

STAFF PAPER

January 2015

IASB Meeting

Project	Narrow-scope amendments to IAS 19 <i>Employee Benefits</i> and IFRIC 14 <i>IAS19—The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction</i>		
Paper topic	Availability of a refund of a surplus from a defined benefit plan when an independent trustee has unilateral powers		
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Introduction

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. The Interpretations Committee discussed this issue at its May, July and September 2014 meetings. The Interpretations Committee decided to propose that amendments to IAS 19 *Employee Benefits* and IFRIC 14 should be made as a narrow scope amendment.

Purpose of this paper

3. The objective of this paper is to:
 - (a) provide a brief description of the issue;
 - (b) explain the rationale for the Interpretations Committee’s decision to recommend that the IASB should amend IAS 19 and IFRIC 14 through narrow-scope amendments;

- (c) analyse the transition provisions and first-time adoption; and
- (d) ask the IASB whether it agrees with the Interpretations Committee's recommendation and the staff recommendation.

Overview of the issue

4. Paragraph 64 of IAS 19 *Employee Benefits* limits the measurement of a net defined benefit asset to the lower of the surplus in the defined benefit plan and the asset ceiling. Paragraph 8 of IAS 19 defines the asset ceiling as 'the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan'.
5. IFRIC 14 provides an interpretation of the requirements in IAS 19, addressing when refunds or reductions in future contributions should be regarded as available.
6. The question raised 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 a unilateral power to:
 - (i) augment the benefits payable to members; or
 - (ii) wind 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.
7. If the plans are closed to accrual of future benefits, the impact of this issue could be significant, because economic benefits from reductions in future contributions are not available (ie economic benefits are available only from a refund of a surplus).
8. In the circumstances mentioned above, there are the following views in practice.

View 1: The trustee's unilateral power to make alternative use of a surplus means that the employer (the entity) does not have an unconditional right to a refund of that surplus, and

therefore, recognition of an asset based on a refund of the surplus is restricted.

View 2: The trustee's unilateral power to make alternative use of a surplus does not, in itself, mean that the employer (the entity) does not have an unconditional right.

9. The result of the outreach conducted on this issue implied that this issue could have significant impacts on some cases and that diversity in practice exists. The result of our outreach also implied that such a trustee's unilateral power to affect a pension promise exists in a number of plans in the UK. Trustees' unilateral powers to buy annuities (without changing a pension promise) are common in the UK and in other jurisdictions.

View 1

10. The supporters of View 1 think that an entity does not have an unconditional right to a refund, because paragraph 12 of IFRIC 14 states that:

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.

11. They think that an entity cannot recognise an asset based on a refund of the surplus, because a refund is not available if an entity does not have an unconditional right to a refund. Paragraph 11 of IFRIC 14 states (emphasis added):

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 (eg in some jurisdictions, the entity may have a right to a refund during the life of the plan, irrespective of whether the plan liabilities are settled); or
- (b) assuming the gradual settlement of the plan liabilities over time until all members have left the plan; or

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when an independent trustee has unilateral powers

(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.

12. The Interpretations Committee's conclusion was close to View 1, particularly for the unilateral power to enhance benefits. The section of this paper on *The Interpretations Committee's conclusions and their rationales* explains it in detail.

View 2

13. The supporters of View 2 think that the fact that any surplus could be extinguished by uncertain future events, including the trustees' future action, is not relevant to the existence of the right to a refund, referring to paragraph BC10 of IFRIC 14. (Paragraph BC10 of IFRIC 14 explains the Interpretations Committee's reasoning related to the last sentence of paragraph 11 of IFRIC 14.)
14. Paragraph BC10 of IFRIC 14 states that (emphasis added):

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 balance sheet date 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 balance sheet date.

15. The Interpretations Committee noted that paragraph BC10 of IFRIC 14 had not envisaged the circumstances in which trustees have such unilateral rights.

The Interpretations Committee's conclusions and its rationales ¹

The unilateral power to enhance benefits

16. The Interpretations Committee observed that the amount of the surplus that the entity recognises as an asset on the basis of a future refund should not include amounts that other parties have the unilateral power to use for other purposes that change the pension promise, for example by enhancing benefits for plan members.
17. This is because this power restricts an entity's ability to use the surplus to generate future cash inflow to the entity and because the entity cannot estimate reliably the amount to be received.
18. On the basis of its analysis and observations, the Interpretations Committee concluded that additional guidance is needed and that such guidance would state that:

The amount of the surplus that the entity recognises as an asset on the basis of a future refund should not include amounts that a third party has the unilateral power to use for other purposes that change the pension promise, for example by enhancing benefits for plan members.

