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

MEMBERS' HANDBOOK

Update No. 72

(Issued November 2009)

This Update contains:

- HKAS 24(Revised) *Related Party Disclosures*; and
- Other consequential amendments.

Document Reference and Title	***Instructions***	***Explanations***
VOLUME II		
Contents of Volume II	Discard the existing pages i to ii and replace with the new pages i to ii.	Revised contents pages
HONG KONG ACCOUNTING STANDARDS (HKAS)		
HKAS 24 (Revised) *Related Party Disclosures*	Insert these pages after HKAS 24 *Related Party Disclosures*.	Revised Standard – Note 1
HKAS 24 *Related Party Disclosures*	Discard the existing page 1 and replaced with new page 1.	Revised Standard – Note 1
HKAS 19 *Employee Benefits*	Replace the Standard and Basis for Conclusions with revised Standard and Basis for Conclusions.	Amendment due to HKAS 24 (Revised) – Note 1 Editorial changes – Note 2
HONG KONG FINANCIAL REPORTING STANDARDS (HKFRS)		
HKFRS 8 *Operating Segments*	Replace the Standard, Basis for Conclusions and Implementation Guidance with revised Standard, Basis for Conclusions and Implementation Guidance.	Amendment due to HKAS 24 (Revised) – Note 1 Editorial changes – Note 3

Notes:

1. HKAS 24 (Revised) simplifies the disclosure requirements for government-related entities and clarifies the definition of a related party. The revised standard is effective for annual periods beginning on or after 1 January 2011, with earlier application permitted.

HKAS 24 requires entities to disclose in their financial statements information about transactions with related parties. In broad terms, two parties are related to each other if one party controls, or significantly influences, the other party.

HKAS 24 has been revised in response to concerns that the previous disclosure requirements and the definition of a 'related party' were too complex and difficult to apply in practice, especially in environments where government control is pervasive. The revised standard addresses these concerns by:

- **Providing a partial exemption for government-related entities.**

  Until now, if a government controlled, or significantly influenced, an entity, the entity was required to disclose information about all transactions with other entities controlled, or significantly influenced by the same government. The revised standard still requires disclosures that are important to users of financial statements but eliminates requirements to disclose information that is costly to gather and of less value to users. It achieves this balance by requiring disclosure about these transactions only if they are individually or collectively significant.

- **Providing a revised definition of a related party.**

  The IASB has simplified the definition and removed inconsistencies.

2. The Institute has taken this opportunity to incorporate amendments resulting from the issuance of HKFRS 8 *Operating Segments,* HKAS 1 (Revised) *Presentation of Financial Statements* and *Improvements to HKFRSs 2008* into the text of HKAS 19 for greater clarity.

3. The Institute has taken this opportunity to incorporate amendments resulting from the issuance of HKAS 1(Revised) *Presentation of Financial Statements* and *Improvements to HKFRSs 2009* into the text of HKFRS 8 for greater clarity.

Hong Kong Institute of
Certified Public Accountants
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MEMBERS' HANDBOOK
CONTENTS OF VOLUME II

(Updated to November 2009)

		Issue/(Review date)
	PREFACE AND FRAMEWORK	
PREFACE	Preface to Hong Kong Financial Reporting Standards	10/06(12/07)
FRAMEWORK	Framework for the Preparation and Presentation of Financial Statements	9/04(12/07)
	HONG KONG ACCOUNTING STANDARDS (HKAS)	
HKAS 1	Presentation of Financial Statements	11/05(12/07)
HKAS 1 Revised	Presentation of Financial Statements	12/07 (7/09)
HKAS 2	Inventories	3/04(10/08)
HKAS 7	Cash Flow Statements	12/04(5/09)
HKAS 8	Accounting Policies, Changes in Accounting Estimates and Errors	9/04(10/08)
HKAS 10	Events after the Balance Sheet Date	3/04(12/08)
HKAS 11	Construction Contracts	12/04(12/07)
HKAS 12	Income Taxes	11/04(7/09)
HKAS 14	Segment Reporting	11/04(3/08)
HKAS 16	Property, Plant and Equipment	11/05(10/08)
HKAS 17	Leases	12/04(5/09)
HKAS 18	Revenue	11/04(5/09)
HKAS 19	Employee Benefits	12/04(11/09)
HKAS 20	Accounting for Government Grants and Disclosure of Government Assistance	12/04(10/08)
HKAS 21	The Effects of Changes in Foreign Exchange Rates	3/04(10/08)
HKAS 23	Borrowing Costs	12/04(12/07)
HKAS 23 Revised	Borrowing Costs	6/07(10/08)
HKAS 24	Related Party Disclosures	12/04(11/09)
HKAS 24 Revised	Related Party Disclosures	11/09
HKAS 26	Accounting and Reporting by Retirement Benefit Plans	8/04
HKAS 27	Consolidated and Separate Financial Statements	11/05(3/08)
HKAS 27 Revised	Consolidated and Separate Financial Statements	3/08(12/08)
HKAS 28	Investments in Associates	3/04(10/08)

