IASB Meeting | Agenda reference **8A**

Staff Paper | Date **October 2009**

Project **Proposed amendments to IFRIC 14**

Topic **Comment Letter Analysis**

Introduction

1. Exposure draft (ED) *Prepayments of a Minimum Funding Requirement* was published on 27 April 2009 with a comment period ending on 27 July 2009.

2. The ED proposed amendments to IFRIC 14 *IAS19–The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*. The proposed amendments would remove an unintended consequence arising from the treatment of prepayments in some circumstances when there is a minimum funding requirement (MFR).

3. This is a limited scope project that is intended only to fix a specific part of IFRIC 14 for an unintended consequence that may arise when a prepayment is made. It is also a short-term project which is intended to be finalised in time for early adoption by entities in their December 2009 financial statements.

Meeting objectives

4. The objective of this meeting is to present the Board with a summary of responses to the ED and to recommend that the Board:

   (a) confirm the scope of the project (paragraphs 15-32)

   (b) confirm the definitions used (paragraphs 33-45)

   (c) reinstate paragraph 22 of IFRIC 14 (paragraphs 46-51)

   (d) confirm the transitional arrangements (paragraphs 52-53)

This paper has been prepared by the technical staff of the IASCF for discussion at a public meeting of the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IASB.

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRIC or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in IASB *Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

5. Issues raised by respondents regarding the drafting of the requirements have been included in Appendix A along with a brief analysis and proposed action to be taken. We do not intend to discuss drafting issues in this meeting unless requested to do so.

Overview of responses

6. We received 30 responses:

	Standard Setters	Accounting Practice	Actuarial	Preparer	Public	Total
Africa	1					1
Asia Pacific (excl ANZ)	3	1				4
Australia/New Zealand	1	2				3
Europe	5	3	1	1	1	11
International		6	2	1	1	10
North America	1					1
Total	**11**	**12**	**3**	**2**	**2**	**30**

7. The majority of respondents agree with the proposal in the ED that a prepayment of a MFR should be recognised as an asset. However, many of these respondents are concerned that the accounting for prepayments of an MFR will be inconsistent with the accounting for surpluses that arise from actuarial gains and losses.

8. While there is a general consensus that the Board should proceed with the amendment on the basis that it is a limited scope amendment, many appear to prefer a more principles-based solution that would be less limited in scope. We discuss the question of scope in paragraphs 15-32.

9. We also note that respondents who believe the Board should proceed with the amendment requested additional clarification on definitions and requested the Board reinstate paragraph 22 of IFRIC 14. We discuss these comments in paragraphs 33-45 and 46-51 respectively.

10. Three respondents did not agree that the Board should proceed with the amendment. One of these respondents[1] believes that IFRIC 14 is inconsistent with IAS 19 as it considers funding considerations whereas IAS 19 disregards them. This respondent notes that

> …the IASB is adopting a piecemeal approach to addressing this problem and that the amendments proposed will result in additional ambiguities in the application of IFRIC 14 and inconsistent accounting treatments.

11. Another respondent[2] does not believe that an entity that has made a prepayment is necessarily in a better economic position than one that has made no prepayment but which is affected by a lesser MFR.

12. In the staff's view, these views are related to the issue of scope, which is described and discussed in more detail below.

13. The third respondent[3] agreed with the Board's conclusion that a prepayment of a MFR is an asset, but believed that the amendment was not necessary. This respondent argued that an entity could use the 'true and fair override' to achieve the same result.

14. We note that the overwhelming majority of respondents agreed with the Board's conclusion that the Board should eliminate the narrow unintended consequence arising from prepayment of MFR. Although some of these note imperfections in the proposed approach, they nonetheless state that the Board should proceed with the amendment. The rest of the paper discusses the issues raised on the assumption that the Board will proceed with the amendment.

