STAFF PAPER

March 2015

IFRS Interpretations Committee Meeting

Project	**IFRIC 14—*IAS 19 The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction***
Paper topic	Should an entity assume continuation of a minimum funding requirement for contributions relating to future service?

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Introduction

1. The IFRS Interpretations Committee ('the Interpretations Committee') received a request to clarify whether an entity should assume that the minimum funding requirement for contributions relating to future service would continue over the estimated life of the pension plan, when IFRIC 14 *IAS19—The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* is applied. The European Securities and Markets Authority ('ESMA') submitted this request.

2. The objective of this Agenda Paper is to provide the Interpretations Committee with the summary of the issue and the staff's analysis and recommendation. This Agenda Paper also contains three questions for the Interpretations Committee.

3. This Agenda Paper is structured as follows:

   (a) summary of the issue;

   (b) staff technical analysis;

   (c) summary of the outreach result;

   (d) agenda criteria assessment;

   (e) staff recommendation;

(f) questions for the Interpretations Committee;

(g) Appendix A—Proposed wording for tentative agenda decision;

(h) Appendix B—Assessment of the Interpretations Committee's agenda criteria and additional criteria for annual improvements; and

(i) Appendix C—Submission.

Summary 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. IFRIC 14 limits the economic benefit available as reductions in future contributions to the cumulative future service cost, less any minimum funding requirement relating to future service. Paragraph 20 of IFRIC 14 states that (emphasis added):

> If there is a minimum funding requirement for contributions relating to future service, the economic benefit available as a reduction in future contributions is the sum of:
>
> (a) any amount that reduces future minimum funding requirement contributions for future service because the entity made a prepayment (ie paid the amount before being required to do so); and
>
> (b) **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 those periods if there were no prepayment as described in (a)**.

6. In the submission and communications between the staff and the submitter, the submitter describes circumstances in which:

   (a) the contribution rate under the minimum funding arrangement is regularly renegotiated with the pension fund trustees, eg on an annual or triennial basis;

   (b) the agreed amounts of the contributions in the arrangement must then be paid for a fixed period;

   (c) a pension regulation or a contractual agreement, or both, require the entity and the trustees to renew the agreement to decide the schedule of contributions regularly and the arrangement is renegotiated between the entity and the trustees if the plan is continued; [1]

   (d) this agreement does not need to be renewed if the plan is wound up; and

   (e) the entity can decide to wind up a plan or close the plan for future accruals, if it agrees with the trustees. However, the entity has decided neither to wind up the plan nor to close the plan.

7. In the circumstances above, the submitter has identified the following views;

   (a) View 1: an entity should assume that the future minimum funding requirement for contributions relating to future service would apply for only the minimum period agreed with the pension trustees.

   (b) **View 2: an entity should assume that the minimum funding requirement for contributions relating to future service would continue over the estimated life of the pension plan.**

[1] For example, Part 3 *Scheme Funding* of the Pension Act 2004 in the UK is applied to some pensions. The Pension Act 2004 is available from the following web page:

http://www.legislation.gov.uk/ukpga/2004/35/contents

View 1

8. Proponents of View 1 argue that paragraph 21 of IFRIC 14 only requires minimum funding requirements to be included in an asset ceiling test for the period to which an entity has contractually agreed as at the end of the reporting period.

9. For example, if the company is only committed to making minimum contributions for five years, they think that only five years of minimum pension contributions would be included in the asset ceiling test.

View 2

10. Proponents of View 2 think that paragraph 21 of IFRIC 14 does not explicitly refer to the period for which minimum funding requirements should be included. They argue that this paragraph requires an entity to use, for any factors not specified by the minimum funding basis, assumptions that are consistent with those used to determine the defined benefit obligation (DBO) and with the situation that exists at the end of the reporting period as determined by IAS 19. Consequently, they think that the period to estimate the future minimum funding requirement contributions should be the estimated life of the pension plan for this case.

