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The Chairman
The Australian Accounting Standards Board
PO Box 204
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By email: standard@aasb.gov.au

Dear Sir

ED 223 Superannuation Entities

Further to the release of AASB Exposure Draft 223 Superannuation Entities ('ED 223') issued in December 2011, we attach our response to the various proposals within the ED. Our submission contains general comments on some of the key areas within the ED and specific comments addressing various matters identified by the AASB where comments have been specifically sought.

Overall, we are generally supportive of the proposals, and believe that the proposals will provide greater transparency and consistency across the industry. They will enhance the current financial reporting framework amongst superannuation funds to facilitate greater comparison across the superannuation industry and other non-super entities. We also believe the principles based approach adopted allows Trustees to tailor their financial reporting to focus on financial risks specific to the structure of their Fund.

There are however, a number of key areas where we have raised some matters for your consideration and clarification. These areas are discussed in more detail in Appendix A:

- Consolidation of controlled entities
- Recognition and measurement of defined benefit liabilities

Our answers to your specific questions are in Appendix B.

Should you wish to discuss any aspects of our submission, please feel free to contact either Denis Thorn, Partner on (03) 8650 7637 or David Jewell, Partner on (02) 9248 5803.

Yours faithfully

Ernst & Young

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Appendix A
Key Comments

1. Consolidation of controlled entities

Paragraph 11

We acknowledge the extent of industry discussion regarding superannuation funds consolidating controlled entities and the desire of the AASB to apply the IFRS conceptual framework and policy of transaction neutrality across all reporting entities. Whilst we generally concur with the current proposals, in our submission on ED 179 we recommended any standard for superannuation entities "consider the intricacies of the superannuation industry and take a 'substance over form' approach when considering whether control exists and provide some further guidance on instances where '...ownership does not constitute control'."

In the absence of this, and in light of the acknowledged debate on ED/2011/4 *Investment Entities*, (as noted in paragraph BC52) we recommend the standard for superannuation entities remain silent on the need for consolidated statements. We believe the existing requirement in paragraph 8, namely "**Unless otherwise specified in this Standard, the financial statements of a superannuation entity shall be prepared in accordance with other applicable Australian Accounting Standards**", already would require the preparation and presentation of consolidated accounts in accordance with AASB 127/AASB10. However should ED/2011/4 *Investment Entities* evolve into an accounting standard with application to entities including superannuation funds, the current inclusion of paragraph 11 in ED 223, would preclude superannuation entities from applying an otherwise applicable accounting standard.

Accordingly we recommend removal of paragraph 11. For completeness, we believe the existing paragraph 12 can remain, albeit amended slightly as follows: "A parent superannuation entity that chooses to present separate financial statements shall present them together with the consolidated financial statements, ***where applicable***."

Paragraph 21

We believe this paragraph as currently worded could be interpreted in different ways where superannuation entities prepare consolidated financial statements.

The first and literal application of the paragraph would be that AASB expects all assets and liabilities, including those of controlled entities, except those relating to member benefits, tax, acquired goodwill and insurance arrangements, be measured at fair value.

The second being that paragraph 21 applies to the parent entity and to any entity within the group which is itself a superannuation entity, and that the measurement of assets and liabilities of other controlled entities be measured in accordance with other applicable Australian Accounting Standards in accordance with paragraph 8 of ED 223.

We favour the latter approach, and accordingly recommend ED 223 limit the application of paragraph 21 to entities within the group that are superannuation entities for the avoidance of doubt.

Non-controlling interest
Illustrative example 1 illustrates non-controlling interest as an element of equity. However, non-controlling interest may only qualify to be equity where a superannuation entity may be consolidating a company rather than other funds. Non-controlling interests may also arise where a superannuation entity has invested in other funds with units that do not meet the definition of equity and are also liabilities. In such cases, the non-controlling interests will be classified as equity.

Therefore we recommend that more discussion is included in the illustrative example as to why non-controlling interest is presented as equity, and an illustration included where the non-controlling interest does not qualify as equity.

Presentation of differences between assets and liabilities

AG 11 requires that any difference between total assets and total liabilities is classified as equity in accordance with applicable standards. We don't however believe that in all instances such differences represent equity as defined in the AASB Framework. In most cases the fund will have some obligation to pass any residual to the fund members or the employer at some point in time, as there are no equity holders in the fund.

Accordingly, we recommend the Board to reconsider the requirement that the whole difference is presented in equity. It is our belief that in most circumstances the difference represents an obligation of the fund to remit the surplus. Whether or not a deficit can exist we discuss further below.

2. Defined benefit liabilities

As with our response to ED 179, we concur with the proposals within the ED that classify members benefits (defined benefit and defined contributions) as liabilities to be recognised by the fund. However, we do not believe that the current proposals for measuring defined benefit liabilities are appropriate. We do however support and prefer a vested benefit approach to measure the liability, for the reasons noted below. In such cases we also support disclosure of the accrued benefits due to members, and a discussion on how this will be funded as proposed in the ED.

