CPA Hong Kong Institute of Certified Public Accountants 香港會計師公會

MEMBERS' HANDBOOK

Update No. 74

(Issued 11 December 2009)

This Update relates to the issuance of:

- HK(IFRIC) Interpretation 19 *Extinguishing Financial Liabilities with Equity Instruments*
- Amendment to HK(IFRIC) Interpretation 14 *HKAS 19–The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*
- Other consequential amendment

Document Reference and Title	***Instructions***	***Explanations***
VOLUME II		
Contents of Volume II	Discard the existing pages i-iii and replace with the new pages i-iii.	Revised contents pages
HONG KONG (IFRIC) INTERPRETATIONS (HK(IFRIC)-Int)		
HK(IFRIC) Interpretation 19 *Extinguishing Financial Liabilities with Equity Instruments*	Insert these pages after HK(IFRIC) - Int 18 *Transfers of Assets from Customers*.	New Interpretation – Note 1
HK(IFRIC) Interpretation 14 *HKAS 19–The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*	Replace the Interpretation with revised Interpretation.	Amendment to HK(IFRIC)–Int 14 – Note 2
Amendments to other HKFRSs		
HONG KONG FINANCIAL REPORTING STANDARDS (HKFRS)		
HKFRS 1 (Revised) *First-time Adoption of Hong Kong Financial Reporting Standards* (Standard)	Replace cover page and page 3 with revised cover page and page 3. Insert page 28 after page 27.	Amendment due to HK(IFRIC)–Int 19

Notes:

1. HK(IFRIC) Interpretation 19 *Extinguishing Financial Liabilities with Equity Instruments* clarifies the requirements of Hong Kong Financial Reporting Standards when an entity renegotiates the terms of a financial liability with its creditor and the creditor agrees to accept the entity's shares or other equity instruments to settle the financial liability fully or partially.

HK(IFRIC)–Int 19 clarified that:

- the entity's equity instruments issued to a creditor are part of the consideration paid to extinguish the financial liability.
- the equity instruments issued are measured at their fair value. If their fair value cannot be reliably measured, the equity instruments should be measured to reflect the fair value of the financial liability extinguished.
- the difference between the carrying amount of the financial liability extinguished and the initial measurement amount of the equity instruments issued is included in the entity's profit or loss for the period.

The interpretation is effective for annual periods beginning on or after 1 July 2010 with earlier application permitted.

2. The amendment to HK(IFRIC)–Int 14, which is itself an interpretation of HKAS 19 *Employee Benefits*. The amendment applies in the limited circumstances when an entity is subject to minimum funding requirements and makes an early payment of contributions to cover those requirements. The amendment permits such an entity to treat the benefit of such an early payment as an asset.

   The amendment, *Prepayments of a Minimum Funding Requirement*, has an effective date for mandatory adoption of 1 January 2011, with early adoption permitted for 2009 year-end financial statement.

Hong Kong Institute of
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HK(IFRIC)-Int 19
Issued December 2009

Effective for annual periods
beginning on or after 1 July 2010

HK(IFRIC) Interpretation 19

Extinguishing Financial Liabilities with Equity Instruments

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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Amendment to HKFRS 1 ***First-time Adoption of Hong Kong Financial Reporting Standards***

Basis for Conclusions

Hong Kong (IFRIC) Interpretation 19 *Extinguishing Financial Liabilities with Equity Instruments* (HK(IFRIC)-Int 19) is set out in paragraphs 1–13 and the Appendix. HK(IFRIC)-Int 19 is accompanied by a Basis for Conclusions. The scope and authority of Interpretations are set out in the *Preface to Hong Kong Financial Reporting Standards*.

Hong Kong (IFRIC) Interpretation 19
Extinguishing Financial Liabilities with Equity Instruments

References

- *Framework for the Preparation and Presentation of Financial Statements*
- HKFRS 2 *Share-based Payment*
- HKFRS 3 (Revised) *Business Combinations*
- HKAS 1 *Presentation of Financial Statements*
- HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- HKAS 32 *Financial Instruments: Presentation*
- HKAS 39 *Financial Instruments: Recognition and Measurement*

Background

1 A debtor and creditor might renegotiate the terms of a financial liability with the result that the debtor extinguishes the liability fully or partially by issuing equity instruments to the creditor. These transactions are sometimes referred to as 'debt for equity swaps'. The International Financial Reporting Interpretations Committee has received requests for guidance on the accounting for such transactions.

Scope

2 This Interpretation addresses the accounting by an entity when the terms of a financial liability are renegotiated and result in the entity issuing equity instruments to a creditor of the entity to extinguish all or part of the financial liability. It does not address the accounting by the creditor.

3 An entity shall not apply this Interpretation to transactions in situations where:

(a) the creditor is also a direct or indirect shareholder and is acting in its capacity as a direct or indirect existing shareholder.

(b) the creditor and the entity are controlled by the same party or parties before and after the transaction and the substance of the transaction includes an equity distribution by, or contribution to, the entity.

(c) extinguishing the financial liability by issuing equity shares is in accordance with the original terms of the financial liability.

Issues

4 This Interpretation addresses the following issues:

(a) Are an entity's equity instruments issued to extinguish all or part of a financial liability 'consideration paid' in accordance with paragraph 41 of HKAS 39?

(b) How should an entity initially measure the equity instruments issued to extinguish such a financial liability?

(c) How should an entity account for any difference between the carrying amount of the financial liability extinguished and the initial measurement amount of the equity instruments issued?

Conclusions

5 The issue of an entity's equity instruments to a creditor to extinguish all or part of a financial liability is consideration paid in accordance with paragraph 41 of HKAS 39. An entity shall remove a financial liability (or part of a financial liability) from its statement of financial position when, and only when, it is extinguished in accordance with paragraph 39 of HKAS 39.

6 When equity instruments issued to a creditor to extinguish all or part of a financial liability are recognised initially, an entity shall measure them at the fair value of the equity instruments issued, unless that fair value cannot be reliably measured.

7 If the fair value of the equity instruments issued cannot be reliably measured then the equity instruments shall be measured to reflect the fair value of the financial liability extinguished. In measuring the fair value of a financial liability extinguished that includes a demand feature (eg a demand deposit), paragraph 49 of HKAS 39 is not applied.

8 If only part of the financial liability is extinguished, the entity shall assess whether some of the consideration paid relates to a modification of the terms of the liability that remains outstanding. If part of the consideration paid does relate to a modification of the terms of the remaining part of the liability, the entity shall allocate the consideration paid between the part of the liability extinguished and the part of the liability that remains outstanding. The entity shall consider all relevant facts and circumstances relating to the transaction in making this allocation.

9 The difference between the carrying amount of the financial liability (or part of a financial liability) extinguished, and the consideration paid, shall be recognised in profit or loss, in accordance with paragraph 41 of HKAS 39. The equity instruments issued shall be recognised initially and measured at the date the financial liability (or part of that liability) is extinguished.

10 When only part of the financial liability is extinguished, consideration shall be allocated in accordance with paragraph 8. The consideration allocated to the remaining liability shall form part of the assessment of whether the terms of that remaining liability have been substantially modified. If the remaining liability has been substantially modified, the entity shall account for the modification as the extinguishment of the original liability and the recognition of a new liability as required by paragraph 40 of HKAS 39.

11 An entity shall disclose a gain or loss recognised in accordance with paragraphs 9 and 10 as a separate line item in profit or loss or in the notes.

Effective date and transition

12 An entity shall apply this Interpretation for annual periods beginning on or after 1 July 2010. Earlier application is permitted. If an entity applies this Interpretation for a period beginning before 1 July 2010, it shall disclose that fact.

13 An entity shall apply a change in accounting policy in accordance with HKAS 8 from the beginning of the earliest comparative period presented.

Appendix
Amendment to HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards*

The amendment in this appendix shall be applied for annual periods beginning on or after 1 July 2010. If an entity applies this Interpretation for an earlier period, these amendments shall be applied for that earlier period.

* * *

The amendments contained in this appendix when this Interpretation was issued have been incorporated into the relevant Standard.

Basis for Conclusions on HK(IFRIC)-Int 19

This Basis for Conclusions accompanies, but is not part of, IFRIC 19.

HK(IFRIC)-Int 19 is based on IFRIC Interpretation 19 *Extinguishing Financial Liabilities with Equity Instruments*. In approving HK(IFRIC)-Int 19, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IFRIC's Basis for Conclusions on IFRIC Interpretation 19. Accordingly, there are no significant differences between HK(IFRIC)-Int 19 and IFRIC Interpretation 19. The IFRIC's Basis for Conclusions is reproduced below. The paragraph numbers of IFRIC Interpretation 19 referred to below generally correspond with those in HK(IFRIC)-Int 19.

