STAFF PAPER

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IFRS Interpretations Committee Meeting

Project	**IFRIC 14 *IAS19—The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction***
Paper topic	Availability of refunds from a defined benefit plan managed by an independent trustee

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Background

1. The IFRS Interpretations Committee (the Interpretations Committee) received a request to clarify whether a trustee's power to augment benefits or to wind up a plan affects the employer's unconditional right to a refund and thus restricts recognition of an asset, in accordance with IFRIC 14 *IAS19—The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*.

2. In May, the Interpretations Committee discussed this issue. The question is whether the trustee's unilateral power to use a surplus is relevant to the existence of a right to a refund of a surplus in the following circumstances.

   (a) the trustee acts on behalf of the plan's members and is independent of the employer;

   (b) the trustee has discretion, in the event of a surplus arising in the plan, to make alternative use of that surplus:

      (i) by augmenting the benefits payable to members; or

      (ii) by winding up the plan through purchase of annuities, or both; and

(c) the trustee has not exercised such a power at the end of the reporting date.

3. The question discussed relates to 'closed plans' that are closed to accrual of future benefits, with the result that there will be no future service costs (ie economic benefits are available only through a refund of a surplus).

4. At its May meeting, the Interpretations Committee tentatively decided to develop either an amendment or an Interpretation on this issue and requested further analysis to clarify how certain facts affect the measurement and how an entity should distinguish the facts that are relevant to the existence of the entity's right to a refund of a surplus from the facts that are relevant to measurement of the surplus.

5. Following a discussion with the submitter, we have added the following additional facts to be considered in this issue:

   (a) The entity:

      (i) does not have a right to a refund of a surplus during the life of the plan, because the plan liabilities must be settled in order to obtain the refund; but

      (ii) it has a right to a refund of a surplus, assuming the gradual settlement of the plan liabilities over time, until all members have left the plan and if a surplus exists after the end of the life of the plan; and

      (iii) it has a right to a surplus assuming the full settlement as a plan wind-up through purchase of annuities, if a surplus exists after the settlement;

   (b) The entity thinks that:

      (i) it is uncertain whether and when the trustee will use the surplus to augment benefits; and

      (ii) it is also uncertain whether and when the trustee will decide to wind up a plan; but

      (iii) there is a high possibility that the trustee will use the surplus to augment benefits or to wind up the plan through buying annuities at some point during the life of the plan.

Objective and structure of this paper

6. The objective of this paper is:

   (a) to clarify the steps that cover when and how an entity should consider the trustee's powers to use a surplus; and

   (b) to propose an amendment to IFRIC 14.

7. This Agenda Paper is structured as follows:

   (a) staff technical analysis;

   (b) staff recommendation;

   (c) questions for the Interpretations Committee; and

   (d) Appendix A—Proposed amendment to IFRIC 14.

Staff technical analysis

8. In IAS 19 *Employee Benefits*, an entity calculates a surplus as the fair value of the plan asset minus the present value of the defined benefit obligation (DBO) at the end of a period. The net defined benefit asset to be recognised in the financial statement should be the lower of the surplus and the asset ceiling (ie the economic benefits available to the entity from the surplus). IFRIC 14 provides an interpretation on the application of the requirements relating to the asset ceiling.

9. We analyse the steps in IAS 19 and IFRIC 14 that cover when and how an entity should consider the trustee's powers to augment benefits, to wind up the plan and to purchase annuities, in the circumstances described in the background section of this paper.

10. We also analyse whether the result after those steps were taken would provide a fair reflection of the economic substance for this issue.

Step 1: Measure DBO and plan assets in IAS 19

11. An entity should measure the DBO and fair value of plan assets as the first step.

Trustees' power to augment benefits

12. In May, the Interpretations Committee noted that:

(a) if the trustee has decided to use a surplus by augmenting the benefits and hence this is reflected in the formal terms of a plan or if the entity has a constructive obligation , this fact should be considered when the entity measures its DBO in accordance with paragraph 88 of IAS 19; and

(b) the amount of surplus to be recognised could be zero, as a consequence of the measurement of the DBO.

13. If an entity does not have an obligation, it does not reflect the trustees' power to augment benefits in the future when it measures the DBO at the end of a period.

