a pro-rata share in the entity's assets.

  We understand that many managed investment schemes will account for unit holders' funds as equity on this basis after applying the amendment to AASB 132. Given the similarity to defined contribution superannuation plans some consistency on this issue would appear appropriate.

  Notwithstanding the comments above, it is possible that a defined contribution plan with no reserves has a provision for reserves or some other form of residual assets, claims on those reserves would have a lower priority on termination and the nature of the claim may not be a pro-rata share for all members. So arguably those reserves (even though currently nil) are the equity in this type of superannuation plan.

- **Defined contribution plans with no reserves that offers member investment choice.** It's difficult to see any distinction between this type of superannuation plan and one without member investment choice. Arguable member investment choice makes it more likely that any residual assets on liquidation would be distributed in something other than a pro-rata share (for example different amounts to different investment choices). But it is not clear why that should necessarily be the case.

- **Defined contribution plans with reserves.** In this case it appears that any residual assets in the reserves may have the lowest priority and members' balances would hence not appear to be equity. However, that is not necessarily the case. If the reserve is for administration expenses or tax, those liabilities would typically be paid ahead of members on liquidation.

- **Defined benefit plans.** Defined benefit plans typically have some excess or shortfall of assets over the value of members' benefits (for defined benefit and defined contribution members). If the amount is an excess it will be typically be dealt with on liquidation after all members' benefits and expenses have been paid. Hence any claim on this excess would appear to be the lowest priority and the most likely candidate to be treated as equity.

The actual treatment of this excess will differ from plan to plan, based on the specific provisions in plans' trust deeds. Typically it would either be payable to the employer or distributable to members. If it is distributable to members, then potentially it could bring defined benefit members' benefits into the definition of equity.

It would be unusual, although not unheard of, for defined benefit and defined contribution members to be treated in the same way in respect of any residual assets. So there would be unlikely that the account balance for a defined contribution member in a defined benefit plan could fall into the definition of equity.

All of the above suggests that in seeking to define equity in terms of existing accounting standards consideration of this issue could be driven by the legal form of superannuation plans' trust deeds, rather than the substance of superannuation plans and the benefits they provide to members. Given the variation and complexity of termination provisions this path is likely to be exceedingly difficult and contradictory.

We note that, in its considerations, the AASB concluded that having different reporting outcomes for different types of superannuation plans would not be desirable. We agree. This may mean that for some entities the result may be inconsistent with International Financial Reporting Standards. However, if International Financial Reporting Standards alone were enough to allow preparation of financial statements for superannuation plans there would be no need for an Australian Standard for superannuation plans. Some inconsistency is implicit in the decision to develop an Australian Standard.

Deciding that a consistent approach is desirable does not of itself lead you to conclude what that approach should be. We believe that the decision between liability and equity should be based on the substance of what superannuation plans provide to members.

Under the Superannuation Industry (Supervision) Legislation the sole purpose of a superannuation plan must be to provide certain benefits to members. In the same way that shareholders are the main beneficiary of company's performance, the substance of what members receive from their superannuation plan is more like equity than anything else. This is even true of defined benefit members where any claim if the assets held by the superannuation plan are insufficient to provide the defined benefit lies more with the employer than the superannuation plan.

Hence to achieve a consistent outcome both across different types of superannuation plans and between superannuation plans and managed investment schemes, we believe that it would be preferable that members' benefits are treated as equity. This of course does not preclude disclosure of the amounts of members' benefit and any shortfall or the establishment of a different class of equity for any residual assets.

*(b) a superannuation plan or approved deposit fund should be required to measure at fair value adjusted for transaction costs all of its:*

*(i) assets, except for:*

*(A) tax assets;*

*(B) assets arising from insurance contracts issued by the entity; and*

*(C) goodwill; and*

*(ii) liabilities, except for:*
*(A) tax liabilities;*
*(B) obligations for defined contribution members' vested benefits;*
*(C) obligations for defined benefit members' accrued benefits; and*
*(D) obligations arising from insurance contracts issued by the entity;*

**IAAust Response**

- No comment on this specific question. However, we intend to make a separate submission on the proposed changes to fair value.

