Comparative Analysis of Social Context, Institutional and Accounting Regulations of Pensions in Australia and Korea: Risks to be Managed and Synergies to be Optimised

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1.1 Introduction

Pension reform is being challenged by policy-makers worldwide. The Organisation for Economic Co-operation and Development (OECD) and the World Bank are increasingly vocal on pension policy issues, especially pension protection at the national level. For example, last year the OECD isolated inadequate funding of occupational pension plans (investment risk), the ranking of workers’ rights in bankruptcy (bankruptcy risk) and insurance arrangements following insolvency (moral hazard risk) as the three main elements to support a private pension framework (The Financial Times, 17 July 2006, “Funding Gap Tops OECD’s Action Plan”). Other emerging risks include longevity risk, the inability of governments to fund retirement in the future and rising health care costs (The Sydney Morning Herald, 19 December, 1998, “Self-funded Aged Care May Ease Coming Budget Crisis”).

Demographic changes such as increased longevity and ageing of the populations carry important fiscal consequences for Governments. In 1900 most people in Western countries died by 65 years; in 1950 only half the people died by 65 years and in 1980 this was only one third. In 1900 the 65 plus age group comprised only 2.5% of the population; in 1960 this was 50% and in 1980 78% with even higher percentages for some ethnic groups. By 2005, it is estimated that over a quarter of the population will live to 85 years. For example, in the USA in 1989 there were over 32,000 people aged 100 years or over whose children are also receiving retirement pensions (Kaplan, 1989, p.344 quoting US Bureau of Census, 1984). Korea is a rapidly ageing population, ageing more quickly than any other country in the world (The Korea Times, 2 April 2007, “The Dawn of Modern
Korea qualified as an “ageing society” in 2000 when more than 7% of its total population was 65 years or older and is expected to become an “aged society” (with more than 14% of total population being 65 years or older) in 2019. However, Korea is unique by the rapidity of the change as it is expected to take only 19 years for Korea to reach an “aged society” compared to 75 years for the USA (USA became an “aged society” in 2000).

Given ageing populations, social well-being in old-age needs to be balanced with economic and affordable solutions if national pension systems (both public and private) are to be sustainable for future generations. National regulators need to establish a stable equilibrium between private and public pension systems and individual savings. As globalisation and the spread of multi-national enterprises (MNEs) continue, communication between national policy-makers is critical to the sustainability of pension systems for future generations. National pension regulations and the accounting for these arrangements carry enormous social, economic and political implications. The role of accounting is to record the pension transaction, thereby reflecting the incidence of risks such as investment, bankruptcy and longevity risk.

Prior to 1992, Australia (along with South Korea, Iceland and New Zealand) was one of a few nations that did not have a private national employment-related retirement income plan (Bateman, Kingston and Piggott, 2001, p.118). Pension reforms in South Korea are more recent with the introduction of private occupational pension plans in December 2005. The (varying) institutional arrangements influence the accounting for pensions. The purpose of this paper is to compare the social contexts, institutional regulations and accounting for superannuation (pensions) between Australia and Korea. For each jurisdiction, the genesis, social context and institutional pension rules will be linked to the accounting regulations in the context of the incidence of investment, bankruptcy and

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1 Countries that do have mandatory privately administered retirement provisions (the “second pillar”) are listed in table 1.4 in Bateman, Kingston and Piggott (p. 14).
2 Subsequent references to South Korea are shortened to “Korea”.
longevity risk.\(^3\) Pension accounting in Australia radically changed with the convergence to international financial reporting standards (IFRS) in 2005. As Korea is aiming to fully adopt IFRS by 2009-2010, pension accounting remains an area where current Korean accounting practice is out-of-step with IFRS and will need much debate before being implemented by Korean companies. This research is timely as Korea seeks to strengthen its economic standing as an “Asian export champion” (The Financial Times, 19 March 2007, “Seoul Sleepwalk”) and Australia aims to strengthen itself as a trading partner with Korea.

The total assets invested by superannuation funds in Australia have grown substantially. In 1983 the total value of assets invested by Australian superannuation funds was $32 billion, in 1991 the total was $135 billion and by 1999 this had grown to $408.643 billion.\(^4\) Excluding funds with less than five members, the assets invested by superannuation funds at March 2007 total $1.1 trillion. Of this, total assets invested by corporate funds total $65.036 billion and total assets invested by public sector funds are $165.609 billion. In Australia today the business of superannuation is conducted primarily through DCP funds, although in economic terms, the DBP and hybrid fund (which is technically a DBP) is still relevant. On the other hand, Korea is just beginning to introduce traditional DBP and DCP structures for retirement purposes. In Australia and Korea, pensions are a central component of the employment contract.

