24 September 2007

Consolidation of Subsidiaries by Superannuation Entities

The Australian Accounting Standards Board (AASB) is undertaking a comprehensive review of AAS 25 *Financial Reporting by Superannuation Plans*. The AASB has tentatively decided that superannuation entities should measure their assets at fair value less anticipated disposal costs.

Consistent with this decision, the majority of AASB members tentatively favour a fair value approach to consolidated financial statements for parent superannuation entities. As this proposal raises a number of significant issues in the context of the current consolidation requirements, the AASB has decided to seek the views of constituents.

The AASB invites comments from Australian constituents on the consolidation approaches (Approaches A, B, C and D) for parent superannuation entities examined in this Consultation Paper. The AASB would particularly value constituents' views in relation to the following questions:

1. Of the four consolidation approaches discussed in this Consultation Paper, which would you most prefer to be applied by parent superannuation entities and why? and
2. Of the four consolidation approaches discussed in this Consultation Paper, which would you least prefer to be applied by parent superannuation entities and why?

Constituents are encouraged to submit written comments on these matters by 30 November 2007 via email to standard@aasb.com.au or mail to:

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

Australian Accounting Standards Board, Level 7, 600 Bourke Street, Melbourne, VIC, 3000
Telephone: +61 3 9617 7600 Facsimile: +61 3 9617 7608 Email: standard@aasb.com.au Internet: www.aasb.com.au
ABN: 92 702 019 575

Executive Summary

E1. The Australian Accounting Standards Board (AASB) is undertaking a comprehensive review of AAS 25 *Financial Reporting by Superannuation Plans*. The AASB considered the various methods available for measuring assets held by superannuation entities. The AASB tentatively decided that there are a number of arguments in favour of requiring superannuation entities to recognise all of their assets at fair value less anticipated disposal costs. In particular, the AASB considers that such a method:

(a) provides relevant information to users about the capacity of superannuation entities to pay their defined contribution members' entitlements;

(b) provides relevant information to users about the capacity of superannuation entities to fund their defined benefit members' entitlements; and

(c) is not significantly different from regulatory and member reporting arrangements.

E2. Consistent with these considerations, the majority of AASB members tentatively favour a fair value approach to consolidated financial statements for parent superannuation entities. The AASB acknowledges that this raises a number of significant issues in the context of the current consolidation requirements. The AASB has considered these issues and has decided that, before proceeding to an Exposure Draft, it would issue this Consultation Paper to seek the views of constituents on whether parent superannuation entities should be required to prepare consolidated financial statements in accordance with any of the following approaches:

(a) Approach A – a full fair value accounting model that involves all assets and liabilities, whether recognised or unrecognised in separate financial statements of parent superannuation entities or their subsidiaries, to be measured at their fair values in consolidated financial statements;

(b) Approach B – a model that involves all assets and liabilities recognised by subsidiaries to be measured at their fair values in consolidated financial statements when fair value measurement is required or permitted under the relevant Australian Accounting Standards [consistent with the approach currently applied in AASB 1023 *General Insurance Contracts* and AASB 1038 *Life Insurance Contracts*];

(c) Approach C – Approach B with the addition in some circumstances of a balancing item in relation to subsidiaries being recognised in consolidated financial statements [similar to that previously required under AASB 1038 *Life Insurance Business* (1998)] that comprises:

  (i) acquired goodwill, to the extent that it remains at the reporting date;

  (ii) changes in internally generated goodwill associated with subsidiaries subsequent to their acquisition; and

(iii) measurement differences resulting from subsidiaries' assets and liabilities being recognised in consolidated financial statements at amounts other than their fair values less or plus anticipated disposal costs; or

(d) Approach D – AASB 3 *Business Combinations* and AASB 127 *Consolidated and Separate Financial Statements*. Under AASB 3 and AASB 127, subsidiaries' identifiable assets and liabilities are recognised in consolidated financial statements at their fair values at the date of acquisition of the subsidiary. Subsequent to their acquisition, subsidiaries' assets and liabilities would be recognised in consolidated financial statements in accordance with relevant Australian Accounting Standards, which treat the fair value of assets and liabilities acquired in business combinations as the cost of the item from the date of the subsidiary's acquisition.

E3. The AASB considers that, while the preparation of consolidated financial statements in accordance with a fair value accounting model is inconsistent with current International Financial Reporting Standards (IFRSs), the AASB is not necessarily obliged to require superannuation entities to comply with IFRSs because:

(a) there is little justification for requiring superannuation entities in Australia to adopt IFRSs since many of the accounting and disclosure issues they face are a consequence of the domestic environment;

(b) IAS 26 *Accounting and Reporting by Retirement Benefit Plans* and many other IFRSs permit entities to adopt measurement methods that are inconsistent with current prudential requirements; and

(c) a fair value accounting model is appropriate for superannuation entities' separate financial statements.

E4. Although the AASB has made no decision on its preferred consolidation model, the majority of AASB members tentatively favour Approach A – a full fair value accounting model.

E5. Table 1 provides a summary of the main similarities and differences between the proposed requirements in Approaches A, B, C and D in relation to preparing consolidated financial statements.