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[1] DTT
[2] Mazars
[3] ACCA

Scope

Respondents' views

15. Some respondents were concerned that the amendments applied only to a prepayment of a MFR. They noted that a similar economic effect arises when a surplus from actuarial gains or losses could be used to reduce future MFR payments. An example is when the regulator approves the use of a surplus for a MFR contributions holiday. When such a surplus occurs, the existing IFRIC 14 permits an entity to recognise an asset only to the extent that the surplus reduces contributions relating to the IAS 19 service cost, not to the extent that it can reduce any higher future MFR payments. These respondents believe that the accounting should be consistent for economically similar situations, ie that the source of the surplus should not affect the accounting. One respondent[4] notes that:

> …where an entity has agreed a contribution reduction with the trustees, the asset to be recognised would be measured based on the amount by which the contributions to be paid [the MFR] are less than the IAS 19 service cost. This leads to an anomaly if the normal level of MFR contributions is higher than this.

16. Further, some view the current proposal and IFRIC 14 as increasing the effect of regulatory funding considerations on the measurement of defined benefit assets and obligations. One respondent[5] notes that:

> IFRIC 14 has introduced funding considerations whereas IAS 19 purposely disregarded them. The broader issue is the extent to which funding requirements should be taken into consideration in determining the assets and liabilities that shall be recognised and whether any discrepancy should exist depending on whether it is an asset or a liability that shall be recognised.

17. Another respondent[6] questioned whether the existence of a MFR changed the characteristics of the benefit, in particular whether the presence of a MFR in

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[4] ICAEW
[5] DTT
[6] PWC

excess of service costs gives rise to a type of 'higher of' plan. This respondent argues that IFRIC 14 results in the defined benefit being measured at the higher of the benefit specified in the benefit formula and the minimum funding requirement.

Staff analysis

18. We agree that IFRIC 14 introduced funding considerations, but only to the following extent:
    - (a) IFRIC 14 effectively requires the pension cost to be measured on a minimum funding basis, but only when that basis is more expensive than the IAS 19 measurement and the entity is unable to recover the additional cost and
    - (b) IFRIC 14 requires expected future MFR contributions to reduce the amount of a surplus that can be recognised as an asset when determining the economic benefit available as reductions in future contributions.
19. The fundamental aspects of IFRIC 14 described above are not within the scope of this project.
20. The proposed amendment extended the impact of funding considerations when there has been a MFR prepayment. Without the proposed amendment, an entity measures the economic benefit available as a reduction in future contributions at:
    - (a) future contributions that would have been needed to cover the *future IAS 19 service* cost less
    - (b) contributions that will still be required under the MFR.
21. For MFR prepayments, the proposed amendment replaces that measure with:
    - (a) future contributions that would have been needed to cover the *MFR* less
    - (b) contributions that will still be required under the MFR.

***Example*[7]**

22. 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.

23. An entity expects a service charge of 10 for a 5-year period 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**	**Total**
Service cost	10	10	10	10	10	**50**
Minimum funding requirement (no prepayment)	15	15	15	15	15	**75**

24. Suppose the entity makes a prepayment of 30 at the beginning of year 5. The MFR contributions would now be:

Year	**1**	**2**	**3**	**4**	**5**	**Total**
Minimum funding requirement (after prepayment)	0	0	15	15	15	**45**

The prepayment does not affect the expected service charge.

25. Without the proposed amendment (paragraph 20), the economic benefit would be:

(a) future contributions that would have been needed to cover the future IAS 19 service cost, less	50
(b) contributions that will still be required under the MFR	45
Economic benefit available as a reduction in future contributions	5

[7] This is the same example from Agenda Paper 10 of the January 2009 meeting.

26. With the proposed amendment (paragraph 21), the economic benefit would be:

(a) future contributions that would have been needed to cover the MFR, less	75
(b) contributions that will still be required under the MFR	45
Economic benefit available as a reduction in future contributions	30

27. Thus the entity recognises an economic benefit of 30, representing the amount of the MFR prepaid.

28. We accept that this makes the measurement of prepayments inconsistent with that of other surpluses. However we note that the Board knew and accepted this when it issued the ED. In the light of the short time in which to make the amendment, the Board decided, to restrict the scope of the amendment to the narrow issue it was asked to address.

29. Nonetheless, we could eliminate that inconsistency by:

    (a) Not proceeding with the proposed amendments for prepayments; or

    (b) Extending the proposed measurement for prepayments to all surpluses whenever an MFR exists.

30. Only one respondent thought we should not proceed with the amendment for prepayments because of this inconsistency. Many respondents stated that we should proceed with the amendment in spite of the inconsistency. As explained in the Basis for Conclusions in the ED, the prepayment is an asset because it reduces payments that the entity would otherwise make in the future. In the example above, the prepayment of 30 reduces the payments required in years 1 and 2.