This paper will proceed by comparing the social context of pensions in Australia and Korea in the next section.\(^5,6\) Section 1.3 discusses the differing institutional arrangements

\(^3\) The economics of pension plans is strongly influenced by the accounting regulations. For example, corporate pension plans in the UK are in deficit due to historically low discount rates, revisions of longevity risk and the outcome of accounting regulations.


\(^5\) Figure 1 (refer Appendix) summarises the plan for this paper. It is adapted from Gordon (2006, p.7).

\(^6\) In future drafts of this paper, the current accounting pension practice of the top 100 companies in Australia listed on the Australian Securities Exchange and the large MNEs, chaebols and companies listed on the Korean Stock Exchange will be examined to document the firm’s pension activities. The time period is from 1 January 2005 (when AASB 119 “Accounting for Employee Benefits” was first operative) to 30
in Australia and Korea and the impact on the accounting for pensions in both jurisdictions is discussed in section 1.4. Section 1.5 briefly summarises the main differences between Australia and Korea and section 1.6 concludes by discussing possible synergies to be achieved by this research.

1.2 Social Context of Pensions

Australia

For more than 100 years prior to award superannuation, superannuation schemes in Australia were generally defined benefit funds (DBPs) (Ward, 1998, p.13). Superannuation was regarded as a managerial gratuity because members were predominantly managers and white collar workers (Ward, 1998, p.9). Also, members of the superannuation funds were predominantly male (Gunasekera and Powlay, 1987, p.3). These early superannuation funds provided a select group of salaried employees an independent retirement income (Gunasekera and Powlay, 1987, p.3). They were established mostly by banks, insurance companies and financial institutions (Richards, 1972, p.6). At the same time, some public sector superannuation funds were established, for example, the Police Superannuation and Reward Fund in 1862 (Ward, 1988, p.10).

Use of selective accrual and vesting rules in Australian DBP trust deeds was common and restricted superannuation benefits to a select few. For example, qualifying periods of at least 10 years of continuous employment were usual. Often, the actual pay-out for early withdrawal fell markedly short of the retirement benefit due, permitting the DBP surplus to accumulate as a pool of unallocated assets.

As the pension means test arrangements were relaxed during the 1950s to 1970s, superannuation in Australia became a supplement to the aged pension (Gunasekera June 2007. This analysis will establish the current state of pension accounting by the larger companies in Australia and Korea and permit informed judgements concerning the expected impact of the adoption of IFRS for pension accounting on the financial statements of Korean companies.
The growth of superannuation funds both in Australia and overseas was phenomenal during the 1950s and 1960s (Palmer, 1976, p.53). The Whitlam government investigated the creation of a national superannuation scheme in 1972. Subsequently, the Hancock Report (1976) recommended the establishment of a contributory national superannuation scheme after the Australian Bureau of Statistics (ABS) identified poor worker coverage for superannuation in 1974. The second Hancock report focussed on private sector funds and recommended compulsory early vesting of benefits and the requirement for the sponsor firm to make-up any deficiencies upon a plan termination, but no action was taken.

The structure of the fund affects how the risks are shared between the employer and the employee. For example, defined benefit and defined contribution funds differ in the way they define the retirement benefit and the placement of risk. For the DBP, risks are pooled across stakeholders, that is, the employee, the employer and the taxpayer (Doyle, Mitchell and Piggott, 2001, p.1). The DBP is also exposed to the bankruptcy risk of the employer whereas the DCP is not (provided the DCP is fully funded and fund asset investment is diversified) (Pesando, 2000, p.338). The Hancock Report noted that, at that time, large funds (membership between 11 and 1000 members) were more likely to be defined benefit plans (DBP) while the smaller funds (ten members or less) were more likely be defined contribution plans (DCP). Although DCP were more numerous, they represented a much smaller proportion of total membership (Gunasekera and Powlay, 1987, p.6).

