KPMG

147 Collins Street
Melbourne Vic 3000

GPO Box 2291U
Melbourne Vic 3001
Australia

ABN: 51 194 660 183
Telephone: +61 3 9288 5555
Facsimile: +61 3 9288 6666
DX: 30824 Melbourne
www.kpmg.com.au

Mr Kevin Stevenson
Chair
Australian Accounting Standards Board
PO Box 204
Collin St West VIC 8007

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Dear Kevin

ED 179 Superannuation Plans and Approved Deposit Funds

We are pleased to have the opportunity to comment on Exposure Draft ED 179 Superannuation Plans and Approved Deposit Funds ("ED 179") issued by the Australian Accounting Standards Board.

Executive summary

KPMG welcomes the AASB's move to review the reporting requirements applicable to superannuation plans and approved deposit funds in order to bring the current standard in line with the concepts maintained by IFRS and to more comprehensively address the specific domestic requirements where IFRS concepts are not relevant or suitable.

KPMG are supportive of the AASB's objectives for issuing principles-based, transaction neutral standards and we would encourage these concepts to be applied to the extent possible to ED 179. We note that AIFRS is applied in full to managed investment schemes, which are similar in nature and operations to superannuation funds. Notwithstanding these similarities, we acknowledge that superannuation funds are different to managed investment schemes in a number of specific ways.

Our view is that ED 179 should apply AIFRS with limited exceptions in order to maintain the AASB's objectives for principles-based, transaction neutral standards. This is also necessary to promote continual development of the financial reporting framework of superannuation funds by ensuring the most up-to-date international financial reporting requirements are applied where relevant. For example, when the definition of control under AASB 127 is changed, this should automatically apply to super funds without having to update the accounting standard for superannuation funds. ED 179 should therefore be silent on accounting treatments already addressed in AIFRS unless there is a specific reason to differ from the AIFRS standard.

Where AIFRS requirements are not suitable for superannuation funds, the additional requirements should be principles-based and should refer back to the principles in AIFRS and why they differ for superannuation funds where possible.

Consequently, our overall view is that ED 179 should require that AIFRS is applied with the following limited exceptions:

- Specify that all financial instruments must be designated as "at fair value through profit or loss" in accordance with AASB 139 and that non-financial instruments (eg investment property and property, plant and equipment) are measured at fair value with fair value changes being recognised in profit and loss. Consistent with the proposals in the IASB's Fair Value ED, we do not see the need to deduct transaction costs as super funds have long term investment objectives and do not hold their assets and liabilities with a view to liquidation or wind up.

- Require the recognition of a fair value premium/discount and a corresponding remeasurement gain or loss on consolidation where there is a difference between the fair value of an investment in a subsidiary and the fair value of its individually identifiable assets and liabilities.

- Specify that defined benefit accrued benefit obligations be measured using a method consistent with AASB 119 to enable comparability and/or reconciliation to employer financial reports and that accrued benefits liability should be recognised on the Balance Sheet.

- The presentation of financial statements should include the five types of financial statements suggested in the ED.

- Funds with significant insurance exposure should apply the principles of AASB 1038, however the requirements should be specifically set out in the ED and should be tailored to superannuation funds.

Specific comments

Our comments on the specific matters raised for comment and on other issues are set out below:

Measurement of assets and liabilities at fair value adjusted for transaction costs

Paragraph 11 of ED 179 specifies that all assets shall be measured at fair value less transaction costs. Paragraph AG7 of the application guidance in ED 179 then refers users to the relevant Australian Accounting Standards for guidance in determining fair values. The relevant Australian Accounting Standard for the majority of superannuation fund assets is AASB 139. The requirements of ED 179.11 are inconsistent with AASB 139.46 which specifies that transaction costs are not deducted from financial assets after initial recognition. If financial statement preparers are required to follow ED 179.11, there is a possibility that the effects of transaction costs will be accounted for twice where bid pricing is used, as bid prices already factor in a buy/sell spread.

We agree that changes in the value of superannuation fund assets and liabilities should be recognised in profit and loss. However, there is no reason for superannuation funds to measure these items any differently to managed investment schemes and other entities. Rather than specify the method of measuring superannuation fund financial assets and liabilities, ED 179 should specify that all financial assets and financial liabilities must be designated as "at fair value through profit and loss" in accordance with AASB 139.9(b). The financial assets and liabilities would then be accounted for under AIFRS in the same way that all other financial instruments are accounted for when designated as at fair value through profit and loss.

In relation to non-financial instruments such as property, plant and equipment and investment property, the ED should specify that these items should also be measured at fair value with fair value changes being recognised in profit and loss. Whilst this removes the measurement choices available to other entities under IFRS, our view is that fair value is a more relevant measurement model for the assets and liabilities of a superannuation fund due to the fiduciary nature of its operations. That is, the trustee is holding assets for another party with legal obligations and restrictions on release of those assets. Fair value numbers are therefore the most relevant for demonstrating to users what the trustee has done with the funds entrusted to it.

