The Voice of Super

File Number: 200757

The Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West, VIC 8007
Email: standard@aasb.com.au

28 November 2007

## ASFA SUBMISSION ON THE AASB CONSULTATION PAPER: CONSOLIDATION OF SUBSIDIARIES BY SUPERANNUATION ENTITIES

The Association of Superannuation Funds of Australia Ltd (ASFA) is pleased to make this submission to the Australian Accounting Standards Board (AASB) on the "Consolidation of Subsidiaries by Superannuation Entities" Consultation Paper ("Consultation Paper"), released for comment on 24 September 2007.

ASFA is a non-profit, non-political national organisation whose mission is to protect, promote and advance the interests of Australia's superannuation funds, their trustees and their members. Our members, which include corporate, public sector, industry and retail superannuation funds, account for more than 5.7 million member accounts and over 80% of superannuation savings.

ASFA appreciates the extensive consultation process undertaken by the AASB. However we are disappointed that the AASB has not taken greater account of the views of the superannuation industry, particularly those expressed by the Project Advisory Panel.

The Consultation Paper is based on the premise that superannuation funds should prepare fair value consolidated financial statements, with the discussion largely restricted to the question of which of four possible approaches should be adopted. ASFA considers that none of the suggested approaches adequately addresses the issues raised by the industry and that further consideration should be given to the underlying question of whether it is appropriate to require superannuation funds to prepare consolidated financial statements.

## IMPACT OF CHANGES IN THE SUPERANNUATION INDUSTRY

Any changes to fund financial statements need to address the needs of users of those statements. Since the release of the current AAS 25, there have been significant changes to the structure of most, if not all, superannuation funds that must be taken into account if financial statements are to meet the needs of users. The Project Advisory Panel has highlighted the following changes that have had a significant impact on funds and therefore on the usefulness of fund financial statements:

- Member investment choice has the effect that a member's benefit depends on the assets underlying a particular investment strategy, not on the net assets of the whole fund. Some funds permit members to invest in specific listed shares, in which case the member's benefit would depend on the value of the chosen shares.

- Many funds have both defined benefit and accumulation divisions. This results in further segmentation of the allocation of the net assets of the fund between different groups of members.

In the past many employer sponsors provided financial and administrative support to funds to help reduce operational costs. This type of employer support is now uncommon. Therefore the increased costs resulting from the proposed changes would be borne by superannuation funds and ultimately by their members.

**FAIR VALUE**

ASFA is concerned that requiring superannuation funds to adopt a fair value approach for financial reporting purposes could lead to inconsistencies between the net asset values reported in financial statements and the net asset values used for the purpose of allocation to members.

Superannuation trustees are required by the *Superannuation Industry (Supervision) Act* (SIS) and by their fiduciary duty to members to allocate net fund earnings between members on a "fair and equitable" basis. For allocation purposes, these requirements have the effect that trustees must value fund assets on a basis that maximises equity between members. While it is possible to use different valuation methodologies for different purposes, it is not desirable. The added complexity resulting from dual valuation methodologies increases both costs and the potential for error, due to increased valuation expense and the greater number of reconciliations required.

The problem is compounded for hybrid funds (i.e. funds with both defined benefit and accumulation sections), where the trustee must allocate the value of the fund's net assets appropriately across the different sections.

Adoption of a fair value methodology is particularly problematic for the valuation of liabilities (Approach A). Valuing a liability at the price that must be paid to transfer the liability to a third party invariably overstates the value of the liability, owing to the need to add margins for both risk and profit. The vast majority of superannuation funds are going concerns and will satisfy all liabilities at face value. The use of a higher value reduces net assets, which in turn would reduce the benefit payment of any member exiting the fund. If the difference were significant, this would create unacceptable inequities between members, which can only be resolved by dual valuation systems (as outlined above).

Using a fair value methodology to value defined benefit liabilities appears to be unworkable. The profit margin and risk margin mentioned above would inflate these liabilities above their actuarially determined values. This could have the effect of making a fund appear underfunded even when there is a very high probability that the fund will be able to meet its liabilities to members. Financial statements prepared on such a basis would be more likely to mislead users than to inform them.

