30 Cannon Street, London EC4M 6XH, United Kingdom
Tel: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411
E-mail: iasb@iasb.org Website: www.iasb.org

International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting:	**18 September 2008, London**
Project:	**Amendments to IAS 24 *Related Party Disclosures***
Subject:	**Redeliberations: Follow-up issues – interaction with other IFRSs (Agenda paper 13E)**

INTRODUCTION

1. The **purpose of this paper** is to discuss the following issues regarding interaction with other IFRSs, and ask the Board to make a decision about them:
   (a) Consequential amendment to IFRS 8 *Operating Segments*.
   (b) Interaction with IAS 19 *Employee Benefits*.

2. The staff originally addressed the issues outlined in paragraph 1 above in a paper for the January 2008 Board meeting – Agenda paper 8E, but deferred discussion of them.

3. The staff's recommendations on those issues listed above focus on principles, rather than detailed wording. The staff will work on the wording in drafting the final Standard.

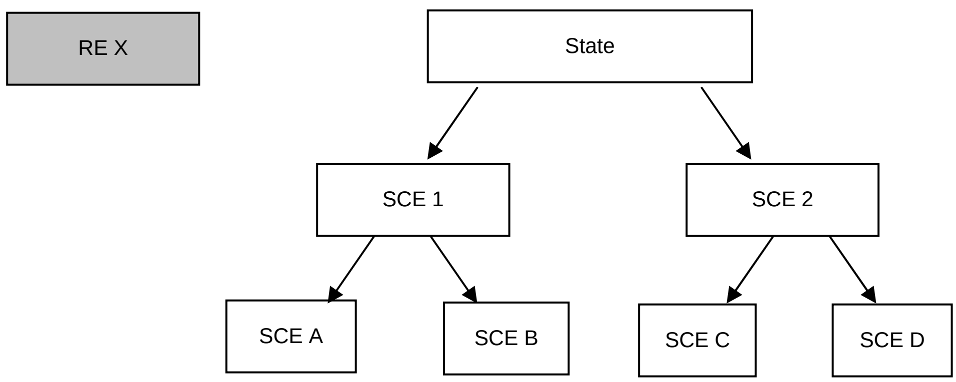
4. Appendices to this paper provide extracts from IFRS 8 and IAS 19.

DETAILED DISCUSSTION OF ISSUES

Consequential amendment to IFRS 8 *Operating Segments*

5. This issue considers more detailed amendment to IFRS 8.34[1] following the Board's previous tentative decision to make a consequential amendment to paragraph 34 of IFRS 8. To summarise:
   (a) Existing IFRS 8.34: a state and entities known to the reporting entity to be under the control of that state shall be considered a single customer.
   (b) The Board's previous tentative decision: entities would not be regarded as a single customer simply because they are controlled by the same state.
   (c) More detailed amendment to be dealt with: under the Board's previous decision in (b) above, which entities should a reporting entity view as a single customer in relation to a state and its subsidiaries?

6. The staff uses the following diagram to help the Board's understanding of this issue when giving examples in the following paragraphs. Entity X is a reporting entity (RE). State controls a state-controlled entity (SCE) 1 and SCE 2. SCE 1 controls SCE A and SCE B. SCE 2 controls SCE C and SCE D.



The Board's previous tentative decision

7. In its November 2007 meeting, the Board tentatively decided to amend paragraph 34 of IFRS 8 *Operating Segments*, so that entities would not be regarded as a single customer simply because they are controlled by the same state.

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[1] See Appendix A

8. When the staff recommended making a consequential amendment to IFRS 8, the reasons provided are as follows:

(a) In applying paragraph 34 of IFRS 8, a reporting entity would encounter the same situations considered in the ED of proposed amendments to IAS 24.

(b) More than anything else, it would in effect be impossible to identify all entities under common control through a state in jurisdictions with a large number of state-controlled entities.

(c) Also, if state-controlled entities do not influence each other and they are not influenced by a common state, in relation to transactions between them and a reporting entity, the disclosure requirement in IFRS 8.34 would fail to achieve its purpose, which is to provide information about the extent of a reporting entity's reliance on its major customers.

More detailed amendment to IFRS 8.34

9. **Under the consequential amendment to IFRS 8.34 in paragraph 7 that the Board tentatively decided to make, which entities should a reporting entity view as a single customer in relation to a state and its subsidiaries?**

The staff's analysis

10. For ease of analysis, the staff considers only the case when the reporting entity is outside a group of a state and its subsidiaries (eg Entity X). However, the staff's analysis in this part could similarly apply to the case when an entity that is within that group is a reporting entity (eg SCE A).

