30 April 2012

The Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West VIC 8007

By email to: standard@aasb.gov.au

Dear Mr Stevenson

Australian Accounting Standards Board Exposure Draft 223 – Superannuation Entities

The Actuaries Institute ("the Institute") is the sole professional body for actuaries in Australia, providing independent, expert and ethical comment on public policy issues where there is uncertainty of future financial outcomes. It represents the interests of over 3,800 members, including more than 2,000 actuaries.

Some of the principles that guide the Institute's inputs into public policy are:

» Acceptance of public sector involvement where the market does not meet societal needs,

» The need to take a long term policy view, with appropriate transitional arrangements,

» Ensuring that consequences of risk taking behaviour are borne by the risk taker,

» Issues of intergenerational equity, and

» Clear and reliable information available for decision-making.

The Institute welcomes the opportunity to submit comments on *Australian Accounting Standards Board Exposure Draft 223 – Superannuation Entities* (ED 223). We note, however, we that we have some concerns with the approaches taken in ED 223 and question whether all the proposals are required in order to produce useful, cost effective, financial reports.

Our concerns mirror the concerns we expressed in our submission on *Australian Accounting Standards Board Exposure Draft 179 – Proposed Changes to Financial Reporting by Superannuation Plans and Approved Deposit Funds* (ED 179) of 30 September 2009.

A recurring concern of the Institute is whether the information included in the proposed financial reporting provided 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. The Institute believes 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.

We remain 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.

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We are also concerned with the costs associated with the measurement of that liability and the new increased disclosure requirements proposed under ED 223. It is not clear that the proposals provide benefits that outweigh the associated costs.

The Appendix to this letter sets out our submission on the specific questions raised in ED 223.

The Actuaries Institute would be pleased to discuss the issues raised in this submission or to respond to specific questions to assist the AASB in the course of its work. Please do not hesitate to contact Andrew Boal, Convenor of the Superannuation Practice Committee on (03) 9655 5103 (andrew.boal@towerswatson.com) or Chief Executive, Melinda Howes, on (02) 9239 6106 (melinda.howes@actuaries.asn.au) if there is any way we can assist.

Yours sincerely

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Appendix – Specific Matters for Comment

Are there any superannuation entities that would meet the criteria in AASB 1053 *Application of the Tiers of Australian Accounting Standards* for applying Tier 2 disclosure requirements, that is, they need to prepare general purpose financial statements but do not have 'public accountability' [as defined in AASB 1053]?

Response

We understand that it is the AASB's view that the standard proposed under ED 223 is not intended to apply to Pooled Superannuation Trusts. However, we note that ED 223 refers to "superannuation entities" and does not specifically exclude Pooled Superannuation Trusts from the definition of superannuation entities. The definition instead creates a definition of "superannuation plan" which is somewhat different to the definition of "superannuation fund" under the *Superannuation Industry (Supervision) Act 1993* (the "SIS Act"). We suggest that this definition could be clearer by directly utilising the definition of superannuation fund under the SIS Act and adding the required proviso about Exempt Public Sector Funds and excluding Pooled Superannuation Trusts.

We also understand that it is the AASB's view that Small APRA Funds are non-reporting entities. All other superannuation plans are deemed to have public accountability under AASB 1053.

If the requirements in AASB 1053 were amended and the general definition of "public accountability" was applied, we believe that there may be some circumstances where a "superannuation entity" as defined in ED 223 will not have external resource providers that are unable to demand reports. An example would be a superannuation fund that has transferred all its members and assets to another superannuation fund and is in the process of winding up.

Are there any significant practical difficulties that would inhibit a superannuation entity disclosing:

(i) Information about defined contribution or defined benefit members' benefits in accordance with the relevant principles and requirements in AASB 7 *Financial Instruments*: *Disclosures* [as proposed in paragraphs 37, 38 and AG27 – AG28 of this Exposure Draft]? If so, please describe the nature of these difficulties and how they might be overcome.

Response

We understand that superannuation entities will be required to consider all the requirements in AASB 7 and to apply those requirements to member benefits (with the exception of those requirements that require fair value disclosures for instruments not accounted for at fair value). It is not completely clear how these provisions will be applied to member benefits in superannuation funds. Hence it is possible that the application of AASB 7 to defined benefit and defined contribution member liabilities will:

- Present significant interpretational issues for the superannuation industry and in many cases will not produce useful information for the users of financial statements, and
- Diverge from the sorts of disclosure requirements now set out under AASB119 2011 Revised.

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We have found that applying the existing wording of AASB 7 to superannuation liabilities is very unclear:

a. **Credit risk** – How should this be measured? The value of the defined contribution liability is defined to be the account balance, whilst the value of the defined benefit obligation is defined to be an AASB 119 measure. It is not apparent how credit risk will impact the measured value of these liabilities. We note that the requirement refers to the member liabilities not the funding of those liabilities by the employer.

