

CORPORATE SUPER ASSOCIATION

Mr David Boymal
Chairman
Australian Accounting Standards Board

By email to standard@asb.com.au

21 November 2007

Dear Mr Boymal

CONSOLIDATION OF SUBSIDIARIES BY SUPERANNUATION ENTITIES

I refer to the consultation paper on the above topic issued on 24 September 2007 by the AASB. The Corporate Superannuation Association appreciates the opportunity to contribute to this discussion and has provided comments below.

1 BACKGROUND

1.1 *The Corporate Super Association*

The Corporate Super Association is Australia's representative body for major Not For Profit corporate superannuation funds and their corporate sponsors.

The Association represents 30 funds, most of the largest funds in the corporate fund sector. The assets of Association members amount to approximately \$38 billion, representing about 53% of total corporate superannuation sector assets in Australia.

1.2 *Abbreviations used in this submission*

The Association	The Corporate Super Association
The Paper	Consultation Paper, <i>Consolidation of Subsidiaries by Superannuation Entities</i> , AASB, Melbourne, 2007
SIS Act, SIS legislation	Superannuation Industry (Supervision) Act 1993, and related legislation

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2 SUMMARY

The Association notes the AASB's support for consolidation of the accounts of controlled entities in the financial statement of superannuation plans.

The Association wishes to register concern with the implied proposition that financial statements for superannuation plans are used in the same way and by the same groups of users as those of other reporting entities such as companies.

The Association has difficulty with the proposal that superannuation funds should prepare accounts using any full consolidation approach. The Association considers it more appropriate to the needs of the users of the accounts for the consolidation information to be disclosed in notes. In the event that there is general support for consolidation of the assets and liabilities of the subsidiary entities, we cannot see a convincing reason why this should not be provided by a proportional consolidation method.

3 DETAILS OF OUR CONCERNS

3.1 Users of financial statements

In our view there are sound reasons for continuing to provide separate accounting standards for superannuation entities and, in devising these standards, for recognizing the very different environment in which they report and the restricted group of users whose needs are to be met.

For a commercial entity there is a range of users of financial statements, including suppliers, customers, shareholders, potential investors, employees, and government regulators.

For a superannuation fund the user group in relation to the annual report is restricted to members and (to a degree) potential members, and the reporting arrangements are radically different. Although financial statements are available on member request, the prime reporting document is the annual member report containing only abridged financial statements with no reporting notes. This annual report is the key document for members. Potential members will refer primarily to the product disclosure statement. The regulators have their own reporting framework with highly specific requirements. "Suppliers", apart from office suppliers, are specialist groups. Service providers such as investment managers, custodians and administrators have access to market intelligence and have specific service agreements that ensure that their interests are protected. Employers have a representative seat at the trustee table and access to many detailed sources of information.

Because of the radically different nature of the user groups, we see it as important for reporting standards for superannuation entities to be framed with the different user group in mind. Hence, what fits the user group in relation to corporations will not necessarily fit the user group for superannuation financial statements. We see a very strong argument for continuing to frame financial statements for superannuation entities to be meaningful, as a primary focus, to members and prospective members. There are no other user groups whose needs are to be met by these statements.

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3.2 Business involvement of superannuation funds in their investments

The nature of a superannuation fund also differs from the nature of a commercial enterprise. The hallmark of most listed and unlisted companies is their focus on business involvement. It is by business activities that they generate profit and hence maximize value for shareholders through dividends or capital appreciation. Superannuation entities are focused on maximizing retirement incomes for members. This requires a focus on maximizing value, but the direction is not on maximizing business income but on maximizing investment returns. There is a focus on diversification of interests in order to reduce risk. Investee entities are viewed primarily as investments rather than as businesses in which the investor entity participates. Involvement at a business level in each substantial investment would simply not be practicable for the entity's trustee.

In fact, there has been a long running debate about whether the sole purpose test for a superannuation fund, under section 62 of the SIS Act, would actually permit superannuation fund trustees to be involved in running a business. The investment focus by superannuation entities is evident in the dealings of major superannuation funds with entities in which they hold controlling interests. Typically, (and as a matter of necessity because of the essential diversification of investment interests) the emphasis is on investment monitoring rather than on hands on involvement in any business undertaken by the controlled entity.

We recognize that there is an increasing trend towards control of enterprises by superannuation entities, arising from the increased market share held by these entities and the increasing level of private market involvement resulting from funds' need for diversification and exposure to as many different market sectors as is both feasible and prudent. Nevertheless, we do not see an increased focus on involvement in the operation of the businesses held by the controlled entities. The pattern that we see emerging would be one where the parent leaves the controlled entity to operate autonomously, because it is not the business of a superannuation entity to involve itself in running a business empire, and it will not have the management resources to do so. Instead, it involves itself in the investment monitoring which is its business. This pattern differs from the approach where the parent is itself a business and may well wish to influence the direction and operations of a controlled entity.