31. We note that some respondents suggested alternative approaches to extend the scope of the amendment. However, we think that extending the proposed measure for prepayments to all surpluses whenever an MFR exists would present the following problems:

(a) In order to measure the asset on the basis of reduced MFR payments, we need to know what the expected reduction in future MFR payments is. In the case of a prepayment, it is obvious – it is the amount that has been prepaid. In the case of other surpluses, it would require estimating what the MFR payments would have been had the surplus not existed, which in some cases may be difficult to determine.

(b) Any such proposals would require re-exposure and hence the amendment would not be finalised in time for December 2009 financial statements.

32. We therefore recommend that the Board does not extend the scope of the amendments beyond the treatment of voluntary prepayments of minimum funding requirements. If appropriate, the Board could consider whether to include issues beyond the scope of this project in a future comprehensive review.

Question 1
Does the Board agree to proceed with an amendment to IFRIC 14 that addresses only the treatment of a prepayment of a minimum funding requirement?

Definitions

Respondents' views

33. Some respondents requested further guidance for the following terms:

(a) Unconditional right to a refund – respondents requested further details as to what an unconditional right to a refund of surplus meant, including guidance on the effect of trustees' powers on termination of a plan in determining whether a right was conditional or not.

(b) Minimum funding requirement – respondents requested clarification over whether the requirements need to be legislative or just an agreement between the trustees and the plan sponsor. Some also

requested clarification of whether the time period for the purpose of calculating the economic benefit extended to the end of the most recent funding report, the end of the payment schedule included in that funding report or the life of the plan. Respondents noted that divergence in practice was emerging from these different interpretations.

(c) Prepayment – respondents note that this term is not defined and questioned whether the allocation of a portion of a surplus to a separate ear-marked account would constitute a prepayment. Respondents also questioned whether a prepayment would have to be tracked in subsequent years.

Staff analysis

Unconditional right to a refund and minimum funding requirement

34. The terms 'unconditional right to the refund' and 'minimum funding requirement' are used in the existing version of IFRIC 14. The proposed amendment did not affect the definitions of these terms, which are discussed in the Basis for Conclusions to IFRIC 14 as follows.

35. Paragraph BC12 of the Basis for Conclusions of IFRIC 14 explains that:

> The IFRIC concluded that an entity controlled the asset only if the entity has an unconditional right to the refund. If that right depends on actions by a third party, the entity does not have an unconditional right.

36. Paragraph BC4 notes that:

> The IFRIC decided to clarify that for the purpose of the Interpretation a minimum funding requirement is **any** requirement for the entity to make contributions to **fund** a post-employment or other long-term defined benefit plan. [emphasis added]

37. Further paragraph 2 of the Interpretation states that:

> Such requirements normally stipulate a minimum amount or level of contributions that must be made to a plan **over a given period**. [emphasis added]

38. In our view any amendments to the definitions of ‘unconditional right to a refund’ and ‘minimum funding requirement’ go beyond the scope of this narrow amendment to IFRIC 14. In addition, we think that the guidance in the Basis for Conclusions on IFRIC 14 on the unconditional right to a refund is sufficient for an entity to apply professional judgement to determine whether an unconditional right to a refund exists.

39. However, we agree that it would be helpful to clarify that a minimum funding requirement must be enforceable, rather than a statement of intent. But given reports of diversity in practice in the comment letters, the staff believes that any amendment would need to be exposed for comment.

40. Thus we propose that, when we incorporate the requirements of IFRIC 14 into IAS 19 in the forthcoming ED of amendments to IAS 19 (main IAS 19 project, see cover note), the Board clarify that a minimum funding requirement is any *enforceable requirement* for the entity to make contributions to fund a post-employment or other long-term defined benefit plan.

41. We think this would clarify the intention in IFRIC 14 and would be consistent with the requirement that an entity should recognise a liability for future MFR payments for past service that cannot be recovered.