   Similarly, we are unsure as to how to reliably and consistently measure the resulting change in the credit risk.

b. **Liquidity risk and "contractual term" of the liability** – Superannuation obligations typically do not have a contractual maturity period. Defined contribution balances are available to members within 30 days under portability legislation. Similarly the vested benefits for defined benefit obligations are typically available immediately on resignation. Does this mean that the provisions of AASB 7 would require these liabilities to be disclosed as effectively at call? Such a conclusion will not reflect the likely term of the liability, will conflict with the typical classification of AASB 119 liabilities as being non-current liabilities on balance sheet, and will provide no useful information on the liquidity risk of the superannuation fund.

   Another, less common, type of defined benefit liability is in respect of life time pensioners. In this case, the "contractual term" of the liability is for the pensioner's life. It is not clear how that should be disclosed or whether disclosure that attempts to comply with the provisions of AASB 7 will provide useful information. Useful information on the liquidity of pension liabilities would show the ongoing payments to pensioners expected each year.

c. **Market risk** – Measuring the impact of market movements for defined contribution liabilities in isolation would not be useful. This is because market risk of the defined contribution liabilities needs to be matched with the associated assets. A more useful disclosure would be to identify and measure the mismatches, only if relevant.

   How different domestic and global asset classes react to given market shocks (eg, interdependencies between risk variables such as interest rates and exchange rates) makes this exercise spurious and of limited value. For example, the dominance of investment options available to fund members also means that there is no aggregated single market movement to be modelled; each option would behave differently, depending on its composition. Quantifying this risk in monetary terms will also depend on individuals' choices. A fund with more aggressive investment options being commonly chosen by members will therefore appear more "risky" in market-risk terms, than a fund with members who have selected more conservative investment options.

   In our view, the most complete way of understanding the superannuation fund (and its investment options) exposure to market risk is via the superannuation fund trustee's member communications rather than anything set out in AASB 7.

   For defined benefit liabilities, the calculations required for the disclosure are potentially complex. A large portion of defined benefit plans have a hybrid element. In those cases the disclosures would require an adjustment to the defined contribution elements of the defined benefit plan and then a subsequent recalculation of the liability value. We are not aware of any capability for superannuation administration systems to perform such calculations so the requirement would fall to the actuary.

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Alternative Approach

In attempting to introduce AASB 7 disclosure requirements into ED 223, the AASB has also diverged from the disclosure requirements of AASB 119. In particular, AASB 119 2011 Revised already sets out requirements for disclosing risks associated with defined benefit plans. Paragraphs 135 – 150 sets out those principles. (Such requirements themselves will present developmental challenges when implemented, but at least these are international and globally established.) In our view, the AASB needs to:

- Compare the disclosure requirements of AASB 7 and AASB 119 2011 Revised, and then
- Decide which of these best fits its preferred disclosure requirements regarding risks, before
- Developing an appropriate interpretation (within its preferred framework) which is better able to be interpreted in the context of Australian superannuation funds.

Are there any significant practical difficulties that would inhibit a superannuation entity disclosing:

(ii) In relation to defined benefit members, qualitative information about non-performance risk and/or economic dependency risk to which the plan is exposed in respect of employer sponsors of such members [as proposed in paragraphs 39 and 40 of this Exposure Draft]? If so, please describe the nature of these difficulties and how they might be overcome.

Response

We question whether this disclosure will produce anything more than boilerplate information that is the same across all defined benefit plans. Other than a small number of exceptions, all defined benefit plans are based around the principle that the employer contribution rate will be set at the level required to meet the benefit obligations and hence there is clearly a credit exposure in respect of those contributions from the employer sponsor.

Those defined benefit plans are quite restricted in their ability to measure or manage the credit risk. Hence that part of the disclosure is likely to be quite limited and consistent across defined benefit superannuation funds.

Are there any significant practical difficulties that would inhibit a superannuation entity disclosing:

(iii) Liquidity risks relating to any non-financial liabilities other than tax liabilities held by the entity [as proposed in paragraphs 41 and 42 of this Exposure Draft]? If so, please describe the nature of these difficulties and how they might be overcome.

Response

It is not clear to us what non-financial liabilities the Board is expecting to be covered by this paragraph. The paragraph indicates that it does not cover tax and we assume that it does not cover member benefit obligations given that those obligations are addressed elsewhere in the standard.

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Are there any significant practical difficulties that would inhibit a superannuation entity disclosing:

(iv) Disaggregated financial information based on the principles and requirements of AASB 8 *Operating Segments* [as proposed in paragraphs 43, 44 and AG31 of this Exposure Draft]? If so, please describe the nature of these difficulties and how they might be overcome.

Response

We do not have any comment on this requirement.

Would it be reasonable to require retrospective application of the replacement Standard for AAS 25 to annual reporting periods beginning two years from the date of issuing that Standard?

Response

We understand that the AASB intends to allow around two years between issuing the standard and the date the first financial statements will be prepared under the standard.

We understand that the standard will require superannuation entities to have a measure of member liabilities as at that the start of the comparative period shown in those first financial statements.

