EFRAG

European Financial Reporting Advisory Group

24 November 2006

D19 Comment Letters
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UK

Dear Sir/Madam,

Re: IFRIC Draft Interpretation D19 IAS 19 - The Asset Ceiling: Availability of Economic Benefits and Minimum Funding Requirements

On behalf of the European Financial Reporting Advisory Group (EFRAG) I am writing to comment on the IFRIC Draft Interpretation D 19 *IAS 19-The Asset Ceiling: Availability of Economic Benefits and Minimum Funding Requirements* (D19). 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 interpretations/amendments on the issues.

D19 clarifies when economic benefits in the form of a refund or reductions in future contributions to the plan may be considered 'available' under the asset ceiling test in IAS 19.58. It further provides guidance on the effect of minimum funding requirements on the measurement of the (net) defined benefit asset or liability.

We agree with IFRIC that these issues are widespread and that there is the potential for divergence in practice. Indeed, we note that the issue could become more widespread in Europe as a result of EC Directive 2003/41 on the activities and supervision of institutions for occupational retirement provision. We therefore welcome IFRIC's decision to develop an Interpretation on the subject.

D19 proposes that:

- it is *not* necessary for an economic benefit (in the form of a refund of a surplus, or a reduction in future contributions) to be *immediately* realisable at the balance sheet date in order for it to be considered as 'available' under IAS 19.58;

- the measurement of 'available' economic benefits in the form of reductions in future contributions shall be determined, for each year of the expected life of the plan, as the present value of the service cost to the entity less any future minimum funding contributions associated with the future accrual of benefits; and

- if the reporting entity has a statutory or contractual obligation to pay additional contributions into a plan in respect of employee services already received, those additional contributions need to be evaluated to determine whether they are 'available' (via refunds or reductions in contributions) to the entity. If (and to the extent that) they will not be available after they are paid into the plan:

- the entity should reduce the (net) defined benefit asset or increase the defined benefit liability when the obligation arises such that no gain or loss is recognised from the (subsequent) calculation of the asset ceiling under IAS 19.58 when the contributions are paid; and

- the adjustment should be taken to profit and loss or to Statement of recognised income and expense in accordance with the current options under IAS 19 paragraphs 61(g) and 93C respectively.

We broadly support these proposals and, therefore, D19. However, we wish to draw to your attention some detailed matters that, if addressed, would we believe result in the Interpretation being clearer and more useful. Those matters are set out in the appendix to this letter.

If you would like further clarification of the points raised in this letter, Nasreen Vadachia or I would be happy to discuss these further with you.

Yours sincerely,

Stig Enevoldsen
EFRAG, Chairman

Appendix
Areas of D19 that we believe could be clarified or improved

1. *Overall*

We recommend that the IFRIC re-consider the title of the Interpretation in order to avoid any confusion, in light of the fact that D19 does not only apply to defined benefit plans that are in surplus at balance sheet date.

2. *Scope*

Paragraph 5 of D19 states that the draft applies to "all long-term and post employment benefit plans that are within the scope of IAS 19". IAS 19 applies to employee benefits that do not fall within the scope of IFRS 2; and paragraph 4 of IAS 19 explains that 'employee benefits' include short-term employee benefits, post-employment benefits, other long-term employee benefits and termination benefits. A literal interpretation of the differences in these wordings would suggest that short-term employee benefits and termination benefits are within the scope of IAS 19 but outside the scope of D19. We understand however that, although IFRIC wishes to exclude short-term employee benefits from D19's scope, the intention was to include termination benefits. If that was indeed the intention, we do not think it has been achieved.

We suggest that IFRIC should use the same wording as in paragraph 4 of IAS 19 to avoid any misunderstandings. Whatever the intended scope, it needs to be very clear.

3. *Consensus – Availability of an economic benefit*

We understand that some arrangements between a plan and sponsor do not address the entitlement of refunds and, as a result uncertainty remains as to how one should account for such plans. We think it would be helpful if IFRIC could clarify how such circumstances should be accounted for.

