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Dear Kevin

Invitation to Comment on ED 179: Superannuation Plans and Approved Deposit Funds

We are responding to your invitation to comment on the above Exposure Draft (ED) on behalf of PricewaterhouseCoopers.

We welcome the opportunity to comment on the Board's proposals on this industry specific topic and we recognise the efforts that the Board has made in responding to requests by the superannuation industry to address this important industry sector.

We are broadly supportive of the ED that is built on the principles of the International Financial Reporting Standards (IFRS). However, we have some fundamental concerns about the proposals in the ED that are outlined below. Our detailed responses to the specific questions of the ED are in Appendix A.

Consolidation Accounting

From a conceptual basis, in a transaction neutral environment, we support the requirement for superannuation funds to comply with the principles in AASB 127 *Consolidated and Separate Financial Statements* and prepare consolidated financial statements. We note that the IASB is considering whether investment companies should measure controlled investments at fair value rather than traditional consolidation. We suggest that the AASB monitors the IASB's deliberation on this topic. If, for these circumstances, the IASB requires fair value rather than consolidation, then we consider this approach is likely to also be more appropriate for superannuation funds.

We recognise the concerns of the industry that in many cases adoption of consolidation provides limited additional decision useful information. Accordingly, from a pragmatic and practical perspective, we would have also supported a decision by the AASB to depart from IFRS and exempt superannuation funds from being required to consolidate "passive investment vehicles", if the AASB had been so inclined on cost benefit grounds.

However we do not support the departure proposed by the AASB from the requirements of AASB127. In particular:

- The requirement to separately revalue recognised intangible assets to fair value less transaction costs on an annual basis imposes a very significant cost burden on the industry for very limited benefit in terms of decision useful information.
- The requirements of paragraph 30(b) and (c) represent a departure from IFRS consolidation principles which will not be generally understood, and which are not available to other entities which adopt fair value accounting for investments and are required to prepare consolidated accounts.

We do not consider that the superannuation industry in Australia should set a global precedent on revaluation of intangible assets.

If the AASB continues to require entities to prepare consolidated accounts, we consider that the consolidation should be performed in accordance with AASB 127 without any modification.

We are aware that a number of commentators are suggesting that the AASB should provide guidance specific to superannuation funds on how to interpret the AASB 127 definition of control. We do not consider the issues that apply to superannuation to be sufficiently different to other entities (such as insurance companies, investment trusts etc) that invest in a similar manner to superannuation funds, and we believe it is inappropriate for the AASB to provide industry specific interpretative guidance of the requirements of AASB 127.

Accrued Benefits / Vested Benefits

We concur with the proposals to account for defined contribution obligations based on the amount of vested benefits as set out in the ED

With respect to defined benefit obligations, there has been considerable debate in the industry as to the appropriate basis to be adopted for measuring defined benefit obligations, with much opposition to the introduction of a new measure for accounting purposes. We are aware of a number of proposals being suggested:

- Vested benefits
- Accrued benefits measured in accordance with the current AAS 25 requirements
- Accrued benefits measured in accordance with AASB 119, without the modifications suggested in BC 51 of the ED.

Many industry commentators believe that a defined benefit plan's liability to members is limited to the amount of vested benefits. Their view seems to be that reports depicting these vested benefits as liabilities and the current value of plan assets provide the most relevant information to users. The strong support for vested benefits amongst industry commentators points to the need for the AASB to undertake more engagement within the industry to articulate the rationale for the principles underlying the ED.

Whilst we acknowledge the comments of the industry, we also recognise that there is limited conceptual basis under current accounting standards for either of the first two bases set out above. Our view is that the measurement of a defined benefit obligation in a superannuation fund should reflect the present value of the probable outflow of resources that will be required to settle this obligation.

We would therefore support the measurement of accrued benefits in accordance with AASB 119 but would suggest that the AASB provide more clarification and explanation on why the accrued benefit approach is the most appropriate for measurement of defined benefit obligations in the Basis of Conclusions of the final standard.

