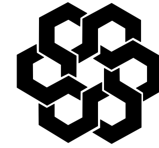

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International Accounting Standards Board

This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.

These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting:	**January 2009, London**
Project:	**Post-employment Benefits**
Subject:	**IFRIC 14 *IAS 19 The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* —Voluntary prepaid contributions under a minimum funding requirement (Agenda paper 10)**

Purpose of this paper

1. The IFRIC has been asked to consider whether there might be unintended consequences arising from the treatment of voluntary prepaid contributions under IFRIC 14 in some circumstances where there is a minimum funding requirement. Paragraph 22 of IFRIC 14 requires an entity to include particular expected cash outflows in the assessment of whether there is an asset at the reporting date. In some cases, the inclusion of these cash flows may be considered inappropriate as the outflows relate to avoidable future expenses.

2. At its November meeting, the IFRIC decided to add this issue to its agenda. Its preliminary discussions indicated that the clearest way of resolving the issue would be to amend the wording in IFRIC 14, rather than to issue further interpretations. Such amendments to an existing Interpretation would have to be approved by the Board. Because we regard this issue as one that should be addressed as soon as possible (see paragraph 30) and the next IFRIC

meeting is in March 2009, we have decided to bring this issue directly to the Board. We have discussed this approach with the IFRIC co-ordinator and some IFRIC members and they agree with this approach. We have circulated this paper to the IFRIC and will report any comments in advance of this meeting.

3. We agree with the IFRIC that the results given by IFRIC 14 may lead to unintended consequences in some circumstances. Accordingly, we recommend that the Board should address this issue, even though it arose from an IFRIC agenda request.

4. This paper illustrates the issue and asks the Board to amend IFRIC 14 to address the issue as quickly as possible.

Staff recommendation

5. The staff recommends that the Board:

   a. amend IFRIC 14 to be consistent with view B (see paragraphs 21-24).

   b. issues a standalone Exposure Draft to deal with this issue.

   c. Sets an exposure period of 60 days, being the standard period that would be allowed for draft IFRIC Interpretations.

6. If the Board agrees with the staff recommendation in this paper, we propose to circulate a preballot draft immediately after the Board meeting.

The issue

7. The IFRIC noted that paragraph 22 of IFRIC 14 *IAS 19 – The Limit on a Defined benefit Asset, Minimum Funding Requirements and their Interaction* has caused difficulties and produced unintended consequences in some circumstances. These relate to the treatment of voluntarily prepaid contributions where there is a minimum funding requirement.

8. The problem occurs when an entity voluntarily prepays[1] contributions to a defined benefit plan that is subject to a minimum funding requirement. The prepayment means that the entity will pay lower contributions in the future. However, the requirements of IFRIC 14 indicate that the surplus in the plan created by the prepayment may not be regarded as available as an economic benefit to the extent that the future minimum funding contribution

[1] We have phrased the discussion in this paper in terms of a prepayment because it illustrates the issue most clearly, and is the issue that caused the request to the IFRIC. However, this issue also arises whenever there is a recoverable surplus and a future minimum funding requirement that exceeds the expected IAS 19 service charge.

required in respect of the future accrual of benefits exceeds the future IAS 19 service cost. To the extent that this is the case, the prepayment is recognised as an expense.

9. We think that the problem is caused by two aspects of IFRIC 14.

10. Paragraph 20 of IFRIC 14 states:

If there is a minimum funding requirement for contributions relating to the future accrual of benefits, an entity shall determine the economic benefit available as a reduction in future contributions as the present value of:

a) the estimated future service cost in each year in accordance with paragraphs 16 and 17[2] less

b) the estimated minimum funding contributions required in respect of the future accrual of benefits in that year.

11. Paragraph 22 of IFRIC 14 states:

If the future minimum funding contribution required in respect of the future accrual of benefits exceeds the future IAS 19 service cost in any given year, the present value of that excess reduces the amount of the asset available as a reduction in future contributions at the end of the reporting period.

12. Thus, paragraph 22 requires an entity to reduce the asset available as a reduction in future contributions by the excess of the future MFR over the future IAS 19 service costs.

Example

13. The issue is illustrated in the following example. For simplicity the example assumes a discount rate and expected return on assets of 0%. We know that these are not realistic assumptions, but they enable the point at issue to be illustrated clearly.

14. An entity expects a service charge of 10 for a 10-year period[3] and is subject to a minimum funding requirement charge of 15 each year. No refunds are available from the plan.

Year	1	2	3	4	**5**	6	7	8	9	10
Service charge	10	10	10	10	**10**	10	10	10	10	10
Minimum funding requirement	15	15	15	15	**15**	15	15	15	15	15

[2] See Appendix

[3] In this example, for simplicity, the service cost derives directly from the benefit formula rather than from a straight-line recognition of back-end loaded benefits.

15. Consider year 5 and assume that everything has happened according to expectations, ie there are no actuarial gains and losses. The entity will have made contributions of 75 (=15*5) in accordance with the minimum funding requirement. However, the service charge over those 5 years will be only 50 (=5*10). Thus, there is a surplus of 25.