11. Before proceeding to further discussion, the staff notes that the exemption for state-controlled entities proposed in the ED cannot apply to paragraph 34 of IFRS 8 in the same way for the following reasons:

(a) A reporting entity under IFRS 8.34 (eg Entity X) may not have the same information about the relationship between a state and entities under the control of that state as state-controlled entities as defined in the ED.

(b) IFRS 8.34 has a different purpose from the exemption proposed in the ED. That is, IFRS 8.34 aims at information about the extent of a reporting entity's reliance on its major customers, whereas the exemption proposed in the ED aims at intragroup transactions between state-controlled entities. In the context of IAS 24, the main question is whether there is influence between the parties. For IFRS 8.34, the main question is whether two entities have such close economic links that they should be regarded as a single customer.

12. Considering the exemption proposed in the ED, the staff identifies the following alternatives for a single customer to be defined in a consequential amendment to IFRS 8.34.

(a) Alternative 1: Each entity is a single customer. Under this alternative, there are seven customers – i.e. state, SCEs 1-2, SCEs A-D.

- Simple but may not provide useful information if some entities within a group could have close economic links with each other.

(b) Alternative 2: Each vertical relationship with a state is viewed as a single customer. Under this alternative, there are four customers – i.e. state-SCE 1-SCE A, state-SCE 1-SCE B, state-SCE 2-SCE C, state-SCE 2-SCE D.

- Each such grouping would be arbitrary and may not cover cases when a state does not influence SCEs regarding transactions outside a group or a state influences more than one SCEs.

(c) Alternative 3: Each relationship that is controlled by a state is viewed as a single customer. Under this alternative, there are two customers – i.e. state-SCE 1-SCEs A and B, state-SCE 2-SCEs C and D.

- Each such grouping would be arbitrary and may not cover cases when a state could concurrently influence SCEs that fall within other group regarding transactions outside a group or a state influences only separate vertical SCEs.

(d) Alternative 4: Permit judgement of a reporting entity based on a principle in IFRS8.34 that an entity shall provide information about the extent of its reliance on its major customers. This alternative may judge as a single customer the same group as under the current IFRS 8.34 (i.e. state and all SCEs) or sub-groups (eg SCE 1-SCEs A and B, SCE 2-SCEs C and D).

- Difficult to judge but most appropriate to achieve the purpose intended in IFRS 8.34.

The staff's conclusion and recommendation

13. The staff concludes that there could exist various ways (including Alternatives 1-4 outlined above) to define a single customer under IFRS 8 but any uniform definition for every reporting entity could create the same problem as in the current IFRS 8. Therefore, the staff recommends Alternative 4 that permits a reporting entity to judge on a single customer, which covers various conditions that the reporting entity encounters. ***Does the Board agree?***

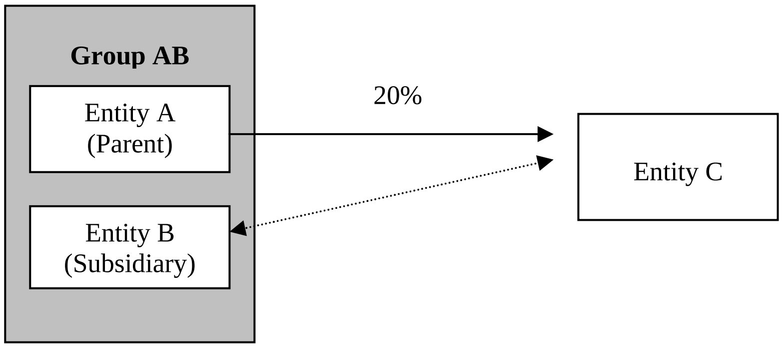
Amended wording example reflecting the staff's recommendation in paragraph 13

IFRS 8.34 An entity shall provide information about the extent of its reliance on its major customers. If revenues from transactions with a single external customer amount to 10 per cent or more of an entity's revenues, the entity shall disclose that fact, the total amount of revenues from each such customer, and the identity of the segment or segments reporting the revenues. The entity need not disclose the identity of a major customer or the amount of revenues that each segment reports from that customer. For the purposes of this IFRS, a group of entities known to a reporting entity to be under common control shall be considered a single customer. However, judgement is required to assess whether ~~and~~ a government (national, state, provincial, territorial, local or foreign) and entities known to the reporting entity to be under the control of that government ~~shall be~~ are considered a single customer.