ED 179 should refer to the resultant standard from the IASB's ED on Fair Value for the principles of fair value measurement, with the only exceptions being that all changes in fair value should go through profit and loss and that intangible assets do not need an active market to be fair valued. Consistent with the proposals in the IASB's Fair Value ED, we do not see the need to deduct transaction costs as super funds have long term investment objectives and do not ordinarily hold their assets and liabilities with a view to liquidation or wind up.

Accounting for differences in the fair value of the investment in the subsidiary and the fair value of the underlying assets and liabilities

We agree with the overall concept of recognising the difference between the value of the subsidiary and the value of the underlying assets and liabilities on consolidation, however, the difference should be considered a "fair value premium or discount" to differentiate it from "acquired goodwill" under IFRS concepts. It is our experience to date that this item is unlikely to be material given the large balance sheets of superannuation funds in Australia, however, we do accept that it is possible.

Paragraph 30 of the ED is difficult to understand without referring to paragraph AG 43. This should be brought into the body of the standard rather than being in the guidance.

We agree with the ED's treatment of goodwill, however, we have some concerns about whether the accounting treatment for a remeasurement gain works in practice including the separate presentation of this under paragraph 30(c)(ii). As demonstrated in the example below, we do not understand why the excess in the fair value of the subsidiary's individual assets and liabilities above the fair value of the investment in subsidiary recognised by the parent should be separately presented as a "remeasurement gain" in the profit and loss when this excess will already be shown as a change in fair value in the consolidated profit and loss.

There may be limited circumstances where the fair value of the subsidiary's individual assets and liabilities exceeds the fair value of the parent's investment in the subsidiary. One such example, as set out below, is where a listed property trust has frozen its redemptions and therefore has a reduced fair value, however the individual assets and liabilities in the trust financials are worth more.

Parent	Subsidiary
Value of investment in listed sub at reporting date: 100 Journal entries of parent: Dr Investment 90 Cr Cash 90 To account for acquisition of subsidiary Dr Investment 10 Cr Change in fair value P/L 10 To account for fair value increase at reporting date	Value of assets and liabilities of listed sub at reporting date: 120 Journal entries of subsidiary: Dr Cash 90 Cr Equity 90 To account for capital raising Dr Assets 90 Cr Cash 90 To account for purchase of assets Dr Assets 30 Cr Change in fair value P/L 30 To account for fair value increase at reporting date

Consolidation:

	Parent	Subsidiary	Adjustments	Consolidation
Investments	100	-	<100>	-
Assets	-	120	-	120
Retained earnings/P&L	10	30	<10>	30*
Equity	90	90	<90>	90
	100	120		120

Treatment under ED 179:

Parent interest	100
Subsidiary assets	120
Remeasurement gain	20

*Why does the 30 gain have to be presented as a remeasurement gain of 20 and 10 "other"?

Illustrative Example C is also overly complex and difficult to understand. We recommend that Illustrative Example C is simplified and amended to clearly show how a remeasurement gain would work in practice.

Recognition of accrued benefits

Accrued benefits meet the definition of a liability under the AASB framework because on receipt of a contribution for a particular member, the fund has a present, legally enforceable obligation to pay out a member's accrued benefit on demand from the member (whether that demand is for cash because a condition of release has been fulfilled, or whether the member is exercising their right to choice of fund by electing to rollover their benefit). In the case of defined benefit member accrued benefits, the obligation arises as member service accrues.

Consequently, we agree with the requirement to recognise accrued benefits as a liability in the balance sheet as proposed in paragraph 10 of the ED. However, we do note that this may create potentially misleading results for some funds that are forced to present a net asset deficit position because the fund is substantially a defined contribution fund for which the accrued benefits are wholly matched by the amount of assets reported on the balance sheet, but a small defined benefit portion of the fund is underfunded. The balance sheets of pure defined contribution funds may also show a deficit position as at reporting date due to accrued benefit liabilities being measured using "stale" unit prices while assets on the balance sheet are measured using more recent audited values. To ensure that users of the financial statements understand the net asset position of the fund and whether a deficit is due to underfunding of the entire fund or just a particular sub-plan, or whether the deficit is due purely to unit pricing timing differences, we recommend that ED 179 requires the following to be shown on the face of the Balance Sheet:

Net assets available for members' accrued benefits		5,550
Less members' accrued benefits - liability		6,550
Net assets		(1,000)
Equity		
Reserves		100
Deficit		
Represented by:		
Adjustments arising from different unit pricing and AIFRS valuations	(200)	
Accrued benefit liabilities of ABC defined benefit sub-plan yet to be funded	(900)	(1,100)
		(1,000)

Measurement of accrued benefits

For the purposes of comparability with employer sponsor financial statements, ideally the measurement method used should be consistent for both AASB 119 and ED 179, just as IAS 26 is designed to complement IAS 19. This would enable users to pick up the financial report of, for example a listed employer sponsor, and match the recognised surplus in the financial statements of the employer to the net asset position of the fund.