E6. This Consultation Paper does not address the practical issues that some entities, including superannuation entities, experience when preparing consolidated financial statements, such as:

(a) identifying the investees that parent superannuation entities control;

(b) determining when during a reporting period control arises and/or is lost; and

(c) different net asset amounts being reported in parent and consolidated columns due to the recognition of minority interests attributable to partly-owned subsidiaries.

Because practical issues such as these are common to all four of the consolidation models discussed in this Consultation Paper, they do not provide a basis for arguing the relative merits of any particular model.

TABLE 1

	Treatment of Parents' Assets and Liabilities in Separate Financial Statements	Treatment of Subsidiaries' Assets and Liabilities in Consolidated Financial Statements: Measurement of Subsidiaries' Assets and Liabilities at Acquisition	Treatment of Subsidiaries' Assets and Liabilities in Consolidated Financial Statements: Re-measurement of Subsidiaries' Assets and Liabilities Subsequent to Acquisition	Treatment of Subsidiaries' Assets and Liabilities in Consolidated Financial Statements: Income Statement Implications of Re-measurement Subsequent to Acquisition
Approach A	Assets – fair value less anticipated disposal costs Liabilities – fair value plus anticipated disposal costs Accrued benefits: *defined contribution* – total assets less total liabilities *defined benefit* – fair value plus anticipated disposal costs	Assets – fair value less anticipated disposal costs Liabilities – fair value plus anticipated disposal costs	Assets – fair value less anticipated disposal costs Liabilities – fair value plus anticipated disposal costs	All changes in fair values recognised as gains or losses in the profit or loss
Approach B and **Approach C**#	Assets – fair value less anticipated disposal costs Liabilities – fair value plus anticipated disposal costs Accrued benefits: *defined contribution* – total assets less total liabilities; *defined benefits* – present value of the defined benefit obligation, related current service cost and past service cost	Assets and Liabilities – fair value in accordance with AASB 3	Assets – fair value for financial assets, property (including investment property), plant, equipment, biological assets, agricultural produce and identifiable intangible assets for which there is an active market. For all other assets, generally cost* less accumulated amortisation/depreciation and any impairment losses determined in accordance with the relevant Australian Accounting Standards Liabilities – fair value for financial liabilities. For other liabilities, either current settlement amount or amortised historical cost determined in accordance with the relevant Australian Accounting Standard	Changes in carrying amounts of assets and liabilities are either recognised as: (a) gains or expenses/losses in the profit or loss; or (b) an increase or decrease in equity (revaluation reserve)
Approach D	Assets – fair value less anticipated disposal costs Liabilities – fair value plus anticipated disposal costs Accrued benefits: *defined contribution* – total assets less total liabilities; *defined benefits* – present value of the defined benefit obligation, related current service cost and past service cost	Assets and Liabilities – fair value in accordance with AASB 3	Assets – generally fair value or cost* less accumulated amortisation/depreciation and any impairment losses in accordance with the various choices available in the applicable Australian Accounting Standards Liabilities – current settlement amount, amortised historical cost or fair value in accordance with the applicable Australian Accounting Standards	Changes in carrying amounts of assets and liabilities are either recognised as: (a) gains or expenses/losses in the profit or loss; or (b) an increase or decrease in equity (revaluation reserve)

* Australian Accounting Standards treat the fair value measurement of assets and liabilities acquired in business combinations as the cost of the item from the date of the subsidiary's acquisition.
# Note that under Approach C, in some circumstances a balancing item is recognised in consolidated financial statements that comprises, among other things, goodwill and measurement differences resulting from subsidiaries' assets and liabilities being recognised in consolidated financial statements at amounts other than their fair values less or plus anticipated disposal costs.

Purpose

1. The Australian Accounting Standards Board (AASB) is undertaking a comprehensive review of AAS 25 *Financial Reporting by Superannuation Plans*. The AASB considered the various methods available for measuring assets held by superannuation entities. The AASB tentatively decided that there are a number of arguments in favour of requiring superannuation entities to recognise all of their assets at fair value less anticipated disposal costs. In particular, the AASB considers that such a method:
   (a) provides relevant information to users about the capacity of superannuation entities to pay their defined contribution members' entitlements;
   (b) provides relevant information to users about the capacity of superannuation entities to fund their defined benefit members' entitlements; and
   (c) is not significantly different from regulatory and member reporting arrangements.

2. Consistent with these considerations, the majority of AASB members tentatively favour a fair value approach to consolidated financial statements for superannuation entities. The AASB acknowledges that this raises a number of significant issues in the context of the current consolidation requirements. The AASB has considered these issues and has decided that, before proceeding to an Exposure Draft, it would issue this Consultation Paper to solicit the views of constituents on whether parent superannuation entities should be required to prepare consolidated financial statements in accordance with any of the following approaches:
   (a) Approach A – a full fair value accounting model that involves all assets and liabilities, whether recognised or unrecognised in separate financial statements of parent superannuation entities or their subsidiaries, to be measured at their fair values in consolidated financial statements;
   (b) Approach B – a model that involves all assets and liabilities recognised by subsidiaries to be measured at their fair values in consolidated financial statements when fair value measurement is required or permitted under the relevant Australian Accounting Standards [consistent with the approach currently applied in AASB 1023 *General Insurance Contracts* and AASB 1038 *Life Insurance Contracts*];
   (c) Approach C – Approach B with the addition in some circumstances of a balancing item in relation to subsidiaries being recognised in consolidated financial statements [similar to that previously required under AASB 1038 *Life Insurance Business* (1998)] that comprises:
      (i) acquired goodwill, to the extent that it remains at the reporting date;
      (ii) changes in internally generated goodwill associated with subsidiaries subsequent to their acquisition; and

