

**This Agenda Paper discusses:**

- (a) the treatment of contributions and benefit payments; and**
- (b) how the definitions of revenue and expense in Australian Accounting Standards could be applied,**

**under a replacement Standard for AAS 25 *Financial Reporting by Superannuation Plans*.**

## Background

1. Currently, under AAS 25 *Financial Reporting by Superannuation Plans*, superannuation plans treat employers' and members' contributions as revenues. Paragraph 29 of AAS 25 states, in part, that:

“Revenues of a superannuation plan may include investment revenue, contributions revenue and other revenue.... Contributions revenue will include members' and employers' contributions, gross of any tax...”
2. A number of Board members have indicated that consideration should be given to whether the current treatment is appropriate. Accordingly, a purpose of this Agenda Paper is to consider, in light of the Board's decisions to date and the relevant requirements in Australian Accounting Standards, how contributions, transfers and rollovers should be treated under a replacement Standard for AAS 25.
3. It is also relevant to note that paragraph 61(i) of AAS 25 requires that a defined benefit plan disclose the benefits it has paid during a reporting period in its statement of changes in net assets. Because a statement of changes in net assets includes items that would not be included in an income statement (such as revaluation increments and decrements relating to property, plant and equipment measured at fair value), it could be considered equivalent to a statement of comprehensive income. Accordingly, this Agenda Paper considers how benefit payments should be treated under a replacement Standard for AAS 25.
4. The current treatment of contributions and benefit payments highlights a potentially significant issue in relation to the application of IFRSs to a superannuation plan or approved deposit fund (ADF). The definition of revenue in AASB 118 *Revenue* and the definition of an expense in the *Framework* are both premised on the recognition of equity. However, some superannuation plans and ADFs do not recognise any equity. Accordingly, this Agenda Paper also considers how the definitions of revenue and expense in IFRS could be applied by a superannuation plan or ADF to facilitate the classification of items that would normally be regarded as revenue or expense items.

### **The treatment of contributions, transfers and rollovers under a replacement Standard for AAS 25**

5. Paragraph 7 of AASB 118 defines revenue as:

“...the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants.”
6. On the basis of the definition, a contribution, transfer or rollover would only be presented as revenue by a superannuation plan or ADF in the context of IFRS if it:
  - (a) resulted in an increase in the equity of the plan or ADF; and
  - (b) did not come from an equity participant in the plan or ADF.

However, as discussed below, all contributions, transfers and rollovers to a superannuation plan or ADF either do not result in an increase in liabilities or are in the nature of contributions by equity participants.

*Contributions that result in an increase in liabilities*

7. At its April 2008 meeting, the Board agreed that members' accrued benefits are a liability of a superannuation plan or ADF. Accordingly, any contribution, transfer or rollover to a superannuation plan or ADF that fully vests in a member would not be revenue of the entity under IFRS because the contribution would result in an increase liabilities rather than equity.
8. Contributions that fully vest in a member include:
  - (a) Superannuation Guarantee (SG) contributions (including SG shortfall amounts);
  - (b) employer contributions in excess of SG contributions and in respect of defined contribution members;
  - (c) member contributions (salary sacrificed and after tax contributions);
  - (d) Government co-contributions; and
  - (e) contributions in respect of a child.

Accordingly, apart from employer contributions in respect of defined benefit members, all contributions currently fully vest in a member.

9. Transfers and rollovers are treated as member contributions by the receiving superannuation plan or ADF and therefore fully vest in a member. Accordingly, transfers and rollovers received would not be revenue of the receiving superannuation plan or ADF under IFRS because the contribution would result in an increase liabilities rather than equity.

