EFRAG
European Financial Reporting Advisory Group

Jörgen Holmquist
Director General
European Commission
Directorate General for the Internal Market
1049 Brussels

17 April 2008

Dear Mr Holmquist

Adoption of IFRIC 14 *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*

Based on the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards we are pleased to provide our opinion on the adoption of IFRIC 14 *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* — henceforth 'IFRIC 14'. It was issued in draft as D19 and EFRAG commented on this draft.

IFRIC 14 provides guidance on three matters:

- Paragraph 58 of IAS19 limits the measurement of a defined benefit asset to the "present value of economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan". IFRIC 14 sheds light on when such refunds or reductions in future contributions should be regarded as 'available' in accordance with paragraph 58 of IAS 19 (ie the limit on the measurement of the defined benefit asset);

- How a minimum funding requirement might affect the availability of reductions in future contributions and

- When a minimum funding requirement might give rise to a liability.

IFRIC 14 becomes effective for annual periods beginning on or after 1 January 2008, with earlier application permitted.

EFRAG has carried out an evaluation of IFRIC 14. As part of that process, EFRAG issued a draft version of this letter for public comment and, when finalising its advice and the content of this letter, it took the comments received in response into account. EFRAG's evaluation is based on input from standard setters, market participants and other interested parties, and its discussions of technical matters are open to the public.

EFRAG supports IFRIC 14 and has concluded that it meets the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards in that:

- it is not contrary to the ‘true and fair principle’ set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and

- it meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

For the reasons given above, EFRAG believes that it is in the European interest to adopt IFRIC 14 and, accordingly, EFRAG recommends its adoption. EFRAG's reasoning is explained in the attached 'Appendix - Basis for Conclusions'.

On behalf of the members of EFRAG, I should be happy to discuss our advice with you, other officials of the EU Commission or the Accounting Regulatory Committee as you may wish.

Yours sincerely

Stig Enevoldsen
EFRAG, Chairman

Appendix
Basis for Conclusions

This appendix sets out the basis for the conclusions reached and for the recommendation made by EFRAG on IFRIC 14 IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*.*

In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG's capacity as a contributor to the IASB's due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of the final IFRS or Interpretation on the issue.

In the latter capacity, EFRAG's role is to make a recommendation about endorsement based on its assessment of the final IFRS or Interpretation against the European endorsement criteria, as currently defined. These are explicit criteria which have been designed specifically for application in the endorsement process, and therefore the conclusions reached on endorsement may be different from those arrived at by EFRAG in developing its comments on proposed IFRSs or Interpretations. Another reason for a difference is that EFRAG's thinking may evolve.

1 When evaluating the merits of IFRIC 14 *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*—henceforth IFRIC 14—EFRAG considered the following key questions:

(a) Is there an issue that needs to be addressed?

(b) If there is an issue that needs to be addressed, is an Interpretation an appropriate way of addressing it?

(c) Is IFRIC 14 a correct interpretation of existing IFRS?

(d) Does the accounting that results from the application of the IFRIC meet the criteria for EU endorsement?

2 Having formed tentative views on the issues and prepared a draft endorsement advice letter, EFRAG issued that draft letter for comment on 20 July 2007 and asked for comments on it by 26 September 2007. EFRAG issued a second consultative paper, mainly on the costs and benefits of implementing IFRIC 14 in the EU, on 11 February 2008 and asked for comments on that paper by 14 March 2008. EFRAG has considered all the comments received in response to the two consultations, and the main comments received are dealt with in the discussion in this appendix.

IS THERE AN ISSUE THAT NEEDS TO BE ADDRESSED?

3 EFRAG understands that questions have been raised in practice with respect to *when* refunds or reductions in future contributions should be regarded as 'available', particularly when a minimum funding requirement exists. EFRAG agrees that there are issues that need to be addressed namely, greater clarification is needed on the interpretation of existing IAS 19 *Employee Benefits* paragraph 58 with respect to when a surplus is available as a refund and a contribution reduction.