14. Paragraph 61 explains a constructive obligation. It states:

> An entity shall account not only for its legal obligation under the formal terms of a defined benefit plan, but also for any constructive obligation that arises from the entity's informal practices. Informal practices give rise to a constructive obligation where the entity has no realistic alternative but to pay employee benefits. An example of a constructive obligation is where a change in the entity's informal practices would cause unacceptable damage to its relationship with employees.

15. Consequently, we think that if the trustee has exercised such a power to augment benefits, or informal practices have given rise to a constructive obligation by which the entity has no realistic alternative but to pay augmented benefits, an entity should reflect that when it measures the DBO.

16. We think that the possibility that the trustee may exercise the power to augment benefits in the future is not sufficient to establish that an entity has an obligation at the end of a period.

Trustees' power to wind up the plan

17. Paragraph 110 of IAS 19 states that an entity shall recognise a gain or loss on the settlement of a defined benefit plan when the settlement occurs.

18. Paragraph BC113 of IAS 19 indicates that an entity should always use the projected unit credit method (ie IAS 19's measurement basis), even in the case of a closed plan or in the case in which an entity expects a future settlement. The DBO in IAS 19 does not reflect the risk premium related to future cash flow to pay benefits and, consequently, it is different from prices in markets. (Paragraph BC13 of IFRIC 14 also explains that the cost of annuities available on the market is expected to be significantly higher than the value of the DBO in IAS 19.)

19. Consequently, we note that the power to wind up the plan is not relevant to the measurement of the DBO at the end of the period.

Trustees' power to purchase annuities

20. The trustees' power to buy annuities is the power to make an investment decision on plan assets.

21. The market price to buy annuities would be generally higher than the amount of the DBO that would be covered by the annuities, because the price of annuities would reflect the risk to be covered by annuities but the DBO in IAS 19 does not reflect the risk premium related to future cash flow to pay benefits, as described in paragraph 16 of this paper.

22. 'Fair value' of plan assets in IAS 19 should be the price 'at the measurement date' (see paragraph 8 of IAS 19).

23. Consequently, we note that the power to buy annuities is not relevant to the measurement of the DBO and the related plan assets at the end of a period.

Step 2: Calculate a surplus

24. An entity calculates a surplus as the fair value of plan asset minus the present value of the DBO at the end of a period, after Step 1.

25. If a surplus exists, an entity needs to continue with the following steps to consider the asset ceiling.

Step 3: Assess whether an entity has an unconditional right to a refund of a surplus in IFRIC 14

26. An entity should assess whether it has an unconditional right to a refund of a surplus in IFRIC 14. This assessment is required in each of the three scenarios described in paragraph 11 of IFRIC 14, which states:

> A refund is available to an entity only if the entity has an unconditional right to a refund:
>
> (a) during the life of the plan, without assuming that the plan liabilities must be settled in order to obtain the refund
>
> (b) assuming the gradual settlement of the plan liabilities over time until all members have left the plan; or
>
> (c) assuming the full settlement of the plan liabilities in a single event (ie as a plan wind-up).
>
> An unconditional right to a refund can exist whatever the funding level of a plan at the end of the reporting period.

27. Paragraph 12 of IFRIC 14 states:

> If the entity's right to a refund of a surplus depends on the occurrence or non-occurrence of one or more uncertain future events not wholly within its control, the entity does not have an unconditional right and shall not recognise an asset.

28. In accordance with paragraphs 11–12 of IFRIC 14, we think that an entity has an unconditional right to a refund of a surplus, if a trustee cannot refuse an entity's request for a refund of a surplus in one or more of the cases described in paragraph 11. For example, we think that an entity could have an unconditional right to a refund of a surplus if a trustee:

(a) can refuse the entity's request for a refund of a surplus, during the life of the plan (paragraph 11(a)); but

(b) cannot refuse the entity's request for a refund of a surplus, assuming the gradual settlement of the plan liabilities over time until all members have left the plan (paragraph 11(b)); and

(c) cannot refuse the entity's request for a refund of a surplus, assuming a plan wind-up (paragraph 11(c)).

29. As the Interpretations Committee noted at its May meeting, the fact that an existing surplus at the balance sheet date could be decreased or extinguished by uncertain future events that are beyond the control of the entity is not relevant to the existence of the right to a refund, in accordance with paragraphs 11–12 and BC10 of IFRIC 14.