*(c) the guidance in paragraphs AG13-AG32 of Appendix B to this Exposure Draft is sufficient to facilitate reliable measurements of obligations for defined benefit members' accrued benefits and comparable measurements of such obligations between superannuation plans and over time. In particular, whether a superannuation plan with defined benefit members who will accrue materially higher levels of benefits as they near retirement age should be:*
*(i) permitted to use a method of its choosing to attribute such members' benefits to reporting periods, provided that the method is appropriate for the plan's circumstances, as proposed in paragraph AG17 of Appendix B to this Exposure Draft;*
*(ii) required to attribute such members' benefits on a straight-line basis in a manner consistent with the approach required under AASB 119 Employee Benefits for defined benefit obligations; or*
*(iii) required to attribute such members' benefits to reporting periods on a basis other than a straight-line basis;*

**IAAust Response**

We believe that the most appropriate measure for reporting the benefit obligations of a defined benefit plan in its financial statements is the total of vested benefits (ie the benefit entitlements were all members to leave service at the date of calculation). Whilst we acknowledge that vested benefits may not provide an idea of the ongoing liabilities of the plan, there are a number of advantages of using this measure:

- It is generally a simple calculation that does not require actuarial input, thus reducing costs and time spent;
- The total of vested benefits is already used as a solvency measure, compared with assets to determine if a plan is in an unsatisfactory financial position for the purposes of the Superannuation Industry (Supervision) Act;
- The concept of vested benefits is familiar to members and is currently disclosed in the financial statements of superannuation plans;
- Members and other readers of the financial statements are likely to better understand the concept of vested benefits rather an actuarial value of accrued benefits calculated in accordance with AASB 119;
- Whereas vested benefits are generally automatically calculated as at the date of the financial statements each year, the AASB 119 liability may not be in some situations – e.g. where the sponsoring company's reporting date is different to the plan's, or where the plan is a multi-employer Superannuation Plan and the relevant

criteria set out in AASB 119 are met permitting each individual entity to account for the plan as if it was a defined contribution Superannuation Plan;

- It avoids most (if not all) of the need to adopt roll-forward approaches in practice, as for AASB 119 calculations, where it is sometimes not possible to obtain defined benefit membership data at the balance date in sufficient time to complete the calculations and hence data at an earlier date is used for this purpose; and
- The value of accrued benefits calculated in accordance with AASB 119 is a requirement of a company accounting standard, and has no relevance to the normal funding requirements of a defined benefit superannuation plan.

Following on from this last point, defined benefit plans are currently required to disclose accrued benefits in financial statements (calculated as at the date of the most recent actuarial funding valuation of the plan). Introducing a new third measure of liabilities will be confusing for readers of the financial statements. There is likely to be significant confusion about the difference between the accrued benefits calculated for a funding valuation and the accrued benefits calculated in accordance with AASB 119.

We also express a concern about the use of a AASB 119 liability in the financial statements of superannuation funds, where the calculations have been based on a roll-forward approach because of the various approximations involved in that process. Those approximations, which may not be material in the context of an employer's balance sheet, may be significantly more material for a superannuation fund that has no other business.

If the Board does ultimately determine that the total of vested benefits is not an appropriate measure for calculating the accrued benefits to be recognised as a liability, we suggest that the standard simply refer to accrued benefits as those calculated in accordance with AASB 119 with no adjustment (although, as highlighted above, this will still involve an additional calculation where the AASB 119 liability is not currently calculated at the date of the financial statements). The Exposure Draft states that the accrued benefits should be calculated in a manner consistent with AASB 119, but with 3 exceptions (excluding expected administration costs; attributing benefits to reporting periods on a basis appropriate to the plan's circumstances where higher benefits accrue in later years; and discounting benefit payments using a risk-free rate of interest).

We do not believe that it is necessary to specify another method of calculation of the liability to be reported in the financial statements, when accrued benefits are already being calculated for AASB 119 purposes. A present value of accrued benefits is also calculated when an actuarial funding valuation is performed. There does not appear to be a need for a third measure of accrued benefits.