Interaction with IAS 19 *Employee Benefits*

14. This issue considers how the Board's proposal in the ED interacts with the definition and accounting treatments of a qualifying insurance policy in IAS 19.

15. The staff uses the following diagram to help the Board's understanding of this issue when giving examples in the following paragraphs. In the diagram below, the full line (20%) indicates significant influence. On the other hand, the dotted line between B and C is both for explanation on the Board's proposal in the ED and for explanation on an interaction with IAS 19.



The Board's proposal in the ED

16. In the ED, the Board considered the relationship between an associate (Entity C) and a subsidiary (Entity B) of an entity ('investor'; Entity A). IAS 24 requires disclosure in the financial statements of the associate, but not in the financial statements of the subsidiary. That is, Entity B is related to Entity C but Entity C is not related to Entity B. The ED proposed to change the definition of a related party to ensure that an associate and a subsidiary of an entity are related parties of each other for both sets of financial statements. Thus, Entity B and Entity C would be related parties of each other.

A qualifying insurance policy as defined in IAS 19

17. IAS 19 defines a qualifying insurance policy as follows:

> *A qualifying insurance policy* is an insurance policy issued <u>by an insurer that is not a related party (as defined in IAS 24 *Related Party Disclosures*) of the reporting entity (emphasis added)</u>, if the proceeds of the policy:

(a) can be used only to pay or fund employee benefits under a defined benefit plan; and

(b) are not available to the reporting entity's own creditors (even in bankruptcy) and cannot be paid to the reporting entity, unless either:

   (i) the proceeds represent surplus assets that are not needed for the policy to meet all the related employee benefit obligations; or

   (ii) the proceeds are returned to the reporting entity to reimburse it for employee benefits already paid.

18. According to paragraphs 102-104[2] of IAS 19, the fair value of any plan assets is deducted in determining the amount (the defined benefit liability) recognised in the statement of financial position under paragraph 54[3]. The plan assets include qualifying insurance policies that exactly match the amount and timing of some or all of the benefits payable under the plan.

19. On the other hand, according to paragraphs 104A-D[4] of IAS 19, when an insurance policy is not a qualifying insurance policy, that insurance policy is not a plan asset. Paragraph 104A deals with such cases: the entity recognises its right to reimbursement under the insurance policy as a separate asset, rather than as a deduction in determining the defined benefit liability recognised under paragraph 54; in all other respects, the entity treats that asset in the same way as plan assets.

The staff's analysis: *Interaction with IAS 19*

20. To take an example from the diagram in paragraph 15, Entity C is an insurer. Entity B bought an insurance policy from Entity C to cover its pension obligation. Considering the Board's proposal in the ED:

(a) Entity C is not related to Entity B under IAS 24, whereas Entity C is related to Entity B under the ED.

(b) Therefore, the insurance policy that Entity B bought from Entity C would be considered a 'qualifying insurance policy' under IAS 24 but *not* under the ED. As a result, under the ED, Entity B recognises its right to reimbursement under that insurance policy as a separate asset. Under

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[2] See Appendix B
[3] See Appendix B
[4] See Appendix B

IAS 24, Entity B treats the insurance policy as a plan asset (i.e. as a deduction in determining the defined benefit liability). In all other respects, the treatment under the ED is the same as under IAS 24.

The staff's conclusion and recommendation

21. The staff concludes that the effect of the interaction with IAS 19 may be insignificant. That is, the effect may be that the insurance policy is presented as a separate asset, rather than as a deduction in determining the defined benefit liability. This is only a difference in presentation and does not alter recognition and measurement.

22. However, because changing the definition of a related party implicitly changes the definition of a qualifying insurance policy, some entities applying IAS 19 may not realise this. Therefore, the staff recommends attaching the following footnote to paragraph 68L of IAS 19 Basis for Conclusions:

** *The definition of a qualifying insurance policy refers to a related party as defined by IAS 24. IAS 24 was amended in 2008.*

23. ***Does the Board agree with the staff's recommendation in paragraph 22?***

APPENDIX A: EXTRACTS FROM IFRS 8

Information about major customers (IFRS 8.34)

34 An entity shall provide information about the extent of its reliance on its major customers. If revenues from transactions with a single external customer amount to 10 per cent or more of an entity's revenues, the entity shall disclose that fact, the total amount of revenues from each such customer, and the identity of the segment or segments reporting the revenues. The entity need not disclose the identity of a major customer or the amount of revenues that each segment reports from that customer. For the purposes of this IFRS, a group of entities known to a reporting entity to be under common control shall be considered a single customer, and a government (national, state, provincial, territorial, local or foreign) and entities known to the reporting entity to be under the control of that government shall be considered a single customer.