¹ For further detail, visit our web page:

<http://www.ifrs.org/Current-Projects/IASB-Projects/IFRIC-14-IAS-19/Pages/Discussion-and-papers-stage-1.aspx>

The unilateral power to decide to wind up the plan at any time

19. The Interpretations Committee also thought that an entity's ability to realise economic benefits through 'a gradual settlement' is restricted if a trustee can decide at any time to wind up the plan, even though paragraph 11 of IFRIC 14 allows the assumption of a gradual settlement over time until all members have left the plan.
20. This is because the third party can decide to wind up the plan at any time before 'all members have left the plan' and therefore the gradual settlement can be prevented. Paragraph 11 of IFRIC 14 states (emphasis added):

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 (eg in some jurisdictions, the entity may have a right to a refund during the life of the plan, irrespective of whether the plan liabilities are settled); **or**

(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.

21. On the basis of its analysis and observations, the Interpretations Committee concluded that additional guidance is needed and that such guidance would state that:

An entity does not have an unconditional right to a refund of a surplus, assuming the gradual settlement described in paragraph 11(b), if other parties (for example, the plan trustees) can unilaterally decide to wind up the plan and prevent the gradual settlement.

The unilateral power to buy annuities or make other investment decisions

22. The Interpretations Committee thought that the trustees' power to buy annuities or make other investment decisions is different from a trustees' power to use a surplus to enhance benefits or to wind up the plan; this is because the latter changes the plan liabilities.
23. The Interpretations Committee thought that the power to buy annuities or make other investment decisions relates to the *amount of* a surplus but does not relate to the *right to* a surplus. It also noted that the result of an investment should be reflected in remeasurement of the net defined benefit liability (asset), as required in paragraph 8 of IAS 19. Consequently, the IASB thought that the power to buy annuities or make other investment decisions, on its own, would not prevent the entity from recognising a surplus as an asset.
24. On the basis of its analysis and observations, the Interpretations Committee concluded that additional guidance is needed and that such guidance would state that:

A third party's unilateral power to buy annuities or make other investment decisions without changing the pension promise is a power to make investment decisions and thus is different from the power to wind up a plan by settling plan liabilities, or the power to use a surplus to enhance benefits, because these actions affect the plan assets but do not change the plan liabilities.

An entity should take account of statutory powers that are substantively enacted

25. The Interpretations Committee also thought that when an entity determines the availability of a refund, an entity should take account of changes in regulations or tax to the extent that the changes are substantively enacted at the end of the reporting period, to be consistent with paragraph 21 of IFRIC 14. Paragraph 21 of IFRIC 14 states that (emphasis added):

An entity shall estimate the future minimum funding requirement contributions for future service taking into account the effect of any existing surplus determined using the minimum funding basis but excluding the prepayment described in paragraph 20(a). An entity shall use assumptions consistent with the minimum funding basis and, for any factors not specified by that basis, 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. **The estimate shall include any changes expected as a result of the entity paying the minimum contributions when they are due. However, the estimate shall not include the effect of expected changes in the terms and conditions of the minimum funding basis that are not substantively enacted or contractually agreed at the end of the reporting period.**

26. Consequently, the Interpretations Committee concluded that it should recommend amending paragraph 7 of IFRIC 14. The amended paragraph 7 of IFRIC 14 would state that (the new text is underlined):

An entity shall determine the availability of a refund or a reduction in future contributions in accordance with the terms and conditions of the plan and any statutory requirements in the jurisdiction of the plan. When an entity determines the availability of a refund or a reduction in future contributions, the entity shall take account of the statutory requirements that are substantively enacted, as well as taking account of the terms and conditions that are contractually agreed and any constructive obligations.

No exemptions would be permitted when a minimum funding requirement exists

27. The Interpretations Committee analysed the consequences that these conclusions could have on the accounting for a minimum funding requirement and noted that

the conclusions should lead to consistent results when a minimum funding requirement exists.