However, we strongly oppose any modifications to the AASB 119 approach. Actuaries already have to calculate accrued benefits for employers based on AASB 119. In our view, the costs that would be incurred from also having to prepare calculations with the suggested modifications to the AASB 119 approach exceed the benefits that would result from adjusting the measurement approach. Furthermore, as the IASB is working on projects regarding the measurement of liabilities in general and the accounting for insurance contracts, the AASB 119 approach should not be modified for the purposes of this ED until more progress is made by the IASB on these projects.

Alternatively, there may be merit in retaining the current status quo of measuring defined benefit obligations under the principles in AAS 25 Financial Reporting by Superannuation Plans until such time as the International Accounting Standards Board (IASB) has completed its work on the insurance contracts project and progressed its broader project on measuring liabilities. The IASB is expected to issue a standard on insurance contracts in 2011. It appears to us that many elements of defined benefit obligations are likely to satisfy the definition of an insurance contract under those proposals. Given the AASB's policy of setting transaction neutral standards, we wonder whether now is the right time to change accounting for defined benefit obligations for a superannuation fund. If the insurance proposals are likely to result in a materially different outcome in the future, there would appear to be little benefit in making a change now.

However, if the AASB retains the AAS 25 approach, our view is that such obligations should be measured annually, rather than triennially as is currently the case.

Insurance

We concur with the position taken in the ED that where a superannuation plan provides benefits that meet the definition of an insurance contract, the financial impact thereof should be accounted for as an insurance contract.

However we have two concerns with the ED:

- Firstly, the IASB is expected to issue a standard on accounting for insurance contracts in 2011. Given the fact that most superannuation funds which provide benefits that meet the definition of an insurance contract "re-insure" their obligations with a group life insurer, the cost of implementing the proposals in the ED would outweigh the benefits for the short period until the IASB issues a standard for insurance contracts. Accordingly, as an interim measure until the insurance contracts standard is finalised, we propose that the AASB require:
 - separate disclosure of insurance contract asset and liability amounts (as required under the ED), but
 - the measurement of insurance contract liabilities (and related asset recoveries where appropriate) be consistent with the basis adopted for measuring other benefits in the final standard (see our comments above on measurement of defined benefit obligations).

Once the insurance contracts standard is finalised, further consideration should then be given to whether this approach should be adopted for superannuation plans and, in particular, whether the benefits to users of that accounting would exceed the costs of preparing the information.

- Secondly, there has been some misunderstanding in the industry regarding which obligations meet the definition of an insurance contract. Many funds simply act as agent for the group life insurer and their obligation is limited to paying a benefit equal to the amount

paid by the group life insurer under the contract. These funds have questioned whether they would also need to apply the requirements in AASB 1038.

We do not believe it is the role of this standard to define which contracts represent obligations of the plan which would be required to be accounted for as insurance contracts. However it would be useful if the AASB could include a paragraph in its basis for conclusions explaining that it does not expect true agency arrangements to be included within the scope of these obligations. This is in contrast to situations where the superannuation plan takes credit or other risk on the group life insurer's obligations and where assets and liabilities will be required to be recognised.

Financial statements

In a transaction neutral environment, the overall requirements for the presentation of financial statements should be the same for superannuation funds and other entities. However, due to the specific nature of superannuation funds, we believe that a Statement of Changes in Equity does not have the same importance and relevance for these funds as it does for other entities.

As such, all types of superannuation funds should have the following financial statements in order to meet the objective of providing information that is useful to users in making economic decisions:

- Statement of Financial Position
- Statement of Comprehensive Income
- Statement of Cash Flows

In addition to the above, we can also see the merit of providing the information required in the Statement of Changes in Equity and Statement of Changes in Members Benefits. However, preparers should be given a choice of providing this information either as a separate primary statement or as notes to the accounts.