Further, the absence of any market for defined benefit liabilities is likely to lead to very different valuations by funds in similar circumstances, which in turn means that comparability would be impossible.

The calculation method required by AAS 25 does involve some professional judgement, as it requires the fund's actuary to estimate an appropriate discount rate. However it is likely to result in more meaningful information to users and greater comparability between funds than the use of a fair value methodology. For these reasons it is preferable to a fair value methodology for the purpose of measuring defined benefit liabilities.

*Recommendation 1:* **That defined benefit liabilities continue to be valued under the method prescribed in AAS 25.**

## CONSOLIDATED FINANCIAL STATEMENTS

### Decision usefulness

Industry participants have continually raised the concern that very few, if any, superannuation fund members or potential members use fund financial statements (whether separate or consolidated) for decision-making purposes. This includes any decision as to whether to invest surplus funds into superannuation or an alternative investment such as listed shares.

In the case of defined benefit members, the financial statements of the sponsoring employer could provide greater information about the ability to pay benefits than the financial statements of the fund. If the net assets of the fund are inadequate to pay the promised benefits (for example, due to a sustained market downturn), the employer is required to increase funding to cover the shortfall.

The lack of relevance of financial statements extends to those members and potential members who employ financial planners to assist in the decision making process. Few, if any, financial planners refer to financial statements at all when researching a superannuation fund.

APRA, and to a lesser extent, employer sponsors of defined benefit funds, are the major (and probably only) users of superannuation fund financial statements. ASFA has been informed that APRA do not recognise consolidated financial statements, to the extent that they instruct funds not to lodge them. Employer sponsors obtain useful information only where the financial statements disclose the defined benefit position of the fund separately.

As consolidated financial statements are rarely, if ever, used by fund members, potential investors or regulators, there would appear to be little justification to impose consolidated financial statements on superannuation funds due to the time, increased staffing and other resources involved in preparing such statements and the resulting cost to members. Any such requirement would be effectively an imposition by the accounting profession rather than a response to the needs of users.

Cost is particularly relevant in a superannuation context, as in the vast majority of funds' costs are met by reducing members' account balances. Imposing costs on funds without any demonstrable benefits to members would appear to be contrary to the purpose of superannuation.

## Transaction neutrality

A closely related issue is the suggestion that fair value consolidated statements are necessary for transaction neutrality. ASFA considers that transaction neutrality is relevant only where financial statements are used to compare different entities, generally with a view to making investment decisions. As noted above, this is not the case for superannuation.

## Accountability

The Consultation Paper suggests that consolidated financial statements are necessary for accountability purposes. While it is true that consolidated statements have the potential to provide greater detail about how fund trustees have managed all the resources controlled by the fund, the same arguments raised above apply. Members and most employers do not require this level of detail for accountability purposes. APRA, as the prudential regulator, already has access to the audited financial statements of subsidiaries, and so does not require consolidated statements.

The disclosure currently mandated by the Corporations Act and Regulations (Product Disclosure Statements, annual reports and periodic statements) provides sufficient information for most members, employers and potential investors, both for decision-making and accountability purposes. An alternative, less costly, solution for the small number of potential users of consolidated statements would be to amend the Corporations Act and/ or Regulations to require funds to provide the financial statements of subsidiaries on request.

*Recommendation 2:* **That the AASB not require superannuation funds to prepare consolidated financial statements.**

## Disclosure by note

ASFA members accept that consolidated financial statements can provide additional detail about the financial health of any subsidiary company investments held by a superannuation fund, although this is not necessarily easy as the information about a particular subsidiary is split across different parts of the consolidated balance sheet. However the information that is relevant to users can be provided equally well by way of notes to the statements of the parent fund.