(iii) measurement differences resulting from subsidiaries' assets and liabilities being recognised in consolidated financial statements at amounts other than their fair values less or plus anticipated disposal costs; or

(d) Approach D – AASB 3 *Business Combinations* and AASB 127 *Consolidated and Separate Financial Statements*. Under AASB 3 and AASB 127, subsidiaries' identifiable assets and liabilities are recognised in consolidated financial statements at their fair values at the date of acquisition of the subsidiary. Subsequent to their acquisition, subsidiaries' assets and liabilities would be recognised in consolidated financial statements in accordance with relevant Australian Accounting Standards, which treat the fair value of assets and liabilities acquired in business combinations as the cost of the item from the date of the subsidiary's acquisition.

3. The purpose of this Consultation Paper is to:

(a) explain the AASB's reasons for requiring parent superannuation entities to prepare consolidated financial statements (paragraphs 4 – 13);

(b) explain why the AASB regards neither 'disclosure only' nor proportionate consolidation as appropriate reporting solutions for parent superannuation entities (paragraphs 14 – 18); and

(c) outline the main issues in relation to parent superannuation entities preparing consolidated financial statements in accordance with:

(i) Approach A (paragraphs 19 – 25);

(ii) Approach B (paragraphs 26 – 31);

(iii) Approach C (paragraphs 32 – 35); and

(iv) Approach D (paragraphs 36 – 40).

The Preparation of Consolidated Financial Statements by Parent Superannuation Entities

The Conceptual Framework and Financial Reporting by Parent Superannuation Entities

4. The *Framework for the Preparation and Presentation of Financial Statements* highlights four issues relevant to the AASB's considerations in relation to superannuation entities consolidating their subsidiaries. They are:

(a) for the purpose of financial reporting, the boundaries of superannuation entities are determined on the basis of the items and entities that superannuation entities control;

(b) the financial statements of superannuation entities should meet the common needs of a range of users;

(c) users should be able to compare the financial statements of superannuation entities to other investment entities to evaluate their relative financial position, financial performance and cash flows; and

(d) to provide sufficient information to users about the financial position, financial performance and cash flows of parent superannuation entities, it is necessary to present consolidated financial statements.

Paragraphs 5 to 13 discuss in greater detail the implications for parent superannuation entities of each of these issues.

The Concept of Control and the Preparation of Consolidated Financial Statements

5. Control is defined in paragraph 4 of AASB 127 as:

> "…the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities."

This definition means, among other things, that an entity's power (capacity) to govern is more relevant than whether or not an entity (or its management) actively governs the policies of another entity.

The Information Needs of Users

6. Some constituents have expressed the view that the benefits derived by users from superannuation entities presenting consolidated financial statements are unlikely to exceed the costs to superannuation entities of preparing them. They argue that most users of the financial statements of superannuation entities, including existing and potential members, currently rely on sources other than financial statements for their information needs, including product disclosure statements, member statements and annual reports.

7. While the AASB acknowledges constituents' concerns regarding the costs and benefits of superannuation entities preparing consolidated financial statements, it notes that:

(a) a proportion of the costs incurred recently by some superannuation entities to comply with AASB 3 and AASB 127 relate to one-off systems costs as some of these entities may not have previously prepared consolidated financial statements;

(b) while the costs of providing consolidated financial statements can be at least notionally quantified, the benefits are often underestimated as they tend to be distributed among all users;

(c) financial reports of superannuation entities provide information that is not available from other sources, e.g.:

(i) short-term capacity to pay out members' benefits;

(ii) audit opinion on the existence, ownership and valuation of the assets held;

(iii) audit opinion on compliance with key prudential requirements;

(iv) total administration and investment expenses incurred;

(v) a comprehensive description of financial position, financial performance and financing and investing results in a general purpose financial report format; and

(d) recent changes to the superannuation industry, particularly the introduction of the Choice of Fund legislation and 'investment choice' arrangements, have placed greater onus on superannuation entities to provide information that is useful to meet the needs of users, particularly members and potential members. As discussed in paragraphs 11 to 13, consolidated financial statements provide decision useful information that is not generally available from separate financial statements of parent superannuation entities.

8. In addition, the financial statements of superannuation entities also provide information that can assist users in monitoring and evaluating trustee stewardship. This information is generally unavailable from other sources. Furthermore, to help provide a complete picture of the results of trustees' stewardship over the resources entrusted to them, the financial statements of superannuation entities need to provide information about all of the resources that superannuation entities control, including the resources and obligations held by entities that superannuation entities control.

The Comparability of the Financial Statements of Superannuation Entities to the Financial Statements of Other Entities

9. Some constituents have expressed the view that, as a consequence of the legal restrictions over the timing and manner of release of superannuation benefits, and the implications for superannuation entities of the Choice of Fund legislation, members of superannuation entities do not face the same type of 'buy/hold/sell' decisions that investors in other financial products face. They argue it is more important that the financial statements of superannuation entities be comparable to those of other superannuation entities rather than the financial statements of entities outside the superannuation industry.