We would welcome the opportunity to discuss our views at your convenience. Please contact me on (02) 86033868 if you would like to discuss this further.

Yours sincerely



Jan McCahey
Partner
Assurance

Appendix A: Issues raised by the AASB

The AASB would particularly value comments on whether:

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

Obligation for members' benefits to be recognised as liabilities

We agree with the proposals in the ED. However, as explained in our cover letter, we would also support a decision of the AASB to retain the status quo of measuring defined benefit obligations under current AAS 25 requirements and make a change only when the IASB's insurance standard is issued or once further progress on the IASB's work on measuring liabilities is made. However, if the AASB adopted this alternative, we consider such obligations should be measured annually, rather than triennially.

Obligations and assets arising from insurance contracts

In principle, we agree that where a superannuation plan provides benefits that meet the definition of an insurance contract, the financial impact thereof should be accounted for as an insurance contract. However, as explained in our cover letter, we propose measuring the obligation under such a contract in the same way as the defined benefit obligations until such time as the IASB has completed its project on accounting for insurance contracts.

Assets and liabilities of a subsidiary – consolidation of subsidiaries

From a conceptual basis, we support the requirement for superannuation funds to comply with the requirements of AASB 127 and prepare consolidated financial statements.

However, we do not support the departure proposed by the AASB from the requirements of AASB 127. In particular:

- The requirement to separately value recognised intangible assets on an annual basis imposes a very significant cost burden on the industry for very limited benefit in terms of decision useful information.
- The requirements of paragraph 30(b) and (c) represent a departure from IFRS consolidation principles which will not be generally understood, and which are not available to other entities that adopt fair value accounting for investments and are required to prepare consolidated accounts.

We believe that consolidation should be performed in accordance with AASB 127 without any modifications.

(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;

We agree with the above proposal.

(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;**

We believe that accrued benefits should be measured in accordance with AASB 119 and do not support any modifications to the AASB 119 approach. The final standard should be made consistent with any revisions made to AASB 119.

(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;

We do not have any comments on this issue.

(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;

As mentioned in our cover letter, we concur with the position taken in the ED that where a superannuation plan provides benefits that meet the definition of an insurance contract, the financial impact thereof should be accounted for as an insurance contract. However we question whether the costs of implementing the requirements of AASB 1038 would outweigh the benefits

given that the IASB intends to complete its project on insurance contracts in 2011. See also our response to question (a) above.

(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;

We do not have any comments on this issue.

(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?

As mentioned in our cover letter and (c) above, we believe that accrued benefits should be measured in accordance with the requirements of AASB 119 without any modifications. As such, the superannuation standard should not deal with specific issues relating to the measurement. Preparers should refer to AASB 119 for guidance on these issues. In any event, we believe a requirement to measure the additional obligation contained in a 'higher of' option at fair value introduces additional complexity and is inconsistent with the general principles in 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;

As explained in our covering letter, we do not support the requirements in paragraphs 30(a) and (b) of the ED. We believe that consolidation should be performed in accordance with AASB 127 without any modification.

(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;

Parent entities should not be permitted to recognise internally generated intangible assets, internally generated goodwill and contingent assets or contingent liabilities that have arisen subsequent to the acquisition, even if they are reliably measurable. Such recognition is not permitted under IFRS and we cannot see any justification why superannuation plans should be treated any different to other reporting entities. The recognition and measurement of the assets and liabilities in the group subsequent to acquisition should comply with the relevant accounting standard that deals with the particular asset or liability.

(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;

We strongly oppose the proposals in paragraph 30 of this ED and believe that consolidation should be performed in accordance with AASB 127 without any modification.

(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;

Consistent with our comments in (h) above, the measurement of non controlling interests should be guided by the measurement principle in AASB 3R on acquisition date and subsequently in accordance with the principles in AASB 127R on consolidation.

