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8 May 2012

Mr Kevin Stevenson
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Re: Exposure Draft ED 223 Superannuation Entities

We are pleased to respond to the Australia Accounting Standards Board (AASB) Exposure Draft (ED) 223 *Superannuation Entities*.

We acknowledge the AASB's objective to revisit the financial reporting requirements applicable to superannuation entities in the light of developments in the superannuation industry since AAS 25 was originally developed, and we welcome the AASB's attempt to align reporting by superannuation entities with other entities applying Australian Accounting Standards.

However, in our opinion the AASB should wait for the finalisation of the International Standards Board (IASB) proposal in IASB's ED /2011/4 *Investment Entities* before finalising its project. The guidance proposed in ED/2011/4 may be relevant for some superannuation entities which otherwise would be in the scope of the guidance proposed in ED 223. We are concerned that the AASB has not elaborated in sufficient detail whether guidance proposed in ED/2011/4 should apply to superannuation entities and, before doing so, should not finalise any diverse accounting guidance.

With regard to superannuation entities to which the guidance proposed in ED 223 would apply, we have concerns about some practical difficulties in applying the reporting requirements by preparers and in turn users understanding the reported information. In particular we see significant practical challenges with the proposed use by superannuation entities of the defined benefits guidance in AASB 119. We further believe that the proposed presentation of financial statements may not always meet users' information needs and that the proposed terminology may be misinterpreted.

Our detailed comments and answers to the questions on the ED 223, along with other comments and suggested changes, are included in the following appendices to this letter:

- Appendix A - Responses to the Specific Maters for Comment
- Appendix B – Additional comments on the proposals

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If you have any questions concerning our comments, please contact Tony Brain on (03) 9671 7149 or Rosie Pollard on (03) 9671 7895.

Yours sincerely

Deloitte Touche Tohmatsu

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Appendix A - Responses to the Specific Maters for Comment

Are there any superannuation entities that would meet the criteria in AASB 1053 *Application of the Tiers of Australian Accounting Standards* for applying Tier 2 disclosure requirements, that is, they need to prepare general purpose financial statements but do not have 'public accountability' [as defined in AASB 1053]?

We have not identified any superannuation entities that meet the criteria in AASB 1053.

The ED does not include any specific disclosure requirements for superannuation entities that are wholly backed by life insurance policies. Under paragraph 66 of AAS 25 the general purpose financial reports of superannuation plans whose only assets (other than temporary deposits at call with a bank) are endowment, whole of life or other long-term insurance policies which match and fully guarantee the benefits to be paid to individual members need only to report:

a) that such policies are in place;
b) whether those policies have been fully maintained as directed by the insurer(s);
c) the identity of the insurer(s);
d) amounts contributed by employers and members during the reporting period;
e) where all amounts contributed by employers and members during the reporting period are not paid as premiums, the premiums paid to insurers during the reporting period; and
f) expenses of the plan incurred by the trustees during the reporting period.

Whilst these plans do not meet the AASB 1053 criteria for Tier 2 disclosure requirements, it is our experience that such plans have legacy systems which will not enable the preparation of Tier 1 general purpose financial statements. The reengineering of systems to enable the preparation of a full set of general purpose financial statements would be a costly exercise and given the nature of the plans would be of limited value. Consideration should be given to including similar exemptions for paragraph 66 superannuation entities in the revised standard as currently exist in AAS 25.

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 AASB 7 *Financial Instruments: Disclosures* [as proposed in paragraphs 37, 38 and AG27 – AG28 of this Exposure Draft]?

AASB 7 requires disclosure around credit risk, liquidity risk and market risk. More guidance is required as to the type of disclosure which is required. The current guidance indicates that disclosures must be made in regards to the "relevant" principles and requirements of AASB 7. Determination of what is "relevant" is likely to differ across superannuation entities resulting in little or no synergy in reporting.

Are there any significant practical difficulties that would inhibit a superannuation entity disclosing, 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 [as proposed in paragraphs 39 and 40 of this Exposure Draft]?