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7 Although Australia was one of the first Western countries to introduce an old age pension, apart from this, there was little government interest and projected allocation of resources for the aging population. The old age pension represents approximately 25% of average weekly earnings. It is paid on a “pay-as-you-go” basis, which means that it can be viewed as an inter-generation debt.
8 Prior to this, there were three unsuccessful attempts to introduce employment related retirement income arrangements between 1913 and 1938.
9 The Hancock committee released its recommendations in two reports, one in 1976 and the second in 1977. Recommendations included that superannuation funds provide annual reports and audited accounts and other actuarial information.
10 In the DBP, the retirement benefit is calculated by reference to a formula (usually based on length of service and / or salary) while for the DCP, the retirement benefit is determined by reference to accumulated contributions plus investment earnings of the fund.
Australia uses a combination of minimum funding requirements, restriction of equity ownership by the fund in the sponsor, the setting of investment policy and disclosure to reduce the bankruptcy risk. However, it is possible for DBP to incur shortfalls even in the presence of minimum funding requirements because vicissitudes in plan asset values may turn a DBP surplus into a deficit. To the extent that the employer “guarantees” the retirement benefit, the investment risk is retained by the employer. On the other hand, for the DCP, there is immediate vesting of benefits while the employer risk ceases on termination of the labour services. For the DCP, the employee retains the investment risk as well as the risk that the retirement monies will “run out”.

Korea

The social context of pensions in Korea is closely tied to the distinction between public and private sector employees. For private sector employees, mandatory retirement allowance plans (RAP) were offered by employers under the Labor Standards Act in 1961 (the “second tier”). RAP provide lump sum termination indemnities similar to those in Italy, Brazil and other countries, with features such as minimum benefits (calculated as final average monthly salary times years of service) paid as a lump sum immediately upon termination (whether termination is voluntary or involuntary). Some Korean companies provide “progressive” and/or “top-up” benefits which are greater than the mandatory minimum. RAP are technically considered defined benefit plans unless accrued benefits are consistently paid out to employees at the end of each year (which is a practice followed by a number of Korean companies). To this extent, RAP payouts resemble redundancy payments. Also, tax laws in Korea provide a significant incentive for employees to take a lump sum (and most people do). RAP may be internally funded, externally funded, or both, with tax exemption up to certain limits for internal funding. Studies show most retirement allowance benefits (about 80%) are paid upon termination before retirement and are used for purposes other than directly providing retirement income.
Korea’s national pension system (NPS) (the “safety net” or first “pillar”) was introduced in 1988. Economic growth and the resulting increase in household income made the introduction of the NPS possible. With this economic growth, the share of the population employed grew significantly. Employees (both public and private sector) agreed to pay certain percentages of their income as pension premiums for their future benefit. These benefits include a public pension, social health insurance, unemployment compensation and industrial accident insurance. The NPS provides for a target pension of 60% of final salary for the average worker with 40 years in the system; normal retirement age of 60; and a funded system with a 9.0% contribution rate (split equally between employers and employees). There are three special occupational plans in Korea (excluding the national pension): that is, the government employees’ pension, military personnel pension, and private school teacher’s pension (Moon, 2001, p.1). Along with the NPS, these three special occupational plans comprise the “first tier” of pensions in Korea. The public sector pension schemes are strongly supported by policymakers because they are a source of investment capital for government economic projects.

The NPS is an essential component of the social safety net but it is currently facing questions of long term sustainability. Korean public pension schemes strongly favor early contributors to the point that their benefits are much higher than their actual contributions. This imbalance between low contributions and high benefits makes the system financially weak and vulnerable, although coverage of the national pension system has broadened over the years. The military personnel pension has already been in deficit for several decades and the government employees pension is about to follow suit. This imbalance is also aggravating inter-generational equity, as the government has no

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11 The literature commonly identifies three “pillars” when discussing retirement support (see Bateman, Kingston and Piggott, 2001, p.7).

12 With the economic growth and stabilizing price levels during the 1970s and early 1980s, the government reviewed the 1973 National Welfare-Pension Act and reintroduced it as the National Pension Act in 1986. This new Act specified that the first public pension scheme was to be implemented in January 1988, covering workers in establishments with 10 or more employees, and that the National Pension Corporation was to be created as an administrative body. In 1992, the compulsory coverage was expanded to those firms with 5 or more employees. In 1995, the coverage was further extended to include farmers and fishermen as well as the self-employed in rural areas. In 1999, the self-employed in urban area as well as workers at small(less than five employees) work places are introduced to the system, thereby establishing a nominally ‘universal’ coverage.
choice but to either lower the benefit levels of late contributors or raise their insurance premiums to restore financial stability to the system. Also, the traditional system of old-age support within families is on the decline, and this trend will worsen over the next few years as the changes in lifestyle and economic opportunities impact family structure (Moon, 2001, p.1). Strong economic growth has also resulted in multiple social classes, producing a feeling of exclusion of the poor. The social contexts of pensions in Australia and Korea are compared in table 1.1.
### Table 1.1: Comparison of the Social Context of Private Pension Plans in Australia and Korea