10. Others take the view that, since members can make voluntary contributions, some investors may contemplate whether they should transfer assets held outside the superannuation regime to a superannuation entity. To ensure that these users are provided with useful information, financial statements of superannuation entities should be comparable to the financial statements of other entities.

The Financial Position and Financial Performance of Parent Superannuation Entities

11. In the absence of consolidated financial statements, useful information regarding subsidiaries' assets and liabilities may not be available to the users of separate financial statements of parent

superannuation entities. This view can be illustrated using the case of a superannuation entity that holds only one asset in the form of all of the outstanding shares in a private company which, in turn, holds a range of financial and non-financial assets and liabilities. The superannuation entity's financial statements would show the net fair value of 100% ownership interest and any dividend revenue recognised. However, in the absence of consolidated financial statements, users of the superannuation entity's separate financial statements may find it difficult to access information regarding the:

(a) amount of any debt held, and the associated interest and debt servicing costs being incurred, by the company;

(b) sources of any income received by the company;

(c) composition of the company's assets, the extent to which they are diversified and whether they indirectly expose members' entitlements to risks other than market risks, such as operational risks; and

(d) liquidity of the company's assets in order to determine the superannuation entity's capacity to pay members' benefits.

In addition, control over the private company's dividend policy would enable the trustee of the superannuation entity to manage the benefits attributable to the entity's members. Accordingly, it is more meaningful to present the results of operations and the financial position of a parent and its subsidiaries as if they were a single economic entity.

12. Whilst controlling interests in pooled superannuation trusts (PSTs) have for some time been a feature of some superannuation entities' investment arrangements, superannuation entities are increasingly holding controlling interests in non-PST entities. Accordingly, some superannuation entities are currently exposed through their controlled entities to operational business risks relating to:

- property development projects and investment properties;
- agricultural enterprises;
- infrastructure ventures;
- administration and/or financial services operations; and
- research and development projects.

13. Although the fair value measurement of investments in controlled entities can provide some indication of expected risks and returns, it is not an adequate substitute for a more comprehensive presentation of investees' assets and liabilities in circumstances where investors have the capacity to govern investees' strategic financing and operating policies.

Other Approaches to Accounting for Subsidiaries Held by Superannuation Entities

'Disclosure Only' Solution

14. The AASB acknowledges that there is support among some of its constituents for a 'disclosure only' approach, whereby parent superannuation entities provide detailed note disclosures regarding the underlying assets and liabilities of each significant subsidiary instead of consolidated financial statements. Proponents of a 'disclosure only' approach argue that consolidated financial statements can potentially inhibit a user's understanding of the risks that particular superannuation entities are exposed to because consolidation:
    (a) gives the impression that superannuation entities operate businesses and, in doing so, may obscure some important information in relation to investment risks;
    (b) introduces minority interests into consolidated financial statements of superannuation entities with partly-owned subsidiaries, which may be considered to be inappropriate since superannuation entities may be regarded as having no equity holders; and
    (c) can portray parent superannuation entities as holding borrowings even though superannuation entities are generally prohibited from doing so and lenders to subsidiaries of superannuation entities do not have recourse to the other assets of parent superannuation entities.

15. The AASB does not regard a 'disclosure only' approach as an appropriate reporting solution because:
    (a) providing note disclosures as opposed to consolidated financial statements may not necessarily produce comparable financial information;
    (b) disclosing items that would otherwise be recognised on the face of the financial statements is inconsistent with the fundamental accounting concept that financial statements recognise the assets, liabilities, income and expenses that an entity controls (as described in the *Framework* and AASB 127); and
    (c) disclosure does not rectify the failure to recognise the assets, liabilities, income and expenses that entities control. Paragraph 16 of AASB 101 *Presentation of Financial Statements* states that:

        > "Inappropriate accounting policies are not rectified either by disclosure of the accounting policies used or by notes or explanatory material."

Proportionate Consolidation

16. The AASB notes that there is support among some of its constituents for a proportionate consolidation model, whereby parent superannuation entities recognise in their consolidated

financial statements their respective proportionate shares in each of their subsidiaries' assets, liabilities, income and expenses. This approach ensures that, when superannuation entities hold, for instance, investments in partly-owned PSTs, differences between the net asset amounts reported in separate and consolidated financial statements do not arise.

17. The preference some constituents have for a proportionate consolidation model derives from their concern that differences between the net asset amounts reported in separate and consolidated financial statements could impact members' perceptions. For instance, if the net asset amount reported in a superannuation entity's separate financial statements is smaller than the net asset amount reported in the corresponding consolidated financial statements (which might arise because minority interests and/or goodwill are recognised in the consolidated financial statements), some users might misinterpret this to mean that the trustee is not crediting certain assets to members. Nevertheless, a proportionate consolidation model is inconsistent with the current reporting framework.