11. They are concerned that an entity would be always able to recognise a full amount of a surplus as an asset, if the entity uses the estimated life of the pension plan for future service costs but uses a much shorter period for the minimum funding requirement for contributions relating to future service. They are concerned that this could be inappropriate.

12. In addition, they argue that using a consistent period for future service costs and minimum funding requirements is a better reflection of how the funding arrangement works in practice.

13. They also refer to Example 3 of the Illustrative Examples to IFRIC 14. They think that this example shows the future service cost and minimum service contributions being extrapolated over the same period.

14. For further details, please refer to the original submission in **Appendix C** to this Agenda Paper.

Staff technical analysis

15. We think that an entity should assume that the funding commitment would continue when it estimates the future minimum funding requirement contributions for future services (ie View 2):

    (a) if a plan wind-up has not been decided at the end of the reporting period; and

    (b) if a statutory requirement or a contractual agreement requires an entity to renew the funding arrangement to continue the plan.

16. This is because paragraph 21 of IFRIC 14 requires an entity to estimate the future minimum funding requirement contributions for future service using assumptions that are consistent (a) with those used to determine the DBO and (b) with the situation that exists at the end of the reporting period, for any factors not specified by the minimum funding basis. 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.

17. We think that:

    (a) the estimate should not include the effect of a future renegotiation or a future wind-up of the plan if it is not contractually agreed at the end of the reporting period, in accordance with paragraph 21 of IFRIC 14; and

    (b) for any factors not specified by the minimum funding basis, the assumptions for determining future service costs and those to estimate the future minimum funding requirement contributions must be consistent, because both paragraph 17 and paragraph 21 of IFRIC 14 require an entity to use assumptions that are consistent (i) with those used to determine the DBO and (ii) with the situation that exists at the end of the reporting period. Paragraph 17 of IFRIC 14 states that (emphasis added):

    > **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 makes a reduction in the number of employees covered by the plan. In the latter case, the assumption about the future workforce shall include the reduction.

18. We note that that the arrangement in the submission does not specify the period for the requirement for contributions relating to future service. This is because the entity must continue to make contributions to the plan if the plan continues after the minimum period, however the level of those contributions will be subject to future negotiations. Consequently, when the entity estimates the future minimum funding requirement contributions, we think that the entity should use a period that is consistent with the period that is used for determining future service costs.

19. Some may argue that a better reflection could be if the entity would reflect the expected results of future renegotiations as the entity's best estimates. We noted that IAS 19 requires the best estimates to determine the DBO, but IAS 19 requires an entity to reflect neither future settlements nor future plan amendments, even if they are planned or expected. Moreover, paragraph 62 of IAS 19 states that:

> The formal terms of a defined benefit plan may permit an entity to terminate its obligation under the plan. Nevertheless, it is usually difficult for an entity to terminate its obligation under a plan (without payment) if employees are to be retained. Therefore, in the absence of evidence to the contrary, accounting for post-employment benefits assumes that an entity that is currently promising such benefits will continue to do so over the remaining working lives of employees.

20. Consequently, we think that the entity should not reflect future changes of the existing funding requirement for future service, when the entity estimates the future minimum funding requirement contributions in the situations described in the submission, in the absence of evidence to the contrary.

Staff conclusions

21. We note that the arrangement in the submission does not specify the level of contributions for periods beyond the minimum period. Although the entity must continue to make contributions to the plan if the plan continues after the minimum

period, the level of those contributions will be subject to future negotiations. When the entity estimates the future minimum funding requirement contributions, we think that the entity should assume a continuation of the existing funding requirement for future service, in the absence of evidence to the contrary,

22. For any factors not specified by the minimum funding basis that affect the future minimum funding requirement contributions in the arrangement, we think that the assumptions for determining future service costs and those to estimate the future minimum funding requirement contributions must be consistent. This is because both paragraph 17 and paragraph 21 of IFRIC 14 require an entity to use assumptions that are consistent with those used to determine the DBO and with the situation that exists at the end of the reporting period. Paragraph BC30 of IFRIC 14 also implies this, stating that (extracted):

> The IFRIC noted that future changes to regulations on minimum funding requirements might affect the available surplus. However, the IFRIC decided that, just as the future service cost was determined on the basis of the situation existing at the end of the reporting period balance sheet date, so should the effect of a minimum funding requirement. The IFRIC concluded that when determining the amount of an asset that might be available as a reduction in future contributions, an entity should not consider whether the minimum funding requirement might change in the future.