We do not agree that qualitative information should be disclosed with the purpose of providing users with a basis for understanding the non-performance risk and /or economic dependency risk to which a plan is exposed in relation to employer sponsors. Practical difficulties will include:

- Superannuation entities are unlikely to be in a position to demand information regarding the creditworthiness of employer sponsors which is not already publicly available.
- As noted in the basis for conclusions of ED 223 the required disclosure is the risk an employer sponsor will have difficulty in making contributions at a level that would be expected to permit the plan to meet members' accrued benefits. Providing such disclosure will put superannuation entities in the position of reporting on the viability of an employer sponsor.
- The introduction of explicit disclosure about the employer sponsor's financial status in the context of the superannuation entity could significantly increase the scope of the financial statement audit of the fund. This would in turn be likely to increase costs significantly and in many cases lead to significant practical difficulties in the conduct of the superannuation entity's financial statement audit.

Rather than include qualitative information regarding non-performance risk, greater disclosure around the funding at an employer specific (whole of plan or division) or sub plan level would be useful to enable users of the financial statements to assess the solvency of the plan in the context of that particular component of the fund. As indicated at AG27 of ED 223 disclosure as to whether the plan has a current Funding and Solvency certificate and the date that the certificate will expire will also provide users with an understanding of the superannuation entity's capacity to meet its obligations to members.

Are there any significant practical difficulties that would inhibit a superannuation entity disclosing liquidity risks relating to any non-financial liabilities other than tax liabilities held by the entity [as proposed in paragraphs 41 and 42 of this Exposure Draft]?

Superannuation entities generally do not have material non-financial liabilities. In the instance where a material non-financial liability does exist the superannuation entity should have ready access to information to enable it to disclose information in regards to the exposures to risk and its methods for managing and measuring the risk. It should also have ready access to information to enable a maturity analysis as required by paragraph 39 of AASB 7.

Are there any significant practical difficulties that would inhibit superannuation entity disclosing disaggregated financial information based on the principles and requirements of AASB 8 *Operating Segments* [as proposed in paragraphs 43, 44 and AG31 of this Exposure Draft]?

Under the proposed standard superannuation entities will need to identify who performs the chief operating decision maker role and document the risks, financial position and performance of each of the operating segments as seen through that person's eyes. Segments should be reported where their measurable component is 10% of the respective total across all segments.

We agree that disaggregation is appropriate, in particular where there is a hybrid fund – information specific to defined benefit, accumulation and pension segments would be useful. Also, where there are a number of sub plans, reporting in relation to the funding for each sub plan and the liability for accrued benefits would be useful.

However we acknowledge that the circumstances of each superannuation entity must be considered.

Difficulties include:

- Defining disaggregated groups that are of value to the users of the financial statements particularly where the superannuation entity is a master trust or industry fund with a large number of employer sponsors. For instance reporting accrued benefit liability at a sub plan level may be of limited use to the users of the financial statements

when their sub plan accounts for less than 10% of the accrued benefit liability resulting in it being grouped with other sub plans and not individually reported.

- The type of information reported at a disaggregated level would differ on a plan by plan basis so there would be no comparability across superannuation entities.
- Aggregation of the information across different groups, i.e. defined benefit amounts from different sub plans would not provide useful information; and
- Superannuation entities will need to modify systems to enable a profit to be reported for each segment.

A cost benefit analysis will need to be made on a plan by plan basis and the practicalities of providing segment reporting considered.

Would it be reasonable to require retrospective application of the replacement Standard for AAS 25 to annual reporting periods beginning two years from the date of issuing that Standard?

Superannuation entities will need to assess what system changes will be required to enable the financial information to be obtained in an appropriate format. Consideration will also need to be given to what additional information is required to meet the new disclosure requirements particularly in regards to the preparation of segment information. These changes will need to be in force to enable comparative financial information for prior periods to be generated. If actuarial valuations for defined benefit obligations and insurance liabilities become a requirement under the final standard 3 years may be more reasonable to enable superannuation entities to be ready, otherwise we agree 2 years is sufficient.

In addition, we recommend that the early adoption of the standard be allowed.

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

We agree that the proposals will result in general purpose financial statements that would be useful to users except in relation to the areas we have discussed above and Appendix B, being:

- the requirement to assess and report on the creditworthiness of employer sponsors;
- the requirement for disaggregated information;
- the requirement for superannuation entities which are effectively acting as “investment entities” to prepare consolidated accounts; and
- the requirement for defined benefit liabilities to be measured in accordance with AASB 119 Employee Benefits.