18. The recognition by parent superannuation entities of their proportionate shares of each of their subsidiaries' assets, liabilities, income and expenses is inconsistent with the fundamental principles of general purpose financial reporting, in particular:
    (a) the concept of control. Consolidated financial statements present all of the assets and liabilities controlled by subsidiaries, not just parents' respective proportionate shares of each of their subsidiaries' assets and liabilities; and
    (b) the entity concept. General purpose financial statements are prepared on the basis that the reporting entity has an identity distinct and separate from its stakeholders. Accordingly, minority interests are treated as a part of consolidated equity. In contrast, while proportionate consolidation is consistent with a member view of parent superannuation entities, it implies a proprietary concept. The proprietary concept is regarded as inappropriate in the context of the current reporting framework because general purpose financial statements are expected to meet the common needs of a range of users, not just stakeholders in parent entities.

Consolidated Financial Statements Prepared in Accordance with Approach A

19. Approach A involves parent superannuation entities preparing consolidated financial statements in accordance with a full fair value accounting model, whereby:
    (a) all assets held by parent superannuation entities and their subsidiaries are recognised at their fair values less anticipated disposal costs; and
    (b) all provisions and liabilities held by parent superannuation entities and their subsidiaries are recognised at their fair values plus anticipated disposal costs.

Consequently, Approach A involves parent superannuation entities potentially recognising in their consolidated financial statements assets and liabilities that meet the relevant definitions but are not permitted to be recognised by Australian Accounting Standards, in particular:

(a) intangible assets that do not meet the identifiability and recognition criteria in paragraph 12 of AASB 138 *Intangible Assets* (particularly internally generated brands, mastheads, publishing titles, customer lists and items similar in substance); and

(b) internally generated goodwill (see paragraph 48 of AASB 138).

20. Some argue that requiring parent superannuation entities to prepare full fair value consolidated financial statements will give rise to a number of practical issues that potentially diminish the benefits of such statements. In particular, they suggest that the current prohibition against recognising internally generated intangible assets means that there may be insufficient professional resources and experience to enable the preparation and audit of fair value information in relation to these types of assets. However, AASB 3 and AASB 138 currently require parent entities to recognise in their consolidated financial statements each of their subsidiaries' reliably measurable intangible assets at the time of acquisition of the subsidiary, irrespective of whether the asset had been recognised by the relevant subsidiary prior to its acquisition. Accordingly, based upon the experience gained in identifying and measuring acquirees' internally generated intangible assets in the context of business combinations, the accounting and valuation professions would be expected to have the requisite skills and expertise to address fair value consolidated financial statements.

21. The accounting prohibition against recognising internally generated goodwill has also been used as a basis for arguing against requiring parent superannuation entities to prepare full fair value consolidated financial statements. However, some parent superannuation entities already recognise internally generated goodwill as a part of upward revaluations of investments in subsidiaries in their separate financial statements.

22. The prohibition against recognising internally generated goodwill does not necessarily mean that a reliable fair value measure for internally generated goodwill could not be determined. For instance, AASB 3 requires acquirers to recognise any goodwill at acquisition date. Because parent superannuation entities are required to recognise their investments in subsidiaries at fair value in their separate financial statements, internally generated goodwill could be determined by employing a hypothetical business combination technique, whereby each subsidiary is assumed to be acquired at each reporting date. Accordingly, any difference between the net fair value of a subsidiary and the fair value of the subsidiary's net identifiable assets plus or minus net anticipated disposal costs would be recognised as goodwill.

23. Approach A has a number of financial reporting implications for liabilities of parent superannuation entities, in particular:

(a) the fair value measurement of any defined benefit obligations. AAS 25 requires accrued benefits of defined benefit members to be measured at the expected future benefit payments up to the reporting date discounted at a current, market-determined, risk-adjusted discount rate appropriate for the entity. In contrast, the fair value measurement of a defined benefit obligation involves determining the price the superannuation entity would have to pay to transfer the liability and is likely to include:

(i) the risk margin that a market participant would demand to compensate the participant for any uncertainty in relation to assuming the defined benefit obligation as a consequence of, for instance, the employer sponsor retaining some level of influence over the future levels of members' salaries;

(ii) the profit margin that a market participant would demand to assume the defined benefit obligation; and

(iii) the impact of the employer sponsor's credit risk on the fair value of the defined benefit obligation [because under fair value measurement, risk that an obligation will not be fulfilled ('non-performance risk') affects the value at which the liability is transferred]; and

(b) the fair value measurement of provisions. AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* requires provisions to be recognised at the lower of the amount an entity would pay to settle the obligation or the amount payable to transfer the obligation to a third party. In contrast, Approach A involves recognising the amount payable to transfer the obligation to a third party plus anticipated disposal costs.

Arguments in Favour of Approach A

24. The benefits of Approach A include:

(a) the provision of more useful information than Approaches B, C or D. For instance, the recognition of all assets and liabilities of subsidiaries at their fair values in consolidated financial statements would facilitate a better understanding among users of the ability of parent superannuation entities to generate cash and cash equivalents, and the timing and certainty of their generation. Accordingly, the recognition of all assets and liabilities of subsidiaries at their fair values would provide users with more useful information regarding the capacity of superannuation entities to:

(i) pay defined contribution benefits; and

(ii) fund defined benefit entitlements.