23. We therefore think that the estimate should not include changes to the minimum funding requirement that will be the consequences of future negotiations with the trustees, in accordance with paragraph 21 of IFRIC 14. Paragraph 21 of IFRIC 14 states (extracted):

> 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.

Summary of the results of outreach

24. In order to gather information about the issue described in the submission, we sent requests to the International Forum of Accounting Standard-Setters, regulators, global accounting firms and specialists in pension accounting and actuarial practices. Specifically, we asked:

Q1: In your jurisdiction, is the funding arrangement that is similar to the arrangement described in the submission common?

Q2: If you answered 'yes' to Question 1, what is the predominant accounting treatment for this? In addition, could you please briefly describe the rationale for that accounting treatment?

Q3: On the basis of your response to Question 2, to what extent do you observe diversity in the accounting treatment?

25. ESMA, as the submitter, observed that such an arrangement is common in the UK and may exist in other jurisdictions and that it had observed diversity in practice.

26. We are still waiting for responses at the time when we are posting this Agenda Paper. We will provide an oral summary of the summary of the results at the March 2015 Interpretations Committee.

Informal comments from IASB members

27. We consulted IASB members at various meetings in March 2015 to inform them of the issue and our tentative analysis and proposals. We did not ask the IASB members to make any decisions when we consulted them. Some members provided comments on this issue.

28. Two IASB members explicitly agreed with the staff analysis and thought that IFRIC 14 provides sufficient guidance for this.

29. No IASB members expressed support for View 1 but some IASB members stated that a better reflection could be if the entity would reflect the expected results of future renegotiations as the entity's best estimates. For example, if an entity expects that the trustees will agree with a change of the level of contributions for future service costs after a specific period, they think that the entity should reflect this.

30. We think that the entity should assume a continuation of the existing funding requirement for future service, when the entity estimates the future minimum funding requirement contributions in the situations described in the submission, in the absence of evidence to the contrary. This is because we think that this is consistent with the approach taken in IAS 19 and IFRIC 14, as explained in this Agenda Paper.

31. On the basis of our analysis we do not propose a change to the model used in IAS 19 and IFRIC 14. Further, we think that sufficient guidance exists and that neither an Interpretation nor an amendment to a Standard is necessary.

Agenda criteria assessment

32. We have assessed the issue against the agenda criteria of the Interpretations Committee as described in paragraphs 5.16–5.17 of the *Due Process Handbook*.

33. Please refer to **Appendix B** of this Agenda Paper for the details of the agenda criteria and the assessment of the issue against the agenda criteria.

Staff recommendation

34. On the basis of our assessment of the Interpretations Committee's agenda criteria, we think that the Interpretations Committee should not add this issue to its agenda, because we think that paragraphs 17, 21 and BC30 of IFRIC 14 provide

sufficient guidance for this issue, as explained in the section for the staff conclusions.

Questions for the Interpretations Committee

Questions
1. Does the Interpretations Committee agree with the staff's technical analysis in paragraphs 15-23 of this Agenda Paper?
2. Does the Interpretations Committee agree with the staff's recommendation that the Interpretations Committee should not add this issue to its agenda?
3. If the answer to Question 2 is 'Yes', does the Interpretations Committee agree with the wording of the tentative agenda decision in Appendix A of this Agenda Paper?

Appendix A—Proposed wording for the tentative agenda decision

IFRIC 14—*IAS 19 The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* —Should an entity assume continuation of a minimum funding requirement for contributions relating to future service?

The Interpretations Committee received a request to clarify whether an entity should assume that the minimum funding requirement for contributions relating to future service would continue over the estimated life of the pension plan, when IFRIC 14 is applied.

