



EUROPEAN COMMISSION

Internal Market and Services DG

FREE MOVEMENT OF CAPITAL, COMPANY LAW AND CORPORATE GOVERNANCE

Financial Reporting

Brussels, 04 February 2010

MARKT F3 D(2010)

Endorsement of amendments to IFRIC 14 *Prepayments of a Minimum Funding Requirement*

Introduction, background and conclusions

Attachment 1: Effect study prepared by the European Financial Reporting Advisory Group (EFRAG)

Attachment 2: Endorsement advice prepared by EFRAG

1. INTRODUCTION

The European Commission has agreed with the European Parliament that Effect Studies should be prepared for new accounting standards and interpretations up for endorsement in the European Union. The Commission Services together with European Financial Reporting Advisory Group (EFRAG) prepare these studies containing description of the accounting issues involved, results from stakeholder consultations as well as an analysis of effects of using the new accounting rules in the EU.

EFRAG has prepared an Effect Study for the amendments to the interpretation IFRIC 14 *Prepayments of a Minimum Funding Requirement* (attached). As the EFRAG Effect Study refers to the Endorsement Advice, we also included it in attachments. In the light of the size and extent of the issue, the Commission Services asked EFRAG to prepare a small report.

This cover note contains introduction, comments and a conclusion by the Commission Services.

2. BACKGROUND ON IFRIC 14

IAS 19 *Employee Benefits* sets out how to account for various types of employee benefits. In the case of defined benefit plans, 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 those obligations. 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 recognize either a liability or 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.

IFRIC 14 *IAS 19— The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* provides some guidance on how to assess to what extent those amounts are available to the entity, e.g. in the case where a defined benefit plan is subject to a minimum funding requirement (MFR).

However, an unintended consequence of IFRIC 14 was identified when an entity subject to a minimum funding requirement makes an early payment of contributions. Under certain circumstances, the entity making such a prepayment of a MFR would be required to recognise an expense.

How do the amendments to IFRIC 14 suggest dealing with the issue?

The amendments to IFRIC 14 ("Amendments") eliminate this unintended consequence and treat this prepayment, like any other prepayment, as an asset (because making such a prepayment should reduce the amount of MFR contributions that would otherwise need to be made in the future).

The Amendments to IFRIC 14 become effective for annual periods beginning on or after 1 January 2011. Earlier application is permitted but must be disclosed.

EFRAG consultations

EFRAG published its initial assessment and supporting analysis on 14 December 2009. EFRAG received five comment letters. Overall the respondents agreed with EFRAG's assessment of the benefits of implementing IFRIC 14 and the associated costs involved for users and preparers and supported EFRAG's recommendation that the amendments to IFRIC 14 be adopted for use in Europe.

3. EFFECT ANALYSIS AND CONCLUSIONS

Main points identified in the EFRAG Effect Analysis

EFRAG supports the Amendments and has concluded that they meet the requirements of Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards in that they are not contrary to the 'true and fair principle' set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC and they meet the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

<p>The Commission Services agree with the EFRAG analysis and conclude that the amendments to IFRIC 14 will contribute to a more consistent application of the standard and provide the necessary clarification needed. In that respect it meets all the qualitative criteria.</p>

Costs and benefits for preparers and users

Costs for preparers

The Amendments will change the accounting only for voluntary prepayments of a minimum funding requirement. The accounting for pensions is already complex, and the Amendments do not reduce or increase that complexity. Thus EFRAG thinks the effort required by entities to estimate the value of their present obligations they have with respect to pensions or the value of any assets held in a plan to fund those obligations will be about the same.

However, EFRAG does believe that some preparers may more readily determine the accounting treatment of a prepayment because reduced analysis of future service costs and future funding requirements will be needed to make the accounting determination. This reduced analysis is expected to lead to some cost savings, but it is likely to be insignificant and only apply to the few entities that are affected by the Amendments. As a result, EFRAG thinks the Amendments will reduce costs for some preparers but the cost savings are likely to be insignificant.

Costs for users

EFRAG concluded that it is not aware of any aspect of the Amendments that will increase the costs users will incur in analysing the financial statements.

Benefits for preparers and users

EFRAG's assessment is that the Amendments will result in an improvement in the quality of the information provided because certain voluntary prepayments of a minimum funding requirement will be reported as assets and will no longer be reported as an expense.