As superannuation entities have the capacity to govern their subsidiaries' strategic financing and operating decisions, the recognition of subsidiaries' assets and liabilities at their fair values would also assist users in monitoring and evaluating the results of trustees' stewardship. For instance, the application of Approach A would assist users in understanding the factors underlying changes in values of investments in subsidiaries recognised in parents' separate financial statements;

(b) alignment between the measurement of subsidiaries' assets and liabilities and the objective of financial reporting by superannuation entities. Such an alignment would, for instance, permit a closer alignment between the net asset amounts reported in parent entities' separate and consolidated financial statements than would be the case under Approach B or Approach D;

(c) subsidiaries' assets and liabilities would be measured on the same basis, thereby avoiding the measurement mismatches that are likely to arise under Approaches B, C and D. The avoidance of measurement mismatches ensures that, for instance, consolidated financial statements do not present some subsidiaries as 'net liability' investments due to their liabilities being recognised at fair value and their assets being recognised at cost less accumulated amortisation/depreciation; and

(d) adding the accrued benefits of parent superannuation entities and the retained profits of their subsidiaries would produce a more meaningful total for the users of the financial statements of superannuation entities than would be the case under Approaches B, C or D. For instance, under Approach D depreciation expense attributable to property, plant and equipment held by subsidiaries would be recognised in the group's profit or loss, whereas under Approach A this would not be the case.

Arguments Against Approach A

25. Arguments against Approach A include:

(a) Approach A is inconsistent with the AASB's policy of transaction neutrality;

(b) parent superannuation entities would not prepare consolidated financial statements in a manner consistent with IFRSs, thereby potentially diminishing their comparability to the financial statements of other investment vehicles;

(c) parent superannuation entities would recognise each of their subsidiaries' assets and liabilities at their fair values and calculate internally generated goodwill on an annual basis. Therefore, Approach A is likely to be more onerous on parent superannuation entities than Approaches B, C or D;

(d) contrary to AASB 138, it could cause some parent superannuation entities to recognise internally generated goodwill in their consolidated balance sheets;

(e) requiring defined benefit obligations to be recognised at their fair values:

(i) may not be cost-beneficial since:

- employer sponsors would presumably continue to apply the requirements in AASB 119 *Employee Benefits* in relation to defined benefit obligations; and
- fair value measurements might be regarded as less reliable than the amounts calculated in accordance with the approaches under AASB 119 and AAS 25. For instance, it is conceivable that some defined benefit members of superannuation entities would be considered uninsurable by a market participant if they were to individually apply for death and/or total and permanent disability insurance coverage. Accordingly, measuring the insurance component of these members' entitlements at fair value would require the application of significant judgement; and

(ii) could give rise to different reporting outcomes for ostensibly similar circumstances because, for example, of the significant judgements required to determine fair values for defined benefit obligations. Such judgements would include an estimate of the impact of the employer sponsor's credit risk since most employer sponsors are not formally rated; and

(f) requiring provisions to be recognised at their fair values could give rise to different reporting outcomes for ostensibly similar circumstances because, in the absence of active markets for provisions, there would be a need to apply significant judgement.

Consolidated Financial Statements Prepared in Accordance with Approach B

26. Approach B involves all assets and liabilities recognised by subsidiaries being measured at their fair values in consolidated financial statements when fair value measurement is required or permitted under the relevant Australian Accounting Standards. This approach is consistent with the approach currently applied to assets in AASB 1023 and AASB 1038.

27. The main difference between Approach A and Approach B is the extent to which items held by subsidiaries are recognised at their fair values in consolidated financial statements. Approach A involves:

(a) all assets held by subsidiaries being recognised at their fair values less anticipated disposal costs; and

(b) all provisions and liabilities held by subsidiaries being recognised at their fair values plus anticipated disposal costs.

In contrast, Approach B involves:

(a) the following assets and liabilities of subsidiaries being recognised at their fair values in consolidated financial statements:

(i) financial assets and financial liabilities;

(ii) biological assets and agricultural produce;

(iii) property (including investment property), plant and equipment;

(iv) identifiable intangible assets for which there is an active market; and

(b) all other assets and liabilities of subsidiaries being recognised in consolidated financial statements at amounts other than their fair values in accordance with the relevant Australian Accounting Standards. For instance:

(i) inventories being recognised at the lower of their cost and net realisable value; and

(ii) provisions being recognised at their current settlement amounts.

28. AASB 1023 and AASB 1038 both specify that assets backing insurance liabilities are to be measured on a basis that is consistent with the measurement of insurance liabilities. As both Standards require insurance liabilities to be measured using an expected present value calculation, both require insurers to recognise assets backing insurance liabilities at fair value with changes in fair value recognised in the income statement wherever this option is available in the applicable Australian Accounting Standards.

29. Insurance liabilities and defined benefit obligations are similar in the sense that both involve claimants to which the entity has a financial obligation and assets are generally held to back both types of liabilities. Furthermore, like insurance liabilities, there is a general presumption that the entitlements of defined benefit members will be measured in a manner consistent with an expected present value calculation. For instance, both AAS 25 and AASB 119 require a discounted cash flow model for measuring defined benefit obligations. Accordingly, Approach B may be regarded as consistent with the current requirements applicable to insurers.