<table>
<thead>
<tr>
<th>Feature</th>
<th>Australia</th>
<th>Korea</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Genesis</strong></td>
<td>Retirement entitlement motivated to avoid fidelity insurance by bondsmen of the bank (for job protection)</td>
<td>As mandatory retirement allowance (RAP) similar to redundancy payouts</td>
</tr>
<tr>
<td><strong>First DBP</strong></td>
<td>ANZ Bank in 1861</td>
<td>RAP introduced 1961</td>
</tr>
<tr>
<td><strong>Industries where first introduced</strong></td>
<td>Banks, insurance and financial institutions</td>
<td>Private sector</td>
</tr>
<tr>
<td><strong>Early basis of membership</strong></td>
<td>Top management and white collar workers</td>
<td>Broad coverage (for companies with five or greater than five employees)</td>
</tr>
<tr>
<td><strong>Early nature of superannuation</strong></td>
<td>As a managerial gratuity</td>
<td>As type of redundancy payment on termination</td>
</tr>
<tr>
<td><strong>Early taxation policy</strong></td>
<td>Favourable treatment of superannuation for a small sector of the community</td>
<td>Incentives for employees to take lump sum</td>
</tr>
<tr>
<td><strong>Funding status</strong></td>
<td>Selective accrual and vesting rules that restricted benefits and permitted the build-up of surplus</td>
<td>Unfunded but most employees take the lump sum on termination, so accrued benefits are paid out.</td>
</tr>
<tr>
<td><strong>Type of benefits</strong></td>
<td>Lump sum and/or pension</td>
<td>Lump sum</td>
</tr>
<tr>
<td><strong>Present status of the private pension sector (Government mandated)</strong></td>
<td>Mandatory (since 1992)</td>
<td>RAP mandatory since 1961</td>
</tr>
<tr>
<td></td>
<td></td>
<td>ERSA reforms 2005 to convert RAP to DBP/DCP</td>
</tr>
<tr>
<td><strong>Present nature of pension benefits</strong></td>
<td>As deferred pay</td>
<td>RAP: deferred until termination</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2005 Reforms: type of deferred pay</td>
</tr>
<tr>
<td><strong>Type of fund</strong></td>
<td>Mainly DCP for the worker but also DBP for white collar workers of larger corporations and the public service</td>
<td>New DCP and DBP structures to provide monies for retirement</td>
</tr>
<tr>
<td><strong>Nature of contributions</strong></td>
<td>Contributory</td>
<td>New DCP and DBP contributory</td>
</tr>
<tr>
<td><strong>Current dollar value of pension assets in 2007</strong></td>
<td>$A1 trillion</td>
<td>KRW 756.8b</td>
</tr>
<tr>
<td><strong>Social welfare (the “safety net” or “first pillar”)</strong></td>
<td>Commonwealth Aged and Invalid pensions introduced in 1908 (workforce participation is not a prerequisite) (unfunded)</td>
<td>National pension system introduced 1988 (partially funded by workforce participation)</td>
</tr>
</tbody>
</table>
1.3 Institutional Pension Regulations

Australia

Dissatisfied with the inadequate coverage of superannuation for the general workforce, the Hawke Government’s “Accord” in 1983 encouraged union interest in superannuation. The achievement of full wage indexation also made it easier for the Government to shift union interest towards extra benefits, such as superannuation. As the union movement became involved in negotiating superannuation benefits for its members, the popularity of the DCP (relative to the DBP) structure increased (Gunasekera and Powlay, 1987, p.6). The unfavourable vesting rules of DBP in Australia at that time also added a further impetus. The 1986 National Wage case delivered a 3% wage productivity increase through superannuation rather than direct wage increases. The industry-based schemes featured the DCP structure with immediate vesting, preservation and portability, modest benefits with a determinable superannuation cost compatible with the wage-fixing directives of the Australian Council of Trade Unions (ACTU) (Gunasekera and Powlay, 1987, p.9). Superannuation coverage of the general workforce in 1986 was 47.3%, but female and part-time workers were under-represented (Gunasekera and Powlay, 1987, p.15). When the Superannuation Guarantee Charge (SGC) legislation was introduced on 1 July 1992, the upshot was to increase the coverage of superannuation for Australian workers. By 1992, 92% of the Australian workforce was covered by superannuation compared to 32% in 1974.

