EFRAG
European Financial Reporting Advisory Group

# INVITATION TO COMMENT ON THE EFFECTS (COSTS AND BENEFITS) OF IFRIC 14

**Comments should be sent to commentletter@efrag.org by 14 March 2008**

EFRAG has been asked by the European Commission to provide it with advice and supporting material on the endorsement of IFRIC 14 *IAS 19 The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*. In order to do that, EFRAG has been assessing IFRIC 14 against the criteria for endorsement set out in Regulation (EC) No 1606/2002 and is now carrying out a separate assessment of the costs and benefits that would arise from its implementation in the EU.

A brief summary of IFRIC 14 is set out in Appendix 1.

Although EFRAG has not yet finalised its technical assessment of IFRIC 14, its near-final conclusion is that IFRIC 14 is not contrary to the true and fair principle and that it meets the criteria of understandability, relevance, reliability and comparability. EFRAG's reasoning in reaching this near-final view is explained in Appendix 2.

EFRAG has carried out an initial assessment of the costs and benefits that would arise from implementing IFRIC 14 in the EU. A summary of the results is set out in Appendix 3.

Before finalising its two assessments, EFRAG would welcome your views on the issues set out below. Please note that all responses received will be placed on the public record unless the respondent requests confidentiality. EFRAG is a transparent organisation and will wish to discuss the responses it receives in a public meeting, so we would prefer to be able to publish all the responses received.

1 Please provide the following details about yourself:

(a) Your name or, if you are responding on behalf of an organisation or company, its name:

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(b) Are you/Is your organisation or company a:

□ Preparer □ User □ Other (please specify)____________

(c) Please provide a short description of your activity/ the general activity of your organisation or company:

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(d) Country where you/your organisation or company is located:

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(e) Contact details including e-mail address:

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2 EFRAG is carrying out an assessment of the costs and benefits that will arise for preparers and for users in implementing IFRIC 14, both in year one and in subsequent years. Some initial work has been carried out, and the responses to this Invitation to Comment will be used to complete the work. The results of the initial assessment are set out in Appendix 3. To summarise, IFRIC 14 will:

- involve preparers incurring some year one costs—in order to read, understand and implement the new requirements—but that those costs will not be significant;
- not involve preparers incurring significant incremental ongoing costs; and
- not involve users incurring any incremental year one or ongoing costs.

Do you agree with this assessment?

Yes ☐ No ☐

If you do not, please explain why you do not and (if possible) explain broadly what you believe the costs involved will be?

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3 As EFRAG believes (as explained in Appendix 3) that IFRIC 14 will improve the quality of the financial information provided and its implementation will involve on an overall level only insignificant additional costs, it has tentatively concluded that the benefits to be derived from IFRIC 14's application will exceed the costs involved.

Do you agree with this assessment?

Yes ☐ No ☐

If you do not, please explain why you do not and what you think the implications should be for EFRAG's endorsement advice?

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4 EFRAG is not aware of any factors other than those mentioned in appendices 2 and 3 that should be taken into account in reaching a decision as to what endorsement advice it should give the European Commission on IFRIC 14.

Do you agree that there are no other factors?

Yes No

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If you do not, please explain why you do not and what you think the implications should be for EFRAG's endorsement advice?

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5 EFRAG's near final technical assessment of IFRIC 14 is that it is not contrary to the true and fair principle and it meets the criteria of understandability, relevance, reliability and comparability. EFRAG's reasoning in reaching this near-final view is explained in Appendix 2.

Do you agree with this assessment?

Yes No

☐ ☐

If you do not agree, it is presumably because you have a *significant* concern about IFRIC 14 when judged against the technical criteria. Please could explain what that concern is, why you have it now (at this late stage of the process) but did not have it earlier, and what you think the implications should be for EFRAG's endorsement advice?

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## APPENDIX 1
## A SUMMARY OF IFRIC 14

1 IAS 19 *Employee Benefits* sets out how to account for various types of employee benefits, including pensions and other types of post-employment benefits (such as post-employment life insurance and medical care).