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

We support the alignment of the accounting standard with IFRS. In revising the standard we strongly recommend that the AASB align its efforts with APRA to ensure there are no inconsistencies in disclosures and reporting standards which may be introduced by Stronger Super and revised APRA Prudential Standards. We do have concerns about the following requirements for which we believe the costs of complying will outweigh the benefits being:

- the requirement to assess and report on the creditworthiness of employer sponsors;
- the requirement for disaggregated information;
- the requirement for superannuation entities which are effectively acting as “investment entities” to prepare consolidated accounts; and
- the requirement for defined benefit liabilities to be measured in accordance with AASB 119 Employee Benefits.

Our concerns in relation to these requirements are outlined above and in Appendix B.

In quantitative or qualitative terms, unless already provided in response to specific matters for comment above, what are the costs and benefits associated with the proposals?

Considerable costs will be borne by superannuation entities in implementing system changes to enable the new measurement and disclosure requirements to be introduced, in particular with the measurement of defined benefit liability for defined benefit funds and preparation of consolidated accounts. In both these areas and the areas noted above in regards to assessing the credit worthiness of employer sponsors of defined benefit funds and providing disaggregated information we do not believe the benefits of providing the information will outweigh the costs.

Appendix B - Additional comments on the proposals

Measurement of defined benefit obligations

We agree that obligations for defined benefits accrued benefits should be recognised as liabilities but do not agree that they should be measured using the 'projected unit credit method' in accordance with the AASB 119 Employees Benefits for defined benefit obligations. We believe that vested benefits should be used to measure the liability for defined benefit accrued benefit. Whilst we understand that as part of the consultative process on Exposure Draft 179 the AASB considered the arguments for the use of vested benefits and determined that the AASB 119 approach is more applicable we disagree with this finding.

Set out below are the key issues to the implementation of the AASB 119 approach and arguments in favour of using a vested benefit figure which have previously been raised by commentators in relation to Exposure Draft 179 and are still relevant:

- Use of the AASB 119 approach will introduce an additional measure on top of measures already used to determine the defined benefit liability, imposing an unnecessary cost on the superannuation entity:
  - vested benefits which is a key measure reported to APRA quarterly; and
  - the actuary's calculation of accrued benefits at least every 3 years to determine employer contribution rates.
- Vested benefits is already used as a solvency measure, compared to assets to determine if a plan is in an unsatisfactory financial position for the purposes of SIS.
- Vested benefit measurement is consistent with the liability measurement proposed for accumulation plans.
- Vested benefits are more likely to be understood by members and is the measure reported in individual member statements
- Whilst the AASB 119 liability is calculated for the employer sponsor using the same methodology, where the superannuation entity has a different year end to the employer sponsor additional costs will be incurred to calculate the liability as at the fund year end and there will be no comparability to the liability recorded in the employer's financial statements.
- Where the superannuation entity is a multi-employer plan there will be no comparability between the liability of the employer and the superannuation entity.
- For hybrid superannuation entities measurement would be different for the accumulation and defined benefit members.
- The vested benefit figure is more readily available after balance date and as the accrued benefit liability will need actuarial input and be reliant on getting timely membership data at the balance date, there will be significant practical difficulties. Delays in receiving actuarial valuations would delay completion of the financial statements, and delay member communication.
- Whilst there may be an adequate funding plan, individuals may perceive any deficit when the liability is compared to net assets as a solvency issue and may elect to leave the superannuation entity. In a hybrid scheme accumulation members may also feel at risk and leave the plan. Such outcomes are based on an arguably misrepresented situation in the financial statements.
- A situation could arise where there are negative equity/reserves in which case the APRA return would include a response of yes in regards to negative reserves. The shortfall in defined benefit members is required to be funded by the employer not the superannuation entity. This will be difficult to explain to members. There is also a requirement for the auditor to report deficiencies under Section 130 of SIS based on the annual audited financial statements. Such outcomes are based on an arguably misrepresented situation in the financial statements.

In continuing to use vested benefits as the measure of defined benefit liabilities there is a need for more transparency in the financial statements so members can understand the solvency/liquidity of their sub plans. In a hybrid plan accumulation members need to have the comfort that they are not funding a deficit within defined benefit sub plans. This could be partially addressed by requiring reporting at a disaggregated level of the vested benefits, defined benefit accrued liability (as calculated for funding and solvency purposes) and any plans in place to address deficits within individual sub plans.