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13 In 1982-83, only 18% of members were covered by DC benefit structure, compared to 82% for DB structure (Gunasekera and Powlay, 1987, p.6).
14 This legislation imposed a non-tax deductible levy on employers that did not abide by the “compulsory” superannuation contribution rates. Superannuation guarantee charge commenced 1 July 1992, starting at 3% of employee earnings (7% from 1/7/98; 8% from 1/7/2000) and increasing to 9% by 2002. It applies to all employees earning more than $450 per month. Two important aspects of SGC are that it endorsed a “compulsory” system of superannuation and superannuation became a taxation issue rather than an industrial relations issue administered through awards.
To protect superannuation arrangements, the Government enacted the first superannuation related legislation in Australia, called the Occupational Superannuation Standards Act (1987) (OSSA). The Insurance and Superannuation Commission (ISC) responsible for administering OSSA and the Occupational Superannuation Standards Regulations (OSSR) was also established at this time. OSSA was replaced by the Superannuation Industry Supervision Act (SIS) on 1 July 1993, and the SIS Regulations, effective 1 July 1994. The SIS Act and Regulations set out the duties of trustees, auditors and plan administrators, including reporting requirements of the superannuation plan. The Australian Prudential Regulation Authority (APRA, established 1 July 1998) is responsible for supervising and regulating superannuation plans. APRA replaced the ISC as principal regulator of superannuation plans in Australia. The objectives of the Superannuation Group within APRA are to ensure the prudent management and sound growth of retirement income savings through superannuation, to protect members’ benefits and to ensure that taxation concessions for superannuation plans are used for approved purposes.

Also, combination plans, now referred to as hybrid plans, emerged in Australia during the 1970s. These plans had a dual benefit structure with the employers’ benefits placed in the DB section and the employees’ contributions plus investment earnings in the DC section. In this way, the advantages of both forms of plan design (that is, DB and DC) could be obtained. This split benefit design was common in public sector schemes during the 1980s, such as the Commonwealth Superannuation Scheme and other major public sector schemes in New South Wales and the Northern Territory. More recently, hybrid plans are becoming popular. This is because changes such as spouse contributions, additional contributions from the employee (not the employer) and roll-overs into corporate plans are more easily accommodated by hybrid plans.

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16 For example, SIS provides that the fund trustee owes a fiduciary duty to the members and requires that trustees act in the members’ best interests (s.52.1.c) for the dominant purpose of providing retirement / death benefits to members (s.62.1.a).

17 As at June 1995, of the total assets invested by Australian superannuation funds, DBP account for 19%, DCP for 51% and hybrid 29% (Bateman and Piggott, 1996, p.62). By June 1999, total assets invested by superannuation funds (excluding funds with less than five members) comprised 7.5% for DBP, 50.79% for DCP and 41.71% for hybrid funds.
Korea

Although Korea is the tenth largest economy in the world, it has only recently introduced an occupational pension system. Defined benefit and defined contribution plans are allowed for the first time beginning December 1, 2005 as replacements for existing mandatory termination indemnities (that is, RAP).\(^{18}\) The Employee Retirement Security Act (“ERSA”) was passed by the Korea National Assembly on December 29, 2004. It allows private sector defined benefit and defined contribution pension plans for the first time. Although ERSA may be regarded as limited legislation, its objective is to reform private sector occupational pensions by encouraging the substitution of RAP by DCP and DBP. A related objective is to move away from lump sum payments and encourage the use of annuities as retirement income streams. ERSA is simple and provides limited choices for employers. It provides three options for employers: to continue a mandatory RAP; adopt a DBP in place of a RAP; or adopt a DCP in place of a RAP. Prior to ERSA, retirement benefits comprised the NPS and the special occupational plans (the first tier), RAP (the second tier) as well as any personal pension plans (the third tier).

However, replacing mandatory RAP with DBP and DCP may not be straightforward. This is because the DBP and DCP look like RAP and adequate incentives need to be provided to encourage retirees to choose annuities under DBP and DCP. This latter choice (of a pension income stream) will require actuarial expertise to ensure the adequate funding of the plans. External funding requirements for DBP and DCP under ERSA should provide employees a sense of security that they will actually receive benefits (that has not always been the case with the RAP system).