A question was raised in the circumstances in which:

(a) the contribution rate under the minimum funding arrangement is regularly renegotiated with the pension fund trustees, eg on an annual or triennial basis;

(b) the agreed amounts of the contributions in the arrangement must then be paid for a fixed period;

(c) a pension regulation or a contractual agreement, or both, require the entity and the trustees to renew the agreement to decide the schedule of contributions regularly and the arrangement is renegotiated between the entity and the trustees if the plan is continued;

(d) this agreement does not need to be renewed if the plan is wound up; and

(e) the entity can decide to wind up a plan or close the plan for future accruals, if it agrees with the trustees. A plan wind-up has not been decided at the end of the reporting period.

In the circumstances above, the submitter asked whether an entity should assume that the future minimum funding requirement for contributions relating to future service would apply for only the minimum period agreed.

The Interpretations Committee noted that the level of those contributions will be subject to future negotiations, although the entity must continue to make contributions to the plan if the plan continues after the minimum period.

When the entity estimates the future minimum funding requirement contributions in the circumstances above, the Interpretations Committee noted that the entity should assume a continuation of the existing funding requirement for future service, in the absence of evidence to the contrary, because:

(a) for any factors not specified by the minimum funding basis, the assumptions for determining future service costs and those to estimate the future minimum funding requirement contributions must be consistent. This is because both paragraph 17 and paragraph 21 of IFRIC 14 require an entity to use assumptions that are consistent with those used to determine the defined benefit obligation and with the situation that exists at the end of the reporting period;

(b) the estimate should not include changes to the minimum funding requirement if such changes require future negotiations with the trustees, in accordance with paragraphs 21 and BC30 of IFRIC 14.

On the basis of the analysis above, the Interpretations Committee determined that, in the light of the existing IFRS requirements, sufficient guidance exists and that neither an Interpretation nor an amendment to a Standard was necessary and consequently [decided] not to add this issue to its agenda.

Appendix B—Assessment against the Interpretations Committee's agenda criteria

B1. In the following table, we have assessed the issue against the agenda criteria of the Interpretations Committee as described in paragraphs 5.14–5.22 of the *Due Process Handbook*.

Agenda criteria of the Interpretations Committee	
We should address issues (see paragraph 5.16 of the IFRS Foundation *Due Process Handbook*):	
that have widespread effect and have, or are expected to have, a material effect on those affected;	**Waiting for the outreach result.**
in which financial reporting would be improved through the elimination, or reduction, of diverse reporting methods; and	**No. We think that IFRIC 14 provides sufficient guidance on this issue.**
that can be resolved efficiently within the confines of existing Standards and the *Conceptual Framework for Financial Reporting*.	N/A
In addition:	
Is the issue sufficiently narrow in scope that the Interpretations Committee can address this issue in an efficient manner, but not so narrow that it is not cost-effective for the Interpretations Committee to undertake the due process that would be required when making changes to IFRS (see paragraph 5.17 of the IFRS Foundation *Due Process Handbook*)?	N/A
Will the solution developed by the Interpretations Committee be effective for a reasonable time period (see paragraph 5.21 of the IFRS Foundation *Due Process Handbook*)? (The Interpretations Committee will not add an item to its agenda if the issue is being addressed in a forthcoming Standard and/or if a short-term improvement is not justified).	N/A

Appendix C—Submission

The Chair

Date: 23 February 2015

Wayne Upton
Chairman of the IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH
United Kingdom

Agenda Item Request: Measurement of minimum funding requirement in pension asset ceiling test

Dear Mr. Upton,

The European Securities and Markets Authority (ESMA) is an independent EU Authority that contributes to enhancing the protection of investors and promoting stable and well-functioning financial markets in the European Union (EU). ESMA achieves this aim by building a single rule book for EU financial markets and ensuring its consistent application across the EU. ESMA contributes to the regulation of financial services firms with a pan-European reach, either through direct supervision or through the active co-ordination of national supervisory activity.