At present, the surplus or deficit reported in the financial statements of an employer can be vastly different to the surplus or deficit in the financial statements of a defined benefit superannuation fund. The following example compares the employer obligation in the financial statements of an actual listed company with the accrued benefits and net assets of the sponsored superannuation fund as at 30 June 2006 (the date of the last actuarial valuation):

ABC Listed Co DB obligation as at 30 June 2006 (119 approach)		$35,800,000
ABC Superannuation Fund:		
Net assets as at 30 June 2006	$887,501,547	
Liability for Accrued Benefits as at 30 June 2006	$889,400,000	
Net deficit under current AAS 25 measurement principles		$1,898,453

If users were to pick up the financial report of the company with a defined benefit obligation of $35.8M compared to a net deficit reported in the financial report of the fund of $1.9M, there may be questions asked as to why the employer sponsor has such a big funding liability when the super fund is only reporting a small deficit and confusion as to which deficit is the true deficit.

In line with the concept of transaction neutrality, we would prefer that the defined benefit obligation reported in the financial statements of the employer is the same or at least reconcilable to the obligation reported in the financial statements of the superannuation fund.

Whilst we understand the technical merits of the measurement technique proposed in the ED, from a cost-benefit perspective, the AASB 119 measurement method should be used so that there are not three different methods of measuring accrued benefits in the market place (being vested benefits, the ED 179 approach and the AASB 119 approach).

Accrued benefits is a more reliable measure of the obligation to members than vested benefits as it reflects the long-term nature of the obligation.

Presentation

The change in the classification of contributions, transfers and benefits paid as a movement in a liability (members' benefits) rather than a profit and loss item aligns the presentation of superannuation funds more closely with the presentation of managed investment schemes, and is more consistent with the conceptual framework definitions of income and expense than the current AAS 25. It also provides a better indication of the fund's underlying performance. We do note, however, that these classifications are not specifically set out in the ED but are only referred to more generally in paragraph 28.

We agree with the suite of five financial statements proposed in the ED. Although the most recent version of AASB 101 requires a Statement of Comprehensive Income, superannuation funds will have very little comprehensive income in the form of movements through equity. Under the most recent AASB 101, a balance sheet, income statement, statement of cash flows and statement of changes in equity still have to be prepared, so the only additional requirement from this for a superannuation fund is the preparation of a statement of changes in member's accrued benefits, which we believe is relevant to users.

Disclosures

The proposed disclosures in relation to the nature, extent and management of risks specified in paragraph 34 of the ED have the effect of tailoring AASB 7 disclosures for a superannuation fund and making them more useful for users.

The components of remeasurement changes in accrued benefits required at paragraph 46 of the ED should only be disclosed if they would match to the components disclosed in the financial statements of the employer sponsor. Otherwise, this could be misleading to users.

Accounting for insurance arrangements

Our view is that if a superannuation fund has significant insurance contract obligations and assets (and is not just acting as an agent between the member and the insurer), then this should be presented on the balance sheet. If the calculation of the accrued benefits liability has already factored in insurance assets and liabilities, then the insurance components should be presented separately from the accrued benefits liability.

Given the specific application of AASB 1038 to the life insurance industry, we would prefer that the relevant requirements of AASB 1038 are set out in ED 179 and tailored specifically to the arrangements of self-insured superannuation funds. The terminology used should be specific to superannuation funds rather than life insurance contracts. Whilst our overall view is that IFRS should be applied with limited exceptions, our view is that this departure will reduce the complexity of the ED.

"Higher of" benefit options

In reference to the proposals under paragraphs BC52 – BC56, current practice is for funds to recognise the "higher option" under the trust deed as a member's vested benefit, provided they have satisfied the conditions for being entitled to that higher benefit.

We do not see any reason to depart from this practice, as the fund is presently obligated to pay the higher amount on demand. The probability of the fund having to pay the higher amount could be factored into the measurement of the liability, however, it is likely that this probability would be very high for most funds.

Inconsistency with APRA reporting requirements

There is an inconsistency between the consolidated reporting requirements of ED 179 and the reporting requirements of APRA. Paragraph 31of the Exposure Draft requires parent financial statements to be presented together with consolidated financial statements whereas APRA only requires parent entity financial statements to be prepared.

Whilst we agree that it is appropriate to present both parent and consolidated financial statements together in order to provide users with all relevant information, we would like to emphasis that this will continue to cause practical difficulties for some superannuation funds that rely on the audited financial statements of subsidiaries in order to prepare consolidated financial statements. In practice, many superannuation funds have little influence on the financial reporting timetables of investment trusts, even if they own a controlling percentage of the units in the trust.

Accounting for hybrid funds

Given that the majority of funds in the industry are hybrid funds, it would be more useful if the examples in the back of ED 179 provided example financial statements for a superannuation plan which comprises both defined contributions and defined benefit members rather than explaining how the financial statements of a plan with defined benefit members only would differ from those of a plan with defined contribution members only.

Approach adopted in drafting the exposure draft

We would prefer a more concise version of the standard which only sets out the required accounting principles where the principles of AIFRS are being departed from. The reasons for the departures should also be provided. We would prefer that the required disclosures are specified clearly and concisely in the body of the standard instead of including the detail of the disclosure requirements in a set of Application Guidance.

We would be pleased to discuss our comments with members of the AASB or its staff. If you wish to do so, please contact me on 03 9288 6948.

Yours sincerely

Sean Hill
Partner