

**This Agenda Paper discusses a number of ‘sweep’ issues identified by staff in preparing draft ED 16X *Superannuation Plans and Approved Deposit Funds*.**

### **Sweep Issue 1 – Benefits resulting from a constructive obligation that go beyond the formal terms of a plan**

1. There are a number of circumstances in which an employer sponsor might recognise a constructive obligation in relation to benefits provided by a superannuation plan, including a past history of providing benefit payments that are in addition to members' formal entitlements. This may occur, for instance, when an employer elects to mitigate the effects of inflation on a member's defined benefit entitlements.
2. It could be argued that, if an employer sponsor recognises a constructive obligation because it has a history of making additional contributions to its plan in order to, for instance, mitigate the effects of inflation, the superannuation plan should recognise an obligation. This is because superannuation benefits are generally paid in full by superannuation plans and employer sponsors rarely, if ever, pay members their superannuation benefits directly due to the taxation implications. However, this argument assumes that trustees are bound to act in a manner consistent with the employer sponsor rather than the members.
3. The recognition of a constructive obligation by an employer sponsor in respect of additional superannuation benefits does not necessarily impose a corresponding constructive obligation on a superannuation plan for the additional benefits because:
  - (a) additional benefits are usually funded by an employer sponsor on a 'pay-as-you-go' basis, whereby if it is likely a member that is potentially entitled to additional benefits will exit the plan, the trustee would notify the employer sponsor and request contributions to fund the members' additional benefits. In these circumstances, the additional benefits are more in the nature of a contingent liability of the plan. Paragraph 10 of AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* defines a contingent liability as:
    - “(a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
    - (b) a present obligation that arises from past events but is not recognised because:
      - (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
      - (ii) the amount of the obligation cannot be measured with sufficient reliability.”

As agreed by the Board at its May 2008 meeting, unless there is a specific contractual agreement between a superannuation plan and an employer sponsor, future contributions are not a receivable controlled by the plan. Accordingly, until the employer sponsor provides funding to cover any additional benefits to a member, the payment of additional benefits is a contingent liability in accordance with AASB 137; and

- (b) if the additional benefits are funded on a prospective basis, whereby the impact of inflation on members' benefits is factored into the level of employer

contributions, the trustee may not be obliged to pay the additional benefits to a member. For instance, if in particular circumstances the trustee decided that it is not in the best interests of all of the members of the plan to pay an exiting member their accrued benefits as well as any additional benefits promised by the employer sponsor, the trustee would not be obliged to pay the additional benefits on top of the member's accrued benefits. Accordingly, it may be argued that the plan has a contingent liability with respect to any benefits in addition to those prescribed in the plan's trust deed.

4. It is also relevant to note that a trustee does not have the same level of discretion over the payment of members' benefits as an employer sponsor. A trustee of a superannuation plan or approved deposit fund (ADF) is required to administer the trust deed of their plan or fund in the best interests of the members and in accordance with the relevant prudential requirements. Accordingly, a trustee of a superannuation plan that paid benefits to a member that were greater than the relevant benefits prescribed in the plan's trust deed, the trustee would arguably be acting in contravention of the trust deed and the prudential requirements, particularly the requirement to act in the best interests of all members of the plan.

***Staff view 1***

Staff consider that a constructive obligation of an employer sponsor for superannuation benefits that go beyond the formal terms of the plan potentially give rise to a contingent liability of a superannuation plan. Accordingly:

- (a) references to benefits that result from a constructive obligation that goes beyond the formal terms of the plan have been deleted in a number of paragraphs in draft ED 16X *Superannuation Plans and Approved Deposit Funds* that have been carried over from the corresponding paragraphs in AASB 119 (see paragraph 33(b), paragraph 35, the first sentence of paragraph 36, paragraphs 40(b) and (c) and paragraph 12 of Appendix B to draft ED 16X); and
- (b) the application guidance in relation to accrued benefits in draft ED 16X (paragraph 45) clarifies that, when an employer sponsor recognises a constructive obligation in respect of defined benefit members' benefits, the superannuation plan discloses information that provides users with a basis for understanding the plan's contingent liability in respect of the benefits.

