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ACCOUNTING STANDARDS BOARD

PROPOSED REVISION OF THE INTERPRETATION OF THE STANDARDS OF GENERALLY RECOGNISED ACCOUNTING PRACTICE

THE LIMIT ON A DEFINED BENEFIT ASSET, MINIMUM FUNDING REQUIREMENTS AND THEIR INTERACTION

(ED xxx)

Issued by the
Accounting Standards Board

XXX 2020

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Acknowledgement

This Interpretation of the Standards of Generally Recognised Accounting Practice (IGRAP) is drawn primarily from the equivalent IFRIC® Interpretation 14 on *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* issued by the IFRS® Interpretations Committee of the International Accounting Standards Board (IASB®). The IASB has issued a comprehensive body of IFRS® Standards and IFRIC® Interpretations. Extracts of the IFRIC Interpretation 14 on *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* are reproduced in this Interpretation of the Standards of GRAP with the permission of the IASB.

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Introduction

Interpretation of the Standards of Generally Recognised Accounting Practice

The Accounting Standards Board (Board) is required in terms of the Public Finance Management Act, Act No. 1 of 1999, as amended (PFMA), to determine generally recognised accounting practice referred to as Standards of Generally Recognised Accounting Practice (GRAP).

The Board must determine GRAP for:

(a) departments (including national, provincial and government components);

(b) public entities;

(c) trading entities (as defined in the PFMA);

(d) constitutional institutions;

(e) municipalities and boards, commissions, companies, corporations, funds or other entities under the ownership control of a municipality; and

(f) Parliament and the provincial legislatures.

The above are collectively referred to as "entities" in Standards of GRAP.

The Board has approved the application of International Financial Reporting Standards (IFRS® Standards) issued by the International Accounting Standards Board® for:

(a) public entities that meet the criteria outlined in the Directive on *The Selection of an Appropriate Reporting Framework by Public Entities;* and

(b) entities under the ownership control of any of these entities.

Financial statements should be described as complying with Standards of GRAP only if they comply with all the requirements of each applicable Standard and any related Interpretations of the Standards of GRAP.

Any limitation of the applicability of specific Standards or Interpretations is made clear in those Standards or Interpretations.

This Interpretation is set out in paragraphs .01 to .24~~3~~. All paragraphs in this Interpretation have equal authority. The status and authority of appendices are dealt with in the preamble to each appendix. This Interpretation should be read in the context of its objective, its basis for conclusions if applicable, the *Preface to Standards of GRAP*, the *Preface to the Interpretations of the Standards of GRAP* and the *Framework for the Preparation and Presentation of Financial Statements*.

Standards of GRAP and Interpretations of Standards of GRAP should also be read in conjunction with any directives issued by the Board prescribing transitional provisions, as well as any regulations issued by the Minister of Finance regarding the effective dates of the Standards, published in the Government Gazette.

Reference may be made here to a Standard of GRAP that has not been issued at the time of issue of this Interpretation. This is done to avoid having to change the Standards already issued when a later Standard is subsequently issued. Paragraph .11 of the Standard of GRAP on *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

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Interpretation of the Standards of GRAP on *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*

References

- GRAP 1 *Presentation of Financial Statements*
- GRAP 3 *Accounting Policies, Changes in Accounting Estimates and Errors*
- GRAP 19 *Provisions, Contingent Liabilities and Contingent Assets*
- GRAP 25 *Employee Benefits*

Background

.01 Paragraph .67~~8~~ of the Standard of GRAP on *Employee Benefits* (GRAP 25) limits the measurement of a defined benefit asset to the lower of the surplus in the defined benefit plan and the asset ceiling ~~"the present value of economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan"~~. Paragraph .08 of GRAP 25 defines the asset ceiling as "the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan". Questions have arisen about when refunds or reductions in future contributions should be regarded as available, particularly when a minimum funding requirement exists.

.02 Minimum funding requirements may exist 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.

Scope

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

.04 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

.05 The issues addressed in this Interpretation are:

(a) When refunds or reductions in future contributions should be regarded as available in accordance with ~~paragraph .68 of GRAP 25~~ the definition of the asset ceiling in paragraph .08 of GRAP 25.

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

Consensus

Availability of a refund or reduction in future contributions

.06 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.

.07 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.

.08 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.

.09 In accordance with the Standard of GRAP on *Presentation of Financial Statements*, 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 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

.10 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 (e.g. the entity may have a right to a refund during the life of the plan, irrespective of whether the plan liabilities are settled);

(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 (i.e. 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.

.11 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

.12 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, where applicable.

.13 In measuring the amount of a refund available when the plan is wound up (paragraph .10(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.

.14 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

.15 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~~, i.e. excluding any part of the future cost that will be borne by employees,~~ for each ~~year~~ period 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.

.16 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 GRAP 25. 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~~ makes 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

.17 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 service~~accrual of benefits~~.

.18 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 .70 to .71~~ to .73~~ in GRAP 25.

.19 If there is a minimum funding requirement for contributions relating to ~~the~~ future service~~accrual of benefits~~, ~~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 (i.e. paid the amount before being required to do so); and

(b) the estimated future service cost in each ~~year~~period in accordance with paragraphs .15 and .16~~;~~ less the estimated minimum funding requirement contributions ~~required in respect of the future accrual of benefits in that year~~ that would be required for future service in those periods if there were no prepayment as described in (a).