EFRAG's conclusion

EFRAG concludes that implementing the Amendments is likely to provide some reduced costs, but only some preparers will be affected by them and the reduction is likely to be insignificant. The Amendments are not likely to involve users in any additional costs.

On the other hand the Amendments are likely to result in benefits for both users and preparers that are affected by the Amendments.

EFRAG's assessment is therefore that the benefits arising from implementation of the Amendments in the EU are likely to exceed the costs of implementation.

Based on the EFRAG analysis the Commission Services note that the amendments to IFRIC 14 provide a necessary clarification and do not result in substantial cost for preparers or users. In addition, the clarification will result in benefits to both, preparers and users, since the information provided will be more useful.

4. OVERALL COST-BENEFIT CONSIDERATIONS AND COMMISSION SERVICES CONCLUSIONS

On the basis of EFRAG's Effect Study, the Commission Services have considered the main costs and benefits of endorsing the amendments to IFRIC 14. The Services conclude that the benefits of the Amendments clearly outweigh the costs introduced.

The Commission Services believe that the amendments to IFRIC 14 will have positive cost-benefits effects and that it should therefore be endorsed in the EU without delay.



The cost and benefits of implementing the amendments to IFRIC 14 *Prepayments of a Minimum Funding Requirement*

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 the amendments to IFRIC 14 *Prepayments of a Minimum Funding Requirement* (the Amendments).
- 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 the Amendments, 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 an initial assessment of the likely costs and benefits of implementing the revision in the EU, to consult on the results of that initial assessment, and to finalise the assessment in the light of the comments received.

EFRAG's endorsement advice

- 3 EFRAG also 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.

A summary of the amendments to IFRIC 14

- 4 IAS 19 *Employee Benefits* sets out how to account for various types of employee benefits. In the case of defined benefit plans, 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 those

obligations. 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.*

IFRIC 14 provides some guidance on how to interpret the italicised text.

- 5 One of the issues 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 (MFR). An MFR normally stipulates a minimum amount or level of contributions that must be made to a plan over a given period. However, an unintended consequence of IFRIC 14 was identified when an entity subject to a minimum funding requirement makes an early payment of contributions. Under certain circumstances, the entity making such a prepayment of a MFR would be required to recognise an expense.
- 6 The Amendment eliminates this unintended consequence and treats this prepayment, like any other prepayment, as an asset (because making such a prepayment should reduce the amount of MFR contributions that would otherwise need to be made in the future).

Effective date

- 7 Entities are required to apply the Amendments for annual periods beginning on or after 1 January 2011. Earlier application is permitted but must be disclosed.

EFRAG's initial analysis of the costs and benefits of the amendments to IFRIC 14

- 8 EFRAG carried out an initial assessment of the costs and benefits expected to arise for preparers and for users both in year one and in subsequent years from implementing the Amendments in the EU.
- 9 The tentative conclusions reached about additional costs for preparers as a result of that initial assessment were that implementing the Amendments is likely to provide some reduced costs, but only some preparers will be affected by them and the reduction is likely to be insignificant.
- 10 EFRAG also tentatively concluded that the Amendments are not likely to involve users in any additional costs.
- 11 As a result, EFRAG's overall tentative conclusion was that the benefits to be derived from implementing the Amendments in the EU are likely to exceed the costs involved.
- 12 EFRAG published its initial assessment and supporting analysis on 14 December 2009 and invited comment on the material by 20 January 2010. In response, EFRAG

received five comment letters and all agreed with EFRAG's initial assessment and had no additional comments, although two stated it had not carried out a detailed examination of the effects involved EFRAG's final analysis of the costs and benefits of the amendments to IFRIC 14.

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

- 13 Based on its initial analysis and on stakeholders' views on that analysis, EFRAG's detailed final analysis of the costs and benefits of implementing the Amendments in the EU is presented in the paragraphs below.

Costs for preparers

- 14 The Amendments will change the accounting only for voluntary prepayments of a minimum funding requirement. The accounting for pensions is already complex, and the Amendments do not reduce or increase that complexity. Thus EFRAG thinks the effort required by entities to estimate the value of their present obligations they have with respect to pensions or the value of any assets held in a plan to fund those obligations will be about the same.