**Sweep Issue 2 – The definitions of defined benefit and defined contribution entitlements**

5. Draft ED 16X proposes that defined benefit superannuation benefits be measured differently from defined contribution superannuation benefits. Accordingly, staff consider that draft ED 16X should identify the main characteristics of both types of benefits to facilitate the consistent application of the replacement Standard for AAS 25 *Financial Reporting by Superannuation Plans* to measuring accrued benefits.
6. The definitions of defined contribution and defined benefit superannuation benefits proposed by staff in Appendix A of draft ED 16X are derived from the definitions of a defined contribution plan and a defined benefit plan in paragraph 10 of AAS 25. The marked-up changes reflect the amendments staff consider appropriate to ensure that the

differential reporting proposals in the ED are reflective of the different natures of members' entitlements.

7. Based on discussions with members of the Project Advisory Group, staff understand that all superannuation benefits offered by Australian superannuation plans and ADFs are either determined:
  - (a) by reference to accumulated contributions by or on behalf of a member and the earnings on the contributions (defined contribution); or
  - (b) by a formula based on a member's years of membership/employment (defined benefit).

Accordingly, the definitions of a defined contribution plan and a defined benefit plan in AAS 25 cover all superannuation plans operating in Australia. In addition, given the regulatory framework applicable to superannuation benefits, it is unlikely that any new types of benefit arrangements will be introduced in the future.

8. While it may be unlikely that new types of superannuation benefits are introduced in Australia in the future, it is conceivable that some employers may consider introducing 'hybrid' defined contribution/defined benefit arrangements to facilitate a movement away from traditional defined benefit arrangements. In order to deal with this possibility, paragraph 4 of Appendix B to draft ED 16X proposes that, if a superannuation benefit exhibits the characteristics of both defined contribution and defined benefit arrangements, the benefit should be treated as a defined benefit for the purpose of the replacement Standard for AAS 25.
9. Rather than using the definitions in AAS 25 as a basis for the definitions of defined contribution and defined benefit in draft ED 16X, staff could have adopted the new definitions for defined contribution and defined benefit entitlements proposed by the IASB in its Discussion Paper *Preliminary Views on Amendments to IAS 19 Employee Benefits* (Employee Benefits DP).
10. Paragraph 5.3 of the IASB's Employee Benefits DP states that:

“The Board's preliminary views are:

- The definitions of post-employment benefits and defined benefit plans in IAS 19 should be revised as follows:

*Post-employment benefits promises* are formal or informal arrangements under which an entity is obliged to provide employee benefits (other than termination benefits) which are payable after the completion of employment.

A Defined benefit promise is a plans are post-employment benefit promise that is not a contributions-based promise plans other than defined contribution plans.

- A new definition of contributions-based promises should be introduced as follows:

*A contributions-based promise* is a post-employment benefit promise in which, during the accumulation phase, the benefit can be expressed as:

- (i) the accumulation of actual or notional contributions that, for any reporting period, would be known at the end of that period, except for the effect of any vesting or demographic risk; and
    - (ii) any promised return on the actual or notional contributions is linked to the return from an asset, group of assets or an index. A contributions-based promise need not include a promised return.
  - The definitions of post-employment benefit plans and defined contribution plans should be deleted.”
11. The IASB formed these views following an extensive review of the different types of retirement benefits currently being offered by entities in Europe and the United States. Appendix A to the Employee Benefits DP, which lists and classifies the different types of benefit arrangements considered by the IASB, is reproduced in Appendix A to this Agenda Paper.
12. Staff consider that the proposed definitions of a defined benefit promise and a contributions-based promise would achieve the same outcomes as the definitions of defined contribution and defined benefit entitlements proposed in draft ED 16X. However, staff do not favour adopting the IASB’s proposed definitions because, as is evident from Appendix A, they have been drafted with a broader range of benefit types than is currently offered or likely to be offered in the future in Australia. As a consequence, the IASB’s proposed definitions contain phrases and concepts that are foreign to and/or inconsistent with Australian arrangements, such as:
- (a) the term ‘promise’. As agreed by the Board at its April 2008 meeting, a superannuation plan or ADF has a legal (regulated or contractual) and/or constructive obligation to fund a member’s superannuation entitlements;
  - (b) the concept of ‘notional contributions’. Australian employers are required to make minimum contributions of 9% of an employee’s salary to a regulated superannuation plan; and
  - (c) ‘vesting or demographic risk’. Neither of these risks are relevant in the context of a defined contribution member of an Australian superannuation plan or ADF because:
    - (i) all member contributions and all post July 2004 employer contributions fully vest in a defined contribution member; and
    - (ii) defined contribution benefits are normally paid as a lump sum benefit rather than a pension.
13. If the Board were to decide that the IASB’s proposed definitions for contributions-based promise and defined benefit promise should be used for the purpose of draft ED 16X, staff consider that significant amendments to the definitions would be needed to make them meaningful in the context of a superannuation plan or ADF.

**Staff view 2**

For the purpose of a replacement Standard for AAS 25, staff consider the definitions of defined contribution plan and defined benefit plan in AAS 25 to be more appropriate bases for developing definitions for defined contribution and defined benefit entitlements than the equivalent terms in the IASB's Employee Benefits DP.

**Sweep Issue 3 – Classification of a non-controlling interest in a subsidiary of a superannuation plan or ADF**

14. Paragraph 27 of AASB 127 *Consolidated and Separate Financial Statements* states that:

“Non-controlling interests shall be presented in the consolidated statement of financial position within equity, separately from the equity of the owners of the parent.”
15. However, the non-controlling interests in a significant number of subsidiaries held by superannuation plans are liabilities as defined in Australian Accounting Standards. For instance, the units of some pooled superannuation trusts (PSTs) are classified as liabilities in the financial statements of the trust.
16. The question of how a non-controlling interest in a subsidiary of a superannuation plan or ADF should be classified by the parent entity in its consolidated financial statements is somewhat further complicated by the recent amendments to AASB 132 *Financial Instruments: Presentation*.
17. AASB 2008-2 *Amendments to Australian Accounting Standards – Puttable Financial Instruments and Obligations arising on Liquidation* introduces an exception to the definition of financial liability in AASB 132 to classify as equity instruments certain puttable financial instruments and certain instruments that impose on an entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation of the entity. In accordance with these amendments, it is likely that some PSTs that apply IFRSs will be required to reclassify their outstanding units as equity in their financial statements when they adopt the amendments to AASB 132. PSTs generally manage their assets on a pooled basis, whereby all unitholders have an equal share in the profits or losses recognised by the entity.
18. At its April 2008 meeting the Board agreed that applying the amendments to AASB 132 arising from AASB 2008-2 to a superannuation plan or ADF would give rise to reporting outcomes that:
  - (a) are inconsistent with the objectives of principles-based standard-setting; and
  - (b) would potentially diminish the comparability of the financial statements of superannuation plans and ADFs and, therefore, are inappropriate in a superannuation context.

Accordingly, the Board agreed that the amendments to AASB 132 arising from AASB 2008-2 should not apply to superannuation plans or ADFs under a replacement

Standard for AAS 25 *Financial Reporting by Superannuation Plans*. Consistent with this decision, paragraph 13 of draft ED 16X states that:

“Accrued benefits of defined contribution or defined benefit members shall be recognised as liabilities of a superannuation plan or approved deposit fund.”