30. Consequently, the trustees' powers to augment benefits, to wind up the plan and to purchase annuities do not affect this assessment in Step 3 of whether the entity has an unconditional right.

31. If an entity has an unconditional right to refund of a surplus, an entity should measure the maximum economic benefit available in the following step.

Step 4: Measure maximum economic benefit available in accordance with IFRIC 14

32. An entity should determine the maximum economic benefit available, in accordance with paragraph 9 of IFRIC 14, which states:

> The economic benefit available does not depend on how the entity intends to use the surplus. An entity shall determine the maximum economic benefit that is available from refunds, reductions in future contributions or a combination of both. An entity shall not recognise economic benefits from a combination of refunds and reductions in future contributions based on assumptions that are mutually exclusive.

33. To decide the maximum economic benefit, an entity should measure the economic benefit available in each of the scenarios in which an entity has an unconditional right to a refund of a surplus. For example, if an entity has an unconditional right assuming a gradual settlement (paragraph 11(b)) and a plan wind-up (paragraph 11(c)), it measures each economic benefit available in the two cases to determine the maximum.

34. We think that an entity does not need to assume that only a wind-up (paragraph 11(c)) will occur, if the trustee has an unilateral power to decide a wind-up or to purchase annuities. This is because paragraph 11 of IFRIC 14 does not impose such a requirement and an entity should use 'maximum economic benefits available' in accordance with paragraph 9 of IFRIC 14.

35. Paragraph 13 of IFRIC 14 states that an entity should measure the economic benefit available through a refund as the amount of the surplus at the end of the period that the entity has a right to receive as a refund, less any 'associated costs'.

36. Paragraph 14 of IFRIC 14 explains that an entity should include the costs to the plan of settling the plan liabilities and making the refund in measuring the amount of a refund available when the plan is wound up (paragraph 11(c)). It also explains that an entity should deduct the costs of any insurance premiums that may be required to secure the liability on wind-up. The amount of a surplus after the deduction of the costs of an insurance premium could be zero, if an entity has an unconditional right only in the case of a plan wind-up (paragraph 11(c)).

37. We think that the cost of insurance premiums to secure the liability on wind-up (paragraph 11(c)) is not relevant when an entity has an unconditional right and measures economic benefits available assuming gradual settlement (paragraph 11(b)); such premiums are not 'associated costs' and are therefore not relevant when a gradual settlement is assumed.

38. Consequently, we note that an entity would use the amount of a surplus less associated costs (for example, taxes on refunds, which is an example given in paragraph 13 of IFRIC 14) in the case of a gradual settlement (paragraph 11(b)) as the maximum economic benefits available, if this (the case of a gradual

settlement) was identified as the unconditional right that led to the maximum value to the entity.

Staff conclusions

The result of the steps

39. As a consequence of the analysis in the steps above, we note that the powers to use a surplus to augment benefits, to wind up the plan and to purchase annuities are not relevant to the measurement of a surplus in Steps 1–2, if an entity has no obligation to augment benefits. This is because:

    (a) an entity should not recognise an obligation to enhance benefits, when it does not have any such obligation; and

    (b) an entity should use the amounts of the DBO and plan assets measured as of the end of the period and should not reflect either future settlement or future investments when measuring them.

40. We also think that these trustees' powers are not relevant to assessing whether an entity has an unconditional right to a refund of a surplus in Step 3, because the facts that any surplus could be reduced or extinguished by uncertain future events that are not within the entity's control are not relevant to the existence of its right to a refund of a surplus, as the Interpretations Committee noted at its May meeting.

41. We note and have a concern that these trustees' powers would be ignored in the measurement of economic benefits available in Step 4, if an entity has a right of a refund and measures economic benefits available during the life of the plan (paragraph 11(a) of IFRIC 14) or assuming gradual settlement (paragraph 11(b) of IFRIC 14). This is because:

    (a) an entity should use the maximum economic benefits available in accordance with paragraph 9 of IFRIC 14;

    (b) an entity should consider the costs of an insurance premium to be paid to secure liabilities on wind-up only under the scenario of winding up the plan (paragraph 11(c)); and

(c) an entity would use the amount of a surplus less the associated cost as the maximum economic benefits, if an entity has an unconditional right to a refund in the cases in paragraphs 11(a) or (b).

