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

MEMBERS' HANDBOOK

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HK (IFRIC) Interpretation 13

Customer Loyalty Programmes

Hong Kong Institute of
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Hong Kong (IFRIC) Interpretation 13 *Customer Loyalty Programmes* (HK(IFRIC)-Int 13) is set out in paragraphs 1 -11 and the Appendix. HK(IFRIC)-Int 13 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 13
Customer Loyalty Programmes

References

- HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- HKAS 18 *Revenue*
- HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

Background

1 Customer loyalty programmes are used by entities to provide customers with incentives to buy their goods or services. If a customer buys goods or services, the entity grants the customer award credits (often described as "points"). The customer can redeem the award credits for awards such as free or discounted goods or services.

2 The programmes operate in a variety of ways. Customers may be required to accumulate a specified minimum number or value of award credits before they are able to redeem them. Award credits may be linked to individual purchases or groups of purchases, or to continued custom over a specified period. The entity may operate the customer loyalty programme itself or participate in a programme operated by a third party. The awards offered may include goods or services supplied by the entity itself and/or rights to claim goods or services from a third party.

Scope

3 This Interpretation applies to customer loyalty award credits that:

(a) an entity grants to its customers as part of a sales transaction, ie a sale of goods, rendering of services or use by a customer of entity assets; and

(b) subject to meeting any further qualifying conditions, the customers can redeem in the future for free or discounted goods or services.

The Interpretation addresses accounting by the entity that grants award credits to its customers.

Issues

4 The issues addressed in this Interpretation are:

(a) whether the entity's obligation to provide free or discounted goods or services ("awards") in the future should be recognised and measured by:

(i) allocating some of the consideration received or receivable from the sales transaction to the award credits and deferring the recognition of revenue (applying paragraph 13 of HKAS 18); or

(ii) providing for the estimated future costs of supplying the awards (applying paragraph 19 of HKAS 18); and

(b) If consideration is allocated to the award credits:

(i) how much should be allocated to them;

(ii) when revenue should be recognised; and

(iii) if a third party supplies the awards, how revenue should be measured.

Conclusions

5 An entity shall apply paragraph 13 of HKAS 18 and account for award credits as a separately identifiable component of the sales transaction(s) in which they are granted (the "initial sale"). The fair value of the consideration received or receivable in respect of the initial sale shall be allocated between the award credits and the other components of the sale.

6 The consideration allocated to the award credits shall be measured by reference to their fair value, ie the amount for which the award credits could be sold separately.

7 If the entity supplies the awards itself, it shall recognise the consideration allocated to award credits as revenue when award credits are redeemed and it fulfils its obligations to supply awards. The amount of revenue recognised shall be based on the number of award credits that have been redeemed in exchange for awards, relative to the total number expected to be redeemed.

8 If a third party supplies the awards, the entity shall assess whether it is collecting the consideration allocated to the award credits on its own account (ie as the principal in the transaction) or on behalf of the third party (ie as an agent for the third party).

(a) If the entity is collecting the consideration on behalf of the third party, it shall:

(i) measure its revenue as the net amount retained on its own account, ie the difference between the consideration allocated to the award credits and the amount payable to the third party for supplying the awards; and

(ii) recognise this net amount as revenue when the third party becomes obliged to supply the awards and entitled to receive consideration for doing so. These events may occur as soon as the award credits are granted. Alternatively, if the customer can choose to claim awards from either the entity or a third party, these events may occur only when the customer chooses to claim awards from the third party.

(b) If the entity is collecting the consideration on its own account, it shall measure its revenue as the gross consideration allocated to the award credits and recognise the revenue when it fulfils its obligations in respect of the awards.

9 If at any time the unavoidable costs of meeting the obligations to supply the awards are expected to exceed the consideration received and receivable for them (ie the consideration allocated to the award credits at the time of the initial sale that has not yet been recognised as revenue plus any further consideration receivable when the customer redeems the award credits), the entity has onerous contracts. A liability shall be recognised for the excess in accordance with HKAS 37. The need to recognise such a liability could arise if the expected costs of supplying awards increase, for example if the entity revises its expectations about the number of award credits that will be redeemed.