Introduction

BC1 This Basis for Conclusions summarises the IFRIC's considerations in reaching its consensus. Individual IFRIC members gave greater weight to some factors than to others.

BC2 The IFRIC received a request for guidance on the application of IAS 39 *Financial Instruments: Recognition and Measurement* and IAS 32 *Financial Instruments: Presentation* when an entity issues its own equity instruments to extinguish all or part of a financial liability. The question is how the entity should recognise the equity instruments issued.

BC3 The IFRIC noted that lenders manage loans to entities in financial difficulty in a variety of ways including one or more of the following:

(a) selling the loans in the market to other investors/lenders;

(b) renegotiating the terms of the loan (eg extension of the maturity date or lower interest payments); or

(c) accepting the creditor's equity instruments in full or partial settlement of the liability (sometimes referred to as a 'debt for equity swap').

BC4 The IFRIC was informed that there was diversity in practice in how entities measure the equity instruments issued in full or partial settlement of a financial liability following renegotiation of the terms of the liability. Some recognise the equity instruments at the carrying amount of the financial liability and do not recognise any gain or loss in profit or loss. Others recognise the equity instruments at the fair value of either the liability extinguished or the equity instruments issued and recognise a difference between that amount and the carrying amount of the financial liability in profit or loss.

BC5 In August 2009 the IFRIC published draft Interpretation D25 *Extinguishing Financial Liabilities with Equity Instruments* for public comment. It received 33 comment letters in response to the proposals.

Scope

BC6 The IFRIC concluded that its Interpretation should address only the accounting by an entity when the terms of a financial liability are renegotiated and result in the entity issuing equity instruments to a creditor of the entity to extinguish part or all of the liability. It does not address the accounting by the creditor because other IFRSs already set out the relevant requirements.

BC7 The IFRIC considered whether to provide guidance on transactions in which the creditor is also a direct or indirect shareholder and is acting in its capacity as an existing direct or indirect shareholder. The IFRIC concluded that the Interpretation should not address such transactions. It noted that determining whether the issue of equity instruments to extinguish a financial liability in such situations is considered a transaction with an owner in its capacity as an owner would be a matter of judgement depending on the facts and circumstances.

BC8 In its redeliberations, the IFRIC clarified that transactions when the creditor and the entity are controlled by the same party or parties before and after the transaction are outside the scope of the Interpretation when the substance of the transaction includes an equity distribution by, or contribution to, the entity. The IFRIC acknowledged that the allocation of consideration between the extinguishment of all or part of a financial liability and the equity distribution or contribution components may not always be reliably measured.

BC9 Some respondents questioned whether the Interpretation should be applied to transactions when the extinguishment of the financial liability by issuing equity shares is in accordance with the original terms of the liability. In its redeliberations the IFRIC decided that these transactions should be excluded from the scope of the Interpretation, noting that IAS 32 includes specific guidance on those financial instruments.

Are an entity's equity instruments 'consideration paid'?

BC10 The IFRIC noted that IFRSs do not contain specific guidance on the measurement of an entity's equity instruments issued to extinguish all or part of a financial liability. Paragraph 41 of IAS 39 requires an entity to recognise in profit or loss the difference between the carrying amount of the financial liability extinguished and the consideration paid. That paragraph describes 'consideration paid' as including non-cash assets transferred, or liabilities assumed, and does not specifically mention equity instruments issued. Consequently, some are of the view that equity instruments are not 'consideration paid'.

BC11 Holders of this view believe that, because IFRSs are generally silent on how to measure equity instruments on initial recognition (see paragraph BC15), a variety of practices has developed. One such practice is to recognise the equity instruments issued at the carrying amount of the financial liability extinguished.

BC12 However, the IFRIC observed that both IFRS 2 *Share-based Payment* and IFRS 3 *Business Combinations* make it clear that equity instruments are used as consideration to acquire goods and services as well as to obtain control of businesses.

BC13 The IFRIC also observed that the issue of equity instruments to extinguish a financial liability could be analysed as consisting of two transactions—first, the issue of new equity instruments to the creditor for cash and second, the creditor accepting payment of that amount of cash to extinguish the financial liability.

BC14 As a result of its analysis, the IFRIC concluded that the equity instruments issued to extinguish a financial liability are 'consideration paid' in accordance with paragraph 41 of IAS 39.

How should the equity instruments be measured?

BC15 The IFRIC observed that although IFRSs do not contain a general principle for the initial recognition and measurement of equity instruments, guidance on specific transactions exists, including:

(a) *initial recognition of compound instruments* (IAS 32). The amount allocated to the equity component is the residual after deducting the fair value of the financial liability component from the fair value of the entire compound instrument.

(b) *cost of equity transactions and own equity instruments ('treasury shares') acquired and reissued or cancelled* (IAS 32). No gain or loss is recognised in profit or loss on the purchase, sale, issue or cancellation of an entity's own equity instruments. These are transactions with an entity's owners in their capacity as owners.

(c) *equity instruments issued in share-based payment transactions* (IFRS 2). For equity-settled share-based payment transactions, the entity measures the goods or services received, and the corresponding increase in equity, directly, at the fair value of the goods or services received, unless that fair value cannot be estimated reliably. If the entity cannot estimate reliably the fair value of the goods or services received (eg transactions with employees), the entity measures their value, and the corresponding increase in equity, indirectly, by reference to the fair value of the equity instruments granted.

(d) *consideration transferred in business combinations* (IFRS 3). The total consideration transferred in a business combination is measured at fair value. It includes the acquisition-date fair values of any equity interests issued by the acquirer.

BC16 The IFRIC noted that the general principle of IFRSs is that equity is a residual and should be measured initially by reference to changes in assets and liabilities (the *Framework* and IFRS 2). IFRS 2 is clear that when goods or services are received in return for the issue of equity instruments, the increase in equity is measured directly at the fair value of the goods or services received.

BC17 The IFRIC decided that the same principles should apply when equity instruments are issued to extinguish financial liabilities. However, the IFRIC was concerned that entities might encounter practical difficulties in measuring the fair value of both the equity instruments issued and the financial liability, particularly when the entity is in financial difficulty. Therefore, the IFRIC decided in D25 that equity instruments issued to extinguish a financial liability should be measured initially at the fair value of the equity instruments issued or the fair value of the liability extinguished, whichever is more reliably determinable.

BC18 However, in response to comments received on D25, the IFRIC reconsidered whether the entity should initially measure equity instruments issued to a creditor to extinguish all or part of a financial liability at the fair value of the equity instruments issued or the fair value of the liability extinguished. The IFRIC noted that many respondents proposed that a preferred measurement basis should be determined to avoid an 'accounting choice' developing in practice, acknowledging that both measurement approaches would need to be used to identify which was more reliably determinable.

BC19 Therefore the IFRIC decided to modify the proposal in D25 and identify a preferred measurement basis. In identifying this preferred measurement basis, the IFRIC noted that many respondents considered that the principles in IFRS 2 and the *Framework* referred to in paragraph BC16 support a measurement based on the fair value of the liability extinguished.

BC20 However, some respondents argued that the fair value of the equity issued should be the proposed measurement basis. They pointed out that this approach would be consistent with the consensus that the issue of an entity's equity instruments is consideration paid in accordance with paragraph 41 of IAS 39. They also argued that the fair value of the equity issued best reflects the total amount of consideration paid in the transaction, which may include a premium that the creditor requires to renegotiate the terms of the financial liability.

BC21 The IFRIC considered that the fair value of the equity issued should be the proposed measurement basis for the reasons described in paragraph BC20. Consequently the IFRIC concluded that an entity should initially measure equity instruments issued to a creditor to extinguish all or part of a financial liability at the fair value of the equity instruments issued, unless that fair value cannot be reliably measured. If the fair value of the equity instruments issued cannot be reliably measured then these equity instruments should initially be measured to reflect the fair value of the liability extinguished.

BC22 In redeliberations, the IFRIC noted that these transactions often take place in situations when the terms of the financial liability are breached and the liability becomes repayable on demand. The IFRIC agreed with comments received that paragraph 49 of IAS 39 is not applied in measuring the fair value of all or part of a financial liability extinguished in these situations. This is because the extinguishment transaction suggests that the demand feature is no longer substantive.

