

The University of Sydney
Faculty of Economics and Business
Discipline of Accounting
NSW 2006 Australia

Dr Isabel Gordon
Senior Lecturer in Accounting

Fax 61 2 9351 6638
DX 1154 SYDNEY
Telephone 61 2 9351 7013
E-mail i.gordon@econ.usyd.edu.au

30 September 2009

The Chairman
Australian Accounting Standards Board
Collins Street West
Melbourne, VIC 8007
E-mail standard@aab.gov.au

Dear Sir/Madam,

Re: Request for Comment on ED 179 “Superannuation Plans and Approved Deposit Funds”

I have prepared the following comments (see below) in response to the Australian Accounting Standards Board’s request for comments on matters detailed in the Preface to ED 179. Should you require further clarification concerning my comments please do not hesitate to contact me.

Yours faithfully,

Isabel Gordon

Comments on ED 179

I would like to comment on the following matters:

- General comment about the objectives of ED 179

In the Preface to ED 179 it is stated that one of the reasons for issuing ED 179 was to address those users in the superannuation context “whose information needs were not the focus of considerations in the promulgation of other Australian Accounting Standards”. To this extent, it is further argued by ED 179 that other Australian accounting standard requirements are not necessarily appropriate for the needs of users of the financial statements of superannuation or approved deposit funds. Paragraph 1 of ED 179 states that “The objective of this standard is to specify requirements for the general purpose financial statements of a superannuation plan or approved deposit fund ... to provide users with information that is useful for decision making in a superannuation plan or approved deposit fund context.”

Most superannuation funds in Australia are trusts, where the superannuation assets are held in trust by the plan trustee for the benefit of the members. The trustee is accountable to the members to show how the assets have been managed and disbursed (the trustee’s duties are set out in the Superannuation Industry (Supervision) Act 1993 (SIS) and regulations). This is the stewardship function of accounting. On the other hand, international standard-setters now centre on the decision usefulness of financial information and emphasise the relevance of financial information to enable users to make resource allocation decisions.

I make the following comments:

1. While members are the principal stakeholders of a superannuation fund, they may also be regarded as one of the user groups of the general purpose financial reports for a superannuation plan (as stated in para. BC10). In this way, members receive information about the superannuation entity (rather than just individual member balances). Currently, there are at least three layers of reporting by a superannuation fund: reporting to APRA; preparing audited financial statements; and (unaudited) annual report to members (with abridged financial statements). APRA’s superannuation reporting requirements occur within an institutional framework aimed at the protection of members while accounting requirements traditionally focus on the interests of investors and shareholders. Regulators emphasise prudence (manifested by lower asset and higher liability values) while international financial reporting standards focus on fair values. There is frequently a disconnect between the accounting requirements contained in accounting standards and the prudential requirements imposed by a regulator because they normally serve different stakeholders. To this extent, it is not clear how ED 179 fits into the overall reporting

framework for superannuation funds. Further, it is unclear how, in practice, employer-sponsors would be regarded as “general purpose” users (see BC11).

2. With choice of fund legislation introduced in 2005 there may be a greater role for general purpose financial reports of superannuation funds for users (although this is an empirical issue). However, often it is very difficult to access the general purpose financial reports of superannuation funds. Unlike publicly listed companies that prepare audited general purpose financial statements, the financial accounts of superannuation plans are not freely available. Further, to compare the performance of superannuation plans is often fraught with difficulties, for example, the lack of comparability of available financial data.

3. Another issue concerns the definition of a defined benefit plan (DBP). ED 179 Appendix A defines a defined benefit member as “A member whose benefits are specified, or are determined, at least in part, by reference to a formula based on their years of membership and/or salary level”. This definition is not risk based. Further, it is not consistent with AASB 119 that defines DBP (by exclusion relative to a DCP) where there is a legal or constructive obligation to pay further contributions in the event of insufficient fund assets to pay all employee benefits. To the extent that the definition of the DBP in ED 179 is not risk based, then the discussion in paragraph AG62 re the sponsor’s credit risk is redundant. That is, if the sponsoring employer does not accept the investment risk of the DBP (a situation possible under the current ED 179 definition of a DBP), there is no difference between a DBP and a DCP, and the bankruptcy risk of the sponsor is no longer relevant to the DBP member (and the discussion in para. AG62 is irrelevant). (I am also unsure of the analogy between the measurement of a DBP accrued benefit and an insurance contract in para. BC46(a) if there is no transfer of risk per the current definition of a DBP in ED 179).

4. The disclosure principles contained in paras. AG52 to AG89 are appropriate and would result in general purpose financial reports that are useful to users.

- Comments about specific matters of ED 179

(a) recognise all of its assets and liabilities in accordance with other applicable Australian Accounting Standards and measure them at fair value adjusted for transaction costs, except that:

(i)

tax balances be measured in accordance with AASB 112 Income Taxes;

(ii)

obligations for defined contribution members’ vested benefits and defined benefit members’ accrued benefits always be recognised as liabilities;

The actuarial literature has regarded realisable value (market value less costs of realisation) as the most appropriate measure for superannuation plan assets so that exiting fund member balances may be calculated using relevant data. Therefore, fair value

(using market exit prices as a surrogate) adjusted for transaction costs is appropriate to measure plan assets.

