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Kevin Stevenson
Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West VIC 8007

7 May 2012

Dear Kevin,

Invitation to comment on ED 223 Superannuation Entities

We are responding to your invitation to comment on the above Exposure Draft (ED) on behalf of PwC.

We welcome the opportunity to comment on the Board's proposals on this industry specific topic and we recognise the efforts that the Board has made in responding to the requests within the superannuation industry to address this important industry sector, incorporating feedback obtained in relation to the previous ED, *ED 179 Superannuation Plans and Approved Deposit Funds*.

Consistent with our submission relating to ED 179, we are broadly supportive of the ED that is built on the principles of the International Financial Reporting Standards (IFRS). However, we continue to have some concerns about the proposals in the ED, as outlined below.

Our detailed responses to the specific questions of the ED are in Appendix A to this submission.

Measurement of member benefits – defined benefit obligations

The accounting for member benefits under defined benefit plans continues to be one of the most contentious issues of the proposals in the ED. We understand the concerns of the industry and appreciate that a fund is not exposed to any liability in excess of what can be recovered from the sponsoring employer. However, in a going concern scenario, the fund will be required to settle the full obligation and has a fiduciary duty to attempt to obtain sufficient funds from the employer to do so. On that basis, we believe that the measurement of a defined benefit obligation should reflect the present value of the probable outflow of resources that will be required to settle this obligation and that the approach in AASB 119 *Employee Benefits* could be a pragmatic way of determining this amount.

Having said that, the measurement of defined benefit liabilities under AASB 119 does have some practical difficulties that the Board should be aware of in their re-deliberations of the proposals.

PricewaterhouseCoopers, ABN 52 780 433 757
Freshwater Place, 2 Southbank Boulevard, GPO BOX 1331L, MELBOURNE VIC 3001
DX 77 Melbourne, Australia
T +61 3 8603 1000, F +61 3 8603 1999, www.pwc.com.au

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Accrued benefits may be lower than vested benefits

For example, we note that there may be situations where the accrued benefits under AASB 119 may be lower than vested benefits, as AASB 119 focuses solely on recognising the amount payable on retirement over the service period and does not consider recognising a minimum amount for vested benefits at any point in time. Settlement losses (or gains) are only recognised under AASB 119 when the settlement occurs.

Vested benefits are commonly based on the higher of the actual contributions paid into the fund and the notional contributions that reflect minimum superannuation guarantee contributions (SGC), plus the actual returns achieved in relation to either of those contributions. Vested benefits may be higher than accrued benefits as a result of the discounting that is applied to accrued benefits, current service cost being lower than the SGC or high actual returns on plan assets. As a general rule, vested benefits are more likely to exceed accrued benefits in the earlier stages of a DB plan rather than when the members are close to retirement.

The increase in the superannuation guarantee contribution from 9% to 12% will result in a further increase in vested benefits and hence could exacerbate the issue described above. That is, the trustee may be reporting a deficit on vested benefits to the Australian Prudential Regulation Authority (APRA) but show a surplus for financial reporting purposes. We note that the IASB did consider this issue when IAS 19 was first released but decided against the recognition of an additional minimum liability in the context of employer-sponsors (IAS 19 *Employee Benefits* BC63-BC65).

If the AASB decides to retain the approach proposed in the ED in relation to defined benefit obligations, it would be helpful if the Basis for Conclusions would discuss this issue and explain why the Board believes that accrued benefits measured under AASB 119 remain the most appropriate measurement basis.

Master trusts and industry funds

Over recent years, many existing defined benefit funds have been transferred into master trusts or industry funds with defined benefit sub-plans such that there are now only a limited number of stand-alone defined benefit funds remaining. We are concerned that the ED does not give sufficient consideration to the special characteristics of master trusts and industry funds with defined benefit sub-plans and the challenges that arise for preparers of their financial reports. We therefore recommend the Board considers carefully how these application difficulties could be addressed.

For example, the surplus or deficit in net assets that is disclosed in the equity of a master trust or industry fund will be an aggregated amount which combines the surpluses and deficits of the individual sub-plans. As these amounts cannot legally be offset, the presentation of a net amount is unlikely to be useful information for members. More useful information would be a breakdown of the amounts by sub-plan, but we recognise the problems in imposing such a disclosure, particularly for funds with large number of sub-plans.

While we note that the Illustrative example on page 42 of the ED discloses a breakdown by sub-plan in the statement of financial position, there is no explicit requirement in the standard to disclose this information and this presentation will be impractical where there are more than just a handful of sub-plans, as is the case with most master trusts and industry funds. In this case, note disclosure would be the only other option, but again likely to be impractical for funds with a very large number of sub-plans.

Similarly, in order to provide useful information to members, the disclosures required under paragraphs 34/35 of the ED would also have to be provided by individual sub-plan, as different sub-plans will have different reasons for a deficit or surplus and also different agreements in relation to them. This all could result in lengthy note disclosures making it difficult for individual members to identify what is relevant to them.