16. For the remaining 5 years, there will be a future service charge of 50 and future payments of 75 to satisfy the MFR. Thus, no surplus is recoverable. That is consistent with the intention behind IFRIC 14. An expense of 25 has been recognised in addition to the service cost. That additional expense represents the excess of the MFR contributions over the service charge in each year.

17. However, suppose the entity makes a prepayment of 30 at the beginning of year 5. The surplus at the end of year 5 is then 55 (=25+30). The expected service cost and MFR contributions would be:

Year	6	7	8	9	10
Service charge	10	10	10	10	10
Minimum funding requirement	0	0	15	15	15

18. We think that the prepayment could be analysed in the following three ways.

View A: IFRIC 14

19. Paragraph 22 of IFRIC 14 states that the recoverable surplus is the difference between the future service charge of 50 and future MFR payments of 45, ie 5. In other words, the prepayment is attributed first to any future irrecoverable excess of MFR contributions over service charge (=25), and then to the service charge(=5).

20. We note that this view is consistent with the measurement of an asset at its value in use in IAS 36. IAS 36 requires that an estimate is made of all future cashflows that the entity expects to derive from the asset. Thus, in assessing the 'value in use' of the prepayment, the entity would incorporate the expected future service charge of 50 and the expected future MFR payments of 45. However, we did not consider this situation when drafting IFRIC 14, and question whether it is appropriate to recognise no asset when an entity clearly expects to receive some benefit from a past action.

View B: Prepayment partially recoverable

21. Some argue that it would be more consistent with IAS 19 to regard the prepayment as being a prepayment of the contributions that would otherwise be payable in the next two years, ie as:

    a. a prepayment of future service cost of 20 (ie 10 in each of years 6 and 7); and

    b. a prepayment of the future irrecoverable excess of MFR contributions over service cost of 10 (ie 5 in each of years 6 and 7).

22. There is no benefit to the entity for the prepayment of the future irrecoverable excess of MFR contributions over service cost and thus that amount is expensed. But an asset can be recognised for the prepayment of the service cost. So an asset of 20 can be recognised. Another way of looking at the resulting expense of 10 is to regard it as an impairment of the prepayment.

23. Those holding this view argue that paragraph 22 of IFRIC 14 is incorrect because it reduces the amount of the asset recognised by the excess of the MFR payment over the service cost. They argue that doing so implies that those future MFR payments are a liability. So in this example, the MFR payments in excess of the service cost, ie 5 in each of years 8-10, reduce the prepayment of 20 that they think should be recognised to 5. They think this is inappropriate because the expectation that a minimum funding requirement will require an entity to pay more than the service cost in future years does not create a liability at the reporting date because those payments are not a *present* obligation of the year. The liability will arise in future years, when the entity is required to make the minimum funding requirement payments. Making a prepayment ought not to result in accelerated recognition of the expense expected to be caused by future MFR overpayments.

24. In the staff's view, this logic is consistent with the other requirements in IFRIC 14. For example, IFRIC 14 does not require recognition at year 0 of a liability of 50 for the total excess of the MFR payments over the service cost. Thus, entities should not be required to anticipate the excess in determining whether the surplus at the reporting date is recoverable.

View C: Prepayment wholly recoverable

25. Some argue that the whole of the prepayment of 30 should be regarded as recoverable because it is available to reduce the required minimum funding contributions in years 6 and 7. They argue that the entity has made a prepayment in the past and expects to obtain future economic benefits from that prepayment in the form of reduced MFR contributions. Thus, they believe that the entity should recognise the whole of the prepayment as an asset.

Additionally, they also believe that the presence of an MFR should not determine the amount of a surplus asset to be recognised.

26. In the staff's view, the economic benefit available as a reduction in contributions refers to the IAS 19 service cost, and not the MFR cost. In the staff's view, View C is inconsistent with the view that future MFR payments in excess of the service cost are not a liability at the reporting date. We agree that, in practice, the entity will almost certainly regard the prepayment as having economic benefit equal to the MFR payments that it would otherwise have to make in future years. But the reason that the excess payments are not regarded as a liability is that, in theory, the entity could wind up the plan at the reporting date and thereby avoid any future MFR payments. Thus, only the service cost gives rise to a future benefit. The excess is a regulatory cost that could be avoided by closing the plan. In other words, by prepaying some of the MFR payments, the entity has deprived itself of the economic benefit of such a wind up and has incurred the expense associated with the excess of the MFR payments that would otherwise arise over the period covered by the prepayment.

Staff recommendation

27. In summary, we think the View A is consistent with IAS 36, View B is consistent with the view in IFRIC 14 that expected future MFR payments in excess of the service cost are not liabilities at the reporting date and View C is consistent with entity's perception of the economic benefit of the prepayment. We think that the Board should amend IFRIC 14 to be consistent with View B for the following reasons:

    a. it makes IFRIC 14 internally consistent

    b. The scenario of voluntary prepayments was not considered when drafting IFRIC 14.

    c. We think that an entity that makes a prepayment and is able to reduce payments in future years has an asset. In the example, the entity will be able to benefit from reduced contributions relating to the service cost in years 6 and 7 as a result of the prepayment at the end of year 5.

    d. Not recognising that prepayment as an asset does not convey the information that the entity is in a more favourable position than one that has not made such a prepayment.