BC23 In response to comments, the IFRIC also clarified that the equity instruments issued should be recognised initially and measured at the date the financial liability (or part of that liability) is extinguished. This is consistent with paragraphs BC341 and BC342 of the Basis for Conclusions on IFRS 3, which discuss the views on whether equity instruments issued as consideration in a business combination should be measured at fair value at the agreement date or acquisition date, concluding that measurement should be at the acquisition date.

How should a difference between the carrying amount of the financial liability and the consideration paid be accounted for?

BC24 In accordance with paragraph 41 of IAS 39, the entity should recognise a gain or loss in profit or loss for any difference between the carrying amount of the financial liability extinguished and the consideration paid. This requirement is consistent with the *Framework*'s discussion of income:

(a) Income is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or *decreases of liabilities that result in increases in equity*, other than those relating to contributions from equity participants. (paragraph 70(a)) (emphasis added)

(b) Gains represent other items that meet the definition of income and may, or may not, arise in the course of the ordinary activities of an entity. Gains represent increases in economic benefits ... (paragraph 75)

(c) Income may also result from the settlement of liabilities. For example, an entity may provide goods and services to a lender in settlement of an obligation to repay an outstanding loan. (paragraph 77)

Full extinguishment

BC25 The IFRIC noted that, as discussed in paragraph BC13, a transaction in which an entity issues equity instruments to extinguish a liability can be analysed as first, the issue of new equity instruments to the creditor for cash and second, the creditor accepting payment of that amount of cash to extinguish the financial liability. Consistently with paragraph BC24, when the creditor accepts cash to extinguish the liability, the entity should recognise a gain or loss in profit or loss.

BC26 Similarly, the IFRIC noted that, in accordance with IAS 32, when an entity amends the terms of a convertible instrument to induce early conversion, the entity recognises in profit or loss the fair value of any additional consideration paid to the holder. Thus, the IFRIC concluded that when an entity settles an instrument by issuing its own equity instruments and that settlement is not in accordance with the original terms of the financial liability, the entity should recognise a gain or loss in profit or loss.

BC27 As a result of its conclusions, the IFRIC decided that the entity should recognise a gain or loss in profit or loss. This gain or loss is equal to the difference between the carrying amount of the financial liability and the fair value of the equity instruments issued, or fair value of the liability extinguished if the fair value of the equity instruments issued cannot be reliably measured.

Partial extinguishment

BC28 The IFRIC also observed that the restructuring of a financial liability can involve both the partial settlement of the liability by the issue of equity instruments to the creditor and the modification of the terms of the liability that remains outstanding. Therefore, the IFRIC decided that the Interpretation should also apply to partial extinguishments. In the case of a partial extinguishment, the discussion in paragraphs BC25–BC27 applies to the part of the liability extinguished.

BC29 Many respondents requested clarification of the guidance on partial extinguishment included in D25. During its redeliberations, the IFRIC acknowledged that the issue of an entity's equity shares may reflect consideration paid for both the extinguishment of part of a financial liability and the modification of the terms of the part of the liability that remains outstanding.

BC30 The IFRIC decided that to reflect this, an entity should allocate the consideration paid between the part of the liability extinguished and the part of the liability that remains outstanding. The entity would consider this allocation in determining the profit or loss to be recognised on the part of the liability extinguished and in its assessment of whether the terms of the remaining liability have been substantially modified.

BC31 The IFRIC concluded that providing additional guidance on determining whether the terms of the part of the financial liability that remains outstanding has been substantially modified in accordance with paragraph 40 of IAS 39 was outside the scope of the Interpretation.

Presentation

BC32 The IFRIC decided that an entity should disclose the gain or loss on the extinguishment of the financial liability by the issue of equity instruments as a separate line item in profit or loss or in the notes. This requirement is consistent with the *Framework* and the requirements in other IFRSs, for example:

(a) When gains are recognised in the income statement, they are usually displayed separately because knowledge of them is useful for the purpose of making economic decisions. (paragraph 76 of the *Framework*)

(b) An entity shall present additional line items, headings and subtotals in the statement of comprehensive income and the separate income statement (if presented), when such presentation is relevant to an understanding of the entity's financial performance. (paragraph 85 of IAS 1 *Presentation of Financial Statements*)

(c) An entity shall disclose net gains or net losses on financial liabilities either in the statement of comprehensive income or in the notes. (paragraph 20 of IFRS 7 *Financial Instruments: Disclosures*)

Transition

BC33 The IFRIC decided that the Interpretation should be applied retrospectively even though it acknowledged that determining fair values retrospectively may be problematic. The IFRIC noted that IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides guidance on circumstances in which retrospective application might be impracticable. The IFRIC concluded that it was preferable to require entities that could apply the Interpretation retrospectively to do so, rather than requiring all entities to apply it prospectively to future transactions. However, to simplify transition, the IFRIC also concluded that it should require retrospective application only from the beginning of the earliest comparative period presented because application to earlier periods would result only in a reclassification of amounts within equity.

Summary of main changes from the draft Interpretation

BC34 The main changes from the IFRIC's proposals in D25 are as follows:

(a) Paragraph 3 was added because the IFRIC identified specific transactions that are outside of the scope of the Interpretation.

(b) Paragraph 6 was modified to state that measurement should be based on the fair value of the equity instruments issued, unless that fair value cannot be reliably measured.

(c) Paragraph 7 was added to reflect the modification to paragraph 6. It also clarifies the intention of the IFRIC that in measuring the fair value of a financial liability extinguished that includes a demand feature (eg a demand deposit), paragraph 49 of IAS 39 is not applied.

(d) Paragraph 8 was added, and paragraph 10 was modified, to clarify how the Interpretation should be applied when only part of the financial liability is extinguished by the issue of equity instruments.

(e) Paragraph 9 was modified to state when the equity instruments issued should be initially measured.

HK(IFRIC)-Int 14
~~Issued September 2007~~Revised December 2009

Effective for annual periods
beginning on or after 1 January 2008

HK (IFRIC) Interpretation 14

HKAS 19—The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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Hong Kong (IFRIC) Interpretation 14 *HKAS 19—The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* (HK(IFRIC)-Int 14) is set out in paragraphs 1 – 28. HK(IFRIC)-Int 14 is accompanied by Illustrative Examples and a Basis for Conclusions. The scope and authority of Interpretations are set out in the *Preface to Hong Kong Financial Reporting Standards*.

Hong Kong (IFRIC) Interpretation 14
HKAS 19—The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction

References

- HKAS 1 *Presentation of Financial Statements*
- HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- HKAS 19 *Employee Benefits*
- HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

Background

1 Paragraph 58 of HKAS 19 limits the measurement of a defined benefit asset to "the present value of economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan" plus unrecognised gains and losses. Questions have arisen about when refunds or reductions in future contributions should be regarded as available, particularly when a minimum funding requirement exists.

2 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. Therefore, a minimum funding requirement may limit the ability of the entity to reduce future contributions.

3 Further, the limit on the measurement of a defined benefit asset may cause a minimum funding requirement to be onerous. Normally, a requirement to make contributions to a plan would not affect the measurement of the defined benefit asset or liability. This is because the contributions, once paid, will become plan assets and so the additional net liability is nil. However, a minimum funding requirement may give rise to a liability if the required contributions will not be available to the entity once they have been paid.

Scope

4 This Interpretation applies to all post-employment defined benefits and other long-term employee defined benefits.

5 For the purpose of this Interpretation, minimum funding requirements are any requirements to fund a post-employment or other long-term defined benefit plan.

Issues

6 The issues addressed in this Interpretation are:

(a) when refunds or reductions in future contributions should be regarded as available in accordance with paragraph 58 of HKAS 19.

(b) how a minimum funding requirement might affect the availability of reductions in future contributions.

(c) when a minimum funding requirement might give rise to a liability.

Conclusions

Availability of a refund or reduction in future contributions

7 An entity shall determine the availability of a refund or a reduction in future contributions in accordance with the terms and conditions of the plan and any statutory requirements in the jurisdiction of the plan.

8 An economic benefit, in the form of a refund or a reduction in future contributions, is available if the entity can realise it at some point during the life of the plan or when the plan liabilities are settled. In particular, such an economic benefit may be available even if it is not realisable immediately at the end of the reporting period.

9 The economic benefit available does not depend on how the entity intends to use the surplus. An entity shall determine the maximum economic benefit that is available from refunds, reductions in future contributions or a combination of both. An entity shall not recognise economic benefits from a combination of refunds and reductions in future contributions based on assumptions that are mutually exclusive.