		Issue/(Review date)
HKAS 29	Financial Reporting in Hyperinflationary Economies	3/04(10/08)
HKAS 31	Interests in Joint Ventures	12/04(10/08)
HKAS 32	Financial Instruments: Presentation	11/04(10/09)
HKAS 33	Earnings per Share	3/04(3/08)
HKAS 34	Interim Financial Reporting	10/04(10/08)
HKAS 36	Impairment of Assets	8/04(5/09)
HKAS 37	Provisions, Contingent Liabilities and Contingent Assets	11/04(3/08)
HKAS 38	Intangible Assets	8/04(5/09)
HKAS 39	Financial Instruments: Recognition and Measurement	1/06(5/09)
HKAS 40	Investment Property	11/05(10/08)
HKAS 41	Agriculture	12/04(10/08)
	HONG KONG FINANCIAL REPORTING STANDARDS (HKFRS)	
HKFRS 1	First-time Adoption of Hong Kong Financial Reporting Standards	5/06(12/08)
HKFRS 1 Revised	First-time Adoption of Hong Kong Financial Reporting Standards	12/08(8/09)
HKFRS 2	Share-based Payment	4/04(7/09)
HKFRS 3	Business Combinations	11/05(3/08)
HKFRS 3 Revised	Business Combinations	3/08
HKFRS 4	Insurance Contracts	3/06(3/09)
HKFRS 5	Non-current Assets Held for Sale and Discontinued Operations	8/04(5/09)
HKFRS 6	Exploration for and Evaluation of Mineral Resources	2/05(12/08)
HKFRS 7	Financial Instruments: Disclosures	9/05(3/09)
HKFRS 8	Operating Segments	3/07(11/09)
IMPROVEMENTS TO HKFRSs	Improvements to HKFRSs	10/08
IMPROVEMENTS TO HKFRSs 2009	Improvements to HKFRSs 2009	5/09

HKAS 24 (Revised)
Issued November 2009

Effective for annual periods
beginning on or after 1 January 2011

Hong Kong Accounting Standard 24

Related Party Disclosures

Hong Kong Institute of
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CONTENTS

	paragraphs
INTRODUCTION	**IN1–IN3**
HONG KONG ACCOUNTING STANDARD 24 ***RELATED PARTY DISCLOSURES***	
OBJECTIVE	**1**
SCOPE	**2–4**
PURPOSE OF RELATED PARTY DISCLOSURES	**5–8**
DEFINITIONS	**9–12**
DISCLOSURES	
All entities	**13–24**
Government-related entities	**25–27**
EFFECTIVE DATE AND TRANSITION	**28**
WITHDRAWAL OF HKAS 24 (2004)	**29**

APPENDICES
A Amendment to HKFRS 8 *Operating Segments*
B Comparison with International Financial Reporting Standards

BASIS FOR CONCLUSIONS

APPENDIX
Amendment to the Basis for Conclusions on HKAS 19 *Employee Benefits*

DISSENTING OPINION

ILLUSTRATIVE EXAMPLES

TABLE OF CONCORDANCE

Hong Kong Accounting Standard 24 *Related Party Disclosures* (HKAS 24) is set out in paragraphs 1-29. All of the paragraphs have equal authority. HKAS 24 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Statements*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

IN1 Hong Kong Accounting Standard 24 *Related Party Disclosures* (HKAS 24) requires a reporting entity to disclose:

(a) transactions with its related parties; and

(b) relationships between parents and subsidiaries irrespective of whether there have been transactions between those related parties.