The legal liability of a fund at any reporting date is the vested benefit allocated to each member. This represents the extent to which the 'defined benefit' liability of the employer is funded. The fund does not have a legal or constructive obligation to make good any shortfall that exists in the fund assets in relation to the defined benefit liability due to the employee. Rather this is the responsibility of the employer. Therefore we do not believe that this should be included in the measurement of the liability of the fund. The fund also has an obligation to hold and safeguard any surplus of assets over the vested benefits and use that surplus to fund future liabilities, as they become due, or to enable an employer to reduce future contributions. This surplus represents an additional obligation of the fund and should therefore also be accounted for as a liability.

The fund is in effect providing a service to the employer, and from a management and operational perspective, strives to generate a return on assets that will satisfy the employers promise to their employees. However, the maximum value the fund is only ever required to pay out is the value of the assets that it holds.

We note that the trustees have an obligation to manage the fund in order to seek to meet the level of benefits promised (and accounted for) by the employer. Trustees therefore have a responsibility to make their best efforts to obtain funding for these liabilities, through maximising employer contributions and

investment returns. However, that responsibility can only be met out of the pool of funds specifically identified to meet the obligation and this pool comprises only contributions from the specific employer plus investment returns on those funds, net of costs and taxes. The primary obligation to fund these liabilities remains with the employer that made the defined benefit promise to the employee.

BC 135 of the ED hints that the Board believes the fund has a constructive obligation to fund any deficit that may exist. We do not believe that this is the case. We do not believe that the BC sufficiently illustrates how the Board has considered the contractual arrangements that exist between the fund/trustee, the employer and its employees and demonstrated how the fund has a constructive obligation for any shortfall, given the fund has no access to any other assets. In the event that a shortfall exists and an employer does not increase its contributions to the fund to eliminate this shortfall, the employee has no right of claim to other assets of the fund or even other funds managed by the trustee. Generally, the employees' only right of claim is against the employer, as this is the entity with which the employee has entered into a contract with for the right to receive such benefits. That is, it is a promise of the employer based on the contract between the employee and the employer. There is no direct promise or contract between the fund and the employee, and therefore no obligation of the fund to be recognised. To this end, it would be misleading to recognise a liability for an amount in excess of that which the fund would be required to pay.

The accrued liabilities approach included in AASB 119 has the objective of requiring a liability to be recognised as services are received from the employee. That is, it is ensuring that a company is allocating its operating costs when it has employees to the period of service it receives. The fund on the other hand does not have the objective of allocating the costs of those employees. Rather its purpose is to invest the contributions it receives to assist the employer in satisfying the obligation that it incurs for the services it receives. Therefore as the fund has a different objective, the application of the accrued benefits approach in AASB 119 to measure the liabilities we believe is inappropriate.

BC139 of the ED highlighted a drawback with the vested benefits approach - that it is inconsistent with the going concern concept. We do not believe that this is the case. As noted above, the fund does not have the contract with the employee nor does it have access to other assets other than those specifically identified. At any point in time, the fund is only responsible for distributing the assets it has received and the returns it has made. This is evidenced by the contract between the fund and the employer. Such a limit exists while the fund is a going concern.

Appendix B
Specific Matters for Comment

ED Specific Matter for Comment	EY response
(a) 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]?	Yes we believe there are: a) Small APRA Funds and Self Managed Superannuation Funds, b) Superannuation funds whose only assets (other than temporary deposits at call with a bank) are endowment, whole of life or other long-term insurance policies which match and fully guarantee the benefits to be paid to individual members, have been assessed historically by Australian standard setters as meeting criteria for lesser disclosure requirements [Refer AAS 25 paragraph 66]. c) An evolving product in the superannuation industry are superannuation master funds on platforms offering individual member self directed investments. We believe these have the same characteristics of SMSF's.
(b) 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;	On the expectation that the concepts of materiality are applied to the underlying objective of the specific disclosure requirements, in our judgement there are no particular matters which would not permit the proposed disclosures to be provided.
(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;	As for (i)
(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;	As for (i)
(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.	As for (i). We hold this view on the assumption that the approach adopted by superannuation entities will be the same as that applied by preparers, auditors and regulators in the corporate reporting environment.
(c) 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?	Yes
(d) Overall, would the proposals result in general purpose financial statements that would be useful to	Overall, we agree that the proposals will assist in greater uniformity across funds, enhance the current

users?	reporting framework, provide great transparency over fund structure, financial risks and management of super funds and provide readers with more meaningful information.
(e) Are the proposals are in the best interest of the Australian economy?	Given the size of the industry and estimated growth of the industry, we agree that the proposals to enhance the financial reporting of superannuation plans are in the best interest of the Australian economy.
(f) 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?	We would expect the costs of preparing and auditing general purpose financial reports of superannuation entities to increase if ED 223 in its current form is adopted.