42. This would result in ignoring the possibility that an entity does not receive cash in the future, because the current guidance on measurement described in paragraphs 13-15 of IFRIC 14 is silent on the case that the amount of a refund is at the discretion of a trustee or any other third party.

Do the steps required fairly reflect the economic substance?

43. The conclusions above are based on the current IFRIC 14. However, we note that that when the Interpretations Committee first developed IFRIC 14, it appears that it did not envisage the circumstances described in this issue, surveying the past discussion and the related agenda paper (Agenda Paper 5 for May IFRIC 2007).

44. Paragraph BC 10 of IFRIC 14 explains future events does not affect the existence or measurement of the asset at the end of the period but it does not deal explicitly with future decisions by a trustee that is not controlled by the entity. Paragraph BC10 of IFRIC 14 states:

> In the responses to D19, some argued that an entity may expect to use the surplus to give improved benefits. Others noted that future actuarial losses might reduce or eliminate the surplus. In either case there would be no refund or reduction in future contributions. The IFRIC noted that the existence of an asset at the end of the reporting period depends on whether the entity has the right to obtain a refund or reduction in future contributions. The existence of the asset at that date is not affected by possible future changes to the amount of the surplus. If future events occur that change the amount of the surplus, their effects are recognised when they occur. Accordingly, if the entity decides to improve benefits, or future losses in the plan reduce the surplus, the consequences are recognised when the decision is made or the losses occur. The IFRIC

noted that such events of future periods do not affect the existence or measurement of the asset at the end of the reporting period.

45. The IFRIC noted that "the available surplus should be measured at the amount that the entity could receive from the plan" (see paragraph BC13 of IFRIC 14) but did not provide guidance on measurement if the amount of a refund is dependent on how much the surplus will be put to alternative uses at the discretion of a trustee or any other third party, thereby denying the entity the refund of the full surplus. We understand that this circumstance was not envisaged at the time of developing IFRIC 14.

46. We think that we should provide guidance in IFRIC 14 to require an entity to consider the trustees' power to enhance benefits for this case, because we think that the staff conclusions based on the current IFRIC 14 would not give a fair reflection of the economic substance in this case.

47. In the specified fact pattern, we think that an entity has a right to a refund and that the costs of an insurance premium to be paid on wind-up are relevant only under the scenario of winding up the plan. However, we think that the amount of an asset should be the amount expected to be received, reflecting the possibility that the surplus is used to augment benefits at the discretion of a trustee.

48. We reported the issue and the Interpretations Committee's tentative decision at its May meeting to IASB members. Many IASB members also expressed concern over recognising and measuring the asset, ignoring the possibility of changes to future cash inflows as a consequence of the trustee's power. Some thought that such an accounting treatment is not consistent with descriptions of an asset in the *Conceptual Framework,* because the entity does not have control over the surplus, in so far as the trustee can prevent the entity's access to the surplus by utilising the surplus to enhance the benefits.

49. We think that an entity should measure the economic benefits available through a refund of a surplus at the amount expected to be received, taking account of past experiences and circumstances including legal terms in its jurisdiction, if the amount of a refund is at the discretion of a trustee or any other third party.

Staff recommendation

50. To clarify the points noted in the staff conclusions and provide guidance on measurement for specific cases, we propose an amendment to IFRIC 14 as described in Appendix A.

51. We have assessed the issues against the agenda criteria of the Interpretations Committee and against the additional criteria for annual improvements.[1]

52. We think that this issue is still appropriate as an agenda item for annual improvements, because our current proposal in Appendix A would provide missing guidance but would not add or change fundamental principles in IAS 19 and IFRIC 14.

Transition provisions and effective date

53. We propose that an entity should apply the amendment retrospectively to achieve comparability between periods. We think that the cost of applying the amendment does not much depend on whether an entity was to apply it retrospectively or not, because we do not expect that either circumstances or judgments related to this issue change materially every period. Earlier application should be permitted.

First-time adopters

54. The basic principle in IFRS 1 *First-time Adoption of International Financial Reporting Standards* is full retrospective application. For IAS 19 and IFRIC 14, there are no exemptions or exceptions other than those for the changes in employee benefit costs that were included in the carrying amount of assets outside the scope of IAS 19 (for example, those within the scope of IAS 2 *Inventories*) and for disclosure about the sensitivity (see paragraph E5 of IFRS1). Because we did not identify any justification for additional exemptions, we think that an amendment to IFRS 1 is unnecessary.

