EFRAG

European Financial Reporting Advisory Group

The costs and benefits of implementing IFRIC 14 *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* in the EU

Introduction

1 Following discussions between the various parties involved in the EU endorsement process, the European Commission decided in 2007 that more extensive information than hitherto needs to be gathered on the costs and benefits of all new or revised Standards and Interpretations as part of the endorsement process. It has further been agreed that EFRAG will gather that information in the case of IFRIC 14 *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*.

2 EFRAG first considered how extensive the work would need to be. For some Standards or Interpretations, it might be necessary to carry out some fairly extensive work in order to understand fully the cost and benefit implications of the Standard or Interpretation being assessed. However, in the case of IFRIC 14, EFRAG's view is that the cost and benefit implications can be assessed by carrying out a more modest amount of work. (The results of the consultations EFRAG has carried out seem to confirm this.) Therefore, as explained more fully in the main sections of the report, the approach EFRAG has adopted has been to carry out detailed initial assessments of the likely costs and benefits of implementing IFRIC 14 in the EU, to consult on the results of those initial assessments, and to finalise those assessments in the light of the comments received.

EFRAG's endorsement advice

3 EFRAG already carries out a *technical* assessment of all new and revised Standards and Interpretations issued by the IASB and IFRIC against the so-called endorsement criteria and provides the results of those technical assessments to the European Commission in the form of recommendations as to whether or not the Standard or Interpretation assessed should be endorsed for use in the EU. As part of those technical assessments, EFRAG gives consideration to the costs and benefits that would arise from implementing the new or revised Standard or Interpretation in the EU. EFRAG has therefore taken the conclusion at the end of this report into account in finalising its endorsement advice.

Description of IFRIC 14

4 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).

5 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.

6 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.

7 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.

8 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*.

9 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.

10 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.

11 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.

EFRAG's initial analysis of the costs and benefits of IFRIC 14 and Stakeholders' views on it

11 EFRAG carried out an initial assessment of the costs and benefits expected to arise for preparers and for users from implementing IFRIC 14, both in year one and in subsequent years.

12 On the basis of that initial assessment, EFRAG tentatively concluded that IFRIC 14 will improve the quality of the financial information provided and, as such, that its implementation will benefit users.

13 EFRAG further tentatively concluded that IFRIC 14 will:

(a) 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;

(b) not involve preparers incurring significant incremental ongoing costs; and

(c) not involve users incurring any incremental year one or ongoing costs.

14 Finally, EFRAG tentatively concluded that the benefits expected to arise from applying IFRIC 14 were likely to exceed the costs involved in its implementation.

15 EFRAG published its initial assessment and supporting analysis on 11 February 2008. It invited comments on the material by 14 March 2008 and received 10 letters in response. The results of this consultation can be summarised as follows:

(a) All respondents agreed with EFRAG's assessment of the costs involved for users and preparers.

(b) All respondents agreed with EFRAG's assessment of the benefits associated with implementing the Interpretation .

(c) All respondents agreed with EFRAG's conclusion that the benefits to be derived from IFRIC 14's application will exceed the costs involved.

16 In addition, EFRAG consulted its User Panel in December 2007 on the impact that IFRIC 14 would have on users. Panel members were generally supportive of the Interpretation because it reduces divergence in practice. Additionally, members thought the costs for users arising from the Interpretation would be small.

EFRAG's final analysis of the costs and benefits of IFRIC 14

17 Based on its initial analysis and the stakeholders' views on that analysis, EFRAG's detailed final analysis of the costs and benefits of IFRIC 14 is presented in the paragraphs below.

18 As explained in the background section above, the first issue that IFRIC 14 clarifies is what exactly is meant by the reference 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.

19 EFRAG has concluded, for the reasons explained in our Endorsement Advice, 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.

20 EFRAG considered whether the accounting treatments required by IFRIC 14 would involve incremental costs for preparers. Its 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.

21 EFRAG considered whether the clarifications in IFRIC 14 in some way increased the burden on users. Its view is that they impose no additional burdens on users.

Conclusion

22 EFRAG's overall assessment is that:

(a) implementing IFRIC 14 will result in some year one costs and some incremental ongoing costs for preparers, but those costs will not be significant. On the other hand, it will not involve users incurring any incremental year one or ongoing costs;

(b) 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; and

(c) The benefits that will result from applying IFRIC 14 are likely to exceed the costs of doing so.

23 During its consultation process, EFRAG did not become aware of any factors other than those mentioned in this report that should be taken into account in assessing the costs and benefits of implementing IFRIC 14 in the EU.

EFRAG
17 April 2008