In any event, in practice there is unlikely to be much difference between the AASB 119 liability and the liability calculated using the method outlined in the Exposure Draft in the majority of cases:

- Generally the AASB 119 liability will not include an allowance for expected administration costs anyway;
- Very few defined benefit plans have a benefit design that accrues materially higher levels of benefits as members approach retirement age; and

- The AASB 119 liability is currently calculated by discounting future benefit payments using a government bond yield, which may be considered to be a risk-free rate.

We note that the term "risk-free rate" does not have a clear objective definition. So while it might be considered to be a government bond yield, it could be interpreted in other ways. Hence we would encourage the AASB to more broadly provide clarity around the meaning of the term "risk-free rate" and not to introduce into new contexts until that clarity has been provided.

In the small number of cases where the two calculation methodologies give different results, requiring another calculation of liabilities from an actuary would add to compliance costs, without significant benefits to the users of the financial statements.

We note that the International Accounting Standards Board (IASB) has proposed that the discount rates used to value defined benefit obligations under IAS 19 be based on corporate bond yields going forward. This suggests that the IASB believes that a corporate bond yield is an appropriate rate at which to discount future benefit payments for reporting purposes, and not necessarily a risk-free rate.

The other advantage of referring specifically to the value of liabilities calculated in accordance with AASB 119 is that if any changes are made to AASB 119 (such as amending the method of setting the discount rate), there is no need to revise the wording of the standard so that it is consistent.

*(d) any superannuation plans in Australia have defined benefit members whose level of benefits could be altered by externally imposed requirements, such as the level of state retirement benefits, as noted in paragraph 18(c) of this Exposure Draft and paragraph AG30 of Appendix B to this Exposure Draft. If so, please describe the nature of these externally imposed requirements and how they are currently incorporated into the measurement of defined benefit members' entitlements;*

**IAAust Response**

Paragraph 18c flags the possibility of benefits being linked to externally imposed requirements. We believe that the wording within ED179 is sufficient as currently drafted, given its likely application in Australia.

- There are very few Australian defined benefit Superannuation Plans providing benefits which are directly integrated with social security benefits (e.g. the amount of a retirement pension provided by the state). This is in contrast to many European defined benefit Superannuation Plans, where such design features are common practice. If there are exceptions within Australia, then we envisage that further interpretation can easily be handled on a case by case basis between auditor and actuary.
- It is common for Australian defined benefit Superannuation Plans to subject their benefits to a minimum of those required to satisfy the Superannuation Guarantee (SG) legislation. The SG minimum formula would commonly be calculated based on earnings up to a government prescribed Maximum Contribution Base (which is

indexed each year with national earnings statistics). It would be common practice for actuaries to make allowance for such increases in their valuation, and we feel that the ED179 wording is sufficient to reflect pre-existing actuarial practice.

*(e) there are any significant practical difficulties that would inhibit the reliable measurement of obligations and assets arising from insurance contracts issued by a superannuation plan or approved deposit fund in accordance with the principles and requirements applicable to life insurance contracts under AASB 1038 Life Insurance Contracts as proposed in paragraph 21 of this Exposure Draft. If so, please describe the nature of these difficulties and how they might be overcome;*

**IAAust Response**

We note that in most cases there are no separate "insurance contracts" issued by the superannuation plan. We understand that cases of direct insurance with an external insurer (with the Superannuation Plan acting only as an agent) would be relatively rare. Instead we believe there are a large number of Superannuation Plans that have a group life insurance contract with the Superannuation Plan debiting money from the member's accounts and paying this to the insurer.

Despite this it is not clear whether the treatment proposed by ED 179 would apply to range of arrangements provided through Superannuation Plans and if so how it would apply. One example of the practical difficulties is that it is not clear what the insured amount is for any particular member in a defined benefit Superannuation Plan, where the benefit is not defined in terms of an accrued amount plus an insured component (the majority of defined benefit Superannuation Plans).