10 In accordance with HKAS 1, the entity shall disclose information about the key sources of estimation uncertainty at the end of the reporting period that have a significant risk of causing a material adjustment to the carrying amount of the ~~net balance sheet asset or liability~~ net asset or liability recognised in the statement of financial position. This might include disclosure of any restrictions on the current realisability of the surplus or disclosure of the basis used to determine the amount of the economic benefit available.

The economic benefit available as a refund

The right to a refund

11 A refund is available to an entity only if the entity has an unconditional right to a refund:

(a) during the life of the plan, without assuming that the plan liabilities must be settled in order to obtain the refund (eg in some jurisdictions, the entity may have a right to a refund during the life of the plan, irrespective of whether the plan liabilities are settled); or

(b) assuming the gradual settlement of the plan liabilities over time until all members have left the plan; or

(c) assuming the full settlement of the plan liabilities in a single event (ie as a plan wind-up).

An unconditional right to a refund can exist whatever the funding level of a plan at the end of the reporting period.

12 If the entity's right to a refund of a surplus depends on the occurrence or non-occurrence of one or more uncertain future events not wholly within its control, the entity does not have an unconditional right and shall not recognise an asset.

Measurement of the economic benefit

13 An entity shall measure the economic benefit available as a refund as the amount of the surplus at the end of the reporting period (being the fair value of the plan assets less the present value of the defined benefit obligation) that the entity has a right to receive as a refund, less any associated costs. For instance, if a refund would be subject to a tax other than income tax, an entity shall measure the amount of the refund net of the tax.

14 In measuring the amount of a refund available when the plan is wound up (paragraph 11(c)), an entity shall include the costs to the plan of settling the plan liabilities and making the refund. For example, an entity shall deduct professional fees if these are paid by the plan rather than the entity, and the costs of any insurance premiums that may be required to secure the liability on wind-up.

15 If the amount of a refund is determined as the full amount or a proportion of the surplus, rather than a fixed amount, an entity shall make no adjustment for the time value of money, even if the refund is realisable only at a future date.

The economic benefit available as a contribution reduction

16 If there is no minimum funding requirement, an entity shall determine the economic benefit available 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, ie 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.

17 An entity shall determine the future service costs using assumptions consistent with those used to determine the defined benefit obligation and with the situation that exists at the end of the reporting period as determined by HKAS 19. Therefore, an entity shall assume no change to the benefits to be provided by a plan in the future until the plan is amended and shall assume a stable workforce in the future unless the entity is demonstrably committed at the end of the reporting period to make a reduction in the number of employees covered by the plan. In the latter case, the assumption about the future workforce shall include the reduction. An entity shall determine the present value of the future service cost using the same discount rate as that used in the calculation of the defined benefit obligation at the end of the reporting period.

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

18 An entity shall analyse any minimum funding requirement at a given date into contributions that are required to cover (a) any existing shortfall for past service on the minimum funding basis and (b) the future accrual of benefits.

19 Contributions to cover any existing shortfall on the minimum funding basis in respect of services already received do not affect future contributions for future service. They may give rise to a liability in accordance with paragraphs 23 – 26.

20 If there is a minimum funding requirement for contributions relating to the future accrual of benefits, an entity shall determine the economic benefit available as a reduction in future contributions as the present value of:

(a) the estimated future service cost in each year in accordance with paragraphs 16 and 17 less

(b) the estimated minimum funding contributions required in respect of the future accrual of benefits in that year.

21 An entity shall calculate the future minimum funding contributions required in respect of the future accrual of benefits taking into account the effect of any existing surplus on the minimum funding requirement basis. An entity shall use the assumptions required by the minimum funding requirement and, for any factors not specified by the minimum funding requirement, assumptions consistent with those used to determine the defined benefit obligation and with the situation that exists at the end of the reporting period as determined by HKAS 19. The calculation shall include any changes expected as a result of the entity paying the minimum contributions due. However, the calculation shall not include the effect of expected changes in the terms and conditions of the minimum funding requirement that are not substantively enacted or contractually agreed at the end of the reporting period.

22 If the future minimum funding contribution required in respect of the future accrual of benefits exceeds the future HKAS 19 service cost in any given year, the present value of that excess reduces the amount of the asset available as a reduction in future contributions at the end of the reporting period. However, the amount of the asset available as a reduction in future contributions can never be less than zero.

When a minimum funding requirement may give rise to a liability

23 If 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, the entity shall determine whether the contributions payable will be available as a refund or reduction in future contributions after they are paid into the plan.

24 To the extent that the contributions payable will not be available after they are paid into the plan, the entity shall recognise a liability when the obligation arises. The liability shall reduce the defined benefit asset or increase the defined benefit liability so that no gain or loss is expected to result from applying paragraph 58 of HKAS 19 when the contributions are paid.

25 An entity shall apply paragraph 58A of HKAS 19 before determining the liability in accordance with paragraph 24.

26 The liability in respect of the minimum funding requirement and any subsequent remeasurement of that liability shall be recognised immediately in accordance with the entity's adopted policy for recognising the effect of the limit in paragraph 58 in HKAS 19 on the measurement of the defined benefit asset. In particular:

(a) an entity that recognises the effect of the limit in paragraph 58 in profit or loss, in accordance with paragraph 61(g) of HKAS 19, shall recognise the adjustment immediately in profit or loss.

(b) an entity that recognises the effect of the limit in paragraph 58 in ~~the statement of recognised income and expense~~ other comprehensive income, in accordance with paragraph 93C of HKAS 19, shall recognise the adjustment immediately in other comprehensive income.

Effective date

27 An entity shall apply this Interpretation for annual periods beginning on or after 1 January 2008. Earlier application is permitted.

27A HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraph 26. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies HKAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.

Transition

28 An entity shall apply this Interpretation from the beginning of the first period presented in the first financial statements to which the Interpretation applies. An entity shall recognise any initial adjustment arising from the application of this Interpretation in retained earnings at the beginning of that period.

Appendix

Amendment to HK(IFRIC) Int-14 *Prepayments of a Minimum Funding Requirement* (issued in December 2009) - effective for annual periods beginning on or after 1 January 2011

The following sets out amendments required for this Interpretation resulting from amendments to HK(IFRIC) Int-14 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Interpretation and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

The rubric and paragraphs 16–18 and 20–22 are amended (new text is underlined and deleted text is struck through). Paragraphs 3A, 27B and 29 are added.

In the rubric ‘paragraphs 1–28’ is replaced by ‘paragraphs 1–29’.

Background

3A In December 2009 the Hong Kong Institute of Certified Public Accountants amended HK(IFRIC)-Int 14 to remove an unintended consequence arising from the treatment of prepayments of future contributions in some circumstances when there is a minimum funding requirement.

Conclusions

The economic benefit available as a contribution reduction

~~*The economic benefit available as a contribution reduction*~~

16 If there is no minimum funding requirement for contributions relating to future service, ~~an entity shall determine~~ the economic benefit available as a reduction in future contributions is ~~as the lower of~~

(a) ~~the surplus in the plan and~~

(b) ~~the present value of~~ the future service cost to the entity~~, ie excluding any part of the future cost that will be borne by employees,~~ for each period ~~year~~ over the shorter of the expected life of the plan and the expected life of the entity. The future service cost to the entity excludes amounts that will be borne by employees.

17 An entity shall determine the future service costs using assumptions consistent with those used to determine the defined benefit obligation and with the situation that exists at the end of the reporting period as determined by HKAS 19. Therefore, an entity shall assume no change to the benefits to be provided by a plan in the future until the plan is amended and shall assume a stable workforce in the future unless the entity is demonstrably committed at the end of the reporting period to make a reduction in the number of employees covered by the plan. In the latter case, the assumption about the future workforce shall include the reduction. ~~An entity shall determine the present value of the future service cost using the same discount rate as that used in the calculation of the defined benefit obligation at the end of the reporting period.~~

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

18 An entity shall analyse any minimum funding requirement at a given date into contributions that are required to cover (a) any existing shortfall for past service on the minimum funding basis and (b) ~~the future accrual of benefits~~ future service.

20 If there is a minimum funding requirement for contributions relating to ~~the~~ future ~~accrual of benefits~~ service, ~~an entity shall determine~~ the economic benefit available as a reduction in future contributions ~~as the present value~~ is the sum of:

(a) any amount that reduces future minimum funding requirement contributions for future service because the entity made a prepayment (ie paid the amount before being required to do so); and

(b) 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 the future accrual of benefits~~ for future service in ~~that year~~ those periods if there were no prepayment as described in (a).