4 Additionally, guidance is needed on how a minimum funding requirement might affect the availability of reductions in future contributions as well as when a

minimum funding requirement might give rise to a liability, in order to achieve greater consistency in practice.

IS AN INTERPRETATION AN APPROPRIATE WAY OF ADDRESSING THIS ISSUE?

5 EFRAG believes that an interpretation is an appropriate way of addressing the issues identified above since the issues arise from a lack of clarity and/or need for more guidance and an Interpretation is one way of providing that clarity or additional guidance**.**

IS IFRIC 14 A CORRECT INTERPRETATION OF EXISTING IFRS?

6 EFRAG believes that IFRIC 14 is a correct interpretation of existing IFRS. Set out below is an explanation of the rationale behind this conclusion.

Consensus on the availability of a refund or reduction in future contributions

7 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 recognised by reference to the present value of economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan. IFRIC 14 first of all clarifies what is meant by "available in the form of refunds…or reductions". In particular, in the absence of minimum funding requirements:

(a) IFRIC 14 makes it clear that a refund is 'available' to an entity only if the entity has an 'unconditional right' to a refund. The IFRIC's rationale here is that an entity only has the control required by the asset definition if it has an unconditional right, in this case to the refund. EFRAG concurs with the rationale proposed by the IFRIC on this aspect of the Interpretation.

(b) IFRIC 14 requires that an entity should measure the economic benefit available as a refund as the amount of the surplus at the balance sheet date that the entity has a right to receive as a refund less any associated costs. EFRAG concurs with this interpretation of IAS 19; wind up costs can be so significant that a plan with an apparent surplus may not be able to recover any of that surplus on wind up.

(c) IFRIC 14 explains in BC8 that it is not necessary for the economic benefit to be realisable immediately in order for it to be 'available' as an economic benefit. EFRAG agrees with this view.

(d) IFRIC 14 clarifies that an entity should determine the economic benefit available as a reduction in future contributions as the lower of (a) the surplus in the plan and (b) the present value of the future service cost to the entity; EFRAG supports the conclusions reached by the IFRIC in this regard since, in the absence of a minimum funding requirement, the amount of a surplus can always be realised through a reduction in contributions if the life of the plan is long enough and the future IAS19 service cost is large enough.

Consensus on the effect of a minimum funding requirement on the economic benefit available as a reduction in future contributions

8 IFRIC 14 also clarifies how to assess the impact of minimum funding requirements on the measurement of the defined benefit asset/liability. In

particular, it states that, in instances where 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 amount described in the previous section of this appendix less the estimated minimum funding contributions required in respect of the future accrual of benefits in that year.

9 EFRAG believes that the IFRIC's reasoning in reaching the above conclusion is correct. Although contribution requirements in respect of future service do not create an additional liability at the balance sheet date—because they do not relate to past services received by an entity—they may reduce the extent to which the entity can benefit from a reduction in future contributions.

Consensus on when a minimum funding requirement gives rise to a liability

10 Paragraphs 23 and 24 of IFRIC 14 state that "if an entity has an obligation under a minimum funding requirement to pay contributions to cover an existing shortfall on the minimum funding basis in respect of services already received, the entity shall determine whether the contributions payable will be available as a refund or reduction in future contributions after they are paid into the plan. To the extent that the contributions payable will not be available after they are paid into the plan, the entity shall recognise a liability when the obligation arises. The liability shall reduce the defined benefit asset or increase the defined benefit liability so that no gain or loss is expected to result from applying paragraph 58 of IAS 19 when the contributions are paid."

11 EFRAG believes this is an appropriate interpretation of existing IFRS and of the Framework. Paragraph 91 of the Framework states that a liability shall be recognised when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and the amount at which the settlement will take place can be measured reliably. In the case described in paragraphs 23 and 24 of IFRIC, if there is a present obligation and the settlement amount will not subsequently be fully available to the entity in form of a refund or a reduction in future contributions, the difference between the settlement amount and the amount available to the entity has to be recognised as a liability because the settlement will partly result in an outflow of resources and this partial amount can be measured reliably.