IN2 The Hong Kong Institute of Certified Public Accountants (HKICPA) revised HKAS 24 in 2009 by:

(a) simplifying the definition of a related party, clarifying its intended meaning and eliminating inconsistencies from the definition.

(b) providing a partial exemption from the disclosure requirements for government-related entities.

IN3 In making those revisions, the HKICPA did not reconsider the fundamental approach to related party disclosures contained in HKAS 24 (as issued in 2004).

Hong Kong Accounting Standard 24
Related Party Disclosures

Objective

1 The objective of this Standard is to ensure that an entity's financial statements contain the disclosures necessary to draw attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances, including commitments, with such parties.

Scope

2 This Standard shall be applied in:

(a) identifying related party relationships and transactions;

(b) identifying outstanding balances, including commitments, between an entity and its related parties;

(c) identifying the circumstances in which disclosure of the items in (a) and (b) is required; and

(d) determining the disclosures to be made about those items.

3 This Standard requires disclosure of related party relationships, transactions and outstanding balances, including commitments, in the consolidated and separate financial statements of a parent, venturer or investor presented in accordance with HKAS 27 *Consolidated and Separate Financial Statements*. This Standard also applies to individual financial statements.

4 Related party transactions and outstanding balances with other entities in a group are disclosed in an entity's financial statements. Intragroup related party transactions and outstanding balances are eliminated in the preparation of consolidated financial statements of the group.

Purpose of related party disclosures

5 Related party relationships are a normal feature of commerce and business. For example, entities frequently carry on parts of their activities through subsidiaries, joint ventures and associates. In those circumstances, the entity has the ability to affect the financial and operating policies of the investee through the presence of control, joint control or significant influence.

6 A related party relationship could have an effect on the profit or loss and financial position of an entity. Related parties may enter into transactions that unrelated parties would not. For example, an entity that sells goods to its parent at cost might not sell on those terms to another customer. Also, transactions between related parties may not be made at the same amounts as between unrelated parties.

7 The profit or loss and financial position of an entity may be affected by a related party relationship even if related party transactions do not occur. The mere existence of the relationship may be sufficient to affect the transactions of the entity with other parties. For example, a subsidiary may terminate relations with a trading partner on acquisition by the parent of a fellow subsidiary engaged in the same activity as the former trading partner. Alternatively, one party may refrain from acting because of the significant influence of another—for example, a subsidiary may be instructed by its parent not to engage in research and development.

8 For these reasons, knowledge of an entity's transactions, outstanding balances, including commitments, and relationships with related parties may affect assessments of its operations by users of financial statements, including assessments of the risks and opportunities facing the entity.

Definitions

9 The following terms are used in this Standard with the meanings specified:

A *related party* **is a person or entity that is related to the entity that is preparing its financial statements (in this Standard referred to as the 'reporting entity').**

(a) A person or a close member of that person's family is related to a reporting entity if that person:

(i) has control or joint control over the reporting entity;

(ii) has significant influence over the reporting entity; or

(iii) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.

(b) An entity is related to a reporting entity if any of the following conditions applies:

(i) The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).

(ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).

(iii) Both entities are joint ventures of the same third party.

(iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.

(v) The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.

(vi) The entity is controlled or jointly controlled by a person identified in (a).

(vii) A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

A *related party transaction* **is a transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged.**

Close members of the family of a person **are those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity and include:**

(a) that person's children and spouse or domestic partner;

(b) children of that person's spouse or domestic partner; and

(c) dependants of that person or that person's spouse or domestic partner.

Compensation **includes all employee benefits (as defined in HKAS 19 *Employee Benefits*) including employee benefits to which HKFRS 2 *Share-based Payment* applies. Employee benefits are all forms of consideration paid, payable or provided by the entity, or on behalf of the entity, in exchange for services rendered to the entity. It also includes such consideration paid on behalf of a parent of the entity in respect of the entity. Compensation includes:**

(a) short-term employee benefits, such as wages, salaries and social security contributions, paid annual leave and paid sick leave, profit-sharing and bonuses (if payable within twelve months of the end of the period) and non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees;

(b) post-employment benefits such as pensions, other retirement benefits, post-employment life insurance and post-employment medical care;

(c) other long-term employee benefits, including long-service leave or sabbatical leave, jubilee or other long-service benefits, long-term disability benefits and, if they are not payable wholly within twelve months after the end of the period, profit-sharing, bonuses and deferred compensation;

(d) termination benefits; and

(e) share-based payment.