3.3 Meaningfulness of consolidation for users

In the above context we question the usefulness of consolidation of the assets and liabilities of controlled entities in the financial statements of superannuation funds.

We ask the AASB to consider whether consolidation in itself provides more meaningful disclosure in the financial statements of a superannuation entity under the following circumstances:

Fund A has an investment of 50% of total capital issued in each of two tollway enterprises.

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Fund B has 10% of total capital issued in each of 10 tollways. In each case, the tollway investments form a fraction of a percentage of the total investment portfolio, which is suitably diversified in conformity with the entity's investment strategy.

Under full consolidation, Fund A would have to consolidate the fair value of 100% of each asset category and liability for each tollway investment and then eliminate the minority interests. Fund B would merely include the tollway investments under one line item "investments".

We concur that if the holder of the investments were in the business of tollway investment or were a business conglomerate, then a distinction should be made between Investor (Fund) A and Investor (Fund) B above. However, in context of a superannuation fund a controlling interest in a tollway will be a small aspect of the total investment pool. As a superannuation entity, the investor is in the business of providing retirement benefits. It is neither a tollway developer or a conglomerate business where consolidation is relevant to investors and other stakeholders.

In both cases, Fund A and Fund B, asset allocations and managers or investments are fully disclosed in the prescribed content of annual reporting and the product disclosure statement. These provide more meaningful information to members and prospective members than any elaborate detail about the assets and liabilities of certain investments which comprise a small element of the portfolio. To add these details provides distracting and irrelevant information for the users of the financial statements. In summary, in just about every case the controlled entity will be only a small component of the overall portfolio. Setting out the detailed debits and credits for, say 1% of the fund when 99% of assets are shown simply as net investment, does not add meaningful detail and is guaranteed to cause confusion. The listing of "minority interests", as mentioned in the Paper, is also likely to cause confusion. Assets are not held for control or trading but as investments to underwrite retirement income of members, hence the concept of non member equity in assets is not an appropriate concept to introduce.

4 OUR PREFERRED APPROACH

In summary we would prefer the AASB to reconsider the entire proposition that superannuation entities be required to consolidate controlled entities. We do not believe that in an appropriately diversified fund portfolio, consolidation will provide information that is relevant in the context of the users' requirements or in view of the nature of the involvement of the entity in the investment.

In the event that there turns out to be widespread support in principle for consolidation, our preferred approaches, in order, are as follows:

- 4.1 If the AASB believes that disclosure is vital, we suggest that notes disclosure could be provided. This would be preferable to the potential confusion to be caused by the introduction of additional assets and liabilities unrelated to the investment focus of the entity.
- 4.2 In the event that there turns out to be widespread support in principle for consolidation we would prefer to see proportionate consolidation rather than full consolidation, thus removing

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the potentially inappropriate inclusion of minority interests in an entity run for the investment benefit of members.

We cannot accept the AASB's rejection of the proportionate approach. The AASB argues (paragraphs 16 to 18 of the Paper) that proportionate consolidation is inconsistent with the principles of general purpose financial reporting and in particular with the entity concept. As indicated at 3.1 above, we do not envisage a need for superannuation entity statements to satisfy the needs of users other than members or prospective members. We question the appropriateness of adding complexity such as minority interests and or assets and liabilities that are not consistently valued. The primary focus for regulators of superannuation entities and consumer advocates has been on meeting the needs of members and prospective members. These, apart from the regulators (who can command as much detailed information in whatever format they wish), are the users. Hence, there is no need for a generic style of presentation that meets the needs of disparate user groups.

4.3 If there turns out to be widespread support for full consolidation, our preferred method would be method A proposed in the Paper. However, from our viewpoint all methods are a significant cost with little benefit. The adverse impact on the carrying value and therefore funding of DB funds referred to in paragraph 23 would result in distorted information to members and could suggest under funding in a situation where a fund was fully funded.

4.4 The reason why there are so many difficulties involved in arriving at an appropriate consolidation method has its roots in the fact that the accounts of a superannuation entity are prepared with the needs of participants in a collective investment scheme in mind. Specific valuation methods are adopted which arise from the collective investment scenario and these do not sit well with a consolidation approach for the assets and liabilities of the investments.

5 CONCLUSION

We believe that the entire consolidation proposition is wrongly conceived. We urge the AASB to reconsider, in the process of re-framing the accounting standard AAS 25.

Please contact me at the Association on 03 9620 5155 if you wish to discuss the above.

Yours sincerely



Bruce McBain
Chief Executive Officer