The institutional background of pensions in Australia and Korea is compared in table 1.2.

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\(^{18}\) The Labor Standards Act was amended in March 1997 to allow employers to convert their retirement schemes into corporate pension schemes. Insurance companies started selling corporate pensions in April 1999.
Table 1.2 Comparison of Institutional Frameworks for Private Pension Plans in Australia Compared to Korea

<table>
<thead>
<tr>
<th></th>
<th><strong>Australia</strong></th>
<th><strong>Korea</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Pre-regulation years</strong></td>
<td>Mid 1800s to 1986 Mainly DBP</td>
<td>RAP introduced in 1961 as redundancy payment (traditional DCP &amp; DBP absent)</td>
</tr>
<tr>
<td><strong>Risks</strong></td>
<td>Coverage restricted to select few Coverage, investment, inflation and longevity risks underwritten by Government (public pension) Political risk</td>
<td>RAP as redundancy not retirement payment Investment, inflation and longevity risks underwritten by Government (public pension) Political risk</td>
</tr>
<tr>
<td><strong>Type of regulation</strong></td>
<td>Plan governance rules</td>
<td>Minimum funding requirements</td>
</tr>
<tr>
<td><strong>Shortcomings/risks of Regulation</strong></td>
<td>Limited accountability by plans Poor coverage Investment, inflation and longevity risks underwritten by Government (public pension) Political risk</td>
<td>Single retirement purpose absent Investment, inflation and longevity risks underwritten by Government (public pension) Political risk</td>
</tr>
<tr>
<td><strong>Type of regulation</strong></td>
<td>Mandatory (increased coverage) Funding system with minimum funding requirements General purpose reporting by plans DCP: investment, inflation and longevity risks assumed by individual member</td>
<td>Allows three choices: (i) to continue a mandatory RAP (ii) adopt a DBP in place of a RAP, or (iii) adopt a DCP in place of a RAP</td>
</tr>
<tr>
<td><strong>Shortcomings/risks of regulation</strong></td>
<td>Bankruptcy risk: deficit of DBP as a liability of the sponsor not enforced by statute DCP: investment, inflation, longevity and bankruptcy risks assumed by individual member (with a minimum level underwritten by public pension) Political risk</td>
<td>Bankruptcy risk: deficit of DBP as a liability of the sponsor DCP: investment, inflation, longevity and bankruptcy risks assumed by individual member (with a minimum level underwritten by public pension) Political risk</td>
</tr>
</tbody>
</table>
1.4 Accounting Pension Regulations

*Australia*

For the reporting by the superannuation plans themselves, the first reporting requirements for superannuation plans in Australia was issued by a Joint Liaison Committee of the actuarial and accounting professions in 1975 in a booklet titled “Reporting for Superannuation Plans in Australia” (but published by the one body, namely the Institute of Actuaries (IA)). OSSR required DBP to provide members with a personal statement of benefits and, upon request, a statement of the value of the plan’s assets. AAS 25 “Reporting for Superannuation Plans”, effective 30 June 1992, represented the first attempt by the accounting profession to specify uniform reporting by superannuation plans (both DBP and DCP).

Measurement and recognition requirements for accounting for DBP pension costs in the books of the sponsoring employer were absent in Australia prior to 1 January 2005. The first accounting standard on accounting for superannuation commitments by the sponsoring employer AASB 1028 “Accounting for Employee Entitlements” required only disclosure of information about DBP sponsored by the employer (AASB 1028, para. 14 (e) (i&ii)). Earlier exposure drafts on accounting for superannuation by sponsoring employers (the first was privately distributed and the second ED 53 “Accounting for Employee Entitlements” was more widely distributed in 1991) did not result in an accounting standard. ED 53 met with strong opposition from the superannuation industry and the actuarial profession. Due to the unpopularity of ED 53, the accounting profession withdrew the superannuation provisions. Finally, AASB 119 “Employee Benefits” (effective 1 January 2005) required accrual accounting and recognition of the net pension position in the sponsor’s balance sheet in Australia as originally suggested in ED 53.

