EFRAG

European Financial Reporting Advisory Group

xx August 2009

International Accounting Standards Board
30 Cannon Street
London
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United Kingdom

DRAFT COMMENT LETTER

Comments should be sent to Commentletter@efrag.org by 31 August 2009

The attached appendix is background material for constituents and is not part of the letter

Dear Sir/Madam

Re: IASB's ED of Proposed Amendments to IFRIC 14

On behalf of the European Financial Reporting Advisory Group (EFRAG) I am writing to comment on the IASB's ED of proposed amendments to IFRIC 14 *Prepayments of a Minimum Funding Requirement*. This letter is submitted in EFRAG's capacity of contributing to IASB's due process and does not necessarily indicate the conclusions that would be reached in its capacity of advising the European Commission on endorsement of the definitive IFRS.

We are pleased that the IASB has decided to address the unintended consequences for the accounting treatment of prepayments of minimum funding requirement contributions relating to future service arising from IFRIC 14 *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding requirements and their Interaction*.

IFRIC 14 currently does not regard a surplus created by a voluntary prepayment of a minimum funding requirement contribution relating to future service as an asset if the future minimum funding contributions required in respect of future service exceeds future service costs. As such, such voluntary prepayments will be expensed even though the entity derives future benefit from them. The proposed amendments in the ED seek to address this anomaly.

EFRAG agrees with the IASB's analysis and reasoning. We note also that prepayments of MFR contributions relating to future service will meet the definition of an asset under the existing Framework. As a result, we support the proposed amendments.

We hope that you find our comments helpful. If you wish to discuss them further, please do not hesitate to contact Jeff Waldier or me.

Yours sincerely

Stig Enevoldsen
EFRAG, Chairman

Appendix – Summary and illustration of the issue being addressed in the ED and the amendment being proposed – Background for EFRAG constituents

Background to IFRIC 14

1 IAS 19 *Employee Benefits* sets out how to account for various types of employee benefits. In the case of defined benefit plans, IAS 19 requires an entity to estimate the value of the present obligations it has in respect of the promises it has made and the value of any assets held in the plan to fund the obligations. IAS 19 permits entities some flexibility to make certain specific adjustments to the value of the present defined benefit obligations. It then requires entities to compare the value of the plan assets and the adjusted value of the present defined benefit obligations and:

(a) if the adjusted value of the obligations is higher, recognise the difference on the balance sheet as a liability;

(b) if the value of the plan assets is higher, recognise the difference on the balance sheet as an asset *to the extent that the amount involved is available to the entity in the form of refunds from the plan and/or reductions in future contributions to the plan*.

IFRIC 14 provides some guidance on how to interpret the italicised text.

2 One of issues IFRIC 14 clarifies is how the requirements of IAS 19 shall be applied when the defined benefit plan is subject to a minimum funding requirement (MFR). An MFR normally stipulates a minimum amount or level of contributions that must be made to a plan over a given period. As such:

(a) it might give rise to a liability. Although normally a requirement to make contributions to a plan would not affect the measurement of the defined benefit asset or liability—because the contributions, once paid, will become plan assets and so the additional net liability is nil—an MFR may give rise to a liability if the required contributions will not be available to the entity once they have been paid; and

(b) it might limit the ability of the entity to reduce future contributions.

3 IFRIC 14 explains that to get the accounting right when there is an MFR, an entity needs to analyse any MFR at a given date into:

(a) contributions that are required to cover any existing shortfall for past service on the minimum funding basis; and

(b) contributions that are required to cover the future accrual of benefits (in other words, to cover future service).

IFRIC 14 sets out the accounting treatment to be followed in each case but, as the ED's proposed amendments relate to (b), the rest of this explanation focuses just on that aspect of the accounting.

4 IFRIC 14 explains that, if an entity has a MFR to pay contributions to cover future service, that obligation to pay additional contributions will not represent a liability. IFRIC 14 then considers whether having a MFR to pay contributions to cover

future service might limit the ability of the entity to reduce future contributions, and therefore have an affect on the asset that is recognised, and it is here that the problems with IFRIC 14 have arisen.

The problem that has arisen

5 Paragraphs 54-60 of IAS 19 set out the amount that should be recognised on the balance sheet as a defined benefit asset or liability. If there is a surplus in the fund, paragraph 58 limits the amount of the defined benefit asset that can be recognised by reference to the present value of economic benefits available from the plan in the form either of refunds from the plan or reductions in future contributions to the plan.