There are also likely to be significant additional costs that would be incurred. This would include the need to:

- Set up valuation models to calculate liabilities.
- Determine assumptions for the calculation of outstanding claims provisions – particularly for disability business.
- Extract data at the balance sheet date.

Any benefits of such measures would outweigh the significant costs where there is little or no real intent for the Superannuation Plan to act as an insurer (and where assets would be materially the same as the liabilities).

Whilst it is possible in some cases that some residual risk may be retained by the superannuation plan (credit risk, operational risk, definition risk) we do not believe that grossing up the balance sheet for insurance liabilities and reinsurance recoveries will add any real benefit to the financial statements (and substantial costs may be incurred in trying to reliably measure these assets and liabilities). In addition in other cases the operation of the Superannuation Plan's trust deed means that there is no residual risk.

We believe that where there is little or no real insurance risk, a more appropriate means of dealing with these arrangements may be by way of disclosing the residual risks (if any) that remain with the Superannuation Plan.

We also believe that if this requirement is to remain then substantial additional guidance in relation to materiality and exactly what would constitute an agency arrangement would be required.

In cases where there is significant "real" insurance provided by the Superannuation Plan and not externally insured (commonly referred to as self-insurance), we recognise the need to disclose the nature of operation of these arrangements in the financial statements, however significant additional costs with the proposed approach, as discussed above, would still apply.

Our primary concern with the proposed approach to these arrangements is that the introduction of AASB 1038 adds a further basis for the determination of part of the liabilities. Any obligation in respect of future benefits, including benefits that appear to have an insurance element or nature and that may be in the course of claim, should be incorporated in the definition of the defined benefit obligation from AASB 119. Hence for consistency again with the AASB 119 defined benefit obligation, for internal consistency within the financial statements and to provide preparers with clarity on the intentions of the standard, it would seem appropriate that any insurance type benefits be included within the measurement of members' interests.

On a related point, we note that paragraph 15 of the Appendix to AASB 1038 provides examples of Life Insurance Contracts which includes "life-contingent annuities and pensions". We note that some defined benefit superannuation funds provide pensions. We assume that the intention of the Board is not to separate the value of those pensions from any other value of members' interests. Hence some clarification is required.

*(f) there are any circumstances in which a difference between a superannuation plan's or approved deposit fund's total assets and its total liabilities (including defined contribution members' vested benefits, defined benefit members' accrued benefits and any obligations to employer sponsors) would not be equity as defined in Australian Accounting Standards;*

**IAAust Response**

If the AASB confirms its conclusion that members' benefits are not to be treated as equity then there remains a question of the treatment of any other surplus or deficit, particularly in a defined benefit superannuation plan. Again the issues here are complex and require detailed consideration.

The first concern is that an asset or liability in respect of any surplus or deficit may be recognised in an employer's financial statements (based on the requirements of AASB 119). It would appear preferable if the counterparties (the plan and the employer) recognise the related assets and liabilities in a complementary fashion.

We note that the AASB concluded that an employer's obligation to contribute under AASB 119 did not represent a reimbursement asset under AASB 137 or a financial instrument asset under AASB 132, unless there was a contract for the payment of employer contributions. We note that such contracts may exist in some circumstances or the superannuation plan's trust deed (which is a legal agreement) may place certain requirements on employer contributions. Hence the legal basis for the recognition of an asset may exist in some circumstances.

However, that doesn't preclude the employer obligation from being an asset. For the superannuation plan the nature of the employer obligation is more in line with a payment receivable than a financial instrument. In fact AASB 119 recognises the double-counting in contributions receivable and specifically excludes them from the fair value of Superannuation Plan assets in developing the employer obligation.

We understand that it is not necessary to have a legal agreement in place to recognise a payment receivable. We understand that it needs to be probable that future economic benefits would flow to the entity. Given the employer is required to recognise a liability (which has presumably passed the complementary probability test) it does seem probable that contributions to fund a deficit will flow to the superannuation plan and could be recognised as a receivable.

The logic for a surplus may be more challenging as arguably either members or the employer may benefit from the surplus. However, it would appear more than probable that the economic benefit of a surplus would flow to either employers or members.