According to IFRIC (BC6) the Framework defines an asset as a resource “from which future economic benefits are expected to the flow to the entity”. In fact, an asset is a resource *controlled* by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.” This is important because under some plans it might not be possible to control any refund from the plan. We suggest that IFRIC explain how to account for plans from which future economic benefits are expected to flow to the entity, but are not controlled by the sponsor.

4. *Consensus – The economic benefit available as a refund*

Paragraph 11 of D19 states that “under IAS 19, the surplus at the balance sheet date is measured at a present value; therefore, even if the refund is realisable only at a future date, no further adjustment for the time value of money shall be made.”

However, although we would agree that, if the future refund is defined as a percentage of the IAS 19 surplus, no further adjustment for the time value of money should be made we think that where the refund corresponds to a lump sum payment, the measurement requirement as provided by paragraph 11 of D19 seems contradictory. This may also be the case when the refund is equivalent to the surplus of the fund minus a termination cost. We suggest that IFRIC explains further the basis of paragraph 11’s requirements.

5. Consensus – The economic benefit available as a contribution reduction

Paragraph 15 of D19 states that "any allowances for expected future changes in the demographic profile of the workforce shall be consistent with the assumptions underlying the calculation of the present value of the defined benefit at the balance sheet date."

According to IAS19, paragraph 73(a), demographic assumptions used to calculate the present value of the defined benefit obligation at the balance sheet date include mortality, rates of employee turnover, and proportion of plan members with dependants who will be eligible for benefits.

Implementing D19 paragraph 13 implies calculating service costs for future periods and as a consequence making additional assumptions compared to those listed in IAS 19, paragraph 73(a).

As stated in BC 27, the IFRIC disagreed with the view that the contribution reduction should be determined by considering only the expected future working lifetime of the active members of the plan. It is not however clear from this paragraph whether assumptions for new members joining the plan after the balance sheet date should be taken into account.

In light of the fact that assumptions on future new entrants could have a significant impact on the value of potential reductions in future contributions, we recommend that IFRIC provide clarification on whether an assumption with respect to new entrants should be taken into account.

The wording in paragraph 14 of D19 is somewhat cryptic in that the first sentence implies that an entity can anticipate future contribution reductions beyond the schedule period, while the second sentence seems to suggest the contrary (ie no subsequent variations to the scheduled contributions can be taken into account until it is agreed). Therefore, we believe that paragraph 14 needs to be made clearer in order to avoid any confusion.

6. Effective date and transitional arrangements

EFRAG believes that the general principle should be that all new Interpretations and new or revised IFRSs should apply retrospectively. For that reason, we support the proposal in D19 for full retrospective application.

However, the work needed to assess minimum funding requirements and entitlements to surplus on a group level should not be underestimated. It is important therefore that the IFRIC provides preparers with sufficient lead time.

7. Illustrative examples

Finally we would like to share our observations in respect of the illustrative examples:

a) In all of the illustrative examples, the future contributions have been discussed in the text, although they have not been taken into account in the actual numbers. This is correct (because the contributions have not been paid yet); however, it might help if it is made clearer at least in a footnote that such contributions have not been recognised on the balance sheet.

b) We recognise that the draft interpretation in general as well as the examples do not include any actuarial gains and losses and past service costs. We understand that this is to avoid introducing complexity where it is not needed. However we believe that it might be worth stating that the changes in expectations of future minimum funding requirements described in paragraph 14 of D19 would probably fall under actuarial gains and losses. In that case it might be worth clarifying by inserting some words in the Interpretation and/or adding an example which includes unrecognised net actuarial losses and past service costs.

c) In illustrative example 3 it is assumed that a clear split can be made between minimum contributions required to make good the shortfall and minimum contributions required to cover the future accrual. We question whether this split can be made in practice and therefore whether a calculation of the asset available as a contribution reduction can be made.

Due to the minimum funding requirement, an entity will be required to make additional payments to the plan. These contributions will lead to additional returns on plan assets in the plan. We assume that this will normally lead to lower contributions to cover future accruals and therefore will increase the economic benefit available. Yet the difference between the current service cost under IAS 19 and contributions in example 3 has been maintained at the same level from year 4 onwards. We question whether this example is realistic.