***Staff view 3***

Staff consider that:

- (a) consistent with the Board’s April 2008 decision, ED 16X should not require a parent superannuation plan or parent ADF to apply the amendments to AASB 132 arising from AASB 2008-2; and
- (b) the Application Guidance to ED 16X should clarify that, if a non-controlling interest is in the nature a liability, it should be presented separately in the entity’s consolidated statement of financial position.

**Sweep Issue 4 – Recognition criteria for the separate financial statements of a parent superannuation plan or parent ADF**

19. In its Consultation Paper *Consolidation of Subsidiaries by Superannuation Entities*, the Board identified four possible consolidation approaches. One of the approaches, Approach A, was characterised in the Consultation Paper as:
  - “a full fair value accounting model that involves all assets and liabilities, whether recognised or unrecognised in separate financial statements of parent superannuation entities or their subsidiaries, to be measured at their fair values in consolidated financial statements.”
20. During its December 2007 meeting, the Board agreed, in light of constituents’ comments with respect to a full fair value accounting model (Approach A):
  - “to propose that a parent superannuation plan or a parent approved deposit fund recognise all assets and liabilities held by a subsidiary at their fair values less or plus anticipated disposal costs in its consolidated financial statements...”
21. The Board, however, has not yet considered the recognition criteria that should apply to the assets recognised in the separate financial statements of a parent superannuation plan or parent ADF. Accordingly, draft ED 16X (Agenda Paper 3.10) does not specify the recognition criteria that a parent superannuation plan or parent ADF should apply in respect of its assets and liabilities.
22. For the purpose of this Agenda Paper, staff have assumed that ‘unrecognised’ assets and liabilities’ are assets and liabilities that meet the relevant definition and recognition criteria identified in the *Framework* but fail to meet relevant additional recognition criteria identified in Australian Accounting Standards. For instance, a product brand name that has been internally generated remains unrecognised because it does not meet the identifiability and recognition criteria in AASB 138 *Intangible Assets*.

23. Proposing that a superannuation plan or ADF apply the relevant recognition criteria in the *Framework* rather than the particular or additional recognition criteria identified in Australian Accounting Standards raises a number of issues, including:
- (a) it could diminish the comparability of the financial statements of a superannuation plan or ADF to the financial statements of other entities. However, considering the types of assets and liabilities that superannuation entities tend to hold, and the manner in which they acquire them, it is unlikely that there are many, if any, unrecognised assets or liabilities being held directly by superannuation plans or ADFs. For instance:
    - (i) superannuation plans and ADFs acquire assets rather than generate them internally; and
    - (ii) few, if any, superannuation plans or ADFs hold intangible assets directly. Moreover, if a superannuation plan or ADF did hold an intangible asset directly, to ensure that the entity complied with the prudential requirements, the asset would arguably need to:
      - A have the characteristics of a ‘separable’ intangible asset as specified in paragraph 12(a) of AASB 138; and
      - B be readily saleable. Accordingly, an active market for the asset would need to exist; and
  - (b) it would be inconsistent with some of the Board’s other decisions to date. For instance, during its May 2008 meeting, the Board agreed that, unless there is a specific contractual agreement between a superannuation plan and an employer sponsor, a deficiency in assets attributable to the plan’s defined benefit members compared with members’ accrued benefits would not give rise to a receivable that is controlled by the plan. This is because the payment of any future contributions by the employer sponsor to address the deficiency:
    - (i) is not based on a contract that is enforceable by law, as required under AASB 132 *Financial Instruments: Presentation*; and
    - (ii) is not a reimbursement that is virtually certain to be received by the superannuation plan, as required under AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*.

In some circumstances, however, a deficiency in assets attributable to defined benefit members might give rise to a receivable from an employer sponsor that would meet the relevant definition and recognition criteria in the *Framework*.