42. Making this change in the forthcoming main IAS 19 ED allows the proposal to be exposed for public comment.

Prepayment

43. IFRIC 14 states that a prepayment is ‘any amount of any minimum funding requirement contributions that the entity has paid before being required to do so that gives the entity the right to reduce future minimum funding requirement contributions.’ In the staff’s view, any further definition would provide too detailed guidance.

44. A surplus allocated to a separate account for the purpose of reducing future MFR payments may meet the definition of prepayment if the entity can identify a payment that gave rise to the surplus. That is a question of detail we would

not expect to cover. Whether any such allocated amount should be treated in the same way as a prepayment regardless of whether it meets the definition of a prepayment is a question of scope, which was discussed in the previous section.

45. We do not think entities will need to track the prepayment and the investments it was used to purchase on an ongoing basis. All that an entity needs to determine at each balance sheet date is the amounts of future MFR payments met by the voluntary prepayment. The staff does not think we need to include any guidance on this.

Question 2
Does the Board agree: (a) not to provide additional guidance in IFRIC 14 on the definitions of 'unconditional right to a refund', 'minimum funding requirement' and 'prepayment'? (b) to propose in the forthcoming ED of proposed amendments to IAS 19 that the definition of a minimum funding requirement be amended to clarify that it must be enforceable?

Paragraphs 22 of IFRIC 14

Respondents' views

46. Many respondents were unsure whether the amendment to paragraph 20 and the addition of paragraph 20A replaced all of the requirements of deleted paragraph 22. These respondents believed that the requirements of paragraph 22 are still valid and would like the Board to ensure that no requirements are lost in the re-drafting.

Staff analysis

47. Paragraph 22 requires that:

> 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. However, the amount of the asset available as a reduction in future contributions can never be less than zero.

48. The second sentence of the above is captured in paragraph 20A which was introduced in the ED.

> If the amount determined in accordance with paragraph 20(b) is less than zero, an entity shall not recognise a liability or a reduction in the asset determined in accordance with paragraph 20(a).

49. Paragraph 22 was deleted because the first sentence of paragraph 22 was thought to be redundant due to the existing requirements of paragraph 20 which was redrafted as paragraph 20(b)(ii) as follows:

> (b) the amount of any economic benefit available as a reduction in future contributions determined as the lower of:
>
> (i) the surplus in the plan excluding any prepayment in (a); and
>
> (ii) the estimated future service cost *in each period* in accordance with paragraphs 16 and 17, less the estimated minimum funding requirement contributions that would be required for future service *in that period* if there were no prepayment of those contributions… [emphasis added]

50. Respondents are concerned that by removing paragraph 22 from IFRIC 14, we inadvertently eliminated the notion that an entity should combine all MFRs and service costs for future periods then assess whether the total is less than zero. They believe that it is not clear under the amended requirements whether the difference between the MFR and the service cost is calculated on a year by year basis or for all the years together. This impacts the calculation since a negative in one year can either be treated as a zero or offset positives in other years.

51. They argue that paragraph 22 in the existing IFRIC 14 is clear that the amount needs to be determined for all the years together. The staff do not believe the Board intended to change this requirement.

Question 3
Does the Board agree to clarify that it did not intend to change the requirements of paragraph 22 by reinstating it?

Transition

52. The ED proposed that an entity should apply the amendments from the beginning of the earliest comparative period presented in the first financial statements in which the entity applied IFRIC 14. Respondents raised a drafting issue in paragraph 28A relating to the timing of the adjustment to retained earnings which is discussed in Appendix A. There were no other objections to the transition requirements.

Question 4
Does the Board confirm that an entity should apply the amendments from the beginning of the earliest comparative period presented in the first financial statements in which the entity applied IFRIC 14?

53. Effective date and early adoption are discussed in the cover note (agenda paper 8).

Appendix A – Drafting issues

This appendix lists the drafting comments set out in the comment letters, along with a brief analysis and proposed action to be taken. We do not intend to discuss drafting issues in this meeting unless requested to do so. The staff would appreciate advance notification of any drafting issue that any Board member wishes to raise at the meeting.