In its considerations the AASB noted the present obligation requirement that is an essential characteristic on a liability. We understand that accounting principles do not require a legal contract to demonstrate that present obligation. It is possible for a constructive obligation to be classified as a liability. The consistent practice in the use of any surplus to provide for either members or employer contributions is consistent with such a constructive obligation.

*(g) a superannuation plan that has members who are entitled to the higher of a defined benefit promise and a contributions-based amount upon their retirement or other event that qualifies as a condition for releasing superannuation benefits (refer to paragraphs BC52-BC56 of the Basis for Conclusions to this Exposure Draft) should recognise the 'higher of' benefit option separately from the defined benefit 'host promise'.*

*If you agree that a superannuation plan should separately recognise a 'higher of' benefit option, how might the option be measured?*

**IAAust Response**

We do not believe that it is necessary for a Superannuation Plan to recognise a "higher of" benefit option separately from a defined benefit "host promise".

It is unlikely that separating the value of the benefit into the two components will provide readers of the financial statements with any useful information, and may even increase confusion without a detailed explanation.

A large number of Australian defined benefit plans have benefit designs that comprise a "higher of" option (or even, multiple "higher of" options). In practice, many actuaries currently value a "higher of" benefit in a defined benefit superannuation plan by projecting forward the accrued defined benefit and the accrued contribution-based benefit on the assumptions adopted, determining the greater of the two at each assumed date of payment and discounting the greater benefit back to the valuation date to arrive at a value of liabilities.

In this way, there is some allowance made for the probability that the contribution-based benefit is the more valuable benefit in the future. We do not believe that there is a need to separate out the components.

The Basis for Conclusions refers to the IASB's discussion paper on proposed amendments to IAS 19, which suggests that a "higher of" benefit option be valued using option valuation techniques. We do not believe that this would be a practical alternative, as it introduces yet another method for valuing liabilities. It would represent a significant change to the techniques that are currently used to value benefits with a "higher of" option. Option valuations are considerably more complicated and expensive. The costs of making this theoretical measurement will almost certainly outweigh the value to the users of the information.

The majority of Australian defined benefit Superannuation Plans have generally been closed to new members for a number of years, and the active membership of such Superannuation Plans can therefore be quite small. It would take a significant amount of work (and related expense) to assess whether option valuation techniques give materially different results to current practices, time and expense that will be difficult to justify as the size of defined benefit arrangements dwindles.

Whilst we do not believe it is necessary to show the defined benefit and "higher of" components of the liability separately, if the AASB did include this requirement in the standard, we suggest that a simple approach would be preferable to the IASB proposal. A reasonable estimate of the value of the "higher of" option would be the difference between the liability calculated using the current approach adopted by most superannuation actuaries as described above (ie comparing the defined benefit and contribution-based benefit at each assumed future date of payment and discounting back to the date of calculation) with the liability based on the defined benefit only (ie ignoring the contribution-based benefit). This approach is consistent with the deterministic methodology implied by AASB 119.

*(h) there are any significant practical difficulties that would inhibit the preparation of consolidated financial statements in accordance with paragraph 30 of this Exposure Draft. If so, please describe the nature of these difficulties and how they might be overcome;*

**IAAust Response**

- No comment

*(i) a parent superannuation plan or parent approved deposit fund should be permitted or required to separately recognise any internally generated intangible assets, internally generated goodwill, contingent assets or contingent liabilities that are attributable to a subsidiary and have arisen subsequent to the subsidiary's acquisition by the parent plan or parent fund when such items are reliably measurable;*

**IAAust Response**

- No comment

*(j) a parent superannuation plan or parent approved deposit fund should be required to recognise and present any excess of the amount of the net assets of a subsidiary that are recognised by the parent over the sum of the parent plan's or parent fund's interest and any non-controlling interests in the subsidiary as a remeasurement gain in the consolidated income statement in the reporting period in which it occurs;*