2 IAS 19 categorises post-retirement benefit plans as either:

(a) defined contribution plans, where the contributions to be paid are specified and no one is obliged to pay any more into the plan if the contributions are insufficient to pay the desired level of benefits or

(b) defined benefit plans, where the benefits to be paid are specified and one party, usually the employer, is obliged to pay additional amounts into the plan if the contributions (if any) paid to date are insufficient to pay the specified benefits.

IFRIC 14 clarifies some of the things IAS 19 says about accounting for post-retirement defined benefit plans.

3 Under a defined benefit plan the employer makes a promise as to the post-retirement benefits the employer will receive. At the same time, the employer may 'fund' the plan (wholly or partially) by putting aside monies in a separate fund that will be used later to meet the obligations that arise from the pension promise made.

4 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.

5 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*.

6 There has been some uncertainty as to how to interpret the italicised text in (b) in certain circumstances and IFRIC 14 provides guidance on the subject.

7 The main uncertainty has been how to apply the requirement when, although a refund or reduction in future contributions of some or all of the difference cannot be realised *immediately*, it can be realised (through a refund or reduction of contributions) at some point during the life of the plan. IFRIC 14 makes it clear that it is sufficient that the amount should be obtainable at some point during the life of the plan. It is not necessary, for example, for the amount to be obtainable at the balance sheet date.

8 In some countries some or all defined benefit plans are subject to minimum funding requirements. The second issue 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.

(a) IFRIC 14 explains that the entity first needs to establish whether the minimum funding requirement has the effect of creating an obligation to pay additional amounts into the plan (in circumstances where 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).

(b) To the extent that those additional amounts payable into the plan will not be available (either as a reduction in future contributions or as a refund) after they are paid into the plan, the entity shall recognise a liability for the amount payable when the obligation arises. That liability shall reduce the defined benefit asset or increase the defined benefit liability that would otherwise be recognised.

## APPENDIX 2
## EFRAG'S TECHNICAL ASSESSMENT OF IFRIC 14 AGAINST THE ENDORSEMENT CRITERIA

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 on 20 July 2007 and asked for comments on it by 26 September 2007. EFRAG issued a second consultation 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 that are relevant to its technical assessment, 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' under paragraph 58 of existing IAS 19 *Employee Benefits*, 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 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 and/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 paragraph 16 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.

## APPENDIX 3
## EFRAG'S EVALUATION OF THE COSTS AND BENEFITS OF IFRIC 14

1 As explained in Appendix 1, the first issue that IFRIC 14 clarifies is what exactly is meant by the reference (see paragraph 6(b) of Appendix 1) to the amount involved being "available" in the form of refunds and/or reductions in future contributions. The second issue addressed in IFRIC 14 concerns the implications of minimum funding requirements for the accounting described. EFRAG has considered what the cost and related benefits of these clarifications might be.

2 EFRAG has concluded, for the reasons explained in Appendix 2, that the clarifications set out in IFRIC 14 will reduce uncertainty as to how to implement aspects of IAS 19 and will as a result reduce divergence in practice and enhance consistency and comparability of the information provided, thereby benefiting all stakeholders.

3 EFRAG has considered whether the accounting treatments required by IFRIC 14 would involve incremental costs for preparers. Its tentative view is that for those entities not already implementing IAS 19 in the way required:

(a) there will be some incremental costs involved in reading and understanding IFRIC 14 and in ensuring it is implemented correctly. Those costs will include putting in place procedures that will enable entities to estimate:

i. the future service cost and future minimum funding contributions for each year of the expected life of the plan, and

ii. the split between minimum funding requirements required to cover on the one hand any existing shortfall for past service on the minimum funding basis and on the other hand the future accrual of benefits.

However, EFRAG's assessment is that those costs will not be significant.

(b) there will also be some incremental costs involved on an ongoing basis, because entities will need to perform the calculations described above in paragraph 2(a) to confirm that no adjustment is required. However, again EFRAG's assessment is that those costs will not be significant.

4 EFRAG has also considered whether the clarifications in IFRIC 14 in some way increase the burden on users. Its tentative view is that they impose no additional burdens on users.