21 An entity shall estimate ~~calculate~~ the future minimum funding requirement contributions for ~~required in respect of the~~ future ~~accrual of benefits~~ service taking into account the effect of any existing surplus determined using ~~on~~ the minimum funding ~~requirement~~ basis but excluding the prepayment described in paragraph 20(a). An entity shall use ~~the~~ assumptions ~~required by~~ consistent with the minimum funding ~~requirement~~ basis and, for any factors not specified by that basis ~~the minimum funding requirement~~, assumptions consistent with those used to determine the defined benefit obligation and with the situation that exists at the end of the reporting period as determined by HKAS 19. The estimate ~~calculation~~ shall include any changes expected as a result of the entity paying the minimum contributions when they are due. However, the estimate ~~calculation~~ shall not include the effect of expected changes in the terms and conditions of the minimum funding basis ~~requirement~~ that are not substantively enacted or contractually agreed at the end of the reporting period.

22 When an entity determines the amount described in paragraph 20(b), i~~I~~f the future minimum funding requirement contributions for future service ~~required in respect of the future accrual of benefits~~ exceed~~s~~ the future HKAS 19 service cost in any given ~~year~~ period, ~~the present value of~~ that excess reduces the amount of the economic benefit ~~asset~~ available as a reduction in future contributions ~~at the end of the reporting period~~. However, the amount ~~of the asset available as a reduction in future contributions~~ described in paragraph 20(b) can never be less than zero.

Effective date

27B *Prepayments of a Minimum Funding Requirement* added paragraph 3A and amended paragraphs 16–18 and 20–22. An entity shall apply those amendments for annual periods beginning on or after 1 January 2011. Earlier application is permitted. If an entity applies the amendments for an earlier period, it shall disclose that fact.

Transition

29 An entity shall apply the amendments in paragraphs 3A, 16–18 and 20–22 from the beginning of the earliest comparative period presented in the first financial statements in which the entity applies this Interpretation. If the entity had previously applied this Interpretation before it applies the amendments, it shall recognise the adjustment resulting from the application of the amendments in retained earnings at the beginning of the earliest comparative period presented.

Illustrative examples

These examples accompany, but are not part of, IFRIC 14.

Example 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

IE1 An entity has a funding level on the minimum funding requirement basis (which is measured on a different basis from that required under IAS 19) of 82 per cent in Plan A. Under the minimum funding requirements, the entity is required to increase the funding level to 95 per cent immediately. As a result, the entity has a statutory obligation at the end of the reporting period to contribute 200 to Plan A immediately. The plan rules permit a full refund of any surplus to the entity at the end of the life of the plan. The year-end valuations for Plan A are set out below.

Market value of assets	1,200
Present value of defined benefit obligation under IAS 19	(1,100)
Surplus	100
Defined benefit asset (before consideration of the minimum funding requirement)[(a)]	100

(a) For simplicity, it is assumed that there are no unrecognised amounts.

Application of requirements

IE2 Paragraph 24 of IFRIC 14 requires the entity to recognise a liability to the extent that the contributions payable are not fully available. Payment of the contributions of 200 will increase the IAS 19 surplus from 100 to 300. Under the rules of the plan this amount will be fully refundable to the entity with no associated costs. Therefore, no liability is recognised for the obligation to pay the contributions.

Example 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

IE3 An entity has a funding level on the minimum funding requirement basis (which is measured on a different basis from that required under IAS 19) of 77 per cent in Plan B. Under the minimum funding requirements, the entity is required to increase the funding level to 100 per cent immediately. As a result, the entity has a statutory obligation at the end of the reporting period to pay additional contributions of 300 to Plan B. The plan rules permit a maximum refund of 60 per cent of the IAS 19 surplus to the entity and the entity is not permitted to reduce its contributions below a specified level which happens to equal the IAS 19 service cost. The year-end valuations for Plan B are set out below.

Market value of assets	1,000
Present value of defined benefit obligation under IAS 19	(1,100)
Deficit	(100)
Defined benefit (liability) (before consideration of the minimum funding requirement)[a]	(100)

(a) For simplicity, it is assumed that there are no unrecognised amounts

Application of requirements

IE4 The payment of 300 would change the IAS 19 deficit of 100 to a surplus of 200. Of this 200, 60 per cent (120) is refundable.

IE5 Therefore, of the contributions of 300, 100 eliminates the IAS 19 deficit and 120 (60 per cent of 200) is available as an economic benefit. The remaining 80 (40 per cent of 200) of the contributions paid is not available to the entity.

IE6 Paragraph 24 of IFRIC 14 requires the entity to recognise a liability to the extent that the additional contributions payable are not available to it.

IE7 Therefore, the entity increases the defined benefit liability by 80. As required by paragraph 26 of IFRIC 14, 80 is recognised immediately in accordance with the entity's adopted policy for recognising the effect of the limit in paragraph 58 and the entity recognises a net ~~balance sheet liability of 180~~ liability of 180 in the statement of financial position. No other liability is recognised in respect of the statutory obligation to pay contributions of 300.

Summary

Market value of assets	1,000
Present value of defined benefit obligation under IAS 19	(1,100)
Deficit	(100)
Defined benefit liability (before consideration of the minimum funding requirement)[a]	(100)
Adjustment in respect of minimum funding requirement	(80)
~~Net balance sheet liability~~Net liability recognised in the statement of financial position	(180)

(a) For simplicity, it is assumed that there are no unrecognised amounts.

IE8 When the contributions of 300 are paid, the net ~~balance sheet asset~~ asset recognised in the statement of financial position will be 120.

Example 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

IE9 An entity has a funding level on the minimum funding requirement basis (which is measured on a different basis from that required under IAS 19) of 95 per cent in Plan C. Under the minimum funding requirements, the entity is required to pay contributions to increase the funding level to 100 per cent over the next three years. The contributions are required to make good the deficit on the minimum funding requirement basis (shortfall) and to cover the accrual of benefits in each year on the minimum funding basis.

IE10 Plan C also has an IAS 19 surplus at the end of the reporting period of 50, which cannot be refunded to the entity under any circumstances. There are no unrecognised amounts.

IE11 The nominal amounts of the minimum funding contribution requirements in respect of the shortfall and the future IAS 19 service cost for the next three years are set out below.

Year	Total minimum contribution requirement	Minimum contributions required to make good the shortfall	Minimum contributions required to cover future accrual
1	135	120	15
2	125	112	13
3	115	104	11

Application of requirements

IE12 The entity's present obligation in respect of services already received includes the contributions required to make good the shortfall but does not include the minimum contributions required to cover future accrual.

IE13 The present value of the entity's obligation, assuming a discount rate of 6 per cent per year, is approximately 300, calculated as follows:

$[120/(1.06) + 112/(1.06)^2 + 104/(1.06)^3]$.

IE14 When these contributions are paid into the plan, the present value of the IAS 19 surplus (ie the fair value of assets less the present value of the defined benefit obligation) would, other things being equal, increase from 50 to 350 (300 + 50).

IE15 However, the surplus is not refundable although an asset may be available as a future contribution reduction.

IE16 In accordance with paragraph 20 of IFRIC 14, the economic benefit available as a reduction in future contributions is the present value of

(a) the future service cost in each year to the entity, less

(b) any minimum funding contribution requirements in respect of the future accrual of benefits in that year

over the expected life of the plan.

IE17 The amounts available as a future contribution reduction are set out below.

Year	IAS 19 service cost	Minimum contributions required to cover future accrual	Amount available as contribution reduction
1	13	15	(2)
2	13	13	0
3	13	11	2
4+	13	9	4

IE18 Assuming a discount rate of 6 per cent, the economic benefit available as a future contribution reduction is therefore equal to:

$(2)/(1.06) + 0/(1.06)^2 + 2/(1.06)^3 + 4/(1.06)^4 + \ldots + 4/(1.06)^{50} + \ldots = 56$.

The asset available from future contribution reductions is accordingly limited to 56.

IE19 Paragraph 24 of IFRIC 14 requires the entity to recognise a liability to the extent that the additional contributions payable will not be fully available. Therefore, the entity reduces the defined benefit asset by 294 (50 + 300 – 56).

IE20 As required by paragraph 26 of IFRIC 14, the 294 is recognised immediately in accordance with the entity's adopted policy for recognising the effect of the limit in paragraph 58 and the entity recognises a net ~~balance sheet liability of 244~~ liability of 244 in the statement of financial position. No other liability is recognised in respect of the obligation to make contributions to fund the minimum funding shortfall.