***Staff view 4***

On balance, staff consider that the specific recognition criteria in Australian Accounting Standards, rather than the more general recognition criteria in the *Framework*, should apply to the separate financial statements of a parent superannuation plan or parent ADF under a replacement Standard for AAS 25.

**APPENDIX A – Classification of Benefit Promises**

(reproduced from Appendix A to the IASB’s Employee Benefits DP)

<b>Promise</b>	<b>Description</b>	<b>Classification</b>
Promise 1	<p>The employer promises a benefit equal to:</p> <ul style="list-style-type: none"> <li>• for the first 15 years of service, a lump sum benefit accumulated as follows: the entity pays contributions of 8 per cent of salary for each year of service and the return on contributions is equal to the return on an equity index.</li> <li>• for the next 15 years service, a lump sum equal to 3 per cent of final salary for each year of service.</li> </ul>	Contribution-based for the first 15 years, defined benefit for the next 15 years
Promise 2	<p>The employer promises to make contributions into a fund of 5 per cent of the employee’s salary during the current reporting period for each year of service. The benefit promise at retirement is a lump sum equal to the contributions increased with the compound return on a specified equity index.</p>	Contribution-based
Promise 3	<p>The employer promises to make contributions into a fund of 5 per cent of the employee’s current salary for each year of service. The benefit promise at retirement is a lump sum equal to the contributions paid plus the actual investment returns on those contributions.</p>	Contribution-based
Promise 4	<p>The employer promises to make notional contributions of 5 percent of the employee’s current salary for each year of service. The benefit promise at retirement is a lump sum equal to the notional contributions increased by interest compounded at the rate of each years return on a specified equity index.</p>	Contribution-based
Promise 5	<p>The employer promises to make notional contributions of 5 per cent of the employee’s current salary for each year of service. The benefit promise at retirement is a lump sum equal to the contributions plus a fixed return on the contributions of 3 per cent per year.</p>	Contribution-based

Promise 6	The employer promises to make notional contributions of 5 per cent of the employee's current salary for each year of service. The benefit promise at retirement is a lump sum equal to the contributions plus a fixed return on the contributions of 0 per cent.	Contribution-based
Promise 7	The benefit is a lump sum at retirement equal to 5 per cent of the career average of the employee's salary for each year of service.	Contribution-based
Promise 8	The benefit is a lump sum at retirement equal to 5 per cent of the employee's final salary at retirement for each year of service.	Defined benefit
Promise 9	The benefit is a lump sum at retirement equal to 5 percent of the average of the employee's final three years salary before retirement, for each year of service.	Defined benefit
Promise 10	The employer promises to make contributions into a fund for each year of service. The contribution in each period of service is 5 per cent of the average of the employee's salary in the most recent two years of service. The benefit promise at retirement is a lump sum equal to the contributions paid.	Contribution-based
Promise 11	The benefit is a lump sum benefit at retirement equal to the number of years service multiplied by 5 per cent of the average of the employee's salary in the most recent (i.e. final) two years of service.	Defined benefit
Promise 12	The employer promises to contribute into a separate fund 5 per cent of the employee's salary for each year of service. The lump sum at retirement, which is equal to the accumulated contributions plus investment returns they earn, is converted into a pension at a fixed annuity rate (i.e. the cost of buying a pension is fixed when the promise is made, rather than being determined by the market rates at retirement date). That pension amount is payable in monthly instalments for the life of the retired employee.	Contribution-based

Promise 13	The employer promises to contribute CU100,000 into a separate fund on the first day of service. The lump sum at retirement is the contribution of CU100,000, plus a fixed return of 0 per cent. The lump sum is converted into a pension at a fixed annuity rate (i.e. the cost of buying a pension is fixed when the promise is made, rather than being determined by the market rates at retirement date). This generates a benefit of CU1,000 per year for the life of the retired employee.	Contribution-based
Promise 14	The employer promises a benefit of CU1,000 per year for each year after the employee retires until his death, regardless of the service period of the employee.	Contribution-based