

This Agenda Paper discusses the merits of requiring a superannuation plan to disclose information in relation to the sensitivity of its defined benefit members' accrued benefits to changes in actuarial assumptions.

Background

1. At its June 2008 meeting, the Board agreed to give further consideration to the information that users would need to understand the impact of changes in assumptions used to measure the accrued benefits of defined benefit members on the measured amount. To this end, the Board directed staff to consult with constituents, particularly actuaries, regarding an appropriate way for a superannuation plan to disclose the sensitivity of defined benefit members' accrued benefits to changes in actuarial assumptions. Accordingly, this Agenda Paper:
 - (a) briefly discusses the main actuarial assumptions used to measure defined benefit obligations under AASB 119 *Employee Benefits* (paragraphs 2 – 3); and
 - (b) considers the views expressed by constituents to AASB staff in relation to the disclosure of information regarding the sensitivity of defined benefit members' accrued benefits to changes in actuarial assumptions (paragraphs 4 – 6).

Actuarial assumptions

2. Actuaries are required to make a number of demographic and financial assumptions for the purpose of measuring a defined benefit obligation under AASB 119. The main assumptions relate to:
 - (a) rates of member turnover, including disability and early retirement;
 - (b) the mortality rate;
 - (c) future salary levels;
 - (d) the inflation rate; and
 - (e) the discount rate.
3. Disability, early retirement and mortality rates, future salary levels and the inflation rate all tend to change relatively slowly and in a predictable manner, particularly over the medium to long term. Accordingly, the difference between actual and assumed experience in relation to these factors is usually negligible, particularly over the life of a defined benefit obligation. In contrast, member turnover and the discount rate are arguably relatively less easy to predict.

Constituents' views on actuarial assumptions and a sensitivity analysis

4. Staff spoke to a number of constituents, including members of the Project Advisory Group, on this topic. The constituents that we spoke to were generally:
 - (a) apprehensive about whether requirements could be drafted that would facilitate the provision of meaningful information regarding the sensitivity of defined benefit members' accrued benefits to changes in assumptions; and
 - (b) not convinced that a sensitivity analysis would provide any significant benefits to users.
5. These views were based on a number of factors, including:
 - (a) the interrelated nature of the main actuarial assumptions underlying the measurement of accrued benefits. Constituents noted that, if the ED adopted a

similar approach to that which is required for medical costs under paragraph 120A(o) of AASB 119, whereby an entity is required to disclose the effect on accrued benefits of, for instance, an increase or decrease of one percentage point in the discount rate, the disclosed information may mislead users, particularly members and beneficiaries.

Constituents noted that entities do not face the same types of issues when measuring medical benefit obligations as they do when measuring defined benefit obligations. For instance, an increase in an assumed medical cost trend of one percentage point would not necessarily lead to a change in other relevant assumptions, such as the discount rate. In contrast, actuarial assumptions are interrelated. As noted in paragraph 75 of AASB 119:

“Actuarial assumptions are mutually compatible if they reflect the economic relationships between factors such as inflation, rates of salary increase, the return on plan assets and discount rates. For example, all assumptions which depend on a particular inflation level (such as assumptions about interest rates and salary and benefit increases) in any given future period assume the same inflation level in that period.”

Accordingly, in order to provide a meaningful portrayal of the impact on accrued benefits of a change in an actuarial assumption, it would be necessary to consider how a change in one assumption would impact on other actuarial assumptions in order to quantify the overall impact on the defined benefit obligation. Constituents noted, however, that it might be difficult for some users, particularly members and beneficiaries, to understand and evaluate the complex interrelationships that exist between actuarial assumptions, and the possibly opposing or reinforcing effects that different assumptions can have on an accrued benefits figure.

Constituents also noted that entities would probably face the same types of issues if the approach in AASB 7 *Financial Instruments: Disclosures* in respect of fair value measurements were adopted for the purpose of the ED.

Paragraph 27(c) of AASB 7 states, in part, that:

“For fair values that are recognised in the financial report, if changing one or more of those assumptions to reasonably possible alternative assumptions would change fair value significantly, the entity shall state this fact and disclose the effect of those changes.”

Constituents noted that actuarial assumptions reflect the most likely outcomes with respect to demographic and financial factors. Accordingly, the disclosure of an outcome based on assumptions that are considered reasonably possible, but not sufficiently likely for the purpose calculating the liability for accrued benefits, may be difficult for some users to understand. Furthermore, constituents expressed concerns that the disclosure of an ‘alternative’ accrued benefits figure or information in relation to ‘alternative’ actuarial assumptions might undermine users’ confidence in the accrued benefits figure recognised in the financial statements;

- (b) the discount rate is generally regarded as an important actuarial assumption because it can have a significant impact on the obligation if it is calculated

incorrectly. Constituents noted that discount rates calculated under AASB 119 (yields on corporate or government bonds) tend to be less volatile than discount rates calculated under AAS 25 *Financial Reporting by Superannuation Plans* (estimated earnings rates). In addition, the move to a 'risk free' rate, as proposed by the Board, is likely to significantly reduce the expected volatility actuaries factor into their calculations of a discount rate under a replacement Standard for AAS 25. Accordingly, constituents queried whether a superannuation plan disclosing that its accrued benefits figure would, for instance, change by 5% as a consequence of a one percentage point change in its discount rate would be relevant or reliable information if such a change in the discount rate is considered unlikely to occur in the first place;

- (c) defined benefit entitlements tend to accrue gradually over time and are not generally prone to significant changes in the short term. In contrast, the value of a superannuation plan's assets can change dramatically in a matter of months. Accordingly, constituents consider that disclosures in relation to a superannuation plan's assets are likely to be more useful to users than information in relation to the sensitivity of the accrued benefit figures to changes in actuarial assumptions, particularly if users are interested in evaluating the capacity of a plan to pay members' benefits as and when they fall due; and
- (d) if information in relation to the sensitivity of accrued benefits to changes in assumptions is considered important to users in a superannuation context, logically it should also be considered important in the context of an employer sponsor. However, AASB 119 does not currently require an entity to disclose information regarding the sensitivity of its defined benefit obligations to changes in actuarial assumptions.

Staff view

In light of constituents' comments, particularly their comments regarding changes in accrued benefits and asset values discussed in paragraph 5(c), staff consider that information regarding the sensitivity of a superannuation plan's assets to market risks would arguably provide more relevant information to users than information regarding the sensitivity of defined benefit members' accrued benefits to changes in assumptions.

During its June 2008 meeting, the Board agreed that the requirements in AASB 7 *Financial Instruments: Disclosures* should be used as a basis for developing principles that would facilitate the disclosure of information in relation to the risks associated with the assets of a superannuation plan or ADF. Paragraphs 40 – 43 of AASB 7 require an entity to disclose, among other things, a sensitivity analysis for each type of market risk to which the entity is exposed. As the disclosure principles in the draft ED encompass the requirements in paragraphs 40 – 43 of AASB 7, staff do not recommend that the draft ED also propose that a superannuation plan also be required to disclose information regarding the sensitivity of its defined benefit members' accrued benefits to changes in actuarial assumptions.