Summary

Surplus	50
Defined benefit asset (before consideration of the minimum funding requirement)	50
Adjustment in respect of minimum funding requirement	(294)
~~Net balance sheet liability~~Net liability recognised in the statement of financial position[(a)]	(244)

(a) For simplicity, it is assumed that there are no unrecognised amounts.

IE21 When the contributions of 300 are paid into the plan, the net ~~balance sheet asset~~ asset recognised in the statement of financial position will become 56 (300 – 244).

Appendix

Amendments to Illustrative Examples on HK(IFRIC) Int-14 *Prepayments of a Minimum Funding Requirement* (issued in December 2009) - effective for annual periods beginning on or after 1 January 2011

The following sets out amendments required for this Illustrative Examples resulting from amendments to HK(IFRIC) Int-14 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Illustrative Examples and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

In the illustrative examples, paragraphs IE9, IE11, IE12 and IE16–IE18 are amended (new text is underlined and deleted text is struck through). Example 4 (paragraphs IE22–IE27) is added.

Example 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

IE9 An entity has a funding level on the minimum funding ~~requirement~~ basis (which ~~is measured~~ it measures on a different basis from that required ~~under~~ by IAS 19) of 95 per cent in Plan C. ~~Under t~~The minimum funding requirements~~,~~ require the entity ~~is required~~ to pay contributions to increase the funding level to 100 per cent over the next three years. The contributions are required to make good the deficit on the minimum funding ~~requirement~~ basis (shortfall) and to cover future service ~~the accrual of benefits in each year on the minimum funding basis~~.

IE11 The nominal amounts of contributions required to satisfy the minimum funding ~~contribution~~ requirements in respect of the shortfall and the future ~~IAS 19~~ service ~~cost~~ for the next three years are set out below.

Year	Total contributions for minimum funding ~~contribution~~ requirement	~~Minimum c~~Contributions required to make good the shortfall	~~Minimum c~~Contributions required to cover future ~~accrual~~ service
1	135	120	15
2	125	112	13
3	115	104	11

Application of requirements

IE12 The entity's present obligation in respect of services already received includes the contributions required to make good the shortfall but does not include the ~~minimum~~ contributions required to cover future service ~~accrual~~.

IE16 In accordance with paragraph 20 of IFRIC 14, the economic benefit available as a reduction in future contributions is the sum ~~present value~~ of:

(a) any amount that reduces future minimum funding requirement contributions for future service because the entity made a prepayment (ie paid the amount before being required to do so); and

(~~a~~b) the estimated future service cost in each period in accordance with paragraphs 16 and 17 ~~year to the entity~~, less

~~(b)~~ ~~any~~ the estimated minimum funding requirement contributions that would be required for ~~requirements in respect of the~~ future service in those periods if there were no prepayment as described in (a) ~~accrual of benefits in that year~~

~~over the expected life of the plan~~.

IE17 In this example there is no prepayment as described in paragraph 20(a). The amounts available as a reduction in future contributions ~~reduction~~ when applying paragraph 20(b) are set out below.

Year	IAS 19 service cost	Minimum contributions required to cover future service ~~accrual~~	Amount available as contribution reduction
1	13	15	(2)
2	13	13	0
3	13	11	2
4+	13	9	4

IE18 Assuming a discount rate of 6 per cent, the present value of the economic benefit available as a future contribution reduction is ~~therefore~~ equal to:

$(2)/(1.06) + 0/(1.06)^2 + 2/(1.06)^3 + 4/(1.06)^4 \ldots + 4/(1.06)^{50} + \ldots = 56.$

Thus in accordance with paragraph 58(b) of IAS 19, the present value of the economic benefit ~~The asset~~ available from future contribution reductions is ~~accordingly~~ limited to 56.

Example 4—Effect of a prepayment when a minimum funding requirement exceeds the expected future service charge

IE22 An entity is required to fund Plan D so that no deficit arises on the minimum funding basis. The entity is required to pay minimum funding requirement contributions to cover the service cost in each period determined on the minimum funding basis.

IE23 Plan D has an IAS 19 surplus of 35 at the beginning of 20X1. There are no cumulative unrecognised net actuarial losses and past service costs. This example assumes that the discount rate and expected return on assets are 0 per cent, and that the plan cannot refund the surplus to the entity under any circumstances but can use the surplus for reductions of future contributions.

IE24 The minimum contributions required to cover future service are 15 for each of the next five years. The expected IAS 19 service cost is 10 in each year.

IE25 The entity makes a prepayment of 30 at the beginning of 20X1 in respect of years 20X1 and 20X2, increasing its surplus at the beginning of 20X1 to 65. That prepayment reduces the future contributions it expects to make in the following two years, as follows:

Year	IAS 19 service cost	Minimum funding requirement contribution before prepayment	Minimum funding requirement contribution after prepayment
20X1	10	15	0
20X2	10	15	0
20X3	10	15	15
20X4	10	15	15
20X5	10	15	15
Total	50	75	45

Application of requirements

IE26 In accordance with paragraphs 20 and 22 of IFRIC 14, at the beginning of 20X1, the economic benefit available as a reduction in future contributions is the sum of:

(a) 30, being the prepayment of the minimum funding requirement contributions; and

(b) nil. The estimated minimum funding requirement contributions required for future service would be 75 if there was no prepayment. Those contributions exceed the estimated future service cost (50); therefore the entity cannot use any part of the surplus of 35 noted in paragraph IE23 (see paragraph 22).

IE27 Assuming a discount rate of 0 per cent, the present value of the economic benefit available as a reduction in future contributions is equal to 30. Thus in accordance with paragraph 58 of IAS 19 the entity recognises an asset of 30 (because this is lower than the IAS 19 surplus of 65).

Basis for Conclusions on HK(IFRIC)-Int 14

This Basis for Conclusions accompanies, but is not part of, *IFRIC 14.*

HK(IFRIC)-Int 14 is based on IFRIC Interpretation 14 *HKAS 19—The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*. In approving HK(IFRIC)-Int 14, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IFRIC's Basis for Conclusions on IFRIC Interpretation 14. Accordingly, there are no significant differences between HK(IFRIC)-Int 14 and IFRIC Interpretation 14. The IFRIC's Basis for Conclusions is reproduced below. The paragraph numbers of IFRIC Interpretation 14 referred to below generally correspond with those in HK(IFRIC)-Int 14.

BC1 This Basis for Conclusions summarises the IFRIC's considerations in reaching its consensus. Individual IFRIC members gave greater weight to some factors than to others.

BC2 The IFRIC noted that practice varies significantly with regard to the treatment of the effect of a minimum funding requirement on the limit placed by paragraph 58 of IAS 19 *Employee Benefits* on the amount of a defined benefit asset. The IFRIC therefore decided to include this issue on its agenda. In considering the issue, the IFRIC also became aware of the need for general guidance on determining the limit on the measurement of the defined benefit asset, and for guidance on when that limit makes a minimum funding requirement onerous.

BC3 The IFRIC published D19 *IAS 19—The Asset Ceiling: Availability of Economic Benefits and Minimum Funding Requirements* in August 2006. In response, the IFRIC received 48 comment letters.

Definition of a minimum funding requirement

BC4 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.

Interaction between IAS 19 and minimum funding requirements

BC5 Funding requirements would not normally affect the accounting for a plan under IAS 19. However, paragraph 58 of IAS 19 limits the amount of the defined benefit asset to the available economic benefit plus unrecognised amounts. The interaction of a minimum funding requirement and this limit has two possible effects:

(a) the minimum funding requirement may restrict the economic benefits available as a reduction in future contributions, and

(b) the limit may make the minimum funding requirement onerous because contributions payable under the requirement in respect of services already received may not be available once they have been paid, either as a refund or as a reduction in future contributions.

BC6 These effects raised general questions about the availability of economic benefits in the form of a refund or a reduction in future contributions.

Availability of the economic benefit

BC7 One view of "available" would limit the economic benefit to the amount that is realisable immediately at the end of the reporting period~~balance sheet date~~.

BC8 The IFRIC disagreed with this view. The *Framework* defines an asset as a resource "from which future economic benefits are expected to flow to the entity." Therefore, it is not necessary for the economic benefit to be realisable immediately. Indeed, a reduction in future contributions cannot be realisable immediately.

BC9 The IFRIC concluded that a refund or reduction in future contributions is available if it could be realisable at some point during the life of the plan or when the plan liability is settled. Respondents to D19 were largely supportive of this conclusion.