Preparers of financial statements will need some time to prepare calculations of those member liabilities. Hence it would be preferable if there was a reasonable period of time between issuing the standard and the start of the comparative period for the first financial statements.

Overall, would the proposals result in general purpose financial statements that would be useful to users?

Response

The Institute is concerned with the inclusion of a liability for members' benefits in a balance sheet for defined benefit plans in particular. This could give rise to a negative equity amount, which is open to misinterpretation by members and other readers of the plan's financial statements. At the extreme, members could convert out of the defined benefit section of the plan based on a perceived fear of the security of their benefit, even though the plan's vested benefits and funding accrued benefits may be adequately covered by assets.

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 more aligned to equity rather than liabilities.

Are the proposals are in the best interest of the Australian economy?

Response

The Institute is concerned that the changes proposed by ED 223 add little useful information while presenting a high risk of being misleading to members.

We previously commented on ED 179 and the challenges associated with proposed measure of defined benefit members' accrued benefits. Those challenges of course remain with the proposals in ED 223 but are now potentially compounded by the complexity of the additional disclosure requirements.

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The challenges we raised previously included the additional costs of preparing the required information and the risks of misleading users of the financial statements. The proposals in ED 223 have increased rather than decreased those concerns.

We discuss some of our concerns about costs below.

In quantitative or qualitative terms, unless already provided in response to specific matters for comment (a)-(e) above, what are the costs and benefits associated with the proposals?

Response

The Institute's view is that the changes in ED 223 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.

a. **Direct costs** – The direct costs of calculating the ED 223 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 ED 223 actuarial valuation might add something like one times the current audit fee. This will be incurred by each Defined Benefit Superannuation Plan. This is a significant cost for Trustees to incur in return for a single figure.
   - Additional consultation time between auditors, actuaries and Trustees to agree on assumptions used

b. **Indirect costs** – 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 ED 223 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 ED 223.

c. **Benefits** – The Institute is concerned that the liability measure advocated in ED 223 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.

Other Issues – Measurement of the Accrued Benefits

Requiring defined benefit members' accrued benefits to be calculated in accordance with AASB 119 will present a number of challenges:

a. **Timing of calculations** – A defined benefit obligation will be calculated in accordance with AASB 119 for inclusion in the employer sponsor's financial statements. However, this will generally be calculated well before the Plan's financial statements need to be prepared. Even if the employer and the Plan have the same reporting date, the figure will usually have been based on data at a date prior to the Plan's reporting date and projected forward to the reporting date.

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If the defined benefit obligation calculated for the employer's financial statements is used for the Plan's financial statements, it will not always be based on final data at the reporting date, and could be inconsistent with the value of assets reported. Hence the approximations used for reporting under AASB 119 may not be appropriate for superannuation funds to use in their financial reports.

On the other hand, if the intention is that an updated AASB 119 defined benefit obligation will be calculated as at the Plan's reporting date, this will involve significant additional costs that will need to be borne by the Plan.

It may also be difficult to determine a final defined benefit obligation in time to meet the deadline for preparing the Plan's financial statements. Often final membership data is not available until close to the end of the 4-month period from the reporting date for preparation of financial statements. This would leave minimal time to then calculate the required defined benefit obligation.

b. **Assumptions for accrued benefits** – The defined benefit obligation calculated for the employer's financial statements is based on assumptions approved by the employer. We imagine that the Trustee will need to agree to the assumptions used to calculate the accrued benefits shown in the Plan's financial statements. If these differ from those used to calculate the figure for the employer's financial statements, this will also require a recalculation and associated additional costs.

   As an alternative we suggest that the use of vested benefits for both defined benefit and accumulation members would involve significantly fewer challenges. Superannuation funds already have a process for calculating vested benefits for disclosure in financial statements prepared under AAS 25. Hence using vested benefits as the measure of member liabilities should not be difficult.

   Australian superannuation funds typically provide a lump sum and are largely fully vested in order to meet the SG requirements, so the vested benefit and AASB 119 measure can be quite similar.

Other Issues – Insurance

We are also concerned about the proposed requirements for insurance.

The requirements potentially require significant additional work for superannuation funds that have no intention to have any material level of self insurance. In many cases superannuation funds will be required to calculate and account for an insurance liability and an offsetting reinsurance asset. The net amount will be nil for these superannuation funds with no self insurance. Even looking at the amount of the asset and liability separately they are unlikely to be material.

We believe that the legal form of the insurance provisions in a superannuation fund's trust deed should not override the substance of the arrangement which is that the superannuation fund is acting as an agent for the insurer even where there is a risk of some incidental and immaterial self insurance.

We also note that the requirement to account for insurance liabilities using AASB 119 and for the "reinsurance asset" using AASB 1038 could be confusing and at worst could lead to an inadvertent inconsistency. We suggest that the requirement to use AASB 1038 to measure the reinsurance asset should be replaced with a requirement to use a basis consistent with the measurement of the insurance liability.

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