.20 An entity shall ~~calculate~~estimate the future minimum funding requirement contributions ~~required in respect of the~~ for future ~~accrual of benefits~~ service 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 GRAP 25. The ~~calculation~~estimate shall include any changes expected as a result of the entity paying the minimum contributions due. However, the ~~calculation~~estimate shall not include the effect of expected changes in the terms and conditions of the minimum funding requirement that are not substantively enacted or agreed at the end of the reporting period.

.21 When an entity determines the amount described in paragraph .19(b), i~~I~~f the future minimum funding requirement contributions ~~required in respect of the~~for future ~~accrual of benefits~~ service exceed~~s~~ the future service cost as determined in accordance with GRAP 25 in any given ~~year~~period, ~~the present value of~~ that excess reduces the amount of the ~~asset~~economic benefit 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 .19(b) can never be less than zero.

Transitional provisions

.22 ***The provisions of this Interpretation shall be applied in conjunction with the transitional provisions on the initial adoption of GRAP 25 (20xx) as prescribed in a directive(s).***

Effective date

.23 ***An entity shall apply this Interpretation in conjunction with the effective date of GRAP 25 (20xx) to be determined by the Minister of Finance in a regulation to be published in accordance with section 91(1)(b) of the Public Finance Management Act, Act No. 1 of 1999, as amended.***

Withdrawal of the Interpretation of the Standards of GRAP on The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction (2010)

.24 This Standard supersedes the Interpretation of the Standards of GRAP on *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* issued in 2010.

Appendix - Illustrative examples

This appendix is illustrative only and does not form part of this Interpretation. The purpose of this appendix is to illustrate the application of this Interpretation and to assist in clarifying its meaning.

Example 1

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

IE1 An entity has a funding level on the minimum funding requirement basis (which is measured on a different basis from that required under GRAP 25) 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~~.

IE2 Plan C also has a surplus determined in accordance with GRAP 25 at the end of the reporting period of R50 000, which cannot be refunded to the entity under any circumstances. ~~There are no unrecognised amounts.~~

IE3 The nominal amounts of contributions required to satisfy the minimum funding ~~contribution~~ requirements in respect of the shortfall and the future service ~~cost~~ determined in accordance with GRAP 25 for the next three years are set out below.

Year	Total contributions for minimum ~~contribution~~ funding requirement	~~Minimum~~ ~~c~~Contributions required to make good the shortfall	~~Minimum~~ ~~c~~Contributions required to cover future ~~accrual~~service
	R'000	R'000	R'000
1	135	120	15
2	125	112	13
3	115	104	11

Application of requirements

IE4 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~~service.

IE5 The present value of the entity's obligation, assuming a discount rate of 6 per cent per year, is approximately R300 000, calculated as follows:

[R120 000 / (1.06) + R112 000 / $(1.06)^2$ + R104 000/ $(1.06)^3$].

IE6 When these contributions are paid into the plan, the present value of the surplus determined in accordance with GRAP 25, (i.e. the fair value of assets less the present value of the defined benefit obligation) would, other things being equal, increase from R50 000 to R350 000 (R300 000 + R50 000).

IE7 However, the surplus is not refundable although an asset may be available as a future contribution reduction.

IE8 In accordance with paragraph .19, the economic benefit available as a reduction in future contributions is the ~~present value~~ sum of:

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

~~(b)~~ the estimated future service cost in each ~~year~~ period in accordance with paragraphs .15 and .16 ~~to the entity;~~ less

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

IE9 In this example there is no prepayment as described in paragraph .19(a). The amounts available as a reduction in future contributions ~~reduction~~ when applying paragraph .19(b) are set out below.

Year	Service cost	Minimum contributions required to cover future ~~accrual~~service	Amount available as contribution reduction
	R '000	R '000	R '000
1	13	15	(2)
2	13	13	0
3	13	11	2
4+	13	9	4

IE10 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:

(R2 000)/(1.06) + R0/$(1.06)^2$ + R2 000/$(1.06)^3$ + R4 000/$(1.06)^4$ + … + R4 000/$(1.06)^{50}$ + …. = R56 000.

Thus in accordance with paragraph .67(b) of GRAP 25, the present value of the economic benefit~~The asset~~ available from future contribution reductions is ~~accordingly~~ limited to R56 000.

IE11 Paragraph .70~~1~~ of GRAP 25 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~~effect of the asset ceiling is R294 000 (R50 000 + R300 000 – R56 000).

IE12 ~~As required by paragraph .712 of GRAP 25, the R294 000 is recognised immediately in the statement of changes in net assets and t~~The entity recognises a net defined benefit liability of R244 000 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

	R '000
Surplus	50
Net d~~D~~efined benefit asset (before consideration of the minimum funding requirement)	50
~~Adjustment in respect of minimum funding requirement~~Effect of the asset ceiling	(294)
Net defined benefit liability ~~recognised in the statement of financial position[(a)]~~	(244)

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

IE13 When the contributions of R300 000 are paid into the plan, the net defined benefit asset ~~recognised in the statement of financial position~~ will become R56 000 (R300 000 – R244 000).

Comparison with the IFRIC® Interpretation on *IAS 19 - The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* (July 2007)

This Interpretation is drawn primarily from the IFRIC Interpretation on *IAS 19 - The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* (IFRIC 14). The main differences between this Interpretation and IFRIC 14 are as follows:

- The guidance and appendix in IFRIC 14 providing guidance on when a minimum funding requirement might give rise to a liability has been included in GRAP 25 and was therefore excluded from this Interpretation.
- The transitional provisions included in this Interpretation are different to those included in IFRIC 14.