Consolidation

During the consultation process for ED 179 concerns were raised in regards to the proposed standard's requirement to consolidate collective investment vehicles. The AASB considered these arguments but concluded that most of the practical difficulties identified are not unique to superannuation entities and are encountered by many other entities including investment type entities and accordingly the consolidation requirement should remain.

In some instances a superannuation entity will clearly satisfy the definition of control and should consolidate controlled entities, for instance where a superannuation entity has established a special purpose entity, or where a PST is set up to hold the investments of the superannuation entity. In these circumstances the trustee board has governance over entity and control of the operational and financial policies clearly exists.

However, superannuation entities generally invest in collective investment vehicles (CIV) operated by fund managers and overseen by third party trustees and responsible entities who have ultimate responsibility for those CIV's operations and activities (including investment activities) in order to benefit from the efficiencies of pooling investment monies with other investors and obtain the expertise of the fund manager. The Trustee or the Responsible Entity of the CIV are not related to the trustee of the superannuation entity which acts as a passive investor not involved in the day to day operation of the CIV. If the superannuation entity Trustee is not happy with the performance of the CIV, the superannuation entity Trustee would generally redeem units rather than step in and change the CIV Trustee, responsible entity or fund manager. In circumstances such as this, it is the fair value of the investments that the users of the financial statements are interested in.

Difficulties in consolidating CIVs include identifying controlled entities, monitoring changes in the holdings throughout the year and in obtaining relevant, reliable and timely information from the CIVs to enable consolidation.

The IASB's ED/2011/4 Investment Entities which was released in August 2011 provides exemptions from consolidation for entities that meet certain criteria:

- The entity's only substantive activities are investing in multiple entities to achieve capital appreciation, earn investment income or both
- The entity's business purpose is investment to earn capital appreciation, investment income, or both and it makes an explicit commitment to investors about this
- Investors own units of investments in the entity
- The entity pools the funds it receives from its investors
- The entity manages and evaluates the performance of its investments on a fair value basis
- The entity provides financial information about its investment activities to its investors.

The investment entities whose circumstances the AASB likened superannuation funds to in considering the requirements to consolidate are now likely to obtain an exemption. We recommend the AASB wait for the outcome of IASB ED/2011/4 before finalising the consolidation requirements for superannuation entities.

Once IASB ED/2011/4 is finalised similar exemptions from consolidation provided to managed investment schemes and other investment entities should also be provided to superannuation entities. The requirement for investors to own units of investments in the entity would currently preclude superannuation entities which are not unitised. Alternative criteria should be outlined in ED 223 to enable superannuation entities to obtain the investment entity exemption in circumstances where they are purely investing to obtain investment income and/or capital appreciation.

Guidance will need to clearly identify factors that would continue to constitute control so as not to dilute the requirements for superannuation entities to consolidate where active control does exist; i.e. a controlled PST.

Insurance Arrangements

Trustees that self-insure are exposed to insurance risk and we agree that liabilities arising from insurance arrangements provided to members should be recognised in accordance with the approach in AASB 119 for defined benefit obligations. Where 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.

Financial Statements

We recommend that the five proposed financial statements be reduced to three, being a Statement of Comprehensive Income, Statement of Financial Position and Statement of Cash Flows.

We recommend that the Income Statement be combined with the Statement of Changes in Members Benefits and presented as a Statement of Comprehensive Income. Users of the financial statements would better understand a Statement of Comprehensive Income as it is has a similar flow to the existing format of member statements.

The reserves of a superannuation entity are ultimately available for the benefit of the members and are more akin to a liability than equity. Rather than present a Statement of Changes in Equity we believe a note to the financial statements detailing the changes in individual reserves is more appropriate.

KMP Disclosure

As was highlighted at the roundtable discussions, information about remuneration of key management personnel (KMP) is often lacking and is inconsistent across superannuation entities. In circumstances where KMP are not remunerated specifically for their management role in regards to the superannuation entity but as an employee of a company for which their role encompasses amongst other things management of the superannuation entity, KMP remuneration is often not disclosed at all. We agree that the AASB should take the opportunity in issuing a new standard to tighten disclosure around KMP so there is an appropriate level of disclosure across the industry.