PRACTICE GUIDELINE 499.06

AUSTRALIAN ACCOUNTING STANDARD AASB 1056 SUPERANNUATION ENTITIES

September 2020

CONTENTS

1. Introduction

1.1 Application

1.1.1 Australian Accounting Standard AASB 1056 Superannuation Entities (AASB 1056) specifies the requirements for the general purpose financial statements of superannuation entities. The standard applies to annual reporting periods beginning on or after 1 July 2016 although early adoption was permitted.

1.1.2 Whilst Members do not have an explicit role under AASB 1056, they may play a prominent role in providing key pieces of information used in the construction of the financial statements. This Practice Guideline considers the actuarial tasks that may be undertaken when preparing financial statements under AASB 1056.

1.1.3 References to AASB 1056 are to the version of the standard issued by the Australian Accounting Standard Board in June 2014.

1.1.4 Work performed under this Practice Guideline is designated as an Applicable Service. As such, the Member's attention is directed towards the requirements of Practice Guideline 1 (General Actuarial Practice).

1.1.5 This version of the Practice Guideline updates the first version (issued September 2016) to incorporate additional conformance changes to align with the Institute's new Code (effective 31 March 2020) and to remove some guidance from Section 6 that is no longer relevant.

1.2 About this Practice Guideline

1.2.1 This Practice Guideline:

a. has been prepared in accordance with the Institute's Policy for Developing Professional Practice Documents; and

b. is to be applied in the context of the Code.

1.2.2 This Practice Guideline is not mandatory. Even so, if this Practice Guideline covers the Services a Member provides, then the Member should consider explaining any significant departure from this Practice Guideline to the Principal, and record that explanation.

1.2.3 This Practice Guideline does not constitute legal advice. Any interpretation or commentary within this Practice Guideline regarding specific legislative or regulatory requirements reflects the expectations of the Institute but does not guarantee compliance under applicable legislation or regulations. Accordingly, Members should seek clarification from the relevant regulator and/or seek legal advice in the event they are unsure or require specific guidance regarding their legal or regulatory obligations.

1.3 Other relevant documents

1.3.1 This Practice Guideline must be applied in the context of the relevant law, and relevant accounting and auditing standards.

1.3.2 A reference to legislation or a legislative provision in this Practice Guideline includes any statutory modification, or substitution of that legislation or legislative provision and any subordinate legislation issued under that legislation or legislative provision. Similarly, a reference to a Professional Standard or Practice Guideline includes any modification or replacement of that Professional Standard or Practice Guideline.

1.3.3 Apart from the Code or a Professional Standard, from legislation or from regulatory standards, no other document, advice or consultation can be taken to modify or interpret the requirements of this Practice Guideline.

1.3.4 If there is a conflict between this Practice Guideline and any legislation, then the legislation takes precedence. In this context, legislation includes regulations, prudential standards, subordinate standards, rules issued by government authorities and standards issued by professional bodies which have the force of law.

2. Commencement date

2.1.1 This Practice Guide commences on 1 November 2020.

3. Definitions and interpretation

'Accrued benefits' has the same meaning as set out in Appendix A of AASB 1056.

'Applicable Services' means Services that are designated in an Institute Professional Standard or Practice Guideline as being Applicable Services.

'Code' means the Code of Conduct of the Institute.

'Defined benefit member' has the same meaning as set out in Appendix A of AASB 1056.

'Defined contribution member' has the same meaning as set out in Appendix A of AASB 1056.

'Membership' means, except where otherwise specified, the period used to determine benefits as appropriate in the particular circumstances.

'Principal' means the Client who is the principal recipient of a Service provided by a Member and the primary party for whom that Service has been performed.

'Reporting date' means the date at which the superannuation entity's financial reports are prepared.

'Superannuation entity' has the same meaning as set out in Appendix A of AASB 1056.

'Vested benefits' has the same meaning as set out in Appendix A of AASB 1056.

Other capitalised terms used in this Practice Guideline have the same meaning as set out in the Code.

4. Background

4.1.1 AASB 1056 was developed by the Australian Accounting Standards Board to replace AAS 25 Financial Reporting by Superannuation Plans. It applies to the general purpose financial statements of superannuation entities.

4.1.2 This Practice Guideline provides guidance on the following elements of AASB 1056:

a. Defined benefit member liabilities:
   - (i) Apportionment of benefits between past and future membership;
   - (ii) Assumptions to calculate defined benefit member liabilities;
   - (iii) Calculating the accrued benefits;
   - (iv) Sensitivity of the defined benefit member liabilities to changes in assumptions;
   - (v) Explaining changes in defined benefit member liabilities;

b. Insurance arrangements.

4.1.3 Members are likely to be involved in assisting superannuation entities to comply with other sections of AASB 1056. However, when considered with its Application Guidance, AASB 1056 is sufficiently detailed such that further actuarial guidance was not deemed to be required beyond the two areas identified above.