Accounting for DBP underscores the problem of recording the short-term financial consequences of a long-term event. It is the placement of risk that makes the accounting

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19 It recommended that fund accounts include a statement of income and expenditure and a statement of net assets recorded at book value. As noted by Klumpes (1994, p.141), there was no discussion of liabilities in the IA publication. The cash basis of accounting was also deemed acceptable by the IA report.
for DBP so problematic for the employer. Unlike the DCP, the employer generally accepts the investment risk in a DBP and assumes a constructive obligation to make-up any funding shortfalls. An actuarial valuation of the plan determines the extent of any shortfall, and recommends a contribution level by the sponsor based on this valuation.\textsuperscript{20} By contrast, the employer’s obligation to the DCP is discharged once the contributions to the plan are paid. Accounting issues subject to debate over the years include the calculation of the pension cost and the treatment of prior service costs and actuarial gains and losses in the sponsor’s profit and loss; choice of actuarial costing method and assumptions that affect the pattern (and volatility) of the pension cost in the sponsor’s profit and loss; uncertainty attached to valuing future payments to employees and recognition of this in the sponsor’s balance sheet. Standard setters overseas have addressed some of these complex accounting issues for accounting for DBPs, although compromises have been met. For example, with convergence to IFRS AASB 119 in Australia (and IAS 19) follow the accounting standard in USA SFAS 87 “Employers’ Accounting for Pensions” (issued December 1985) and permit the “corridor method” to deal with actuarial gains and losses. The corridor method alleviates lobbying concerns about volatility in the sponsor’s profit and loss.

\textbf{Korea}

The differing nature of RAP in Korea compared to the more traditional DCP and DBP structures elsewhere in the world impact the accounting for pensions. Even though RAP are technically considered to be like DBP, the manner in which payments are made (that is, as a lump sum on termination) resemble the DCP arrangement. That is, the difficult accounting issues that attach to DBP are absent if the termination payments under RAP extinguish the employer’s obligation. Current Korean accounting standards requires a balance sheet liability equal to the total amount of benefits that would have to be paid if all employees terminated as of the measurement date, less any externally funded assets. However, discounting of the long term RAP liability is not required in Korea.

\textsuperscript{20} A third type of benefit structure for a superannuation plan is a hybrid plan. Hybrid plans for accounting purposes are technically DBPs.
Generally, Korean based companies do not follow IAS 19, FAS 87 or other actuarially based standards on accounting for the cost of retirement allowances plans (although some Korean subsidiaries of European Union, United States, United Kingdom may). However, the Korean Accounting Standards Board (KASB) is considering adoption of IAS 19 or a version of it in the near future. Given the reported adverse effect of IFRS pension accounting on the financial statements of sponsors in other countries such as the UK, Korean employers are concerned about converting the RAP to a DBP.

1.5 Australia and Korea Pension Systems: brief comparison

Pensions represent a component of employees’ entitlements in both Australia and Korea. The social context and institutional rules vary in Australia compared to Korea. The genesis of pensions in Korea in the private sector was as a redundancy payment on termination endorsed by Korean Labor Law in 1961. Although the redundancy payment (called a RAP) may be taken as either a pension or lump sum, Korean tax incentives encourage the lump sum payment. Consequently, the lump sum payment is rarely used for retirement purposes. Recent reforms in Korea to address the ageing population aim to establish retirement plans using the traditional DBP/DCP structures that exist in Australia, UK, USA and Japan. In step with these reforms, the Korean accounting profession plans to adopt IFRS requirements in 2009-2010.

In Australia pensions in the private sector originally comprised mainly DBP and benefits were restricted to a select few. The union movement negotiated pay increases in the form of superannuation in the 1980s. The result was that coverage of superannuation spread to the rank and file workers and superannuation was considered as a type of deferred pay. Immediate vesting that attaches to DCP was also attractive to the union movement. When the SGC legislation was introduced in 1992, superannuation support from the employer became mandatory in Australia for all workers earning in excess of $450 per month. The SGC legislation encouraged the spread of DCP. Accounting requirements for DCP and DBP superannuation commitments by the Australian sponsor initially required disclosure
(see the Companies Code and accounting standard AASB 1028). With convergence to IFRS recognition of the DBP net pension position on the sponsor’s balance sheet is required as well as disclosures for both DBP and DCP (see AASB 119).

The uncertainty that attaches to the retirement transaction (for example, when to retire, life expectancy after retirement, asset returns and inflation risk, and the changing hearts of governments) reduces the efficient sharing of risks between the parties to the retirement transaction (that is, the retiree, the Government and the employer) so that this efficient allocation is difficult to achieve (Bateman et al., p. 10). Investment, longevity, inflation and political risks exist to varying degrees in both Australia and Korea. To the extent that DBP are tied to the employer, bankruptcy risk also exists. Given these risks, there is a demand for clear policy by Governments and industry bodies to endorse policies that affect specific parameters such as funding, benefits, contributions, taxation and fund governance. Also, the nature of these risks, the communication of these risks to stakeholders and a common language to do so requires more attention from the accounting profession.