Effective date and transition

10 An entity shall apply this Interpretation for annual periods beginning on or after 1 July 2008. Earlier application is permitted. If an entity applies the Interpretation for a period beginning before 1 July 2008, it shall disclose that fact.

11 Changes in accounting policy shall be accounted for in accordance with HKAS 8.

Appendix—Application guidance

This appendix is an integral part of the Interpretation.

Measuring the fair value of award credits

AG1 Paragraph 6 of the conclusions requires the consideration allocated to award credits to be measured by reference to their fair value, ie the amount for which the award credits could be sold separately. If the fair value is not directly observable, it must be estimated.

AG2 An entity may estimate the fair value of award credits by reference to the fair value of the awards for which they could be redeemed. The fair value of these awards would be reduced to take into account:

(a) the fair value of awards that would be offered to customers who have not earned award credits from an initial sale; and

(b) the proportion of award credits that are not expected to be redeemed by customers.

If customers can choose from a range of different awards, the fair value of the award credits will reflect the fair values of the range of available awards, weighted in proportion to the frequency with which each award is expected to be selected.

AG3 In some circumstances, other estimation techniques may be available. For example, if a third party will supply the awards and the entity pays the third party for each award credit it grants, it could estimate the fair value of the award credits by reference to the amount it pays the third party, adding a reasonable profit margin. Judgement is required to select and apply the estimation technique that satisfies the requirements of paragraph 6 of the conclusions and is most appropriate in the circumstances.

Illustrative examples

These examples accompany, but are not part of, HK(IFRIC)-Int 13.

Example 1—Awards supplied by the entity

IE1 A grocery retailer operates a customer loyalty programme. It grants programme members loyalty points when they spend a specified amount on groceries. Programme members can redeem the points for further groceries. The points have no expiry date. In one period, the entity grants 100 points. Management expects 80 of these points to be redeemed. Management estimates the fair value of each loyalty point to be one currency unit (CU1), and defers revenue of CU100.

Year 1

IE2 At the end of the first year, 40 of the points have been redeemed in exchange for groceries, ie half of those expected to be redeemed. The entity recognises revenue of (40 points / 80[*] points) × CU100 = CU50.

Year 2

IE3 In the second year, management revises its expectations. It now expects 90 points to be redeemed altogether.

IE4 During the second year, 41 points are redeemed, bringing the total number redeemed to 40[†] + 41 = 81 points. The cumulative revenue that the entity recognises is (81 points / 90[&] points) × CU100 = CU90. The entity has recognised revenue of CU50 in the first year, so it recognises CU40 in the second year.

Year 3

IE5 In the third year, a further nine points are redeemed, taking the total number of points redeemed to 81 + 9 = 90. Management continues to expect that only 90 points will ever be redeemed, ie that no more points will be redeemed after the third year. So the cumulative revenue to date is (90 points / 90[φ] points) × CU100 = CU100. The entity has already recognised CU90 of revenue (CU50 in the first year and CU40 in the second year). So it recognises the remaining CU10 in the third year. All of the revenue initially deferred has now been recognised.

Example 2—Awards supplied by a third party

IE6 A retailer of electrical goods participates in a customer loyalty programme operated by an airline. It grants programme members one air travel point with each CU1 they spend on electrical goods. Programme members can redeem the points for air travel with the airline, subject to availability. The retailer pays the airline CU0.009 for each point.

IE7 In one period, the retailer sells electrical goods for consideration totaling CU1 million. It grants 1 million points.

[*] total number of points expected to be redeemed
[†] number of points redeemed in year 1
[&] revised estimate of total number of points expected to be redeemed
[φ] total number of points still expected to be redeemed.

Allocation of consideration to travel points

IE8 The retailer estimates that the fair value of a point is CU0.01. It allocates to the points 1 million × CU0.01 = CU10,000 of the consideration it has received from the sales of its electrical goods.