BC10 In the responses to D19, some argued that an entity may expect to use the surplus to give improved benefits. Others noted that future actuarial losses might reduce or eliminate the surplus. In either case there would be no refund or reduction in future contributions. The IFRIC noted that the existence of an asset at the end of the reporting period ~~balance sheet date~~ depends on whether the entity has the right to obtain a refund or reduction in future contributions. The existence of the asset at that date is not affected by possible future changes to the amount of the surplus. If future events occur that change the amount of the surplus, their effects are recognised when they occur. Accordingly, if the entity decides to improve benefits, or future losses in the plan reduce the surplus, the consequences are recognised when the decision is made or the losses occur. The IFRIC noted that such events of future periods do not affect the existence or measurement of the asset at the end of the reporting period~~balance sheet date~~.

The asset available as a refund of a surplus

BC11 The IFRIC noted that a refund of a surplus could potentially be obtained in three ways:

(a) during the life of the plan, without assuming that the plan liabilities have to be settled in order to get the refund (eg in some jurisdictions, the entity may have a right to a refund during the life of the plan, irrespective of whether the plan liabilities are settled); or

(b) assuming the gradual settlement of the plan liabilities over time until all members have left the plan; or

(c) assuming the full settlement of the plan liabilities in a single event (ie as a plan wind-up).

BC12 The IFRIC concluded that all three ways should be considered in determining whether an economic benefit was available to the entity. Some respondents to D19 raised the question of when an entity controls an asset that arises from the availability of a refund, in particular if a refund would be available only if a third party (for example the plan trustees) gave its approval. The IFRIC concluded that an entity controlled the asset only if the entity has an unconditional right to the refund. If that right depends on actions by a third party, the entity does not have an unconditional right.

BC13 If the plan liability is settled by an immediate wind-up, the costs associated with the wind-up may be significant. One reason for this may be that the cost of annuities available on the market is expected to be significantly higher than that implied by the IAS 19 basis. Other costs include the legal and other professional fees expected to be incurred during the winding-up process. Accordingly, a plan with an apparent surplus may not be able to recover any of that surplus on wind-up.

BC14 The IFRIC noted that the available surplus should be measured at the amount that the entity could receive from the plan. The IFRIC decided that in determining the amount of the refund available on wind-up of the plan, the amount of the costs associated with the settlement and refund should be deducted if paid by the plan.

BC15 The IFRIC noted that the costs of settling the plan liability would be dependent on the facts and circumstances of the plan and it decided not to issue any specific guidance in this respect.

BC16 The IFRIC also noted that the present value of the defined benefit obligation and the fair value of assets are both measured on a present value basis and therefore take into account the timing of the future cash flows. The IFRIC concluded that no further adjustment for the time value of money needs to be made when measuring the amount of a refund determined as the full amount or a proportion of the surplus that is realisable at a future date.

The asset available in the form of a future contribution reduction

BC17 The IFRIC decided that the amount of the contribution reduction available to the entity should be measured with reference to the amount that the entity would have been required to pay had there been no surplus. The IFRIC concluded that is represented by the cost to the entity of accruing benefits in the plan, in other words by the future IAS 19 service cost. Respondents to D19 broadly supported this conclusion.

BC18 When the issue of the availability of reductions in future contributions was first raised with the IFRIC, some expressed the view that an entity should recognise an asset only to the extent that there was a formal agreement between the trustees and the entity specifying contributions payable lower than the IAS 19 service cost. The IFRIC disagreed, concluding instead that an entity is entitled to assume that, in general, it will not be required to make contributions to a plan in order to maintain a surplus and hence that it will be able to reduce contributions if the plan has a surplus. (The effects of a minimum funding requirement on this assumption are discussed below.)

BC19 The IFRIC considered the assumptions that underlie the calculation of the future service cost. In respect of the discount rate, IAS 19 requires the measurement of the present value of the future contribution reduction to be based on the same discount rate as that used to determine the present value of the defined benefit obligation.

BC20 The IFRIC considered whether the term over which the contribution reduction should be calculated should be restricted to the expected future working lifetime of the active membership. The IFRIC disagreed with that view. The IFRIC noted that the entity could derive economic benefit from a reduction in contributions beyond that period. The IFRIC also noted that increasing the term of the calculation has a decreasing effect on the incremental changes to the asset because the reductions in contributions are discounted to a present value. Thus, for plans with a large surplus and no possibility of receiving a refund, the available asset will be limited even if the term of the calculation extends beyond the expected future working lifetime of the active membership to the expected life of the plan. This is consistent with paragraph 77 of the Basis for Conclusions on IAS 19, which states that "the limit [on the measurement of the defined benefit asset] is likely to come into play *only* where … 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" (emphasis added). If the contribution reduction were determined by considering only the term of the expected future working lifetime of the active membership, the limit on the measurement of the defined benefit asset would come into play much more frequently.

BC21 Most respondents to D19 were supportive of this view. However, some argued that the term should be the shorter of the expected life of the plan and the expected life of the entity. The IFRIC agreed that the entity could not derive economic benefits from a reduction in contributions beyond its own expected life and has amended the Interpretation accordingly.

BC22 Next, the IFRIC considered what assumptions should be made about a future workforce. D19 proposed that the assumptions for the demographic profile of the future workforce should be consistent with the assumptions underlying the calculation of the present value of the defined benefit obligation at the end of the reporting period ~~balance sheet date~~. Some respondents noted that the calculation of service costs for future periods requires assumptions that are not required for the calculation of the defined benefit obligation. In particular, the assumptions underlying the present value of the defined benefit obligation calculation do not include an explicit assumption for new entrants.

BC23 The IFRIC agreed that this is the case. The IFRIC noted that assumptions are needed in respect of the size of the future workforce and future benefits provided by the plan. The IFRIC decided that the future service cost should be based on the situation that exists at the end of the reporting period~~balance sheet date~~ determined in accordance with IAS 19. Therefore, increases in the size of the workforce or the benefits provided by the plan should not be anticipated. Decreases in the size of the workforce or the benefits should be included in the assumptions for the future service cost at the same time as they are treated as curtailments in accordance with IAS 19.

The effect of a minimum funding requirement on the economic benefit available as a refund

BC24 The IFRIC considered whether a minimum funding requirement to make contributions to a plan in force at the end of the reporting period~~balance sheet date~~ would restrict the extent to which a refund of surplus is available. The IFRIC noted that there is an implicit assumption in IAS 19 that the specified assumptions represent the best estimate of the eventual outcome of the plan in economic terms, while a requirement to make additional contributions is often a prudent approach designed to build in a risk margin for adverse circumstances. Moreover, when there are no members left in the plan, the minimum funding requirement would have no effect. This would leave the IAS 19 surplus available. To the extent that the entity has a right to this eventual surplus, the IAS 19 surplus would be available to the entity, regardless of the minimum funding restrictions in force at the end of the reporting period~~balance sheet date~~. The IFRIC therefore concluded that the existence of a minimum funding requirement may affect the timing of a refund but does not affect whether it is ultimately available to the entity.

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

BC25 The entity's minimum funding requirements at a given date can be analysed into the contributions that are required to cover (a) an existing shortfall for past service on the minimum funding basis and (b) the future accrual of benefits.

BC26 Contributions required to cover an existing shortfall may give rise to a liability, as discussed in paragraphs BC31 – BC37 below. But they do not affect the availability of a reduction in future contributions for future service.

BC27 In contrast, future contribution requirements in respect of future service do not generate an additional liability at the end of the reporting period~~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. Therefore, the IFRIC decided that the available asset from a contribution

reduction should be calculated as the present value of the IAS 19 future service cost less the minimum funding contribution requirement in respect of future service in each year.

BC28 If the minimum funding contribution requirement is consistently greater than the IAS 19 future service cost, that calculation may be thought to imply that a liability exists. However, as noted above, an entity has no liability at the end of the reporting period ~~balance sheet date~~ in respect of minimum funding requirements that relate to future service. The economic benefit available from a reduction in future contributions can be nil, but it can never be a negative amount.

BC29 The respondents to D19 were largely supportive of these conclusions.

BC30 The IFRIC noted that future changes to regulations on minimum funding requirements might affect the available surplus. However, the IFRIC decided that, just as the future service cost was determined on the basis of the situation existing at the end of the reporting period ~~balance sheet date~~, so should the effect of a minimum funding requirement. The IFRIC concluded that when determining the amount of an asset that might be available as a reduction in future contributions, an entity should not consider whether the minimum funding requirement might change in the future. The respondents to D19 were largely supportive of these conclusions.