*Contributions by equity participants*

10. As discussed in Agenda Paper 4.2 to the Board's December 2008 meeting, to be an equity holder in a superannuation entity, an employer sponsor would arguably have to hold a residual interest in the net assets of the entity. While the trust deeds of some plans with defined benefit obligations detail an employer sponsor's rights over any defined benefit surplus as well its obligations in relation to any deficiency, most are silent on the issue. Accordingly, if a superannuation plan's trust deed;
  - (a) specifies that the employer sponsor has rights over any defined benefit surplus, employer contributions would arguably relate to 'equity' participants and therefore would not be revenues under IFRS;
  - (b) specifies that any defined benefit surplus could only be used for the benefit of relevant members, employer contributions would result in an increase in liabilities rather than equity. Accordingly, in these circumstances employer contributions would not be revenues under IFRS; and
  - (c) is silent with respect to the employer sponsor's rights over any defined benefit surplus, it would be necessary to determine whether any informal practices

have been adopted that establish whether a surplus would normally be returned to the employer sponsor or be used to fund members' benefits. Nevertheless, because members and employers are the only stakeholders in a superannuation plan, employer contributions would not be revenues for the reasons identified in either (a) or (b) above.

*The implications of contributions, transfers or rollovers not being revenues*

11. As noted in Agenda Paper 4.2 to the Board's December 2007 meeting, AAS 25 requires a defined contribution plan to present a statement of cash flows, but does not require a defined benefit superannuation plan to present such a statement. Furthermore, a superannuation plan is not currently required to apply AASB 101 *Presentation of Financial Statements* with respect to the presentation of a statement of changes in equity or equivalent thereof. Accordingly, in this context, presenting contributions, transfers and rollovers as revenues under AAS 25 ensures that all superannuation plans disclose these items in a consistent manner.
12. During its December 2007 meeting, the Board agreed, among other things, that:
  - (a) the current exemption in relation to the presentation of a statement of cash flows by a defined benefit superannuation plan should not be retained. Accordingly, each superannuation plan and ADF should present a cash flow statement in accordance with AASB 107 *Cash Flow Statements*; and
  - (b) a residual interest in the net assets of a superannuation plan or an ADF should be classified as equity and disclosed in accordance with the relevant requirements in AASB 101.

As these Board decisions will facilitate the separate disclosure of contributions, transfers and rollovers by a superannuation plan or ADF, staff consider there to be no substantive reasons for retaining the current approach.

***Staff view 1***

Staff consider that neither contributions, transfers nor rollovers to a superannuation plan or ADF are revenues as defined in AASB 118 *Revenue*. Accordingly, the current requirement in AAS 25 to present contributions, transfers and rollovers as revenues should not be retained.

**The treatment of benefit payments under a replacement Standard for AAS 25**

13. As noted above, paragraph 61(i) of AAS 25 requires a defined benefit plan to disclose benefits paid during a reporting period in its statement of changes in net assets. However, benefit payments are arguably not expenses as defined in the *Framework*.
14. Paragraph 70(b) of the *Framework* states that:

“Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletion of assets or incurrences of

liabilities that result in decreases in equity, other than those relating to distributions to equity participants.’

15. Consistent with the foregoing discussion, benefit payments are not expenses because they are in the nature of payments to members, whose interests represent liabilities of a superannuation plan or ADF. Accordingly, benefit payments by a superannuation plan or ADF:
  - (a) do not result in decreases in the equity of the entity; and
  - (b) are not distributions to equity participants.

*The implications of benefit payments to defined benefit members not being expenses*

16. There are a number of arguments in favour of treating benefit payments to defined benefit members as expenses under AAS 25, including:
  - (a) to facilitate the disclosure of benefits paid by all superannuation plans and ADFs. Because defined benefit superannuation plans are not required to present a statement of cash flows or an equivalent of a statement of changes in equity under AAS 25, some plans might not disclose their benefits paid; and
  - (b) to facilitate contributions and benefit payments being treated in a consistent manner by all superannuation plans and ADFs.

However, as the Board’s December 2007 decisions in relation to the application of AASB 107 and AASB 101 will facilitate the separate disclosure of benefit payments, staff consider there to be no substantive reasons for retaining the current approach.

***Staff view 2***

Staff consider that benefit payments are not in the nature of expenses as defined in the *Framework*. Accordingly, consistent with Staff view 1, staff consider that the current requirement in AAS 25 to present benefit payments to defined benefit members as expenses should not be retained.