Information about major customers (IFRS 8.BC58)

BC58 ED 8 proposed that, in respect of the disclosures about major customers, a group of entities known to be under common control should be treated as a single customer. Some respondents noted that this could be difficult when entities are state-controlled. The Board noted that it was considering proposals to amend IAS 24 *Related Party Disclosures* with regard to state-controlled entities, and a consequential amendment to the IFRS on reporting segments might result from those proposals. In the meantime, the Board decided to require in the IFRS that a government (whether national, state, provincial, territorial, local or foreign) and entities known to the reporting entity to be controlled by that government should be treated as a single customer. This makes the requirements relating to government-controlled entities the same as those relating to privately controlled entities.

APPENDIX B: EXTRACTS FROM IAS 19

Balance sheet (IAS 19.54)

54 The amount recognised as a defined benefit liability shall be the net total of the following amounts:

(a) the present value of the defined benefit obligation at the balance sheet date (see paragraph 64);

(b) plus any actuarial gains (less any actuarial losses) not recognised because of the treatment set out in paragraphs 92 and 93;

(c) minus any past service cost not yet recognised (see paragraph 96);

(d) minus the fair value at the balance sheet date of plan assets (if any) out of which the obligations are to be settled directly (see paragraphs 102–104).

Recognition and measurement: plan assets

Fair value of plan assets (IAS 19.102-104)

102 The fair value of any plan assets is deducted in determining the amount recognised in the balance sheet under paragraph 54. When no market price is available, the fair value of plan assets is estimated; for example, by discounting expected future cash flows using a discount rate that reflects both the risk associated with the plan assets and the maturity or expected disposal date of those assets (or, if they have no maturity, the expected period until the settlement of the related obligation).

103 Plan assets exclude unpaid contributions due from the reporting entity to the fund, as well as any non-transferable financial instruments issued by the entity and held by the fund. Plan assets are reduced by any liabilities of the fund that do not relate to employee benefits, for example, trade and other payables and liabilities resulting from derivative financial instruments.

104 Where plan assets include qualifying insurance policies that exactly match the amount and timing of some or all of the benefits payable under the plan, the fair value of those insurance policies is deemed to be the present value of the related obligations, as described in paragraph 54 (subject to any reduction required if the amounts receivable under the insurance policies are not recoverable in full).

Reimbursements (IAS 19.104A-D)

104A When, and only when, it is virtually certain that another party will reimburse some or all of the expenditure required to settle a defined benefit obligation, an entity shall recognise its right to reimbursement as a separate asset. The entity shall measure the asset at fair value. In all other respects, an entity shall treat that asset in the same way as plan assets. In the income statement, the expense relating to a defined benefit plan may be presented net of the amount recognised for a reimbursement.

104B Sometimes, an entity is able to look to another party, such as an insurer, to pay part or all of the expenditure required to settle a defined benefit obligation. Qualifying insurance policies, as defined in paragraph 7, are plan assets. An entity accounts for qualifying insurance policies in the same way as for all other plan assets and paragraph 104A does not apply (see paragraphs 39–42 and 104).

104C When an insurance policy is not a qualifying insurance policy, that insurance policy is not a plan asset. Paragraph 104A deals with such cases: the entity recognises its right to reimbursement under the insurance policy as a separate asset, rather than as a deduction in determining the defined benefit liability recognised under paragraph 54; in all other respects, the entity treats that asset in the same way as plan assets. In particular, the defined benefit liability recognised under paragraph 54 is increased (reduced) to the extent that net cumulative actuarial gains (losses) on the defined benefit obligation and on the related reimbursement right remain unrecognised under paragraphs 92 and 93. Paragraph 120A(f)(iv) requires the entity to disclose a brief description of the link between the reimbursement right and the related obligation.

104D If the right to reimbursement arises under an insurance policy that exactly matches the amount and timing of some or all of the benefits payable under a defined benefit plan, the fair value of the reimbursement right is deemed to be the present value of the related obligation, as described in paragraph 54 (subject to any reduction required if the reimbursement is not recoverable in full).