Onerous minimum funding requirements

BC31 Minimum funding requirements for contributions to cover an existing minimum funding shortfall create an obligation for the entity at the end of the reporting period ~~balance sheet date~~ because they relate to past service. Nonetheless, usually minimum funding requirements do not affect the measurement of the defined benefit asset or liability under IAS 19. This is because the contributions, once paid, become plan assets and the additional net liability for the funding requirement is nil. However, the IFRIC noted that the limit on the measurement of the defined benefit asset in paragraph 58 of IAS 19 may make the funding obligation onerous, as follows.

BC32 If an entity is obliged to make contributions and some or all of those contributions will not subsequently be available as an economic benefit, it follows that when the contributions are made the entity will not be able to recognise an asset to that extent. However, the resulting loss to the entity does not arise on the payment of the contributions but earlier, at the point at which the obligation to pay arises.

BC33 Therefore, the IFRIC concluded that when an entity has an obligation under a minimum funding requirement to make additional contributions to a plan in respect of services already received, the entity should reduce the ~~balance sheet~~ asset or increase the liability recognised in the statement of financial position to the extent that the minimum funding contributions payable to the plan will not be available to the entity either as a refund or a reduction in future contributions.

BC34 Respondents to D19 broadly supported this conclusion. But some questioned whether the draft Interpretation extended the application of paragraph 58 of IAS 19 too far. They argued that it should apply only when an entity has a defined benefit asset. In particular, it should not be used to classify a funding requirement as onerous, thereby creating an additional liability to be recognised beyond that arising from the other requirements of IAS 19. Others agreed that such a liability existed, but questioned whether it fell within the scope of IAS 19 rather than IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

BC35 The IFRIC did not agree that the Interpretation extends the application of paragraph 58 of IAS 19. Rather, it applies the principles in IAS 37 relating to onerous contracts in the context of the requirements of IAS 19, including paragraph 58. On the question whether the liability falls within the scope of IAS 19 or IAS 37, the IFRIC noted that employee benefits are excluded from the scope of IAS 37. The IFRIC therefore

confirmed that the interaction of a minimum funding requirement and the limit on the measurement of the defined benefit asset could result in a decrease in a defined benefit asset or an increase in a defined benefit liability.

BC36 The IFRIC also discussed whether the liability in respect of the minimum funding requirement and the effect of any subsequent remeasurement should be recognised immediately in profit or loss or whether they should be eligible for the options for deferred recognition or recognition outside profit or loss that IAS 19 specifies for actuarial gains and losses. The IFRIC noted that the liability in respect of any minimum funding requirements arises only because of the limit on the measurement of the ~~balance sheet~~ asset recognised in the statement of financial position under paragraph 58 of IAS 19. Furthermore, all consequences of paragraph 58 should be treated consistently.

BC37 Therefore, the IFRIC concluded that any liability in respect of a minimum funding requirement and the effect of any subsequent remeasurement should be recognised immediately in accordance with paragraph 61(g) or 93C of IAS 19. This is consistent with the recognition of other adjustments to the net ~~balance sheet~~ asset or liability recognised in the statement of financial position under paragraph 58 of IAS 19. The respondents to D19 broadly agreed with this requirement.

Transitional provisions

BC38 In D19, the IFRIC proposed that the draft Interpretation should be applied retrospectively. The draft Interpretation required immediate recognition of all adjustments relating to the minimum funding requirements. The IFRIC therefore argued that retrospective application would be straightforward.

BC39 Respondents to D19 noted that paragraph 58A of IAS 19 causes the limit on the defined benefit asset to affect the deferred recognition of actuarial gains and losses. Retrospective application of the Interpretation could change the amount of that limit for previous periods, thereby also changing the deferred recognition of actuarial gains and losses. Calculating these revised amounts retrospectively over the life of the plan would be costly and of little benefit to users of financial statements.

BC40 The IFRIC agreed with this view. The IFRIC therefore amended the transitional provisions so that IFRIC 14 is to be applied only from the beginning of the first period presented in the financial statements for annual periods beginning on or after the effective date.

Summary of changes from D19

BC41 The Interpretation has been altered in the following significant respects since it was exposed for comment as D19:

(a) the issue of when an entity controls an asset arising from the availability of a refund has been clarified (paragraphs BC10 and BC12);

(b) requirements relating to the assumptions underlying the measurement of a reduction in future contributions have been clarified (paragraphs BC22 and BC23); and

(c) the transitional requirements have been changed from retrospective application to application from the beginning of the first period presented in the first financial statements to which the Interpretation applies (paragraphs BC38 – BC40).

Appendix

Amendments to Basis for Conclusions on HK(IFRIC) Int-14 *Prepayments of a Minimum Funding Requirement* (issued in December 2009) - effective for annual periods beginning on or after 1 January 2011

The following sets out amendments required for this Basis for Conclusions resulting from amendments to HK(IFRIC) Int-14 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

Paragraph BC3A, a heading above paragraph BC30A and paragraphs BC30A–BC30D and BC41(d) are added. Paragraph BC25 is amended (new text is underlined and deleted text is struck through).

BC3A In November 2009 the International Accounting Standards Board amended IFRIC 14 to remove an unintended consequence arising from the treatment of prepayments in some circumstances when there is a minimum funding requirement (see paragraphs BC30A–BC30D).

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

BC25 The entity's minimum funding requirements at a given date can be analysed into the contributions that are required to cover (a) an existing shortfall for past service on the minimum funding basis and (b) ~~the~~ future service ~~accrual of benefits~~.

Prepayments of a minimum funding requirement

BC30A If an entity has prepaid future minimum funding requirement contributions and that prepayment will reduce future contributions, the prepayment generates economic benefits for the entity. However, to the extent that the future minimum funding requirement contributions exceeded future service costs, the original version of IFRIC 14 did not permit entities to consider those economic benefits in measuring a defined benefit asset. After issuing IFRIC 14, the Board reviewed the treatment of such prepayments. The Board concluded that such a prepayment provides an economic benefit to the entity by relieving the entity of an obligation to pay future minimum funding requirement contributions that exceed future service cost. Therefore, considering those economic benefits in measuring a defined benefit asset would convey more useful information to users of financial statements. In May 2009 the Board published that conclusion in an exposure draft *Prepayments of a Minimum Funding Requirement*. After considering the responses to that exposure draft, the Board amended IFRIC 14 by issuing *Prepayments of a Minimum Funding Requirement* in November 2009.

BC30B Some respondents noted that the amendments increase the effect of funding considerations on the measurement of a defined benefit asset and liability and questioned whether funding considerations should ever affect the measurement. However, the Board noted that the sole purpose of the amendments was to eliminate an unintended consequence in IFRIC 14. Thus, the Board did not re-debate the fundamental conclusion of IFRIC 14 that funding is relevant to the measurement when an entity cannot recover the additional cost of a minimum funding requirement in excess of the IAS 19 service cost.

BC30C Many respondents noted that the proposals made the assessment of the economic benefit available from a prepayment different from the assessment for a surplus arising from actuarial gains. Most agreed that a prepayment created an asset, but questioned why the Board did not extend the underlying principle to other surpluses that could be used to reduce future payments of minimum funding requirement contributions.

BC30D The Board did not extend the scope of the amendments to surpluses arising from actuarial gains because such an approach would need further thought and the Board did not want to delay the amendments for prepayments. However, the Board may consider the matter further in a future comprehensive review of pension cost accounting.

Summary of changes from D19

BC41 …

(d) In November 2009 the Board amended IFRIC 14 to require entities to recognise as an economic benefit any prepayment of minimum funding requirement contributions. At the same time, the Board removed references to 'present value' from paragraphs 16, 17, 20 and 22 and 'the surplus in the plan' from paragraph 16 because these references duplicated references in paragraph 58 of IAS 19. The Board also amended the term 'future accrual of benefits' to 'future service' for consistency with the rest of IAS 19.

HKFRS 1 (Revised)
Revised ~~August~~ December 2009

Effective for annual periods
beginning on or after 1 July 2009

Hong Kong Financial Reporting Standards 1 (Revised)

First-time Adoption of Hong Kong Financial Reporting Standards

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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Amendments resulting from other HKFRSs

The following sets out amendments required for this Standard resulting from other newly issued HKFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standard and this appendix will be deleted.

HK(IFRIC)-Int 19 *Extinguishing Financial Liabilities with Equity Instruments* (issued in December 2009) - effective for annual periods beginning on or after 1 July 2010

A heading and paragraph D25 are added to Appendix D.

Extinguishing financial liabilities with equity instruments

D25 A first-time adopter may apply the transitional provisions in HK(IFRIC)-Int 19 *Extinguishing Financial Liabilities with Equity Instruments*.