Control **is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.**

Joint control **is the contractually agreed sharing of control over an economic activity.**

Key management personnel **are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.**

Significant influence **is the power to participate in the financial and operating policy decisions of an entity, but is not control over those policies. Significant influence may be gained by share ownership, statute or agreement.**

Government **refers to government, government agencies and similar bodies whether local, national or international.**

A *government-related entity* **is an entity that is controlled, jointly controlled or significantly influenced by a government.**

10 In considering each possible related party relationship, attention is directed to the substance of the relationship and not merely the legal form.

11 In the context of this Standard, the following are not related parties:

(a) two entities simply because they have a director or other member of key management personnel in common or because a member of key management personnel of one entity has significant influence over the other entity.

(b) two venturers simply because they share joint control over a joint venture.

(c) (i) providers of finance,

(ii) trade unions,

(iii) public utilities, and

(iv) departments and agencies of a government that does not control, jointly control or significantly influence the reporting entity,

simply by virtue of their normal dealings with an entity (even though they may affect the freedom of action of an entity or participate in its decision-making process).

(d) a customer, supplier, franchisor, distributor or general agent with whom an entity transacts a significant volume of business, simply by virtue of the resulting economic dependence.

12 In the definition of a related party, an associate includes subsidiaries of the associate and a joint venture includes subsidiaries of the joint venture. Therefore, for example, an associate's subsidiary and the investor that has significant influence over the associate are related to each other.

Disclosures

All entities

13 Relationships between a parent and its subsidiaries shall be disclosed irrespective of whether there have been transactions between them. An entity shall disclose the name of its parent and, if different, the ultimate controlling party. If neither the entity's parent nor the ultimate controlling party produces consolidated financial statements available for public use, the name of the next most senior parent that does so shall also be disclosed.

14 To enable users of financial statements to form a view about the effects of related party relationships on an entity, it is appropriate to disclose the related party relationship when control exists, irrespective of whether there have been transactions between the related parties.

15 The requirement to disclose related party relationships between a parent and its subsidiaries is in addition to the disclosure requirements in HKAS 27, HKAS 28 *Investments in Associates* and HKAS 31 *Interests in Joint Ventures*.

16 Paragraph 13 refers to the next most senior parent. This is the first parent in the group above the immediate parent that produces consolidated financial statements available for public use.

17 An entity shall disclose key management personnel compensation in total and for each of the following categories:

(a) short-term employee benefits;

(b) post-employment benefits;

(c) other long-term benefits;

(d) termination benefits; and

(e) share-based payment.

18 If an entity has had related party transactions during the periods covered by the financial statements, it shall disclose the nature of the related party relationship as well as information about those transactions and outstanding balances, including commitments, necessary for users to understand the potential effect of the relationship on the financial statements. These disclosure requirements are in addition to those in paragraph 17. At a minimum, disclosures shall include:

(a) the amount of the transactions;

(b) the amount of outstanding balances, including commitments, and:

- **(i) their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and**

- **(ii) details of any guarantees given or received;**

(c) provisions for doubtful debts related to the amount of outstanding balances; and

(d) the expense recognised during the period in respect of bad or doubtful debts due from related parties.

19 The disclosures required by paragraph 18 shall be made separately for each of the following categories:

(a) the parent;

(b) entities with joint control or significant influence over the entity;

(c) subsidiaries;

(d) associates;

(e) joint ventures in which the entity is a venturer;

(f) key management personnel of the entity or its parent; and

(g) other related parties.

20 The classification of amounts payable to, and receivable from, related parties in the different categories as required in paragraph 19 is an extension of the disclosure requirement in HKAS 1 *Presentation of Financial Statements* for information to be presented either in the statement of financial position or in the notes. The categories are extended to provide a more comprehensive analysis of related party balances and apply to related party transactions.