Arguments in Favour of Approach B

30. The benefits of Approach B include:

(a) Approach B is consistent with the AASB’s policy of transaction neutrality;

(b) parent superannuation entities would prepare consolidated financial statements in a manner consistent with IFRSs, thereby potentially enhancing their comparability to the financial statements of other investment vehicles;

(c) net asset amounts reported in parent entities’ separate and consolidated financial statements would be more closely aligned than they would be under Approach D. However, under Approach B different net asset amounts would still arise due to the non-recognition of anticipated disposal costs in relation to subsidiaries’ assets and liabilities, and the recognition of minority interests and internally generated goodwill when either or both of these items exist;

(d) on-going reporting requirements would presumably be less onerous than those associated with Approach A because not all assets and liabilities of subsidiaries would be required to be recognised at their fair values; and

(e) in contrast to Approach A and Approach C, parent superannuation entities would not be required to recognise internally generated goodwill in their consolidated balance sheets.

Arguments Against Approach B

31. Arguments against Approach B include:

(a) parent superannuation entities would not be required to recognise all of the assets and liabilities of their subsidiaries at their fair values in consolidated financial statements. Consequently, Approach B:

(i) provides less useful information than Approach A; and

(ii) could be regarded as inconsistent with the objective of financial reporting by superannuation entities;

(b) Approach B limits any potential improvements in the measurement models applied to the assets and liabilities controlled by superannuation entities to any future changes in IFRSs, which is inconsistent with the AASB's view that there is little justification for requiring Australian superannuation entities to adopt IFRSs;

(c) net asset amounts reported in parent entities' separate and consolidated financial statements would be less closely aligned than they would be under Approach A or Approach C. Approach A and Approach C both require anticipated disposal costs to be recognised in relation to subsidiaries' assets and liabilities, and internally generated goodwill to be recognised when it exists;

(d) on-going reporting requirements would presumably be more onerous than those required under Approach D because more assets and liabilities of subsidiaries would be required to be recognised at their fair values than is the case under Australian Accounting Standards; and

(e) in comparison to the results reported under Approach A:

(i) some subsidiaries' assets and liabilities would be recognised at amounts other than their fair values, thereby embedding measurement mismatches with respect to these assets and liabilities in consolidated financial statements and increasing the likelihood that some subsidiaries would be presented as 'net liability' investments in consolidated financial statements;

(ii) adding the accrued benefits of parent superannuation entities and the retained profits of their subsidiaries together would not produce meaningful totals for the users of the financial statements of parent superannuation entities; and

(iii) changes in carrying amounts of some assets and liabilities of subsidiaries would be recognised in consolidated financial statements as increases or decreases in revaluation reserves (equity), which may be considered to be inappropriate since superannuation entities may be regarded as having no equity holders.

Consolidated Financial Statements Prepared in Accordance with Approach C

32. Approach C involves all assets and liabilities recognised by subsidiaries to be measured in accordance with Approach B with the addition in some circumstances of the recognition of a balancing item in relation to subsidiaries in consolidated financial statements. The balancing item would normally be presented as an asset in consolidated balance sheets and represents the difference between the fair value of the parent's investments in its subsidiaries less anticipated disposal costs and the subsidiaries' net assets. Accordingly, the balancing item comprises:
    (a) acquired goodwill, to the extent that it remains at the reporting date;
    (b) changes in internally generated goodwill associated with subsidiaries subsequent to their acquisition; and
    (c) measurement differences resulting from subsidiaries' assets and liabilities being recognised in consolidated financial statements at amounts other than their fair values less or plus anticipated disposal costs.

    This balancing item is similar to that previously required under AASB 1038 (1998).

33. Under AASB 1038 (1998), investments in subsidiaries were recognised in life insurers' separate balance sheets at their net market values and any increments or decrements in the net market values were recognised in insurers' separate income statements as revenues or expenses. This treatment was justified on the basis that insurers manage their investments in subsidiaries on a net basis. The balancing item was generally described as the excess of market value over net assets ('EMVONA').

Arguments in Favour of Approach C

34. The benefits of Approach C include:
    (a) the provision of more useful information than Approaches B or D regarding:
        (i) the ability of subsidiaries to generate cash and cash equivalents and the timing and certainty of their generation; and
        (ii) information to assist users in monitoring and evaluating managerial performance regarding all of the resources that superannuation entities control;
    (b) net asset amounts reported in parent entities' separate and consolidated financial statements would be as closely aligned as they would be under Approach A, and more

closely aligned than they would be under Approach B or Approach D. However, as with Approach A, under Approach C different net asset amounts would still arise where there are minority interests; and

(c) on-going reporting requirements would presumably be less onerous than those associated with Approach A because fewer assets and liabilities of subsidiaries would be required to be recognised at their fair values.