6 Paragraph 20 of IFRIC 14 explains that, if there is a MFR for contributions relating to future service, the economic benefit available from the plan in the form of reductions in future contributions to the plan shall be the lower of the surplus in the plan and the PV of the amount by which the future contributions can be reduced below future service cost in each year over the remaining life of the plan (or of the entity if shorter) without triggering the MFR. In particular, it states that:

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

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

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

2 Further, paragraph 22 of IFRIC 14 states:

If the future minimum funding contribution required in respect of the future accrual of benefits exceeds the future IAS 19 service cost in any given year, the present value of that excess reduces the amount of the asset available as a reduction in future contributions at the balance sheet date. However, the amount of the asset available as a reduction in future contributions can never be less than zero.

3 The IASB's concern is that the interaction of these two paragraphs has unintended consequences for the treatment of voluntary prepayments of contributions intended to meet MFR. (Apparently this has been a particular issue in Belgium and Switzerland, but might be an issue in other jurisdictions too.) The IASB believes that, if voluntary prepayments of MFR contributions are made, they should (like any other prepayment) result in an asset being recognised (because making such a prepayment should reduce the amount of MFR contributions that would otherwise need to be made in the future). Yet, under IFRIC 14 a surplus in a plan created by a prepayment is not regarded as available as an economic benefit (and therefore an asset) "if the future minimum funding contribution required in respect of future service exceeds the future IAS 19 service cost. Therefore, in such cases the prepayment is recognised as an expense."

4 This issue is illustrated in the following example[1]:

For illustration assume a discount rate and return on plan assets of 0% and the plan does not continue after five years. Further, the plan has an initial surplus of CU35 that cannot be refunded to the entity under any circumstances but can be used for reductions in future contributions.

An entity expects a service charge of CU10 for the remaining five years of the plan and is subject to a minimum funding requirement charge of CU15 for each of those years.

Year	20x1	20x2	20x3	20x4	20x5
Service charge	10	10	10	10	10
Contribution to cover MFR	15	15	15	15	15

For the remaining 5 years, there will be a service charge of CU50 and future payments of CU75, so none of the surplus is recoverable. Under paragraph 22 of IFRIC 14, since the future minimum funding requirement exceeds the future service costs the excess of the MFR contributions over the service charge (CU25) is recognised as an additional expense.

However, if the entity voluntarily prepays CU30 prior to 20x1 towards the MFRS contributions for years 20x1 and 20x2, the effect will be to increase the fund's surplus at the beginning of 20x1 to CU65 and reduce the MFR contributions it expects to make in the following two years as follows:

Year	20x1	20x2	20x3	20x4	20x5
Service charge	10	10	10	10	10
Contributions to cover MFR	0	0	15	15	15

In the above example, application of paragraph 22 of IFRIC 14 will result in a recoverable surplus of CU5 (being the difference between the future service charge of CU50 (=10*5) and future minimum funding requirement payments of CU45 (=15*3)). As a result, CU25 of the prepayment would be recognised as expense in the year the prepayment was made, even though every penny of the prepayment has resulted in an equivalent reduction in the MFR contribution.

5 The IASB believes this is not appropriate and that, if and to the extent that a prepayment of an MFR contribution has the effect of reducing future contributions needed to meet future MFRs, the prepayment should be recognised as an asset.

[1] Source: example adapted from agenda paper 10 of IASB 23 January meeting to be same as example in ED.

6 The proposal is therefore to delete paragraph 22 of IFRIC 14, amend existing paragraph 20, insert a new paragraph 20A and make various other consequential amendments. The revised paragraph 20 and new 20A would read as follows:

20 If there is a minimum funding requirement for contributions relating to future service, an entity shall recognise an asset comprising:

(a) the amount of any prepayment of the minimum funding requirement contributions, ie 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; and

(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 costs 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 as described in (a).

20A 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).

7 The ED includes an example illustrating the application of this amendment using similar assumptions to the prepayment illustration above. The ED states (in paragraph IE26):

In accordance with paragraph 20 of IFRIC 14, the entity recognises an asset compromising:

(a) CU30, being the amount of the prepayment of the minimum funding requirement contribution; and

(b) CU0, No part of the surplus of CU35 described in paragraph IE23 may be recognised because, if there were no prepayment, the estimated minimum funding requirement contributions (CU75) that would be required for future service exceeds the estimated future service costs (CU50).

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).