**The implications for a superannuation plan or ADF applying the definition of revenue in AASB 118 and the definition of an expense in the *Framework***

***Classification***

17. As noted above, the definition of revenue in AASB 118 specifies that revenues arise when an inflow results in an increase in equity. The *Framework* specifies that an expense arises when an outflow results in a decrease in equity. Accordingly, both definitions are potentially problematic in the context of defined contribution superannuation plans that have no equity or ADFs. That is, entities that typically do not have equity may not be able to present any inflows as revenues or outflows as expenses.
18. A defined contribution superannuation plan may recognise ‘equity’ in the form of a difference between the plan’s assets and members’ accrued benefits when an employer sponsor has made superannuation contributions in excess of its SG

obligations and/or its obligations under the relevant industrial award that are subject to a progressive vesting scale. However, because very few superannuation plans have unvested benefits in respect of defined contribution members, and employer contributions in respect of defined contribution members now fully vest in a member, most defined contribution plans do not recognise any 'equity'.

19. Because ADFs are not permitted to receive any employer or member superannuation contributions, they are not capable of recognising a residual interest in their net assets in the form of either unvested benefits or a defined benefit surplus or deficiency.
20. Notwithstanding that some superannuation plans and ADFs do not recognise equity, staff consider the definition of revenue in AASB 118 and the definition of an expense in the *Framework* to be adequate to facilitate the recognition of 'revenue' and 'expense' items by a superannuation plan or ADF.
21. In contrast to contributions, transfers and rollovers, inflows from investment activities (such as dividends, interest revenue and capital gains) do not vest in a member when received or accrued by a superannuation plan or ADF. Returns from investment activities only vest in a member when they are credited by the trustee to a member's account, which may be some time after the receipt or accrual. Consistent with the definition of revenue in AASB 118, investment returns would cause an increase in a superannuation plan's or an ADF's assets, but do not initially alter members' benefits. Accordingly, dividends, interest revenue and capital gains can be considered to be revenues of a superannuation plan or ADF in accordance with AASB 118.
22. When returns from investment activities are credited to a member's account, the 'equity' that had previously arisen is replaced by a liability. Some argue that, because returns from investment activities will eventually be credited to a member's account, they are effectively liabilities when recognised by the superannuation plan or ADF. However, not all investment returns are credited to a member's account. The trustees of some superannuation plans and ADFs credit the majority of returns from investment activities to member's accounts and the balance is credited to a reserve account, which is used to pay administration and other expenses. Moreover, other non-superannuation investment vehicles, such as managed investment schemes, initially recognise returns from investment activities as 'equity', even when management intends that those returns will eventually be declared payable to unitholders.
23. Applying the same reasoning as used in relation to returns from investment activities, outflows other than benefit payments, such as operating costs, are expenses of a superannuation plan or ADF in accordance with the *Framework*. The costs associated with operating a superannuation plan or ADF are unlikely to be charged to a member's account at the same time as the cost is incurred. For instance, some superannuation plans and ADFs charge their members for administration services on a weekly basis whereas the fees payable to the administrator may accrue on a daily basis. Other operating costs, such as audit fees, are often charged to a member's account at the end of the year as a part of the final crediting rate. Accordingly, outflows other than benefit payments would cause a superannuation plan's or an ADF's assets to decrease but generally do not initially alter members' benefits.

24. It is relevant to note that the application of the definition of revenue in AASB 118 or the definition of expense in the *Framework* to a superannuation plan with defined benefit members would not raise the same types of concerns as those discussed above. This is because investment returns and expenditures do not alter a defined benefit member's accrued benefits. As discussed in agenda papers to past Board meetings, a defined benefit member's accrued benefits is the product of the member's salary at or near retirement, a benefit factor and the number of years of service the member has served with an employer or employers or else the number of years of membership of the plan. Accordingly, the recognition of, for instance, returns from investment activities would increase the assets attributable to the member but does not alter the plan's liability for members' benefits.

***Staff view 3***

Staff consider the definition of revenue in AASB 118 and the definition of an expense in the *Framework* to be sufficient to facilitate the recognition of investment income as 'revenue' and operating costs as 'expense' items by a superannuation plan or ADF.