- 15 However, EFRAG does believe that some preparers may more readily determine the accounting treatment of a prepayment because reduced analysis of future service costs and future funding requirements will be needed to make the accounting determination. This reduced analysis is expected to lead to some cost savings, but it is likely to be insignificant and only apply to the few entities that are affected by the Amendments. As a result, EFRAG thinks the Amendments will reduce costs for some preparers but the cost savings are likely to be insignificant.

Costs for users

- 16 EFRAG is not aware of any aspect of the Amendments that will increase the costs users will incur in analysing the financial statements.

Benefits for preparers and users

- 17 EFRAG's assessment is that the Amendments will result in an improvement in the quality of the information provided because certain voluntary prepayments of a minimum funding requirement will be reported as assets and will no longer be reported as an expense.

Conclusion

- 18 EFRAG's overall assessment is therefore that:
- (a) implementing the Amendments is likely to provide some reduced costs, but only some preparers will be affected by them and the reduction is likely to be insignificant;
 - (b) the Amendments are not likely to involve users in any additional costs; and
 - (c) the Amendments are likely to result in benefits for both users and preparers that are affected by the Amendments.
- 19 EFRAG's assessment is therefore that the benefits arising from implementation of the Amendments in the EU are likely to exceed the costs of implementation.

- 20 During its consultation process, EFRAG did not become aware of any other factors that should be taken into account in assessing the costs and benefits of implementing the revised standard in the EU.

Stig Enevoldsen
EFRAG, Chairman
29 January 2010

Attachment 2



Jörgen Holmquist
Director General
European Commission
Directorate General for the Internal Market
1049 Brussels

29 January 2010

Dear Mr. Holmquist

Adoption of the Amendments to IFRIC 14 *Prepayments of a Minimum Funding Requirement*

Based on the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards, we are pleased to provide our opinion on the adoption of the Amendments to IFRIC 14 *Prepayments of a Minimum Funding Requirement* (the Amendments), which was published in November 2009. The amendments were proposed in an exposure draft on which EFRAG commented.

The Amendments remove an unintended consequence of IFRIC 14 for entities that are subject to a minimum funding requirement (MFR). IFRIC 14 provides guidance on how an entity accounts for employee benefit plan assets and liabilities that are subject to a MFR, and prior to the Amendments, an entity that prepaid a MFR was required to expense the prepayment under certain circumstances. The Amendments eliminate this unintended consequence and treats this prepayment, like any other prepayment, as an asset (because making such a prepayment should reduce the amount of MFR contributions that would otherwise need to be made in the future).

Entities are required to apply the Amendments for annual periods beginning on or after 1 January 2011. Earlier application is permitted but must be disclosed.

EFRAG has carried out an evaluation of Amendments. As part of that process, EFRAG issued a draft assessment of the Amendments against the EU endorsement criteria for public comment and, when finalising its advice and the content of this letter, it took the comments received in response into account. EFRAG's evaluation is based on input from standard setters, market participants and other interested parties, and its discussions of technical matters are open to the public.

EFRAG supports the Amendments and has concluded that they meet the requirements of Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards in that:

- they are not contrary to the ‘true and fair principle’ set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and
- they meet the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

For the reasons given above, EFRAG believes that it is in the European interest to adopt the Amendments and, accordingly, EFRAG recommends their adoption. EFRAG’s reasoning is explained in the attached ‘Appendix – Basis for Conclusions’.

On behalf of the members of EFRAG, I should be happy to discuss our advice with you, other officials of the EU Commission or the Accounting Regulatory Committee as you may wish.

Yours sincerely

Stig Enevoldsen

EFRAG, Chairman

APPENDIX BASIS FOR CONCLUSIONS

This appendix sets out the basis for the conclusions reached and for the recommendation made by EFRAG on the Amendments to IFRIC 14 Prepayments of a Minimum Funding Requirement.

In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG's capacity as a contributor to the IASB's due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of the final IFRS or Interpretation on the issue.

In the latter capacity, EFRAG's role is to make a recommendation about endorsement based on its assessment of the final IFRS or Interpretation against the European endorsement criteria, as currently defined. These are explicit criteria which have been designed specifically for application in the endorsement process, and therefore the conclusions reached on endorsement may be different from those arrived by EFRAG in developing its comments on proposed IFRSs or Interpretations. Another reason for a difference is that EFRAG's thinking may evolve.