Revenue recognition

IE9 Having granted the points, the retailer has fulfilled its obligations to the customer. The airline is obliged to supply the awards and entitled to receive consideration for doing so. Therefore the retailer recognises revenue from the points when it sells the electrical goods.

Revenue measurement

IE10 If the retailer has collected the consideration allocated to the points on its own account, it measures its revenue as the gross CU10,000 allocated to them. It separately recognises the CU9,000 paid or payable to the airline as an expense. If the retailer has collected the consideration on behalf of the airline, ie as an agent for the airline, it measures its revenue as the net amount it retains on its own account. This amount of revenue is the difference between the CU10,000 consideration allocated to the points and the CU9,000 passed on to the airline.

Basis for Conclusions on HK(IFRIC)-Int 13

This Basis for Conclusions accompanies, but is not part of, HK(IFRIC)-Int 13.

HK(IFRIC)-Int 13 is based on IFRIC Interpretation 13 *Customer Loyalty Programmes*. In approving HK(IFRIC)-Int 13, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IFRIC's Basis for Conclusions on IFRIC Interpretation 13. Accordingly, there are no significant differences between HK(IFRIC)-Int 13 and IFRIC Interpretation 13. The IFRIC's Basis for Conclusions is reproduced below. The paragraph numbers of IFRIC Interpretation 13 referred to below generally correspond with those in HK(IFRIC)-Int 13.

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.

Scope

BC2 Customer loyalty programmes are widespread, being used by businesses as diverse as supermarkets, airlines, telecommunications operators, hotels and credit card providers. IFRSs lack specific guidance on how entities should account for the awards offered to customers in these programmes. As a result, practices have diverged.

BC3 The main area of diversity concerns award credits that entities grant to their customers as part of a sales transaction, and that the customers can redeem in the future for free or discounted goods or services. The Interpretation applies to such award credits.

BC4 In some sales transactions, the entity receives consideration from an intermediate party, rather than directly from the customer to whom it grants the award credits. For example, credit card providers may provide services and grant award credits to credit card holders but receive consideration for doing so from vendors accepting payment by credit card. Such transactions are within the scope of the Interpretation and the wording of the consensus has been drafted to accommodate them.

Issues

BC5 Different views have emerged about how the entity granting award credits should recognise and measure its obligation to provide free or discounted goods or services if and when customers redeem award credits.

BC6 One view is that the obligation should be recognised as an expense at the time of the initial sale and be measured by reference to the amount required to settle it, in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. In support of this view, it is argued that:

(a) customer loyalty programmes are marketing tools designed to enhance sales volumes. Therefore the costs of the programmes are marketing expenses.

(b) the value of awards is often insignificant compared with the value of the purchases required to earn them. The obligation to exchange award credits for awards is not a significant element of the sales transaction. Thus, when the initial sale is made, the entity has met the conditions set out in IAS 18 *Revenue* for recognising revenue from that sale. Paragraph 16 of IAS 18 indicates that a selling entity can recognise revenue before it has completed all of the acts required of it under the contract, providing it does not retain the significant risks and rewards of ownership of the goods sold. Paragraph 19 requires expenses relating to the sale, including those for costs still to be incurred, to be recognised at the same time as the revenue.

BC7 A second view is that some of the consideration received in respect of the initial sale should be allocated to the award credits and recognised as a liability until the entity fulfils its obligations to deliver awards to customers. The liability would be measured by reference to the value of the award credits to the customer (not their cost to the entity) and recognised as an allocation of revenue (not an expense). In support of this view, it is argued that:

(a) award credits granted to a customer as a result of a sales transaction are an element of the transaction itself, ie the market exchange of economic benefits between the entity and the customer. They represent rights granted to the customer, for which the customer is implicitly paying. They can be distinguished from marketing expenses because they are granted to the customer as part of the sales transaction. Marketing expenses, in contrast, are incurred independently of the sales transactions they are designed to secure.