(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;**

We support including superannuation specific disclosures in the ED and providing guidance on how to apply specific disclosures to the superannuation industry. However the ED goes much further than that and in many areas replicates or paraphrases existing disclosure requirements of other standards. This will create two difficulties:

- A preparer will still need to look to other accounting standards for the disclosure requirements which can be cumbersome and inevitably inconsistencies will exist.
- Over time the disclosure requirements in other accounting standards will change and the proposed standard on superannuation will need to be updated to keep up with these changes

For example the guidance in AG57 - AG60 on fair value disclosures is not unique to the superannuation industry and therefore should not be duplicated in the ED.

Our preference would be to limit the disclosure requirements in the ED to:

- superannuation specific disclosures
- guidance to assist in applying the disclosure requirements of other standards to specific superannuation issues. Examples of areas that preparers may need guidance on are:
 - whether the employer and the trustee(s) are related parties
 - what type of transactions between the fund and the employer/trustee(s) require disclosure
 - how to apply the segment disclosures

With respect to related party transactions, we believe that there will be significant practical challenges in interpreting the "normal" requirements of paragraph AG97. As an alternative, the objectives of para AG97 would also be achieved if the standard limited itself to requiring compliance with AASB 124, supplemented with the following:

- a statement that employer sponsors and trustee(s) are related parties within the context of AASB 124, and
- an exemption from the requirement to disclose:

- transactions arising from trustee directors' membership of the fund provided their membership is on conditions no more favourable than available to other members of the same membership class, and
- contributions made by the employer in accordance with the requirements of the trust deed.

(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;

We concur with the AASB that there are many plans for which some level of disaggregation is appropriate. However we believe that the industry should be given a reasonable amount of flexibility in terms of the requirement to provide disaggregated information. For example, where there are multiple sub groups of defined benefit members in a master trust where the majority of members are defined contribution members, the trustee allocates the assets on a defined benefit/defined contribution sub-plan level and the ED could be interpreted to mean a plan would need to disclose disaggregated information for every sub-plan. The ED should clarify that the disaggregation be based on the way a plan is managed, which is akin to the segment disclosures 'through the eyes of management' as required by AASB 8 *Operating Segments*

(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;

We agree with the requirement to disclose these details separately.

(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);

Yes, it would be more useful if the proposed standard provided example financial statements for a superannuation plan which comprises both a defined contribution and a defined benefit section. There are few stand alone defined benefits funds left in Australia.

(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;

Subject to our comments in the covering letter and our responses to the specific questions above, we agree that the approach adopted is generally helpful.

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

We agree broadly with the proposals of the ED, subject to our comments on specific areas above.

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

If the AASB requires superannuation funds to prepare consolidated accounts, we strongly believe that the consolidation approach should be in accordance with AASB 127 without any modification. This standard is not the place to set new rules for the recognition and measurement of intangible assets in a transaction neutral environment.

As mentioned in our response to question (f), we recommend the standard refer to other accounting standards rather than replicating those requirements in this standard, wherever possible. Applying this approach will retain consistency across all standards and reduce the need for the superannuation standard to be amended every time the other accounting standard it replicates from is amended or revised.

Other Comments on the ED

- The example cashflow statement includes a contribution surcharge tax paid. As the contribution surcharge tax was abolished in 2005 we would suggest this be deleted.
- Loss attributable to members as provided in the illustrative financial statements is misleading, as it represents merely a timing difference between earnings and allocations, not a loss.
- The illustration provided has too much detail in respect of investing activities separating purchase and proceeds by class of asset. This is significantly more than is typically provided in a set of financial statement of a unit trust which reports under IFRS, where all purchases and all proceeds are shown together.
- We would question the value in disclosing the numbers of members and beneficiaries holding in each type of benefit and the numbers of members and beneficiaries classified as active, deferred or pensioner by type of benefit as this information is usually disclosed in fund annual reports.