5. Defined benefit member liabilities

5.1 Overview

5.1.1 AASB 1056 requires member liabilities to be recognised and measured as the value of accrued benefits of members on a basis set out in the standard.

5.1.2 Accrued benefits are to be measured at the reporting date, although approximate methods may be used in the measurement.

5.1.3 Members would be expected not to apply a vested benefit minimum when calculating accrued benefits to comply with the requirements of AASB 1056 (refer to paragraph AG25 of AASB 1056).

5.2 Apportionment of benefits between past and future membership

5.2.1 Accrued benefits relate to membership up to the reporting date.

5.2.2 Members are free to determine a reasonable basis for apportioning benefits between past and future membership, subject to the requirements of Professional Standard 402 (Determination of Accrued Benefits for Defined Benefit Superannuation Funds).

5.2.3 Members would be expected to indicate which of the methods described in Professional Standard 402 has been used to determine accrued benefits or, if a basis other than one described in Professional Standard 402 is adopted, describe the basis used and the reason for using it.

5.3 Assumptions to calculate defined benefit member liabilities

5.3.1 The superannuation entity is responsible for the method and assumptions used to calculate the defined benefit member liability although in practice assumptions would typically be prepared in consultation with their actuary.

Discount rates

5.3.2 Paragraph 17 of AASB 1056 states that "defined benefit member liabilities shall be measured as the amount of a portfolio of investments that would be needed as at the reporting date to yield future net cash inflows that would be sufficient to meet accrued benefits as at that date when they are expected to fall due."

5.3.3. Paragraph AG 25(c) states that the portfolio of investments would not necessarily be "expected to yield contractual net cash inflows that match the timing of the expected net cash outflows relating to the liability. It might be a portfolio that is expected to yield either contractual or non-contractual net cash inflows that match the timing of expected net cash outflows relating to the liability". Therefore, the portfolio of investments could include fixed interest investments, which are expected to yield contractual net cashflows, but equally could comprise other assets that are expected to yield non-contractual net cashflows.

5.3.4 Paragraph AG 25(d) states that "the investment returns relevant to measuring the liability are those expected on a portfolio of investments that reflects the opportunities available in investment markets and not necessarily the actual investments held by the superannuation entity to meet accrued defined benefit member liabilities." Therefore it is not a requirement to use the entity's actual portfolio of investments when setting the discount rate to value the liabilities. However, given that many superannuation entities are required to fund their defined benefit member liabilities and take into account the size and timing of the expected net cash outflows relating to the liabilities, in many of these cases there will be a strong relationship between the portfolio of investments used for setting the discount rate and the entity's actual portfolio of investments.

5.3.5 In circumstances where the entity's actual portfolio of investments is not used to set the discount rate to value the liabilities, Members would typically be expected to document the reasons for recommending the consideration of particular investments that are not held by the superannuation fund when setting the discount rate.

5.3.6 The amount of a portfolio of investments can be considered as made up of a series of future cash flows and an expected return that will equate the future cash flows with the current amount of the portfolio. When calculating the value of accrued benefits, the actuary will typically have an estimate of future cash flows from accrued benefits and require a discount rate to derive a current value from those cash flows. Applying the expected return on the portfolio of investments as a discount rate will provide a value of the accrued benefit that is consistent with the amount of a portfolio of investments expected to deliver sufficient cash flows to meet accrued benefits.

5.3.7 Where the cash flows from the portfolio of investments are contractual in nature, an expectation of the return on the portfolio can be derived from the cash flows and the current value of the portfolio. Where the cash flows from the portfolio of investments are non-contractual, the expectation of the return on the portfolio would be expected to represent the Member's best estimate of the rate of return to be earned over the weighted-average term to settlement of the related liabilities, without any margins for conservatism.

5.3.8 In all cases, the discount rate(s) used would be expected to:

a. be current and therefore reviewed or revised at each reporting date, based on market conditions applying at that date;

b. be appropriate to the profile and weighted-average term to settlement of the liabilities; and

c. include appropriate allowance for rates of taxation and investment expense on the investment income and capital gains.

5.3.9 Members would also be expected to consider the following factors when determining the appropriate discount rate(s):

a. the investment policy of the superannuation entity;

b. data on investment returns for various asset classes over a period consistent with the duration of the liabilities;

c. likely reinvestment rates;

d. any evidence that the actual investments are not being made in accordance with the superannuation entity's investment policy; and

e. any other factor which, in the opinion of the Member, is relevant.

Other assumptions

5.3.10 When valuing the defined benefit member liabilities, Members may be required to make reasonable assumptions to allow for mortality, disability, salary increases, pension increases, member turnover, retirement patterns, family dependants and member options (e.g. choice of lump sum and pension at retirement). AASB 1056 requires these assumptions to provide the expected cashflows, hence in setting these assumptions conservatism which has a material impact on the accrued benefits should be avoided.