As a result of the review of financial statements carried out by national competent authorities and ESMA's co-ordination activities, we have identified an issue related to the application of IFRIC Interpretation 14 *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction.*

A detailed description of the case is set out in the appendix to this letter.

We would be happy to further discuss this issue with you.

Yours sincerely,

Steven Maijoor

APPENDIX - DETAILED DESCRIPTION OF THE ISSUE

1. As part of their monitoring and supervisory activities, ESMA and national enforcers have identified divergent application of IFRS requirements regarding the performance of the pension asset ceiling test referred to in paragraph 64 of IAS 19 *Employee Benefits.* Divergence exists in estimating the minimum funding requirement for future service, which is one of the test's inputs.

Description of the issue

2. When entities with defined benefit pension plans have identified a surplus of pension assets over pension liabilities, paragraph 64 of IAS 19 requires them to perform an asset ceiling test in order to calculate how much of the surplus to recognise as an asset. One of two possible methods of performing the asset ceiling test considers the potential economic benefit of the surplus being available to the company as a reduction in future pension contributions. Using this method, IFRIC 14 limits the amount of pension asset that can be recognised to the cumulative future pension service cost, less any minimum pension funding requirement relating to future service.

3. Paragraph 17 of IFRIC 14 requires an issuer to determine the cumulative future service costs using assumptions consistent with those used to determine the defined benefit obligation and with the situation existing at the balance sheet date.

4. Paragraph 21 of IFRIC 14 requires the future minimum funding requirement contributions to be estimated using assumptions consistent with the minimum funding basis and, for any factors not specified by that basis, assumptions consistent with the defined benefit calculation in IAS 19. The estimate must not include the effect of expected changes in the terms of the minimum funding basis that are not substantively enacted or contractually agreed at the end of the reporting period.

5. When estimating future service costs, paragraph 16 of IFRIC 14 is clear that an entity should estimate them over the shorter of the life of the pension plan and the life of the entity. However, ESMA has identified divergent views with respect to the period for which the future minimum funding requirement contributions should be included in the calculation when these are contractual amounts agreed with pension trustees.

6. Under such arrangements, minimum funding arrangements are regularly renegotiated with the pension fund trustees, e.g. on an annual or triennial basis. The negotiated amount must then be paid for a fixed period, e.g. five years. There may be a notice period required before an entity can choose to cease future pension funding, however it will not be contractually required to continue with future pension contributions over the life of the plan.

View 1 - Assume that the future minimum funding requirement will apply for only the minimum period agreed with the pension trustees

7. Proponents of view 1 argue that paragraph 21 of IFRIC 14 only requires minimum funding requirements to be included in an asset ceiling test for the period to which an entity has contractually agreed to as at the balance sheet date.

8. For example, if the company is only committed to make minimum contributions for five years, only five years of minimum pension contributions would be included in the asset ceiling test.

View 2 - Assume that the minimum funding requirement will continue over the estimated life of the pension plan

9. Proponents of view 2 argue that the requirement to use terms and conditions contractually agreed at the balance sheet date refers only to the agreed contribution rate. Paragraph 21 does not explicitly refer to the period for which minimum funding requirements should be included. It also refers to using IAS 19 assumptions for any factors not specified by the minimum funding basis. Proponents of view 2 argue that using the same period for future service costs and minimum funding requirements is a better reflection of how the funding arrangements work in practice.

10. Proponents of view 2 also refer to Example 3 of the Illustrative examples to IFRIC 14. This example shows the future service cost and minimum service contributions being extrapolated over the same period. However, the assumptions underlying this example are not specified.

Request

11. ESMA seeks clarification of whether an entity with a contractually agreed future minimum funding requirement should assume that this requirement will exist over the life of the pension plan when performing an asset ceiling test.

12. ESMA is aware of examples of this divergent practice that have recently been identified by European jurisdictions. Accordingly, ESMA kindly suggests that the IFRS Interpretations Committee considers clarifying the accounting requirements in this respect.