We are also aware that industry participants are concerned about the costs involved in determining the necessary data, since master trusts and industry funds do not currently get sufficiently detailed information on an annual basis. AASB 119 valuations undertaken for employers may be for different reporting dates and use different assumptions and hence may not be usable for the fund's annual report.

Insurance arrangements

We concur with the position taken in the ED that where a superannuation plan provides benefits that meet the definition of an insurance contract, the liability arising from the arrangement should be accounted for in accordance with the principles set out in AASB 119.

We note from our involvement in discussions within the industry, however, that there is some confusion over the definition of an agency arrangement as referred to in AG20. For example, is the fund acting as an agent if it offers group insurance cover, reinsures the risk with a registered insurer and is only required under the deed to make a payment to the member once it has received payment from the insurer? We understand that the entity would be acting in the capacity of an insurer in this case, as it is providing the insurance in its own name, and hence should recognise an insurance liability and a reinsurance asset. However, it would be useful if the AASB could provide some further clarifications on these points in the Basis for Conclusions.

We also noticed that the ED continues to refer to AASB 1038 *Life Insurance Contracts* in relation to the accounting for reinsurance assets. While we understand that this is meant to ensure the reinsurance assets are measured on the same basis as the associated liabilities, this is not immediately apparent from AASB 1038. Furthermore, not many preparers (or users) of superannuation financial reports are familiar with the requirements of AASB 1038 and there are concerns in the industry about the additional level of training that may be required. To address this concern, the we suggest that the Board considers replacing the reference to AASB 1038 with a statement that reinsurance assets should be measured on the same basis as the liability, adjusted as necessary for the extent of cover provided by the reinsurance.

Consolidation

We continue to recognise the concerns of the industry that, in many cases, the preparation of consolidated financial statements provides limited additional decision useful information. Fund members are primarily interested in the value of the investments held by the fund, regardless of the ownership interest held.

While *ED 220 Investment Entities* proposes to exempt investment entities from consolidation, the exemption would not apply to many superannuation entities since they are not unitised, which is one of the proposed conditions for the exemption. Non-unitised superannuation funds would therefore be treated quite differently to managed investment schemes and superannuation funds which are unitised, even though both types of entities may manage their investments on the same basis. This would be inconsistent with the AASB's policy of transaction neutrality. If the proposals in ED 220 are approved without change, we recommend that the AASB includes a similar exemption from consolidation in the standard for superannuation entities.

If the AASB decides not to exempt superannuation entities from the consolidation requirements, we would urge the Board to reconsider the requirement to measure acquired intangible assets at fair value (paragraph 21 of the ED). AASB 138 *Intangible Assets* only permits the use of the revaluation model if there is an active market for the particular types of assets and notes that this will only rarely be the case. We do not believe that there is sufficient justification to depart from the principles in AASB 138 and treat superannuation entities differently to all other entities that are reporting under IFRS. This would be inconsistent with the Board's policy of transaction neutrality and would also not be warranted on cost-benefit grounds.

Financial statements

We continue to believe that a statement of changes in equity does not have the same importance and relevance for superannuation entities, on the basis that members' funds or reserves are not considered to be equity. Trust deeds and rules typically refer to assets, member liabilities and reserves and give no mention to terminology such as shareholders and equity. Since the only equity balances that superannuation commonly have are reserves, the statement could be renamed to "Fund reserves", "Amounts not yet allocated to members" or a similar description, as permitted under AASB 101 paragraph 10. In addition, we recommend giving superannuation entities the option of providing the information in the notes rather than presenting it in the form of a primary financial statement.

We would welcome the opportunity to elaborate on our views if you wish. Please contact me on (03) 8603 3868 or David Coogan on (03) 8603 3841 if you would like to have a discussion.

Yours sincerely,

Jan McCahey

Jan McCahey
Partner
Assurance

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Appendix A: Specific matters for comments

The AASB would particularly value comments on the following:

a) Are there any superannuation entities that would meet the criteria for applying Tier 2 disclosure requirements?

We believe that the only superannuation entities that may meet the criteria for applying tier 2 disclosure requirements would be Self Managed Superannuation Fundss and Small APRA Funds as per Appendix B of AASB 1053. Since these entities are also likely to be non-reporting entities, they will therefore be able to decide which of the disclosures in the standard are required for the users of their financial statements. On that basis, it will not be necessary to specify tier 2 disclosures in the superannuation standard.

However, this is only appropriate while the reporting entity concept as we know it is still in place. Should the AASB decide in the future to remove the reporting entity concept, all superannuation entities will be required to provide all of the disclosures in the proposed standard, regardless of whether they are publicly accountable or not, and whether users of the financial statements would require this kind of information. We therefore ask the Board to review the application of the disclosures to non-publicly accountable superannuation entities should the reporting entity concept be removed at a future point in time.

b) Are there any significant practical difficulties that would inhibit a superannuation entity disclosing:

Information about defined contribution or defined benefit members' benefits in accordance with the relevant principles and requirements in the AASB7: Financial Instruments: Disclosures

The majority of superannuation entities currently disclose their vested member benefits as a current liability within the AASB 7 note disclosures, deeming them to be transferrable to another entity within the industry at any given time. As such, we do not believe that any practical difficulties exist, other than those raised in the covering letter in relation to the measurement of the liabilities in general.