**IAAust Response**

- No comment

*(k) a parent superannuation plan or parent approved deposit fund should be permitted or required to measure any non-controlling interests at fair value of equity at the end of each reporting period in a manner consistent with the approach illustrated in Illustrative Example D of Appendix C to this Exposure Draft;*

**IAAust Response**

- No comment

*(l) the disclosure principles in paragraphs 32-50 of this Exposure Draft:*
*(i) are appropriate for a superannuation plan or approved deposit fund;*
*(ii) would provide useful information for users of the general purpose financial statements of a superannuation plan or approved deposit fund; and*
*(iii) would be sufficient to facilitate reliable and comparable disclosures between superannuation entities and over time;*

**IAAust Response**

An extensive amount of information is already required to be reported to members of a superannuation plan by the Trustee on a regular basis in accordance with the Superannuation Industry Superannuation (SIS) legislation. For example:

- Annual reports, which meet specified criteria, must be issued to all members each year.
- Statements must be issued to members on joining the plan, annually while a member of the plan and on leaving the plan.

- Particular information must be made available to members on request and when they make inquiries or complaints, and to other persons entitled to make inquiries or complaints.

The proposed disclosures under ED 179 impose a further detailed set of disclosures on the Trustee, which increases operating costs without providing any additional benefits to the users of the financial statements, given that all users either already receive this type of information or have access to it.

Specifically, AG52 paragraph (b) requires the superannuation plan to disclose (as a minimum):

- The types of benefits provided;
- The numbers of members and beneficiaries holding each type of benefit;
- The numbers of members and beneficiaries classified as active, deferred or pensioner by type of benefit; and
- Whether the entity can accept new defined benefit members.

It would be reasonable to include a general description of the type of Superannuation Plan (defined contribution or defined benefit) in the financial statements and this is consistent with AASB119. It might also be reasonable to refer to the latest Annual Report for further information. However, we cannot see any merit in having to disclose details of numbers of members by type of benefit and/or pension.

In many cases, superannuation plans would not be able to disclose the number of "unique members" as many members have dual accounts or memberships as a result of working for more than one employer and/or at more than one time. The same member may also be an active member, a deferred member and potentially, a pensioner all at the same time. In addition, we see no benefit in disclosing the number of normal retirement pensioners versus disability pensioners versus spouse pensioners.

In our view, there is no benefit in requiring this type of disclosure, given the SIS requirements for annual disclosure.

We have provided a sample Annual Report for your reference.

We have no issue with the remaining disclosures referred to in paragraphs 32-50.

*(m) there are any significant practical difficulties that would inhibit a superannuation plan or approved deposit fund disclosing information in relation to any segregated groups of assets attributable to different groups of members, and the related obligations to those members, in accordance with paragraph 40 of this Exposure Draft and paragraphs AG80-AG88 of Appendix B to this Exposure Draft. If so, please describe the nature of these difficulties and how they might be overcome;*

**IAAust Response**

Paragraph 40 of the Exposure Draft and the guidance in paragraphs AG83-AG88 require a plan to disclose information on assets, the financial position and significant financial risks for each segregated group of assets within a plan. A segregated group of assets is defined as a section of a plan for which separate financial information is available and evaluated regularly by management of the Superannuation Plan to allocate resources and assess performance.

It would appear from the guidance in the Exposure Draft that a sub-plan in a master trust would be considered a segregated group of assets. For example, where a master trust contains defined benefit sub-plans, the Trustee would be provided with information on the performance of the sub-plans at regular intervals (at least once every 3 years). If this is the intention of the Exposure Draft, this would add significant additional time and expense to the preparation of the financial statements.

Some master trusts have tens or even hundreds of sub-plans – to require the master trust to disclose asset, profit or loss and financial position information for each one would be extremely onerous, particularly where a sub-plan provides defined benefits to its members. It would add significantly to the size of the financial statements, and the cost of producing them, and add little value to the readers of the statements (who, if they are members, would generally only be interested in the sub-plan of which they are a member). We could envisage the financial statements for a large master trust running to hundreds of pages in order to comply with these requirements. The sheer size of the statements would outweigh any possible benefit from the information disclosed.

