



<b>To:</b>	AASB Members	<b>Date:</b>	22 July 2009
<b>From:</b>	Dean Ardern	<b>Agenda Item:</b>	11.4
<b>Subject:</b>	IASB ED/2009/4 <i>Prepayments of a Minimum Funding Requirement</i> [AASB ED 182]	<b>File:</b>	

## Action

Consider the draft submission to the IASB on Exposure Draft ED/2009/4 *Prepayments of a Minimum Funding Requirement* (proposed amendments to IFRIC 14) and provide staff with directions for finalising the submission to be sent to the IASB by 7 August 2009.

## Background

AASB Exposure Draft ED 182 *Prepayments of a Minimum Funding Requirement* [AASB Interpretation 14] was published for public comment on 5 June 2009. ED 182 incorporates the IASB's Exposure Draft ED/2009/4, which was published for public comment on 28 May 2009. ED/2009/4 is open for comment until 27 July 2009. However, AASB staff have received an extension from IASB staff in respect of the AASB's submission on the ED to 7 August 2009.

If adopted, the proposed amendments in ED/2009/4 would remove an unintended consequence arising from the treatment required under IFRIC 14 *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* for prepayments of defined benefit obligations in circumstances where there is a minimum funding requirement.

IFRIC 14 currently specifies that the surplus in a superannuation plan created by the prepayment of contributions is not regarded as available as an economic benefit to an employer sponsor if the future minimum funding contribution required in respect of future service exceeds future IAS 19 *Employee Benefits* service cost. Therefore, in such circumstances the prepayment is recognised as an expense.

The IASB considered whether this approach is appropriate and concluded that an entity that has made a prepayment expects to obtain future economic benefits from that prepayment in the form of reduced cash flows in future years in which payments would otherwise have been required. Those cash outflows relate to both future service cost and future minimum funding requirement contributions. Accordingly, the IASB concluded that the entity has an asset.

## Proposed amendments to IFRIC 14

ED/2009/4 proposes that paragraph 20 of IFRIC 14 be amended as follows.

“If there is a minimum funding requirement for contributions relating to ~~the future accrual of benefits~~ service, an entity shall recognise an asset comprising:

- (a) the amount of any prepayment of the minimum funding requirement contributions, ie any amount of any minimum funding requirement contributions that the entity has paid before being required to do so that gives the entity the right to reduce future minimum funding requirement contributions; and
- (b) the amount of any ~~determine the~~ economic benefit available as a reduction in future contributions determined as the lower present value of:
  - (i) the surplus in the plan excluding any prepayment in (a); and
  - ~~(a)~~(ii) the estimated future service cost in each year period in accordance with paragraphs 16 and 17, less ~~(b)~~ the estimated minimum funding requirement contributions that would be required in respect of for future ~~accrual of benefits~~ service in that year period if there were no prepayment of those contributions as described in (a).”

The proposed amendments in part (a) of paragraph 20 clarify that the amount of any prepayment of the minimum funding requirement contributions is an asset of the employer sponsor. In addition, the proposed amendments in part (b) of paragraph 20 align the treatment of a prepayment in circumstances where minimum funding requirements apply with the requirements in paragraph 16 of IFRIC 14, which deals with the treatment of a prepayment in circumstances where no minimum funding requirements apply.

Paragraph 16 of IFRIC 14 states that:

“If there is no minimum funding requirement, an entity shall determine the economic benefit 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, i.e. excluding any part of the future cost that will be borne by employees, for each year over the shorter of the expected life of the plan and the expected life of the entity.”

This treatment of a surplus in circumstances where no minimum funding requirements apply is justified on the grounds that any economic benefits to an employer sponsor from a reduction in

future contributions would not exceed any corresponding surplus in the plan, and may be less than the amount of any surplus when:

“...the plan is very mature and has a very large surplus that is more than large enough to eliminate all future contributions and cannot be returned to the entity” (paragraph 77 of the Basis for Conclusions to IAS 19 *Employee Benefits*).