In relation to defined benefit members, qualitative information about non-performance risk and/or economic dependency risk to which the plan is exposed in respect of employer sponsors of such members

We agree that is important to disclose how the process relating to surplus, deficit and funding requirements is managed by the superannuation entity and we are comfortable with the proposed qualitative disclosure requirements proposed in paragraph 39 of the ED in relation to the credit risk disclosures. However, there are concerns within the industry that the application of AASB 7 would also require disclosure of the credit ratings of participating employers, which is not information that is commonly obtained by trustees.

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It would seem that the reason for the confusion is partly because the disclosure requirements in the ED overlap with those in other standards, in particular AASB 7. We do not believe that disclosure of specific information such as employers credit ratings would be required under AASB 7 (unless this is information that is provided internally to fund management), but it would be helpful if the AASB could clarify in the Basis for Conclusions which requirements apply to which items in the balance sheet and income statement.

Liquidity risks relating to any non-financial liabilities other than tax liabilities held by the entity

Typically, superannuation entities do not have any non-financial liabilities and we therefore do not believe that this disclosure would apply to many superannuation entity financial reports.

Disaggregated financial information based on the principles and requirements of AASB8 Operating Segments

We note from discussions within the industry that there could be some diversity in the disclosures arising from the implementation of AASB 8 *Operating Segments* for superannuation entities, mainly because the disclosures could be either product driven (e.g. MySuper, accumulation, defined benefit and pensions) or investment driven (e.g. by investment choice).

However, we would expect most disclosures to be on a product-line basis and we have provided a potential example of what such disclosures could look like, at a basic level, within Appendix B to this submission.

c) Would it be reasonable to require retrospective application of the replacement standard for AAS25 to annual reporting periods beginning two years from the date of issuing that standard?

We agree that an application date of two years from the date of issuing the standard should give the industry sufficient lead time to allow retrospective application and the associated restatement of comparatives.

d) Overall, would the proposals result in general purpose financial statements that would be useful to members?

Subject to our specific concerns raised above, we believe that the current ED would result in financial statements that would be more useful to members.

e) Are the proposals in the best interest of the Australian economy?

Overall, we believe that the replacement of AAS 25 with a standard that is built on the principles of International Financial Reporting Standards is in the best interest of the Australian economy.

f) In quantitative or qualitative terms, what are the costs and benefits associated with the proposals?

The requirement to measure the defined benefit obligations under AASB 119 on an annual basis could be costly for entities such as large master trusts.

Editorial and other comments

Paragraphs 6 and 7 are identical and paragraph 7 should be deleted.

We have noticed that purchases and sales of investments are shown gross in the example statement of cash flow for a hybrid superannuation plan in Appendix C of the ED. This has been interpreted by some to mean that the exemption provided in AASB 107 paragraph 22 to report cash flows on a net basis does not apply to superannuation entities. It would be helpful if the AASB could amend the example to show the cash flows on a net basis, since this is probably the more common scenario. A footnote could clarify that the cash flows have been offset based on the assumption that the conditions for offsetting in AASB 107 paragraph 22 are satisfied .

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Appendix B – Illustrative segmental information disclosure

Note X: Segment information

a) Description of segments

Management report to the Trustee (the chief operating decision maker) on the investment income, expenses, financial assets and liabilities at an investment option level. The following operating segments are based on the reports reviewed by the Trustee.

b) Segment information provided to the chief operating decision maker

The following information was provided to the Trustee for the year ended 30 June 200x:

	DB section $'000	Accumulation section $'000	MySuper section $'000	Pensions section $'000	Total $'000
Interest	x	x	x	x	**x**
Dividend income	x	x	x	x	**x**
Distributions from unit trusts	x	x	x	x	**x**
Change in the net market value of investments	x	x	x	x	**x**
Total segment income	**x**	**x**	**x**	**x**	**x**
Insurance premiums	x	x	x	x	**x**
Trustee fees	x	x	x	x	**x**
Adviser fees	x	x	x	x	**x**
Total segment expenses	x	x	x	x	**x**
Investment assets	x	x	x	x	**x**
Member liabilities	x	x	x	x	**x**

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c) Other segment information

Reportable segment income is reconciled to total investment income as follows:

	200x	200y
	$'000	$'000
Total segment income	x	x
Other investment income	x	x
Total investment income	**x**	**x**

Reportable segment expenses are reconciled to total expenses as follows:

Total segment expenses	x	x
Other expenses	x	x
Total expenses	**x**	**x**

Reportable segment assets are reconciled to total assets as follows:

Investment assets	x	x
Cash and cash equivalents	x	x
Receivables	x	x
Deferred tax assets	x	x
Other assets	x	x
Total assets	**x**	**x**

Reportable segment liabilities are reconciled to total liabilities as follows:

Member liabilities	x	x
Income tax payable	x	x
Other payables	x	x
Total liabilities	**x**	**x**