

10 January 2008

Status: Final

Effective date:

Periods beginning on or after 1 January 2008 – early application is permitted. But IFRIC 14 has not yet received EU endorsement.

Accounting impact:

Possible restriction of a surplus or a recognition of an onerous obligation due to Minimum Funding Requirements



International Financial Reporting Bulletin

IFRIC Interpretation 14: *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*

Background

IAS 19 *Employee Benefits* restricts the amount that may be recognised as an asset in respect of a defined benefit plan to the total of any cumulative unrecognised net actuarial losses and past service costs and the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan (IAS 19 (58)). Many countries have a minimum funding requirement (MFR) which stipulates a minimum amount or level of contributions that must be made to a plan over a specified period. IFRIC Interpretation 14: *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* addresses the differing treatments that have arisen in practice in dealing with the effect of a MFR on the limit imposed by IAS 19.

IFRIC 14 was issued in July 2007. Subsequently, in August 2007, the IFRIC issued a press release addressing various key issues that had arisen as a result of “an inaccurate assessment of the effect of IFRIC 14” observed by IFRIC “in several press articles and statements by market commentators”.

The IASB have given examples of jurisdictions where IFRIC 14 is likely to have an effect as Belgium, the Netherlands and Switzerland.

Requirements

1. Scope

IFRIC 14 applies to all post-employment defined benefits and other long-term employee defined benefits. Minimum funding requirements are any requirements to fund a post-employment or other long-term defined benefit plan.

2. Accounting

IFRIC 14 considers three issues:

- A. When refunds or reductions in future contributions should be regarded as available
- B. How a minimum funding requirement might affect the availability of reductions in future contributions
- C. When a minimum funding requirements might give rise to a liability.

These are considered in turn below.

**A: Availability of a refund
or reduction in future
contributions as an economic
benefit**

Such an economic benefit is available if the entity has an unconditional right to realise it at some point during the life of the plan or when the plan liabilities are settled. Such a benefit may be available even if it cannot be realised immediately at the balance sheet date. This clarifies the interpretation of the availability of a surplus. Some have argued that, under IAS 19, a surplus is not available to a plan sponsor unless it is immediately available at the balance sheet date. IFRIC 14 requires that the plan sponsor only needs to have an unconditional right to use the surplus at some point during the life of the plan (which might be through a reduction in future contributions or in the form of a refund) or on its wind up.

The economic benefit is determined as the maximum available from refunds, reductions in contributions or a combination of both; in accordance with the terms and conditions of the plan and any statutory requirements that apply.

The economic benefits available as a refund are included only if the entity has an unconditional right to a refund. This means that the refund must not be dependent on the occurrence or non-occurrence of one or more uncertain events outside of the entity's control. If the refund were only available if a third party (such as the fund trustees) gave approval, then the entity does not have an unconditional right. The amount of the economic benefits available as a refund is measured 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. Such costs might include taxes, other than income tax, and the costs of settling liabilities and making a refund, if the refund is measured as the amount available on a wind up of the scheme.

The economic benefits available as a reduction in future contributions in the absence of a MFR are the lower of:

- The surplus in the plan and
- The present value of the future service cost to the entity (i.e. excluding costs borne by the employees) over the shorter of the expected life of the plan and that of the entity.

The assumptions used to determine the future service costs should be consistent with those used to determine the defined benefit obligation (including the discount rate) and with the situation at the balance sheet date determined in accordance with IAS 19. An entity:

- should not assume any changes to the benefits to be provided by a plan in the future until the plan is amended; and
- should assume a stable workforce in the future unless it is demonstrably committed at the balance sheet date to make a reduction in the number of employees covered by the plan, in which case the assumption about the future workforce is required to include the reduction.

B: The effect of a minimum funding requirement on the economic benefits available as a reduction in future contributions

IFRIC 14 distinguishes contributions due under a MFR between:

- a. Those that cover an existing shortfall for past service. These do not affect future contributions for future service but may give rise to a liability at the balance sheet date (see C below).
- b. Future MFR contributions in respect of future service as these may reduce the extent to which the entity can benefit from a reduction in future contributions. In this instance, the economic benefits available as a reduction in future contributions are measured as:
 - the present value of the future service cost to the entity; less
 - the estimated minimum funding contributions required in respect of the future accrual of benefits.

Although the amount of the asset available as a reduction in future contributions is reduced by the present value of the excess of:

- the future minimum funding contribution required in respect of the future accrual of benefits; over
- the IAS 19 service cost in any given year;

the aggregate asset available as a reduction in future contributions can never be less than zero.

The calculation of the estimated minimum funding contributions in respect of the future accrual of benefits should take into account the effect of any existing surplus on the MFR basis and should use the assumptions required by the MFR. For any factors not specified by the MFR, assumptions should be consistent with those used to determine the defined benefit obligation and with the situation that exists at the balance sheet date as determined by IAS 19. Expected changes in the terms and conditions of the MFR should only be included if they are substantively enacted or contractually agreed at the balance sheet date.

C: When a minimum funding requirement might give rise to a liability

It was noted in B(a) above that contributions due under a MFR to cover an existing shortfall for past service may give rise to a liability at the balance sheet date. An entity should determine whether such contributions payable will, once they are paid into the plan, be available as a refund or reduction in future contributions. To the extent that they will not be so available, a liability is recognised when the MFR obligation arises. The liability will either reduce the defined benefit asset or increase the defined benefit liability, so that no gain or loss is expected to result from applying IAS 19(58) when the contributions are paid.

The August press release emphasises that two conditions must be met at the same time for an additional liability to be recognised: a statutory or contractual obligation to pay additional amounts and a restriction on the ability to recover those amounts by refund or otherwise.

3 Examples IFRIC 14 includes 3 illustrative examples:

1. Effect of the minimum funding requirement when there is an IAS 19 surplus and the minimum funding contributions payable are fully refundable to the entity
2. Effect of a minimum funding requirement when there is an IAS 19 deficit and the minimum funding contributions payable would not be fully available to the entity
3. Effect of a minimum funding requirement when the contributions payable would not be fully available, and the effect on the economic benefit available as a future contribution reduction.

Effect For entities operating defined benefit schemes in a jurisdiction with a MFR, IFRIC 14 may reduce the amount of an asset that may be recorded or give rise to a liability in respect of MFR contributions required to cover an existing shortfall for past service.

Action required Companies with a surplus on a defined benefit pension scheme should consider whether IFRIC 14 requires them to restrict the amount of surplus that they can recognise. IFRIC 14 gives guidance on the measurement of a surplus whether or not a MFR exists.

Companies with a defined benefit scheme in a jurisdiction where a MFR exists should consider whether that MFR represents an onerous obligation for which they should recognise a liability.



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