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[1] . For details of the assessments, see Appendix A in the paper for the Interpretations Committee in May: http://www.ifrs.org/Meetings/MeetingDocs/Interpretations%20Committee/2014/May/AP14_-_IFRIC_14_Availability_of_refunds_from_DP_plans[1].pdf.

Consequential amendments

55. We have reviewed other Standards for potential consequential amendments triggered by this proposed amendment. As a result of this review, we do not propose any consequential amendments.

Questions for the Interpretations Committee

Questions
1. Does the Interpretations Committee agree with the staff's technical analysis in paragraphs 35-49 of this paper?
2. Does the Interpretations Committee agree with proposed amendment in Appendix A of this paper, as an item for annual improvement?

Appendix A—Proposed amendment to IFRIC 14 *IAS 19—The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*

Paragraphs 11–13 are amended and paragraphs 15A and 27D is added. New text is underlined. Paragraphs 9–10 and 14–15 have not been amended but have been included for ease of reference.

9 The economic benefit available does not depend on how the entity intends to use the surplus. An entity shall determine the maximum economic benefit that is available from refunds, reductions in future contributions or a combination of both. An entity shall not recognise economic benefits from a combination of refunds and reductions in future contributions based on assumptions that are mutually exclusive.

10 In accordance with IAS 1, the entity shall disclose information about the key sources of estimation uncertainty at the end of the reporting period that have a significant risk of causing a material adjustment to the carrying amount of the net asset or liability recognised in the statement of financial position. This might include disclosure of any restrictions on the current realisability of the surplus or disclosure of the basis used to determine the amount of the economic benefit available.

The right to a refund

11 A refund is available to an entity only if the entity has an unconditional right to a refund:

(a) during the life of the plan, without assuming that the plan liabilities must be settled in order to obtain the refund

(b) assuming the gradual settlement of the plan liabilities over time until all members have left the plan; or

(c) assuming the full settlement of the plan liabilities in a single event (ie as a plan wind-up).

An unconditional right to a refund can exist whatever the funding level of a plan at the end of the reporting period. <u>The possibility that a surplus could be reduced or extinguished by future events does not affect the existence of the asset at the end of the reporting period.</u>

12 If the entity's right to a refund of a surplus depends on the occurrence or non-occurrence of one or more uncertain future events not wholly within its control, the entity does not have an unconditional right and shall not recognise an asset. <u>For example, an entity has an unconditional right to a refund of a surplus if no third parties can refuse an entity’s request for a refund of a surplus in one or more of the three cases described in paragraph 11 of IFRIC 14.</u>

Measurement of the economic benefit

13 An entity shall measure the economic benefit available as a refund as the amount of the surplus at the end of the reporting period (being the fair value of the plan assets less the present value of the defined benefit obligation) that the entity has a

right to receive as a refund, less any associated costs. For instance, if a refund would be subject to a tax other than income tax, an entity shall measure the amount of the refund net of the tax. If an entity has an unconditional right in respect of more than one of the three cases described in paragraph 11, the entity should determine the maximum economic benefits available in accordance with paragraph 9 of IFRIC 14.

14 In measuring the amount of a refund available when the plan is wound up (paragraph 11(c)), an entity shall include the costs to the plan of settling the plan liabilities and making the refund. For example, an entity shall deduct professional fees if these are paid by the plan rather than the entity, and the costs of any insurance premiums that may be required to secure the liability on wind-up.

15 If the amount of a refund is determined as the full amount or a proportion of the surplus, rather than a fixed amount, an entity shall make no adjustment for the time value of money, even if the refund is realisable only at a future date.

15A If the amount of a refund is dependent on how much the surplus will be put to alternative uses at the discretion of a trustee or any other third party, an entity shall use the amount expected to be received, taking account of past experiences and other circumstances including legal terms.

…

Effective date

…

27D *Annual Improvements to IFRSs [2013–2015] Cycle*, issued in [date], amended paragraphs 11–13 and added paragraph 15A. An entity shall apply that amendment retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* for annual periods beginning on or after [date]. Earlier application is permitted. If an entity applies that amendment for an earlier period it shall disclose that fact.