(b) award credits are separately identifiable from the other goods or services sold as part of the initial sale. Paragraph 13 of IAS 18 states that:

> The recognition criteria in this Standard are usually applied separately to each transaction. However, in certain circumstances, it is necessary to apply the recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction. For example, when the selling price of a product includes an identifiable amount for subsequent servicing, that amount is deferred and recognised as revenue over the period during which the service is performed.

Because loyalty awards are not delivered to the customer at the same time as the other goods or services, it is necessary to divide the initial sale into components and apply the recognition criteria separately to each component in order to reflect the substance of the transaction.

BC8 A third view is that the accounting should depend on the nature of the customer loyalty programme. The criteria for determining which accounting treatment should be adopted could refer to the relative value or nature of the awards, or the method of supplying them. Award credits would be regarded as marketing expenses if, say, their value were insignificant and/or they were redeemable for goods or services not supplied by the entity in the course of its ordinary activities. In contrast, award credits would be regarded as a separate component of the initial sales transaction if their value were significant and/or they were redeemable for goods or services supplied by the entity in the course of its ordinary activities.

Consensus

Attributing revenue to award credits

BC9 The consensus reflects the second view, described in paragraph BC7. In reaching its consensus, the IFRIC noted that:

(a) the first and second views apply different paragraphs of IAS 18. The first view (paragraph BC6) applies paragraph 19 to recognise the cost of the awards at the time of the initial sale. The second view applies paragraph 13 to identify the award credits as a separate component of the initial sale. The issue is to identify which of the two paragraphs should be applied. IAS 18 does not give explicit guidance. However, the aim of IAS 18 is to recognise revenue when, and to the extent that, goods or services have been delivered to a customer. In the IFRIC's view, paragraph 13 applies if a single transaction requires two or more separate goods or services to be delivered at different times; it

ensures that revenue for each item is recognised only when that item is delivered. In contrast, paragraph 19 applies only if the entity has to incur further costs directly related to items already delivered, eg to meet warranty claims. In the IFRIC's view, loyalty awards are not costs that directly relate to the goods and services already delivered—rather, they are separate goods or services delivered at a later date.

(b) the third view, described in paragraph BC8, would be difficult to justify conceptually. It can be argued that the substance of the incentives is the same, whatever their form or value. A dividing line could lead to inconsistencies and accounting arbitrage. Particular difficulties could arise if a programme offered customers a choice of awards, only some of which would be supplied by the entity in the course of its ordinary activities.

BC10 The IFRIC considered an objection that the costs of applying the approach set out in the consensus view in paragraph BC7 exceed the benefits. Those raising the objection argued that:

- the approach is more complicated to apply than a cost accrual approach;
- it produces information that is less reliable, and no more relevant; and
- the additional costs are not merited because the amounts involved are often relatively insignificant.

BC11 The IFRIC acknowledged that entities might have to incur costs to change systems and procedures to comply with the Interpretation. However, it did not agree that the ongoing costs would exceed the benefits. It noted that most of the variables that have to be estimated to measure the revenue attributable to award credits (such as redemption rates, timing of redemption etc) also need to be estimated to measure the future cost of fulfilling the obligation. In the IFRIC's view, benefits to users will arise from customer loyalty award obligations being measured on the same basis as other separately identifiable performance obligations to customers.

Allocation method

BC12 IAS 18 requires revenue to be measured at the fair value of the consideration received or receivable. Hence the amount of revenue attributed to award credits should be the fair value of the consideration received for them. The IFRIC noted that this amount is often not directly observable because the award credits are granted as part of a larger sale. In such circumstances, it must be estimated by allocating the total consideration between the award credits and other goods or services sold, using an appropriate allocation method.

BC13 IAS 18 does not prescribe an allocation method for multiple-component sales. However, its overall objective is to determine the amount the customer is paying for each component, which can be estimated by drawing on the entity's experience of transactions with similar customers. Hence, the Interpretation requires the consideration allocated to award credits to be measured by reference to their fair value.