- 21 The Amendments to IFRIC 14 *Prepayments of a Minimum Funding Requirement* (the Amendments) eliminates an unintended consequence of IFRIC 14 and treats this type of prepayment, like any other prepayment. When evaluating the Amendments, EFRAG considered whether the accounting that results from their application meets the criteria for EU endorsement, in other words, that the accounting:
- (a) is not contrary to the 'true and fair principle' set out in Article 16(3) of Council Directive 83/349/EEC and in Article 2(3) of Council Directive 78/660/EEC; and
 - (b) meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

EFRAG has also considered whether it is in the European interest to adopt the Amendments.

- 22 Having formed tentative views on these issues and prepared a draft assessment, EFRAG issued that draft assessment on 14 December 2009 and asked for comments on it by 20 January 2010. EFRAG has considered all the comments received, and all were supportive of EFRAG's tentative views.

Does the accounting that results from the application of the Amendments meet the criteria for EU endorsement?

Comparability

- 23 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.
- 24 Under existing IFRIC 14, an entity may be required to recognise additional expense simply by making a voluntary prepayment of a MFR. If an entity under identical

circumstances chose instead to defer making the contribution until required to do so, its pension expense would be lower in the reporting period. In EFRAG's view, this is indeed an unintended consequence of existing IFRIC 14 because the timing of the payment should not give rise to additional expense recognition. The Amendment will change the accounting for certain prepayments of a MFR to remove the unintended consequence and make the accounting similar to other types of prepayments such as a prepayment of a lease obligation. As a result, EFRAG's assessment is that the Amendments meet the comparability criterion.

Relevance

- 25 According to the Framework, information has the quality of relevance when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations.
- 26 EFRAG considered whether the Amendments would result in the provision of relevant information; in other words, information that has predictive value, confirmatory value or both. EFRAG's assessment about the Amendments' relevance is very similar to its assessment of comparability; a prepayment either reduces a liability or creates an asset because the entity making the prepayment receives an economic benefit through reduced future contributions. The Amendment eliminates the unintended consequence of existing IFRIC 14 that treated certain prepayments as an expense, thus enhancing the relevance of the financial information. For that reason, EFRAG's overall assessment is that the Amendments meet the relevance criterion.

Reliability

- 27 EFRAG also considered the reliability of the information that will be provided by applying the Amendments. The Framework explains that information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.
- 28 In EFRAG's view, the Amendments do not raise any issues concerning freedom from material error and bias or completeness. In addition, EFRAG believes a key issue to be considered in the context of faithful representation is whether the Amendment correctly portrays a voluntary prepayment transaction. EFRAG believes the Amendments, by removing an unintended consequence of a voluntary prepayment of a minimum funding requirement, results in an improvement in the representational faithfulness of the accounting treatment of the transactions falling within its scope. As a result, EFRAG's overall assessment is that the Amendments will not give rise to reliability concerns.

Understandability

- 29 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting and the willingness to study the information with reasonable diligence. Although there are a number of aspects to the notion of 'understandability', EFRAG believes that most aspects are covered by the discussion above about relevance, reliability and comparability (because, for example, information that represents something as similar when it is in fact dissimilar is not comparable, and

that lack of comparability will mean it is also not understandable). As a result, EFRAG believes that the main additional issue it needs to consider in assessing whether the information resulting from the application of the Amendments is understandable is whether that information will be unduly complex.

- 30 In EFRAG's view the Amendments do not introduce any new complexities into the financial statements.

True and fair view

- 31 EFRAG has also concluded that there was no reason to believe that the information resulting from the application of the Amendments would be contrary to the true and fair view principle.

Cost and benefit

- 32 EFRAG has considered whether the benefits of implementing the Amendments in the EU exceed the cost of doing so. EFRAG's assessment is that the benefits of implementing the Amendments do outweigh the costs involved.

Conclusion

- 33 After considering all the above arguments, EFRAG has concluded that, on balance, the Amendments satisfies the criteria for EU endorsement and that it is likely to be in the European interest to adopt the Amendments. Accordingly, EFRAG recommends its endorsement in Europe.