1.6 Conclusion

This paper compared the social context, institutional and accounting regulations of pensions in Australia and Korea by addressing the incidence of investment, longevity, inflation and bankruptcy risks. The importance of pension systems is more pronounced in those countries that are experiencing aging populations and increasing costs to support the elderly such as Korea and Australia. Dialogue between Australia and Korea with respect to pensions should be stimulated by this research and contribute to the understanding of pension systems between both these countries. This research will assist Korea to develop high quality financial reporting standards for pensions and permit Korea’s transition to IFRS for pension accounting to benefit from the Australian experience. Also, this project will inform other professions (such as the Korean actuarial profession) to ensure that DBPs are adequately funded to minimise possible adverse political and economic consequences, such as replacing DBPs with DCPs. As accounting for employee
entitlements including pensions represents one of the main accounting issues that has been unsettled by convergence to IFRS and Korea is planning to adopt IFRS in 2009-2010, there are prospects to encourage future research in this area. There are also opportunities to inform Korea’s policy-makers and accounting standard-setters about the likely impact that IFRS will have on the economic arrangements of Korea’s pensions.

Australian policy-makers will also benefit from this research. Presently, Australia has a private mandatory pension system that encourages DCP. This benefit structure transfers the investment and longevity risks to the employee/member. To date, there is no evidence on how well employee/members will manage these risks and how adept they are at asset management for their retirement. While companies may not be interested in this in the short-term, policy-makers should be concerned about the longer-term implications of a generation of (potential) mismanaged assets that will place further stress upon the public purse. The upshot is that the public pension system underwrites a minimum level for the investment and longevity risks (when the source of private retirement plans runs out).

OECD Guidelines on Funding and Benefit Security (2006, p.2) presents good practice guidelines for regulators, supervisors and other entities participating in the design, administration and management of occupational pension plans. As fellow OECD members, Australia and Korea are committed to improving economic growth and living standards. Because pensions are a component of workers’ remuneration in both Australia and Korea, the mutual economic relationship between both countries is supported and fostered by offering opportunities to reduce possible impediments to the free-flow of labour between both countries. Increasing the dialogue between Australia and Korea concerning superannuation/pension rights of the workforce will contribute to the common knowledge shared by Australians and Koreans and support trading and the exchange of labour resources between both countries.
References


**Appendix: Figure 1**

**Australia**

*Social context of superannuation*
- Early plans for “white collar” membership
- Early plans: defined benefit
- To encourage employee loyalty

*Institutional regulations*
- SIS Act (1993): fosters DCP
- Post-SIS Act: superannuation coverage increased to 92%
- Funding system supported by good plan governance and disclosures

*Accounting regulations*
- Convergence to IFRS 1 January 2005: introduced accrual accounting for pensions
- Adopts IAS 19: net pension position (fair values) on sponsor’s balance sheet
- Discourages growth of DBP

*Impacts allocation of economic and social resources*
- OECD member
- Market-based economy
- Ageing population
- Economic relevance of assets invested in superannuation September 2006 A$945.6b

**Synergies**

- Provide connections for dialogue between Australia and Korea

**Korea**

*Social context of pensions*
- Wide coverage of workers
- Mostly defined benefit (66.4% total plan assets)
- Called redundancy plans

*Institutional regulations*
- Pension regulations introduced 1 December 2005
- Permits both DBP and DCP
- To protect members and employers

*Accounting regulations*
- Accounting for pensions varies from IFRS
- Does not follow IAS 19
- Transition to IFRS for pension accounting planned for 2009-2010
- Need to establish high quality pension accounting standards

*Impacts allocation of economic and social resources*
- OECD member 1996
- Moves to market-based economy
- Ageing population
- Economic relevance of assets invested in superannuation February 2007 KRW 756.8b

- Increased understanding of institutional pension regulations between Australia and Korea
- Inform local policymakers in Australia/Korea

- Australia as knowledge base to assist Korean transition to IFRS for pension accounting
- Inform Korean actuarial profession of adverse impact of IFRS before-the-fact

- Korea as source of extensive manpower to ease Australia’s skills shortage: informed workforce with improved living standards
- Korea to maintain the balance between DBP and DCP