28. Consequently, the Interpretations Committee concluded that no exemptions should be permitted when a minimum funding requirement exists, because the Interpretations Committee could not identify any circumstances in which an exemption is needed.²

Consistency between these conclusions and the requirements of IAS 19

29. The Interpretations Committee analysed the consistency between these conclusions and the requirements of IAS 19. It noted that there should be no conflicts, because the application of the asset ceiling requirements discussed by the Interpretations Committee is separate from the determination of a surplus (or deficit).
30. When an entity's legal or constructive obligation to enhance benefits has arisen in accordance with paragraph 61 of IAS 19, the entity should reflect it in the measurement of the defined benefit obligation, in accordance with paragraph 88 of IAS 19. The Interpretations Committee observed that this is related to the determination of a surplus (or deficit) and these requirements are sufficiently clear in IAS 19.

Accounting for the asset ceiling and past service cost or a gain or loss on settlement

31. The Interpretations Committee discussed the interaction between the asset ceiling and past service cost or a gain or loss on settlement, because a plan amendment or settlement occurs if the trustee decides to enhance benefits or wind up a plan, using the unilateral power. It thought that when a plan amendment or settlement occurs, the accounting for the asset ceiling and past service cost or a gain or loss on

² For detail of the assessment of the minimum funding requirement in IFRIC 14, see Agenda Paper 5 discussed at the September 2014 Interpretations Committee meeting.

<http://www.ifrs.org/Meetings/MeetingDocs/Interpretations%20Committee/2014/September/AP05%20IFRIC%202014%20Availability%20of%20refunds%20from%20DP%20plans.pdf>

settlement is not sufficiently clear in the existing requirements in IAS 19, although principles for the accounting exist in IAS 19.

32. The Interpretations Committee concluded that an amendment to IAS 19 is needed to clarify that, when a plan amendment or settlement occurs:
- (a) a gain or loss on settlement or past service cost should be calculated and recognised in profit or loss in accordance with paragraphs 99—112 of IAS 19; and
 - (b) an entity should reassess the asset ceiling to be applied to the updated surplus and the adjustment to the asset ceiling should be recognised in other comprehensive income as required in paragraph 57(d)(iii) of IAS 19.

Assessment against the agenda criteria

33. The Interpretations Committee has assessed the issues against the agenda criteria of the Interpretations Committee and against the additional criteria for Annual improvements.³
34. It concluded that the issues meet the agenda criteria of the Interpretations Committee. It also concluded that the proposed amendments did not meet the criteria for Annual Improvements, because some are concerned that this proposal is too significant for an Annual Improvement.
35. Consequently, the Interpretations Committee decided to recommend a narrow-scope amendment to IFRIC 14 and IAS 19.

³ For details of the agenda criteria, see Appendix A of Agenda Paper 14 discussed at the May 2014 Interpretations Committee meeting.

http://www.ifrs.org/Meetings/MeetingDocs/Interpretations%20Committee/2014/May/AP14_-_IFRIC_14_Availability_of_refunds_from_DP_plans%5b1%5d.pdf

Staff analysis and recommendation on transition provisions and first-time adoption

Transition provisions

36. We propose that an entity should apply the amendments retrospectively to achieve comparability between periods, in accordance with the general requirement of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. We do not think that either circumstances or judgements related to this issue would change materially every period and that the amendments do not require new estimates to be made. Consequently, we expect that the amendments can be applied retrospectively without significant difficulty in most circumstances.
37. We note, however, that the amendments may affect the carrying amount of assets outside the scope of IAS 19 that include employee benefit costs (for example, those within the scope of IAS 2 *Inventories*). We think that the cost of adjusting the carrying amount of such assets retrospectively might outweigh the benefit of the adjustment. We note that relief from retrospective adjustment of the carrying amount of such assets was granted in respect of the revisions to IAS 19 made in 2011 (see paragraph 173(a) of IAS 19). A similar relief is already provided for first-time adopters of IFRS in paragraph E5 of IFRS 1 *First-time Adoption of International Financial Reporting Standards*. Consequently, we propose that a similar relief is provided for existing preparers in respect of these amendments.
38. We think that earlier application should be permitted.

First-time adopters

39. The basic principle in IFRS 1 is full retrospective application. For IAS 19 and IFRIC 14, there are no exemptions or exceptions other than that for:
- (a) 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
 - (b) disclosure about 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.

Questions to the IASB

Questions

1. Does the IASB agree with the Interpretations Committee's recommendation to propose narrow-scope amendments to IAS 19 and IFRIC 14, adding guidance in line with the conclusions of the Interpretations Committee?
2. Does the IASB agree with the staff recommendation on transition provisions and first-time adopters?