5.4 Calculating the accrued benefits

5.4.1 Generally, the most accurate approach to calculating the defined benefit member liability will be to obtain a full extract of the superannuation entity's membership data as at the AASB 1056 reporting date, calculate the accrued benefits at an individual member level and determine the actuarial value of the accrued benefits using the methods described in Professional Standard 402. However, for some entities, this exercise may not be feasible due to costs or the timeframe permitted to finalise the financial statements.

5.4.2 AASB 1056 confirms (paragraph AG26) that "superannuation entities may use estimates, averages and computational shortcuts provided that the application of those shortcut techniques yield a reasonable approximation of the defined benefit member liabilities."

5.4.3 Shortcut techniques that could be considered by Members include (but are not limited to):

a. Adjusting a more readily available liability measure, such as the vested benefits liability, to approximate the defined benefit member liability;

b. Rolling forward, in an approximate manner, the defined benefit member liability calculated as part of the most recent actuarial investigation and adjusting the liability to allow for market conditions as at the AASB 1056 reporting date; or

c. Obtaining a full extract of membership data and calculating the accrued benefits at an individual member level in advance of the AASB 1056 reporting date so as to ensure that the results will be delivered within the financial reporting timescales. This approach would also likely require the liabilities to be rolled forward and adjusted so that they allow for market conditions as at the AASB 1056 reporting date.

5.4.4 Members would be expected to consider and be able to demonstrate the appropriateness of the shortcut technique adopted.

5.4.5 Regardless of the approach adopted, it will be important for Members to identify and consider material inconsistencies the approach to measuring the liability could introduce between the measurement of the liabilities and the assets. For example, this might include (but is not limited to) adjusting for:

a. Member exits that have been captured in the asset value but not taken into account in the liability value;

b. Actual additional accumulation accounts of defined benefit members; and

c. Pensioner deaths that have occurred since the date the calculations were performed.

5.5 Sensitivity of the defined benefit member liabilities to changes in assumptions

5.5.1 Paragraph 25(a)(iii) of AASB 1056 requires disclosure of the sensitivity of defined benefit member liabilities to changes in key assumptions used in their measurement which can be performed on a univariate basis or on a multivariate basis.

5.5.2 The superannuation entity is responsible for the sensitivity analyses to include in the financial statements. The Member may need to consider and advise on the implications of the uncertainty identified in key financial and demographic assumptions. The key assumptions may include the gap between future investment earnings and future salary increases, and pensioner mortality.

5.5.3 The assumptions used in these analyses would be expected to illustrate the impact on results when a reasonable variation to key assumptions is made, possibly in both directions.

5.6 Explaining changes in defined benefit member liabilities

5.6.1 Paragraph 30 of AASB 1056 requires the superannuation entity to "disclose information that provides users with a basis for understanding the overall change in defined benefit member liabilities". Paragraph 31 confirms that quantitative and qualitative information can be used to meet this requirement.

5.6.2 Whilst it will be for the superannuation entity to decide how the relevant information is disclosed to the users of its accounts, Members may be requested to provide an explanation of the change in defined benefit member liabilities. The explanation would be expected to include all elements that the Member is aware of that have had a material impact on the change in defined benefit member liabilities over the relevant period. This may include (in quantitative or qualitative form) the following elements:

a. Increase in liabilities due to interest on existing liabilities (i.e. unwinding the discount rate);

b. Increase in liabilities due to the accrual of new benefits;

c. Reduction in liabilities due to the payment of benefits;

d. Change in liabilities due to changes in assumptions, with the impact of the key assumptions identified separately; and

e. Change in liabilities due to other experience over the period.

6 Insurance arrangements

6.1.1 Members who are asked to provide an opinion on whether a superannuation fund is acting as an insurer would be expected to refer to the guidance included in AASB 1056 (paragraphs AG 40 – AG 42).

6.1.2 Where the Member is informed that the superannuation entity is to be considered as acting as an insurer for the purposes of AASB 1056 paragraph 33, AASB 1056 does not require insurance related liabilities for defined benefit members to be separately identified. However, particular attention may be required where separate self-insurance reserves are shown in the superannuation entity's financial statements.

7 Reporting

7.1.1 When reporting the results of the analysis undertaken Members are reminded of their reporting responsibilities as set out in Paragraph 6 of the Code and clause 3 of Practice Guideline 1.

8 Auditor

8.1.1 The auditor may have specific requirements and the Member may liaise directly with the auditor if requested to do so by the client. Note that auditors are subject to Guidance Statement GS 005 (Evaluating the Appropriateness of a Management's Expert's Work) issued by the Auditing and Assurance Standard Board in using the work of an actuary. Members should also refer to Practice Guideline 199.02 (Relationship with the auditor when actuarial work is used in an audit).

END OF PRACTICE GUIDELINE 499.06