An alternative to disclosing this information for every sub-plan could be to inform readers of the financial statements that they can obtain more detailed information on a particular sub-plan from the Trustee of the master trust (eg the report on the actuarial valuation of a defined benefit sub-plan).

The Application Guidance to the Exposure Draft suggests that a plan with multiple investment options would not need to disclose separate information for each option, where financial information for management is prepared on a single plan basis. It is not clear from this guidance what the requirements would be if management uses information to rebalance the plan's assets between investment options to match assets and member liabilities. Does this represent segregation of assets, and hence mean separate disclosures are required? If so, this would result in the same issues as for a master trust with multiple sub-plans – significant additional costs and time spent on preparing financial statements.

Where a master trust has multiple sub-plans, each of which offers its members investment choice, how would the plan determine the segregation of assets under the proposed requirements? Would it need to disclose separate information for each sub-plan, and then within each sub-plan separate information for each investment option? This would seem to be impractical.

We do not believe that plans should be required to disclose separate information for each sub-plan or each investment option, as the benefits of disclosure are limited compared with the significant additional costs that would be incurred. If the AASB believes that there are circumstances in which separate disclosure is warranted, we suggest that the new standard is very clear in defining segregation. The current wording of the standard and the guidance could easily be interpreted differently for the same set of circumstances, and plans could spend considerable time and expense producing information for disclosure that is not intended by the standard.

*(n) the separate disclosure of the components of remeasurement changes in defined benefit members' accrued benefits, particularly benefit cost, interest cost and actuarial gains and losses, would provide useful information for users. If you agree that the proposals in paragraph 46 of this Exposure Draft would not be adequate for users' needs, please explain how this information should be presented;*

**IAAust Response**

We understand that the reason this information is provided under AASB 119, is to provide some guidance to analysts seeking to estimate the impact of employee benefits on future profits.

We do not believe that the users of Superannuation Plan accounts would be seeking to estimate future profits, particular given as most future profit will relate to future movements in investment markets which are unknown.

Given that difference in users' needs it is not clear that this disclosure provides any useful information to users.

However, if the AASB wishes to include such disclosure we believe that the movement due to changes in assumptions should be disclosed separately to other actuarial gains and losses.

*(o) it would be more useful if the Standard provided example financial statements for a superannuation plan comprising both defined contribution and defined benefit members rather than explaining how the financial statements of a plan with defined benefit members only would differ from those of a plan with defined contribution members only (as provided in Illustrative Examples A and B in Appendix C to this Exposure Draft);*

**IAAust Response**

We agree that further sample financial statements would be useful.

*(p) the approach adopted in drafting this Exposure Draft is helpful for understanding how a superannuation plan or approved deposit fund might apply the proposals in this Exposure Draft, particularly the disclosure principles, in conjunction with the relevant principles and requirements in other Australian Accounting Standards. If you do not consider the approach adopted in this Exposure Draft to be helpful, please describe the type of approach you would prefer;*

**IAAust Response**

ED179 represents a substantial change to pre-existing disclosure requirements. On balance, we feel that:

- The drafting approach adopted in preparing ED179 is a reasonable summary of the issues considered to-date by the AASB. However, as stated in our response, the Institute has significant concerns with some of the conclusions reached within ED179.
- There is insufficient detail in some of the guidance provided within the ED179 and (once the principles are adopted) we strongly recommend the AASB issue strong guidance in any finalised replacement standard for AAS25. (From our experience in AASB119, lack of guidance is the primary cause of quite legitimate professional differences in opinion in how that standard should be interpreted. Such differences in opinion have resulted in materially different disclosures under that statement, as well as adding significantly to the cost of preparing such statements.)

*(q) overall, the proposals would result in general purpose financial statements that would be useful to users; and*

### IAAust Response

We do not believe that the proposed ED179 Accrued Benefit measure will provide useful (and even confusing) financial information to users.

We have already noted that APRA, Trustees and Plan members already receive significant purpose-specific financial information which already measures Defined Benefit Superannuation Plan financial information using a variety of measures.