Para	**Issue**	**Analysis**	**Proposed Action**
20	Respondents noted that the proposed amendments are not clear whether the recognition of an asset in respect of a prepayment would be restricted to a plan in a surplus position. These respondents do not believe that a separate asset for the prepayment should be recognised if a plan continues to be in a deficit position after the prepayment. They suggest that the amendments should be clear that all of paragraph 20 applies only when paragraph	The question is whether the wording of the amendment requires an asset to be recognised for the prepayment, even if overall the plan is in deficit. For example, if the plan before a prepayment had a deficit of 70 and a prepayment is made of 50, does the amendment require recognition of an asset of 50 and a deficit of 70, or a net deficit of 20. We think the Board's intention was not to require the separate recognition of an asset in these cases.	Amend drafting to ensure that a separate asset for the prepayment is not required by using the term 'economic benefit' instead of 'asset' to describe the prepayment. This will tie in with the requirements of IAS 19.58(b) which refers to the economic benefit available and it will also be consistent with the words used in the rest of IFRIC 14, including the words used in other items discussed below.

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Para	Issue	Analysis	Proposed Action
	IAS 19.58(b) is applicable.		
20	Some respondents noted that the ED does not state why a 'lower-of' hurdle is introduced in 20(b)(i) or an explanation of its intended impact. These respondents were concerned with how the hurdle introduced in paragraph 20(b) interacts with the existing hurdles in paragraphs 16 of IFRIC 14 and 58(b) of IAS 19. Respondents note that paragraphs 54 and 58 of IAS 19 always guarantee that the asset recognised is not higher than the surplus in the plan.	'Lower of' has been included to ensure that the amount recognised as an asset does not exceed the surplus in the plan. A similar requirement is included in paragraph 16 which relates to the economic benefit available as a contribution reduction. However we also note that 58 of IAS 19 already limits the amount of any asset to the lower of the amount calculated under paragraph IAS 19.54 and the result of IAS 19.58(b).	We suggest deleting the 'lower of' requirements from both paragraphs 16 and 20. The requirement is redundant because it is already specified in IAS 19.58.
20(b)(ii)	Some respondents believe that 'present value' was inadvertently omitted from paragraph 20 (b) (ii).	We note that IAS 19.58(b)(ii) already requires the present value of the economic benefits, and that 'present value' is also used in	We suggest deleting the 'present value' requirements from both paragraphs 16 and 20. The requirement is redundant because it is

Para	Issue	Analysis	Proposed Action
		paragraph 16.	already specified in IAS 19.58.
21	A few respondents noted that 'in assumptions' was inserted in paragraph 21. These respondents want the Board to explain why this change has been made as it appears it is limiting any changes included in the calculation to only those that arise due to changes in assumptions as opposed to other potential changes.	The amendment was included to improve consistency with the preceding sentences which refer to assumptions used in the calculations.	Retain "in assumptions". However we propose to clarify in the final amendment that the first sentence of paragraph 21 refers to the surplus excluding any prepayment in 20(a).
28A	Some respondents believe the transition requirements as drafted in the ED need further clarification, particularly relating to the timing of the adjustment to retained earnings: An entity shall apply the amendments … from the beginning of the earliest comparative	Concern is raised around the use of 'that period' in the second sentence (ie the earliest comparative period presented in the first financial statements in which the entity adopted IFRIC 14). Since 'that period' may not be a period presented in the financial	Redraft paragraph as follows: An entity shall apply the amendments in paragraphs 18, 20, 20A, 21 and 22 from the beginning of the earliest comparative period presented in the first financial statements in which the entity applied IFRIC 14. <u>In the first</u>

Para	Issue	Analysis	Proposed Action
	period presented **in the first financial statements in which the entity applied IFRIC 14.** An entity shall recognise in retained earnings at the beginning of **that period** any initial adjustment arising from the application of those amendments. [emphasis added]	statements when the amendment is adopted then the adjustment to retained earnings will not be in the financial statements.	<u>financial statements in which an entity applies those amendments, it</u> ~~An entity~~ shall recognise <u>the resulting adjustment</u> in retained earnings at the beginning of ~~that period~~ <u>the earliest comparative period presented</u> ~~any initial adjustment arising from the application of those amendments~~.
General	Some respondents questioned why the ED changed the phrase ‘future accrual of benefits’ to ‘future service’	When developing the ED, some Board members found the term future accrual of benefits confusing. The phrase ‘future service’ means the same and is consistent with the rest of IAS 19.	We propose to explain in the Basis for Conclusions why the wording has changed.