Arguments Against Approach C

35. Arguments against Approach C include:

(a) Approach C is inconsistent with the AASB's policy of transaction neutrality;

(b) parent superannuation entities would not prepare consolidated financial statements in a manner consistent with IFRSs, thereby potentially diminishing their comparability to the financial statements of other investment vehicles;

(c) parent superannuation entities would not be required to recognise all of the assets and liabilities of their subsidiaries at their fair values in consolidated financial statements. Consequently, Approach C:

(i) provides less useful information than Approach A; and

(ii) is inconsistent with the objective of financial reporting by superannuation entities;

(d) Approach C limits any potential improvements in the measurement model applied to the assets and liabilities controlled by superannuation entities to any future changes in IFRSs, which is inconsistent with the AASB's view that there is little justification for requiring Australian superannuation entities to adopt IFRSs;

(e) on-going reporting requirements would presumably be more onerous than those required under Approach D because more assets and liabilities of subsidiaries would be required to be recognised at their fair values than is the case under Australian Accounting Standards;

(f) contrary to AASB 138, it could cause some parent superannuation entities to recognise internally generated goodwill in their consolidated balance sheets; and

(g) in comparison to the results reported under Approach A:

(i) some subsidiaries' assets and liabilities would be recognised at amounts other than their fair values, thereby embedding measurement mismatches with respect to these assets and liabilities in consolidated financial statements and increasing the likelihood that some subsidiaries would be presented as 'net liability' investments in consolidated financial statements;

(ii) adding the accrued benefits of parent superannuation entities and the retained profits of their subsidiaries together would not produce meaningful totals for the users of the financial statements of parent superannuation entities; and

(iii) changes in carrying amounts of some assets and liabilities of subsidiaries would be recognised in consolidated financial statements as increases or decreases in revaluation reserves (equity), which may be considered to be inappropriate since superannuation entities may be regarded as having no equity holders.

Consolidated Financial Statements Prepared in Accordance with Approach D

36. Superannuation entities that hold interests in subsidiaries are currently required to prepare consolidated financial statements in accordance with AASB 3 and AASB 127.

37. AASB 3 requires that subsidiaries' identifiable assets and liabilities be recognised at their fair values at the date of the subsidiary's acquisition. Subsequent to their acquisition, Australian Accounting Standards treat the fair value of assets and liabilities acquired in business combinations as the cost of the item from the date of the subsidiary's acquisition. Accordingly, when preparing consolidated financial statements subsequent to the acquisition date of a subsidiary, a parent entity would:
   (a) recognise its subsidiary's identifiable assets at either fair value or cost less accumulated amortisation/depreciation and any impairment losses in accordance with the choices available in applicable Australian Accounting Standards; and
   (b) recognise its subsidiary's identifiable provisions and liabilities at fair value, current settlement amount or amortised historical cost in accordance with the applicable Australian Accounting Standards.

38. In comparison to Approach A, Australian Accounting Standards currently require significantly fewer assets and liabilities to be recognised at their fair values, in particular:
   (a) not all financial assets are required to be recognised at fair value, e.g., loans, receivables and held-to-maturity investments would be recognised at their amortised cost using the effective interest method;
   (b) some financial liabilities could be recognised at their amortised cost;
   (c) property (including investment property), plant, equipment and identifiable intangible assets could be recognised at their cost less accumulated amortisation/depreciation and any impairment losses;
   (d) non-current assets held for sale and discontinued operations are recognised at the lower of their carrying amount and fair value less costs to sell; and
   (e) inventories are recognised at the lower of their cost and net realisable value.

Arguments in Favour of Approach D

39. The benefits of continuing to require parent superannuation entities to prepare consolidated financial statements in accordance with AASB 3 and AASB 127 include:
    (a) the approach is consistent with the AASB's policy of transaction neutrality;
    (b) parent superannuation entities would prepare consolidated financial statements in a manner consistent with IFRSs, thereby potentially enhancing their comparability to the financial statements of other investment vehicles;
    (c) on-going reporting requirements would presumably be less onerous than those associated with Approaches A, B or C because fewer assets and liabilities of subsidiaries would be required to be recognised at their fair values; and
    (d) in contrast to Approach A and Approach C, parent superannuation entities would not be required to recognise internally generated goodwill in their consolidated balance sheets.

Arguments Against Approach D

40. Arguments against continuing to require parent superannuation entities to prepare consolidated financial statements in accordance with AASB 3 and AASB 127 include:
    (a) parent superannuation entities would not be required to recognise all of the assets and liabilities of their subsidiaries at their fair values in consolidated financial statements. Consequently, Approach D:
        (i) provides less useful information than Approach A; and
        (ii) is inconsistent with the objective of financial reporting by superannuation entities;
    (b) Approach D limits any potential improvements in the measurement models applied to the assets and liabilities controlled by superannuation entities to any future changes in IFRSs, which is inconsistent with the AASB's view that there is little justification for requiring Australian superannuation entities to adopt IFRSs;
    (c) net asset amounts reported in parent entities' separate and consolidated financial statements would be less closely aligned than they would be under Approaches A, B or C. Different net asset amounts would arise due to the non-recognition of anticipated disposal costs in relation to subsidiaries' assets and liabilities, and minority interests and goodwill being recognised when either or both of these items exist; and
    (d) in comparison to the results reported under Approach A:
        (i) some subsidiaries' assets and liabilities would be recognised at amounts other than their fair values, thereby embedding measurement mismatches with respect to these assets and liabilities in consolidated financial statements and increasing the likelihood that some subsidiaries would be presented as 'net liability' investments in consolidated financial statements;

(ii) adding the accrued benefits of parent superannuation entities and the retained profits of their subsidiaries together would not produce meaningful totals for the users of the financial statements of parent superannuation entities; and

(iii) changes in carrying amounts of some assets and liabilities of subsidiaries would be recognised in consolidated financial statements as increases or decreases in revaluation reserves (equity), which may be considered to be inappropriate since superannuation entities may be regarded as having no equity holders.