BC14 The Interpretation does not specify whether the amount allocated to the award credits should be:

(a) equal to their fair value (irrespective of the fair values of the other components); or

(b) a proportion of the total consideration based on the fair value of the award credits relative to the fair values of the other components of the sale.

The IFRIC noted that IAS 18 does not specify which of these methods should be applied, or in what circumstances. The IFRIC decided that the Interpretation should not be more prescriptive than IAS 18. The selection of one or other method is therefore left to management's judgement.

Revenue recognition—awards supplied by the entity

BC15 The consideration allocated to award credits represents the amount that the entity has received for accepting an obligation to supply awards if customers redeem the credits. This amount reflects both the value of the awards and the entity's expectations regarding the proportion of credits that will be redeemed, ie the risk of a claim being made. The entity has received the consideration for accepting the risk, whether or not a claim is actually made. Hence, the Interpretation requires revenue to be recognised as the risk expires, ie based on the number of award credits that have been redeemed relative to the total number expected to be redeemed.

BC16 After granting award credits, the entity may revise its expectations about the proportion that will be redeemed. The change in expectations does not affect the consideration that the entity has received for supplying awards: this consideration (the revenue) was fixed at the time of the initial sale. Hence the change in expectations does not affect the measurement of the original obligation. Instead, it affects the amount of revenue recognised in respect of award credits that are redeemed in the period. The change in expectations is thus accounted for as a change in estimate in the period of change and future periods, in accordance with paragraph 36 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

BC17 A change in expectations regarding redemption rates may also affect the costs the entity expects to incur to supply awards. If estimated redemption rates increase to the extent that the unavoidable costs of supplying awards are expected to exceed the consideration received and receivable for them, the entity has onerous contracts. The Interpretation therefore highlights the requirement of IAS 37 to recognise a liability for the excess.

Revenue recognition—awards supplied by a third party

BC18 Some customer loyalty programmes offer customers awards in the form of goods and services supplied by a third party. For example, a grocery retailer may offer customers an option to redeem award credits for air travel points or a voucher for free goods from an electrical retailer. The IFRIC noted that, depending on the terms of the arrangement, the reporting entity (the grocery retailer in this example) may retain few, if any, obligations in respect of the supply of the awards. In such circumstances, the customer is still receiving the benefits of—and implicitly paying the entity consideration for—the rights to awards. Hence, consideration should be allocated to the award credits.

BC19 However, the entity may in substance be collecting the consideration on behalf of the third party, ie as an agent for the third party. If so, paragraph 8 of IAS 18 would need to be taken into consideration. This paragraph states that:

> Revenue includes only the gross inflows of economic benefits received and receivable by the entity on its own account … in an agency relationship, the gross inflows of economic benefits include amounts collected on behalf of the principal and which do not result in increases in equity for the entity. The amounts collected on behalf of the principal are not revenue. Instead, revenue is the amount of commission.

BC20 Depending on the terms of the agreement between the entity, award credit holders and the third party, the gross consideration attributable to the award credits might not represent revenue for the entity. Rather, the entity's revenue might be only the net

amount it retains on its own account, ie the difference between the consideration allocated to the award credits and the amount paid or payable by the entity to the third party for supplying the awards.

BC21 The IFRIC noted that, if the entity is acting as an agent for a third party, its revenue arises from rendering agency services to that third party, not from supplying awards to the award credit holders. The entity should therefore recognise revenue in accordance with paragraph 20 of IAS 18. As the outcome of the transaction can be estimated reliably (the consideration has been received and the amount payable to the third party agreed), revenue is recognised in the periods in which the entity renders its agency services, ie when the third party becomes obliged to supply the awards and entitled to receive consideration for doing so.

