



IGRAP 7

ACCOUNTING STANDARDS BOARD

INTERPRETATION OF THE STANDARDS OF GENERALLY RECOGNISED ACCOUNTING PRACTICE

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

(IGRAP 7)

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

Introduction

Interpretations 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 (national and provincial);
- (b) public entities;
- (c) constitutional institutions;
- (d) municipalities and boards, commissions, companies, corporations, funds or other entities under the ownership control of a municipality; and
- (e) Parliament and the provincial legislatures.

The above are collectively referred to as “entities”.

The Board has approved the application of Statements of Generally Accepted Accounting Practice (GAAP), codified by the Accounting Practices Board (APB) and issued by the South African Institute of Chartered Accountants (SAICA) to be GRAP for:

- (a) government business enterprises (GBEs)(as defined in the PFMA);
- (b) trading entities (as defined in the PFMA);
- (c) any other entity, other than a municipality, whose ordinary shares, potential ordinary shares or debt are publicly traded on the capital markets; and
- (d) entities under the ownership control of any of these entities.

The Board believes that Statements of GAAP are relevant and applicable to financial statements prepared by all such entities including those under their ownership control.

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



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

The Interpretation of the Standard of GRAP on *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* is set out in paragraphs .01 to .23. All paragraphs in this Interpretation of the Standards of GRAP have equal authority. The status and authority of appendices are dealt with in the preamble to each appendix. This Interpretation of the Standards of GRAP 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 of GRAP, published in the Government Gazette.

Reference may be made to a Standard of GRAP that has not been issued at the time of issue of this Interpretation of the Standards of GRAP. This is done to avoid having to change the Standards already issued when a later Standard is subsequently issued. Paragraph .12 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.



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* (as revised in 2010)
- GRAP 3 *Accounting Policies, Changes in Accounting Estimates and Errors* (as revised in 2010)
- GRAP 19 *Provisions, Contingent Liabilities and Contingent Assets* (as revised in 2010)
- GRAP 25 *Employee Benefits*

Background

- .01 Paragraph .68 of the Standard of GRAP on *Employee Benefits* 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'.
- .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 of the Standards of GRAP applies to all post-employment defined benefits and other long-term employee defined benefits.
- .04 For the purpose of this Interpretation of the Standards of GRAP, 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 of the Standards of GRAP are:
- (a) When refunds or reductions in future contributions should be regarded as available in accordance with paragraph .68 of the Standard of GRAP on

Employee Benefits.

- (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* (as revised in 2010), 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); 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 (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, 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, i.e. 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.
- .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 the Standard of GRAP on *Employee Benefits*. Therefore, an entity shall assume no change to the benefits to be provided by a plan in the future until the plan is amended and shall assume a

stable workforce in the future unless the entity is demonstrably committed at the end of the reporting period to make a reduction in the number of employees covered by the plan. In the latter case, the assumption about the future workforce shall include the reduction. An entity shall determine the present value of the future service cost using the same discount rate as that used in the calculation of the defined benefit obligation at the end of the reporting period.

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

- .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 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 .71 to .73 in the Standard of GRAP on *Employee Benefits*.
- .19 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 .15 and .16 less
 - (b) the estimated minimum funding contributions required in respect of the future accrual of benefits in that year.
- .20 An entity shall calculate the future minimum funding contributions required in respect of the future accrual of benefits taking into account the effect of any existing surplus on the minimum funding requirement basis. An entity shall use the assumptions required by the minimum funding requirement and, for any factors not specified by the minimum funding requirement, assumptions consistent with those used to determine the defined benefit obligation and with the situation that exists at the end of the reporting period as determined by the Standard of GRAP on *Employee Benefits*. 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 agreed at the end of the reporting period.
- .21 If the future minimum funding contribution required in respect of the future accrual of benefits exceeds the future service cost as determined in accordance with the Standard of GRAP on *Employee Benefits* in any given year, the present value of that excess reduces the amount of the asset available as a reduction in future



contributions at the end of the reporting period. However, the amount of the asset available as a reduction in future contributions can never be less than zero.

Transitional provisions

- .22** *The provisions of this Interpretation of the Standards of GRAP shall be applied in conjunction with the transitional provisions on the initial adoption of the Standard of GRAP on Employee Benefits as prescribed in a directive(s).*

Effective date

- .23** *An entity shall apply this Interpretation of the Standards of GRAP in conjunction with the effective date of the Standard of GRAP on Employee Benefits 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.*

Illustrative examples

This appendix is illustrative only and does not form part of the Interpretation of the Standards of GRAP. The purpose of the appendix is to illustrate the application of the Interpretation of the Standards of GRAP 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 the Standard of GRAP on *Employee Benefits*) 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.
- IE2 Plan C also has a surplus determined in accordance with the Standard of GRAP on *Employee Benefits* 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 the minimum funding contribution requirements in respect of the shortfall and the future service cost determined in accordance with the Standard of GRAP on *Employee Benefits* 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
	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.
- IE5 The present value of the entity's obligation, assuming a discount rate of 6 per cent per year, is approximately R300, 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 the Standard of GRAP on *Employee Benefits*, (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 of this Interpretation, the economic benefit available as a reduction in future contributions is the present value of
- the future service cost in each year to the entity, less
 - any minimum funding contribution requirements in respect of the future accrual of benefits in that year over the expected life of the plan.
- IE9 The amounts available as a future contribution reduction are set out below.

Year	Service cost	Minimum contributions required to cover future accrual	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

- IE1 Assuming a discount rate of 6 per cent, the economic benefit available as a future

contribution reduction is therefore equal to:

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

The asset available from future contribution reductions is accordingly limited to R56 000.

- IE1 Paragraph .71 of the Standard of GRAP on *Employee Benefits* 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 R294 000 (R50 000 + R300 000 – R56 000).
- IE1 As required by paragraph .72 of the Standard of GRAP on *Employee Benefits*, the R294 000 is recognised immediately in the statement of changes in net assets and the entity recognises a net 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
Defined benefit asset (before consideration of the minimum funding requirement)	50
Adjustment in respect of minimum funding requirement	(294)
Net liability recognised in the statement of financial position ^(a)	(244)

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

- IE1 When the contributions of R300 000 are paid into the plan, the net asset recognised in the statement of financial position will become R56 000 (R300 000 – R244 000).



Comparison with the Interpretation of IFRS on *IAS 19 - The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* (IFRIC 14) (July 2007)

This Interpretation of the Standards of GRAP on *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* (IGRAP 7) is drawn primarily from the Interpretation of IFRS 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 the Standard of GRAP on *Employee Benefits* and was therefore excluded from this Interpretation.
- The transitional provisions included in this Interpretation are different to those included in IFRIC 14.