(a) The limit on the measurement of the defined benefit asset (IAS 19, paragraph 58) may make the funding obligation onerous;

(b) If an entity is obliged to pay contributions and some/all of those contributions will not subsequently be available as an economic benefit, it follows that when the contributions are made the entity will not be able to recognise an asset to that extent (based on the premise that an asset should reflect only its recoverable amount). However, the resulting loss to the entity does not arise on payment of the contributions but earlier, at the point at which the obligation to pay arises;

(c) The principles in IAS37 relating to onerous contracts have been applied within the context of the requirements of IAS 19; in other words, it is equivalent to an entity having an onerous contract to pay additional contributions to the plan from which no future economic benefits will be received. Onerous contracts are accepted as giving rise to liabilities under IAS 37.

DOES THE ACCOUNTING THAT RESULTS FROM THE APPLICATION OF IFRIC 14 MEET THE ENDORSEMENT CRITERIA?

12 EFRAG has considered whether IFRIC 14 meets the requirements of the European Parliament and of the Council on the application of international accounting standards, in other words whether:

(a) it is not contrary to the 'true and fair principle' set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and

(b) it meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

13 EFRAG has also considered whether IFRIC 14's adoption is in the European interest.

Consensus on the availability of a refund or reduction in future contributions

14 IFRIC 14 clarifies paragraph 58 of IAS 19, a paragraph that is currently the subject of some uncertainty, and consequently ought to result in the paragraph being interpreted and applied more consistently. This should enhance comparability.

15 Additionally, the information provided by applying this interpretation ought also to be relevant to users by virtue of the fact that it aids their understanding as to the extent to which a pension asset is available as a refund or a reduction in future contributions, and is therefore useful.

16 EFRAG did not identify any significant reliability concerns from this part of the consensus. The estimates of future service costs needed to determine the reduction in future contributions will be based on assumptions that are broadly in line with IAS19, with the exception of assumptions that need to be made regarding new entrants, where IFRIC 14 provides specific guidance (ie assume a stable work force).

17 Finally, EFRAG believes that the consensus reached on the availability of a refund or reduction in future contributions reinforces, but neither changes nor adds to, the requirements of IAS 19. As EFRAG has previously concluded that IAS 19 is not contrary to the true and fair principle, it believes it follows that IFRIC 14 is also not contrary to the true and fair principle.

Consensus on the effect of a minimum funding requirement on the economic benefit available as a reduction in future contributions and on the recognition of a liability

18 Again, as practice varies with respect to the treatment of the effect of a minimum funding requirement on the limit placed by paragraph 58 of IAS19 on the amount of a defined benefit asset as well as the issue of the interaction between the minimum funding requirement and the limit placed by paragraph 58 of IAS19, the clarifications in IFRIC 14 ought to result in more consistent accounting thereby enhancing comparability.

19 Similarly, by reinforcing the existing requirements of IAS 19, IFRIC 14 ought to help ensure that the information provided for users is relevant and understandable.

20 Similar to the comments in paragraphs 14-17 above, EFRAG did not identify any significant concerns about the reliability of the information resulting from the application of this aspect of the interpretation.

21 Finally, EFRAG believes that the consensus reached on the effect of a minimum funding requirement on the economic benefit available as a reduction in future contributions and on liability recognition reinforces, but neither changes nor adds to, the requirements of IAS 19. As EFRAG has previously concluded that IAS 19 is not contrary to the true and fair principle, it believes it follows that IFRIC 14 is also not contrary to the true and fair principle.

Conclusion

22 For the reasons set out above, EFRAG has concluded that it is in the European interest for the EU to adopt IFRIC 14 and therefore recommends IFRIC 14 for adoption.