28. We also think that the clearest way of resolving the issue would be to amend the wording in IFRIC 14, rather than to issue further interpretations.

29. Accordingly, we recommend that the Board should amend IFRIC 14 to be consistent with View B.

Logistics of making an amendment to IFRIC 14

30. IFRIC 14 has an effective date of annual periods beginning on or after 1 January 2008. Accordingly, we are unable to take any action that would resolve any issues that might arise for entities preparing financial statements for the year ended December 2008.

31. However, if the Board agrees with the staff recommendation in paragraph 29, we think it should do so as quickly as possible. We note that the circumstances in which the issue arises are likely to become more common because the minimum funding requirement basis is likely to become a more prudent and conservative basis in response to the credit crisis. IAS 19 remains a best estimate basis.

32. We could amend IFRIC 14 by including the issue:

    a. as Board's annual improvements project;

    b. as part of the Board's project on amendments to IAS 19; or

    c. as a standalone exposure draft.

33. The annual improvements process is designed to deal with non-urgent but necessary amendments to IFRSs. The Board issued its most recent exposure draft of annual improvements in August 2008. That project is expected to be completed in April 2009. Accordingly, if the Board decided to address this issue within its annual improvement project it would include the issue in its 2008-2010 project cycle, and the amendments would be completed in April 2010.

34. We also considered whether the Board should deal with this issue as part of its existing project on IAS 19. However, that project has a wide scope, and the scope of that project is not yet clear (see agenda paper 16A). This means that the timetable for that project is not yet certain. We think that it is unlikely that any issues addressed in that project would be finalised before January 2010.

35. Accordingly, we do not recommend including this issue as part of the annual improvements project, or as part of the Board's existing project on amendments to IAS 19. We think that would take too long. We argue that the quickest way to deal with the issue is to issue a standalone exposure draft. This could allow the Board to make amendments to IFRIC 14 that could be adopted before the end of December 2009 (see paragraph 38).

36. **We therefore recommend that the Board issue a standalone exposure draft to implement the staff recommendation in paragraph 29.**

Project plan

37. If the Board decided to deal with this issue as a standalone exposure draft, we also recommend that the Board do so as quickly as possible. To that end:

    a. If the Board agrees to amend IFRIC 14, we propose to circulate a preballot draft immediately after this meeting.

    b. We will only circulate one preballot draft.

    c. **We recommend an exposure period of 60 days, the standard period that would be allowed for draft IFRIC Interpretations.** Although this amendment is being considered by the Board, it relates to an IFRIC interpretation so we argue that a 60 day exposure period is appropriate. We further argue that an exposure period shorter than the Board's standard 120 days is justified because this matter is exceptionally urgent, the document is short, and we believe from IFRIC discussions that there is likely to be a broad consensus on the issue. We intend to discuss this issue with the Employee Benefits Working Group on 26 January to confirm whether there is likely to be a broad consensus on this issue.

38. A possible timetable is set out below.

Date	**Activity**
2009	
January (this meeting)	Board agrees to proceed with issuing an Exposure Draft of amendments to IFRIC 14 Discuss with Employee Benefits Working Group (26 January) Drafting and balloting
February	Publish ED
April (end)	End of comment period (60 days)
May	Comment letter analysis
June	Board considers comment letter analysis and redeliberates issues raised. Board finalises revised IFRIC 14.
July	Drafting and balloting Publish final amendments

39. This timetable assumes:

    a. The Board needs only one meeting to discuss the issue before finalising an ED

    b. There is only one preballot draft at exposure draft and final standard stage

    c. There is a 60 day comment period

    d. The Board needs only one meeting to consider the comment letter analysis and finalise the amendments.

40. If the Board needs to discuss the issue at more than one meeting, then it would still be possible to publish the amendment before December 2009.

Appendix

Paragraphs 16 and 17 of IFRIC 14 state:

16 If there is no minimum funding requirement, an entity shall determine the economic benefit available as a reduction in future contributions as the lower of:

a) the surplus in the plan and

b) the present value of the future service cost to the entity, ie excluding any part of the future cost that will be borne by employees, for each year over the shorter of the expected life of the plan and the expected life of the entity.

17 An entity shall determine the future service costs using assumptions consistent with those used to determine the defined benefit obligation and with the situation that exists at the end of the reporting period as determined by IAS 19. Therefore, an entity shall assume no change to the benefits to be provided by a plan in the future until the plan is amended and shall assume a stable workforce in the future unless the entity is demonstrably committed at the end of the reporting period to make a reduction in the number of employees covered by the plan. In the latter case, the assumption about the future workforces shall include the reduction. An entity shall determine the present value of the future service cost using the same discount rate as that used in the calculation of the defined benefit obligation at the end of the reporting period.