In fact, we believe that the ED179 Accrued Benefit will confuse users of the information, when they compare this against other pre-existing sources of information available to them. Some users will be better able to reconcile the differences than others:

- For APRA and Trustees, this information (together with their direct access to the Superannuation Plan Actuary) already provides them with scope to obtain sufficient information to understand and oversee each Superannuation Plan's financial management. Therefore, such bodies are unlikely to gain any new useful information from ED179 as drafted.

  Furthermore, if and when confusion about ED179 Accrued Benefit measures emerges amongst Trustees, we expect the education of Trustees to be manageable. By way of illustration, AASB119 has resulted in actuaries devoting considerable time explaining to Company offices and Trustees the differences between funding valuations and AASB119 (corporate comparison) measures. The key message provided is around the different purposes for which the valuations are conducted; namely that the AASB119 measure is used for corporate comparisons by market analysts. Such discussions are technical, require face-to-face consultations, and are ultimately understood to sufficient extent – although this is no doubt aided by the amount of time spent and those officers' existing familiarity with financial issues.
- By contrast, we are extremely concerned about the ability to instill a similar level of understanding in Defined Benefit members (compounded substantially by the impracticalities of gaining sufficient access to a superannuation actuary to gain this knowledge). We strongly believe that there is a high likelihood that Defined Benefit members either:
  - Continue to ignore published accounts, or

- o Misinterpret the ED179 Accrued Benefit measure, when it conflicts with other liability information they receive. This could lead to poor decisions about their superannuation.

  In turn, this will add further costs as Trustees devote resources to managing newly emerging concerns of their members.

- Aside from confusion, there is no compelling "comparison" argument from the member's perspective which would support the ED179 Accrued Benefit proposal. Arguably, a "comparison" argument can be made to provide AASB119 disclosure information to stock analysts / investors within corporate accounts. But in the case of ED179, and because almost all Australian Defined Benefit Superannuation Plans are closed to new members, there is no opportunity for Defined Benefit members to join a different sponsoring employers' defined benefit Superannuation Plan.

We have suggested alternative approaches to measuring the defined benefit obligations, and strongly recommend that consideration be given to their adoption on pragmatic grounds.

*(r) the proposals are in the best interest of the Australian economy.*

**IAAust Response**

The Institute's view is that the changes in ED179 will only be in the interests of the Australian economy if the perceived value of the additional information received by users is greater than the associated increases in costs.

Almost all Australian Defined Benefit Superannuation Plans have now been closed off to new members, and therefore the membership will only fall. In our experience, the average expected future membership periods of such Superannuation Plans is typically 8-12 years.

**Costs**

The direct costs of calculating the ED179 measure of the benefit obligation will include:

- Additional valuation fees. Requiring actuarial input to generate a valuation figure will incur annual actuarial fees, which will vary considerably depending on the level of complexity and level of assistance needed in completing the required disclosure notes. As a broad indication, the ED179 actuarial valuation might add something like one times the current audit fee. This will be incurred by each Defined Benefit Superannuation Plan or Defined Benefit sub-Plan in the country (the work depends primarily on complexity and category numbers, more than Superannuation Plan or sub-Plan size). This is a significant premium for Trustees to incur in return for revaluing a single result.
- Additional consultation time between auditors, actuaries and Trustees to agree on assumptions used

The indirect costs will include

- Time spent responding to Defined Benefit members' questions about the conflicting measures of the Defined Benefit liability, when comparing the ED179 measure against their Vested Benefit and Accrued Benefit measure for funding purposes.
- Poor decisions being made by individual defined benefit members, who may be misled about the security of their benefits by the Accrued Benefit measure proposed under ED179.

**Benefits**

As noted in our response to ***(q)*** above, the Institute is extremely concerned that the new Benefit Obligation measurement advocated under ED179 will add very little useful information to that already in existence. In fact, the additional information emerging has a high risk of being misleading to members.

Given the absence of any apparent "gains" for users of the financial statements, in the face of the additional compliance costs for measuring defined benefit obligations, the Institute strongly opposes the Benefit Obligation aspect of ED179 proposal.