Changes from draft Interpretation D20

BC22 A draft of the Interpretation—D20 *Customer Loyalty Programmes*—was published for comment in September 2006. The most significant changes made in the light of comments received relate to:

(a) *allocation of consideration to award credits.* D20 proposed that consideration should be allocated between award credits and other components of the sale by reference to their relative fair values. The IFRIC accepted suggestions that another allocation method—whereby the award credits are allocated an amount equal to their fair value—could also be consistent with IAS 18, and would be simpler to apply. So, as explained in paragraph BC14, the consensus has been revised to avoid precluding this latter method.

(b) *awards supplied by a third party.* The consensus in D20 did not refer to the possibility that an entity may have collected consideration on behalf of the third party, and hence that its revenue may need to be measured net of amounts passed on to the third party. However, as some commentators pointed out, awards are often supplied by third parties and so this possibility will often need to be considered for transactions within the scope of the Interpretation. The requirements of IAS 18 in this respect have therefore been added to paragraph 8 of the consensus and are explained in paragraphs BC19 – BC21.

(c) *customer relationship intangible assets.* Customer loyalty programmes may create or enhance customer relationship intangible assets. The consensus in D20 had pointed out that such assets should be recognised only if the recognition criteria in IAS 38 *Intangible Assets* had been met. The IFRIC accepted that this comment appeared to suggest that there would be circumstances in which intangible assets were recognised, whereas the requirements of IAS 38 were such that recognition was very unlikely. It also decided that the comment was peripheral to the issues being addressed in the Interpretation. It deleted the comment from the consensus.

(d) *guidance on measuring the fair value of award credits.* Paragraph AG2 explains that the fair value of award credits may be measured by reference to the fair value of the awards for which they could be redeemed, reduced to take into account various factors. The list of factors in D20 had referred to the time value of money. However, the IFRIC accepted suggestions that the effect of the time value of money will often not be material—especially if awards are specified in non-monetary terms — and that it should not therefore be highlighted as a factor that will routinely need to be measured.

(e) *location of application guidance.* Two paragraphs of the consensus in D20 comprised guidance on how to apply the paragraphs that preceded them. They have been moved to an appendix, and supplemented by additional explanation that had been located in the Basis for Conclusions in D20.

(f) *illustrative examples.* These have been added to help readers understand how to apply the revenue recognition requirements, especially in relation to forfeited award credits and changes in estimates of forfeiture rates.

HK(IFRIC)-Int 14
Issued September 2007

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 balance sheet date.

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 balance sheet date that have a significant risk of causing a material adjustment to the carrying amount of the net balance sheet asset or liability. 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 balance sheet date.

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 balance sheet date (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 balance sheet date 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 balance sheet date 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 balance sheet date.

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 balance sheet date 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 balance sheet date.

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 balance sheet date. 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, in accordance with paragraph 93C of HKAS 19, shall recognise the adjustment immediately in the statement of recognised income and expense.

Effective date

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

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.

Illustrative examples

These examples accompany, but are not part of, HK(IFRIC)-Int 14.

Example 1—Effect of the minimum funding requirement when there is an HKAS 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 HKAS 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 balance sheet date 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 HKAS 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 HK(IFRIC)-Int 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 HKAS 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 HKAS 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 HKAS 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 balance sheet date to pay additional contributions of 300 to Plan B. The plan rules permit a maximum refund of 60 per cent of the HKAS 19 surplus to the entity and the entity is not permitted to reduce its contributions below a specified level which happens to equal the HKAS 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 HKAS 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 HKAS 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 HKAS 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 HK(IFRIC)-Int 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 HK(IFRIC)-Int 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. 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 HKAS 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	(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 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 HKAS 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 HKAS 19 surplus at the balance sheet date 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 HKAS 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 HKAS 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 HK(IFRIC)-Int 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	HKAS 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 HK(IFRIC)-Int 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 HK(IFRIC)-Int 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. 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[(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 will become 56 (300 – 244).

Basis for Conclusions on HK(IFRIC)-Int 14

This Basis for Conclusions accompanies, but is not part of, HK(IFRIC)-Int 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 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 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 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 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 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 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 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 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 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 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 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 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 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 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).