***Proposed explanatory material***

25. Most constituents in the superannuation industry do not consider contributions, transfers and rollovers to be 'revenues', or benefit payments to be 'expenses', except that AAS 25 requires them to be treated as such. However, staff consider that the same constituents may be uncertain about the manner in which the definition of revenue in AASB 118 and the definition of expense in the *Framework*, particularly the references to 'equity', would apply to a superannuation plan or ADF.

***Staff view 4***

Staff consider that the Basis for Conclusions to the ED should provide an explanation of the Board's reasons for proposing changes to the current treatment of contributions, transfers, rollovers and benefit payments.

***Presentation***

26. While staff anticipate that most constituents will agree that contributions, transfers and rollovers are not 'revenues' and benefit payments are not 'expenses', the proposal to discontinue the current treatment is likely to raise significant concerns among constituents regarding the presentation of operating results, particularly in the context of Board decisions to date.
27. At its February 2008 meeting, the Board agreed to use the approach in AASB 119 *Employee Benefits* as a basis for developing a proposed treatment for the purpose of a replacement Standard for AAS 25. Accordingly, staff have assumed that changes in members' accrued benefits will be treated as income or expenses. This approach is consistent with:

- (a) the treatment of changes in a defined benefit obligation by an employer sponsor; and
  - (b) the Board's decisions in relation to the treatment of assets held by a superannuation plan or ADF.
28. However, treating changes in members' accrued benefits as income or expenses could potentially mean that:
- (a) superannuation plans that are predominantly defined contribution in nature and ADFs would recognise little, if any, operating profits because most, if not all, of the income and expenses recognised during a reporting period would be offset by changes in members' accrued benefits, which would include the profits or losses credited to members' accounts; and
  - (b) superannuation plans that are predominantly defined benefit in nature would recognise operating losses because they operate on the assumption that at least some of the increase in defined benefit members' accrued benefits will be offset by employer and/or member contributions.
29. Within the context of AASB 101, a superannuation plan or ADF could present additional line items, headings and subtotals in its statement of comprehensive income to distinguish its 'operating' performance (investment returns, investment expenses, administration costs, change in accrued benefits) from its 'overall' performance (change in net assets over the period, including benefits generated from operations and contributions). However, this approach may still be regarded by many constituents as inconsistent with providing decision useful information because some users, particularly relatively unsophisticated members and beneficiaries, may place undue emphasis on the 'operating' performance without considering the 'overall' performance.
30. Staff have identified the following two ways in which the presentation issues that are likely to arise from contributions, transfers, rollovers and benefit payments not being treated as revenues or expenses under a replacement Standard for AAS 25 could be dealt with.

**Approach A** – require changes in accrued benefits (including contributions, transfers and rollovers) to be presented as components of other comprehensive income. An advantage of this approach is that it would facilitate the presentation of a 'balanced' overall performance figure. However, a disadvantage of this approach is that items that are arguably not revenues and expenses as defined in Australian Accounting Standards would be presented in comprehensive income statements, thereby diminishing the comparability of the financial statements of superannuation plans and ADFs with other investment-type vehicles.

**Approach B** – require a superannuation plan or ADF to disclose changes in accrued benefits in a statement of changes in 'equity' (members' benefits), which would include contributions, transfers, rollovers and benefit payments. An advantage of this approach is that it would arguably facilitate a clearer presentation of 'operating' results in a statement of comprehensive income. In recent times, a number of articles have appeared in the press discussing the perception that the investment returns of superannuation plan lack clarity. By requiring superannuation plans and ADFs to disclose changes in members' accrued benefits separately from operating results in a

statement of changes in members' benefits, the comprehensive income statements of superannuation plans and ADFs would focus on operating items such as investment returns and administration costs. However, a disadvantage of this approach is that it is inconsistent with the Board's June 2008 decision not to require a superannuation plan to present a reconciliation of its defined benefit members' accrued benefits.

***Staff view 5***

On balance, staff consider Approach B to be a more appropriate approach to reporting changes in accrued benefits and operating results of a superannuation plan or ADF.