On the other hand, the actuarial literature has opposed treating member benefits as liabilities of the plan. This has been partly due to the earlier superannuation accounting standards (especially in the UK and the USA) having a “profit and loss” focus rather than the current balance sheet focus of the IASB. Adopting the balance sheet approach, it is apposite to recognise vested (DCP) and accrued (DBP) benefits as liabilities of the plan. However, in Australia (unlike the USA and the UK) for DBP there is no regulatory imposed guarantee that the sponsoring employer must make good any DBP deficit. This being so, in the absence of regulation, it may be argued that the DBP deficit represents a constructive (and not legal liability) in Australia. Also, for the DBP, reference should be made in the notes to the accounts to the trust deed clause that details the sponsor’s guarantee of the DBP deficit so that users of the financial statements are clear that this guarantee is currently in place.

iii)

obligations for defined contribution members’ vested benefits be measured at the amount payable to, or on behalf of, such members on demand;

(iv)

obligations for defined benefit members’ accrued benefits be measured at the present value of the expected future benefit payments to such members using the Projected Unit Credit Method in a manner consistent with the approach required under AASB 119 Employee Benefits in respect of defined benefit obligations, except that:

(A) expected administration costs are not included in the measurement of accrued benefits;

(B) if a plan’s benefit formula prescribes that defined benefit members accrue materially higher levels of benefits as they near retirement age, the plan attributes benefits to reporting periods on a basis appropriate to the plan’s circumstances; and

(C) benefit payments be discounted for the time value of money using a risk-free discount rate based on current observable, objective rates that relate to the nature, structure and terms of the obligations for such payments;

The DCP members’ vested benefits should be measured as the amount that reflects the sum of accumulated contributions plus investment earnings that is (legally) payable on demand.

On the other hand, the DBP accrued benefits will need to be regularly assessed by the actuary. If “backloading” is present in the DBP benefit formula, and the actuary determines that the PUC is inappropriate, then another actuarial costing method should be

permitted. The reason for the departure from the PUC should be disclosed as well as the alternative funding method used.

(vi)

any difference at the end of the reporting period between:

(A) the sum of a parent plan's or parent fund's interest and the non-controlling interests in the subsidiary; and

(B) the amount of the net assets of the subsidiary that are recognised by the parent plan or parent fund;

be recognised and presented separately as goodwill in the consolidated statement of financial position or, if negative, as a remeasurement gain in the consolidated income statement;

This paragraph reflects the recent changes in AASB 3 that incorporates the NCI into the calculation of goodwill (where the parent interest in the acquiree is substituted for the consideration transferred). Assuming the net assets of the subsidiary are measured at fair value, then on balance goodwill should be comparable with other requirements consistent with consolidation accounting. However, valuing the NCI may be problematic. The valuation basis for the NCI should be disclosed.

(d)

present any difference between the amount of total assets and total liabilities (including member benefits and any obligations to employer sponsors) as equity in accordance with applicable Australian Accounting Standards;

(e)

that prepares separate financial statements for the purpose of meeting the information needs of general purpose users, present its separate and consolidated financial statements together; and

(f)

disclose in the notes information that provides users of its financial statements with a basis for understanding:

(i)

the nature of the entity and the nature of the benefits it provides to its members;

For the DBP, reference should be made in the notes to the accounts to the trust deed clause that details the sponsor's guarantee of the DBP deficit so that users of the financial statements are clear that this guarantee is currently in place. Any changes to this clause should be similarly disclosed.

(ii)

the nature and amount of expenses incurred by the entity;

(iii)

how the fair values of assets and liabilities of the entity are determined;

(iv)

the nature and extent of the financial risks to which the entity is exposed during the reporting period and at the end of the reporting period;

(v)

how the entity manages the financial risks to which it is exposed;

(vi)

how the entity arranges and manages assets attributable to different groups of members, and the related obligations to those members;

Contribution holidays by the sponsoring employer should be clearly disclosed. It should also be clear to what group of members this applies.

How assets are managed between groups of members is also relevant for DBP members for whom the choice of fund legislation does not apply.

(vii)

where an entity manages assets attributable to different groups of members, and the related obligations to those members, on a 'segregated' basis:

(A) the type and nature of assets within each segregated group of assets;

(B) the financial performance and financial position of each segregated group of assets; and

(C) the significant financial risks to which each segregated group of assets is exposed when the levels of such risks differ materially from the levels of the corresponding risks at the entity level;

The presentation of consolidated financial statements is just as important in the context of superannuation as for other business contexts. This is because it permits users to assess the activities controlled by the superannuation fund in their entirety and gain a better understanding of the risks attached to these activities. For example, if a controlled entity employs the key management personnel of the superannuation fund, then remuneration details should be disclosed as part of related party disclosures. Treating the difference between the plan's assets and liabilities as equity accommodates the consolidation process.

(viii)

the entity's obligations for member benefits;

(ix)

the size, nature, causes of and any strategies for addressing any difference between the amount of net assets attributable to defined benefit members and such members' accrued benefits;

Given the recent credit crisis, and the fact that there is no regulatory backed guarantee for DBP deficits in Australia, information on the amount of any DBP deficit and strategies to deal with it are very relevant to older members.

(x)

the components of remeasurement changes in defined benefit members' accrued benefits;

If the actuary's report is presented separately from the plan's financial accounts, it is difficult to see how the audit report can be interpreted separately from the actuary's report. The actuary's report should be presented as part of the plan's financial statements.

(xi)

the nature of the entity's relationships with its employer sponsors and trustee or trustees;

and

(xii)

any transaction during the reporting period or balance at the end of the reporting period involving the entity and an employer sponsor or trustee that would not be considered 'normal' in a superannuation context.

Disclosure of related party and unusual transactions is very important to ensuring the safety and security of retirement monies, and permitting users to assess risk exposure.