With respect to the prepayment of contributions under minimum funding requirements, paragraph BC27 of the Basis for Conclusions to IFRIC 14 states, in part, that:

“...future contribution requirements in respect of future service do not generate an additional liability at the balance sheet date because they do not relate to past services received by the entity. However, they may reduce the extent to which the entity can benefit from a reduction in future contributions...”

Where a minimum funding requirement requires an employer sponsor to, for instance, make a fixed level of contributions to a plan each period, and the employer sponsor is unable to receive any surplus as a refund, the minimum funding requirement effectively prevents the employer sponsor from utilising any defined benefit surplus by reducing future contributions. Accordingly, under the proposed amendments to paragraph 20 of IFRIC 14, the employer sponsor’s asset would be limited to the amount of any prepayment of contributions.

However, in circumstances where, for instance, an employer sponsor is required to maintain its defined benefit plan at a minimum funding level (such as plan assets equal to or greater than 100% of members’ accrued benefits), and the employer sponsor is unable to receive any surplus as a refund, the recognition of an asset arising from any surplus would be subject to the surplus being available to the employer sponsor for reducing future contributions. Accordingly, under the proposed amendments to paragraph 20 of IFRIC 14, the employer sponsor would recognise an asset comprising:

- (a) any prepayment of contributions in respect of future services costs; and
- (b) the amount of any surplus excluding any prepayment if it is available to the employer sponsor for reducing future contributions; or
- (c) no additional asset if any surplus excluding any prepayment is not available to the employer sponsor for reducing future contributions.

## **Implications for entities reporting in Australia**

Staff noted that entities with Australian-based employees with defined benefit entitlements, in some circumstances, are subject to minimum **contribution** requirements (in the form of Superannuation Guarantee (SG) contributions) rather than minimum **funding** requirements. While the notion of a

minimum funding requirement as described in IFRIC 14 arguably covers arrangements that require an employer sponsor to make a minimum amount or level of contributions, staff do not consider the SG requirements that underpin defined benefit arrangements in Australia to be a minimum funding requirement for the purpose of IFRIC 14.

Paragraph 2 of IFRIC 14 states that:

“Minimum funding requirements exist in many countries to improve the security of the post-employment benefit promise made to members of an employee benefit plan. Such requirements normally stipulate a minimum amount or level of contributions that must be made to a plan over a given period...”

In addition, paragraph BC4 of IFRIC 14 states that:

“D19 referred to statutory or contractual minimum funding requirements. Respondents to D19 asked for further guidance on what constituted a minimum funding requirement. The IFRIC decided to clarify that for the purpose of the Interpretation a minimum funding requirement is any requirement for the entity to make contributions to *fund* a post-employment or other long-term defined benefit plan.”

Most of the characteristics of minimum funding requirements described in paragraphs 2 and BC4 of IFRIC 14 are not evident in defined benefit arrangements in Australia. In most cases the level of contributions required to fund defined benefit arrangements in Australia exceeds the level of SG contributions for such members. In addition, the proposed amendments to paragraph 20 of IFRIC 14 arguably anticipate that minimum funding requirement contributions would approximate future service cost.

***Staff view***

Staff agree with the IASB’s conclusion that the prepayment of a minimum funding requirement would give rise to an asset, even when the future minimum funding contribution required in respect of future service exceeds future service cost. Accordingly, staff recommend the Board support the IASB’s proposed amendments to IFRIC 14 in Exposure Draft ED/2009/4.

## Attachments

- Agenda Paper 11.4.1      draft AASB submission on the IASB's Exposure Draft ED/2009/4 *Prepayments of a Minimum Funding Requirement* (proposed amendments to IFRIC 14)
- Agenda Paper 11.4.2      AASB Exposure Draft 182 *Prepayments of a Minimum Funding Requirement* [AASB Interpretation 14]
- Agenda Paper 11.4.3      Copy of the joint submission by CPA Australia, the Institute of Chartered Accountants in Australia and the National Institute of Accountants to the IASB on Exposure Draft ED/2009/4 *Prepayments of a Minimum Funding Requirement* (Proposed amendments to IFRIC 14)