

# Prepayments of a minimum funding requirement – amendments to IFRIC 14

On 26 November 2009, the International Financial Accounting Standards Board (IASB) issued *Prepayments of a Minimum Funding Requirement* which amends IFRIC 14 IAS 19 - *The limit on a defined benefit asset, minimum funding requirements and their interaction*.

## Why did IFRIC 14 need to be amended?

The amendment was made to remove an unintended consequence when an entity is subject to minimum funding requirements (MFR) and makes an early payment of contributions to cover those requirements.

If a pension asset cannot be recovered by a refund, its carrying value is restricted to the amount recoverable through reduced future contributions. When an entity is subject to MFR for future service, the amount recoverable is currently defined as the present value of:

- a) Future current service costs (net of employee contributions), less
- b) The part of the future MFR that relates to future service (as distinct from the part of the MFR that relates to past service).

It follows that if (b) exceeds (a), then no asset may be recognised. In some jurisdictions, the MFR are set on much more prudent basis than the IAS 19 measure of service cost, with the result that so far no asset was recognised.

The problem identified in practice relates to the ability, in some jurisdictions, to prepay the future MFR. Such a prepayment result in an increase in plan assets, with IAS 19's restriction then applying to the higher surplus. If it is the case that no asset can be recognised, the attendant loss is recorded in the period the prepayment is made. This problem is illustrated in the following example which is based on the one in the amendment.

The amendment requires entities to treat the benefit of such an early payment as a pension asset. Subsequently, the remaining surplus in the plan, if any, is subject to the same analysis as if no prepayment had been made.

## Illustration

A company has a defined benefit scheme and is legally required to pay MFR each year to cover the service cost of that year. The plan has a surplus of CU35m at the end of year 1 which is not refundable under any circumstances. For simplicity: a five-year time horizon is considered, discounting and asset returns are ignored, and the company does not use the corridor.

The current service cost for each of the next five years is expected to be CU10m and the MFR to be CU15m.

Year	2	3	4	5	6	Total
CSC CUm	10	10	10	10	10	50
MFR CUm	(15)	(15)	(15)	(15)	(15)	(75)
						(25)

Under the original IFRIC 14, because future MFR exceed the future current service cost, the surplus has been restricted to zero. No additional liability is recognised as the MFR relate to future service.

If, at the end of year 1, the company were to prepay the MFR for years two and three (CU30m), the surplus would rise to CU65m and the future MFR would be reduced accordingly.

Year	2	3	4	5	6	Total
CSC CUm	10	10	10	10	10	50
MFR CUm			(15)	(15)	(15)	(45)
						5

Under the original IFRIC 14, that surplus would have been restricted to CU5m (CU10m x 5 - CU15m x 3). This is despite the fact that cash outflows of CU15m for each of the next two years, which otherwise

would have been required, can now be avoided. Another effect is that a cost is recognised in the period during which the company chooses to pay it and not in the future service periods.

The amendments require the recognition of the prepayment as a pension asset and then apply the normal rules as if no prepayment had been made. The effect of this for the example given would be to recognise the prepayment at CU30m. The reduced future contributions would then be assessed as if no prepayment had been made, resulting in no further pension asset as MFR exceeds current service cost.

The revised IFRIC 14 is effective for annual periods beginning on or after 1 January 2011, with early application permitted.

The IASB aligned the transitional provisions of these amendments with those of the original IFRIC 14. This means that entities have to assess the adjustment resulting from this amendment by going back to the beginning of the earliest comparative period presented in the first financial statements in which the entity applied the original Interpretation.

## Business impact

The changes to IFRIC 14 require entities sponsoring defined benefit plans to assess whether prepayments have been made that now need to be re-assessed for their impact on recoverability on pension assets. Entities applying the corridor to recognise actuarial gains and losses may also need to take into account the potential interaction between corridor and the recoverability of plan assets.

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EYG no. AU0407

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