The Issues Paper prepared for the AASB meeting of 27/28 June suggests that disclosure by note is inferior because:

- it may not necessarily (emphasis added) produce comparable financial information;
- it is inconsistent with the *Framework for the Preparation and Presentation of Financial Statements*; and
- the findings from some research studies suggest the information may be potentially less reliable (emphasis added).

SECRETARIAT

Piccadilly Tower
Level 19
133 Castlereagh St
Sydney NSW 2000

PO Box 1485
Sydney NSW 2001

T +61 2 9264 9300

F +61 2 9264 8824

outside Sydney
1800 812 798

However superannuation fund statements, including notes to the financial statements, are required to be audited. As the auditors would almost certainly apply a consistent materiality level across all the financial statements, including the notes, the use of notes is unlikely to reduce reliability.

ASFA considers that disclosure by note, if properly done, has the capacity to provide both comparable and reliable information at a much lower cost to fund members. Disclosure by note actually has the potential to provide more detail about particular subsidiaries where this information would be beneficial to users. For example, disclosure by note could overcome many of the issues that could result if the accounts of a subsidiary have not been audited prior to the finalisation of the parent fund's accounts.

While such disclosure is not consistent with the *Framework*, rigid adherence to the *Framework* should not take priority over the need to provide information to actual, as opposed to hypothetical, users without imposing unnecessary costs on fund members.

***Recommendation 3:*** **That the AASB permit superannuation funds to disclose information about subsidiaries by way of notes to the parent fund's financial statements.**

**Proportional consolidation**

The Consultation Paper argues against a proportional consolidation model on the basis that it is inconsistent with the fundamental principles of general purpose financial reporting, specifically the concept of control and the entity concept. This argument is based on the fact that general-purpose financial statements are expected to meet the common needs of a range of users.

As previously noted, ASFA does not accept the existence of a range of users for superannuation statements. Further, for those members (if any) who do use the financial statements, full consolidation would be confusing and potentially misleading in cases where minority interests are included. Fund members would expect the net assets reported in the consolidated statements to be available to pay benefits and would generally regard any discrepancy between the consolidated statements and parent fund statements as evidence of the alienation of some assets.

The concept of "control" can also be misleading in a superannuation context, as the ownership of over 50% of the units in a particular investment does not necessarily confer control on the owner of those units. For example, property investments are often structured in such a way that control remains with the investment manager. Exerting any form of control over the manager generally requires the agreement of all (or almost all) unit holders. In practical terms, the most common option available to trustees that disagree with management is to sell their units in the investment. Consolidated statements that imply the fund controls an investment of this type would mislead users.

Proportional consolidation would be of more use than full consolidation for the small number of members, potential members and employers who might refer to consolidated statements.

***Recommendation 4:*** **That, in the event that disclosure by way of notes to the parent fund's financial statements is not adopted, the AASB permit superannuation funds to report on a proportionate consolidation basis.**

Consideration of the different approaches

ASFA does not support any of the approaches outlined in the Consultation Paper. Approach A is the most consistent. However it is unacceptable because of the method of valuing defined benefit liabilities. In addition it would be costly for funds to implement without any commensurate benefit to members.

The other approaches do not cause a problem with defined benefit valuations, but they contain other difficulties. In particular, the possibility of "net liability investments" and the recognition of changes in carrying amounts as equity. Neither of these outcomes is acceptable for superannuation funds.

All of the approaches fail to recognise the practical difficulties that funds would face, including identifying the investee companies the fund actually controls, determining when control arises and/or is lost during a reporting period and the confusion caused by the inclusion of minority interests.

All of the approaches outlined in the Consultation Paper would create practical difficulties and increased costs for members. As there are no identifiable benefits to members or other potential users that would offset the increased costs, ASFA is unable to support any of the proposed approaches.

***Recommendation 5:*** **That the AASB not proceed with any of the approaches outlined in the Consultation Paper.**

If you have any questions or comments on this submission, please feel free to contact Sue Willems, Senior Policy Adviser or me at the ASFA Secretariat on 02 9264 9300.

Yours sincerely,

Dr Brad Pragnell
Director, Policy and Best Practice