21 The following are examples of transactions that are disclosed if they are with a related party:

(a) purchases or sales of goods (finished or unfinished);

(b) purchases or sales of property and other assets;

(c) rendering or receiving of services;

(d) leases;

(e) transfers of research and development;

(f) transfers under licence agreements;

(g) transfers under finance arrangements (including loans and equity contributions in cash or in kind);

(h) provision of guarantees or collateral;

(i) commitments to do something if a particular event occurs or does not occur in the future, including executory contracts* (recognised and unrecognised); and

(j) settlement of liabilities on behalf of the entity or by the entity on behalf of that related party.

22 Participation by a parent or subsidiary in a defined benefit plan that shares risks between group entities is a transaction between related parties (see paragraph 34B of HKAS 19).

23 Disclosures that related party transactions were made on terms equivalent to those that prevail in arm's length transactions are made only if such terms can be substantiated.

24 Items of a similar nature may be disclosed in aggregate except when separate disclosure is necessary for an understanding of the effects of related party transactions on the financial statements of the entity.

Government-related entities

25 A reporting entity is exempt from the disclosure requirements of paragraph 18 in relation to related party transactions and outstanding balances, including commitments, with:

(a) a government that has control, joint control or significant influence over the reporting entity; and

(b) another entity that is a related party because the same government has control, joint control or significant influence over both the reporting entity and the other entity.

26 If a reporting entity applies the exemption in paragraph 25, it shall disclose the following about the transactions and related outstanding balances referred to in paragraph 25:

(a) the name of the government and the nature of its relationship with the reporting entity (ie control, joint control or significant influence);

(b) the following information in sufficient detail to enable users of the entity's financial statements to understand the effect of related party transactions on its financial statements:

(i) the nature and amount of each individually significant transaction; and

(ii) for other transactions that are collectively, but not individually, significant, a qualitative or quantitative indication of their extent. Types of transactions include those listed in paragraph 21.

27 In using its judgement to determine the level of detail to be disclosed in accordance with the requirements in paragraph 26(b), the reporting entity shall consider the closeness of the related party relationship and other factors relevant in establishing the level of significance of the transaction such as whether it is:

(a) significant in terms of size;

(b) carried out on non-market terms;

(c) outside normal day-to-day business operations, such as the purchase and sale of businesses;

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* HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets* defines executory contracts as contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent.

(d) disclosed to regulatory or supervisory authorities;

(e) reported to senior management;

(f) subject to shareholder approval.

Effective date and transition

28 An entity shall apply this Standard retrospectively for annual periods beginning on or after 1 January 2011. Earlier application is permitted, either of the whole Standard or of the partial exemption in paragraphs 25-27 for government-related entities. If an entity applies either the whole Standard or that partial exemption for a period beginning before 1 January 2011, it shall disclose that fact.

Withdrawal of HKAS 24 (2004)

29 This Standard supersedes HKAS 24 *Related Party Disclosures* (as issued in 2004).

Appendix A
Amendment to HKFRS 8 *Operating Segments*

The amendments in this appendix shall be applied for annual reporting periods beginning on or after 1 January 2011. If an entity applies this HKFRS for an earlier period, these amendments shall be applied for that earlier period. In amended paragraphs, deleted text is struck through and new text is underlined.

* * *

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

Appendix B
Comparison with International Financial Reporting Standards

This comparison appendix, which was prepared in November 2009 and deals only with significant differences in the standards extant, is produced for information only and does not form part of the standards in HKAS 24 (Revised).

The International Financial Reporting Standard comparable with HKAS 24 (Revised) is IAS 24 *Related Party Disclosures*.

There are no major textual differences between HKAS 24 (Revised) and IAS 24.

Basis for Conclusions on IAS 24 *Related Party Disclosures*

This Basis for Conclusions accompanies, but is not part of, IAS 24.

HKAS 24 (Revised) is based on IAS 24 (Revised) *Related Party Disclosures.* In approving HKAS 24 (Revised), the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IAS 24. Accordingly, there are no significant differences between HKAS 24 (Revised) and IAS 24. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IAS 24 referred to below generally correspond with those in HKAS 24 (Revised).

Introduction

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching its conclusions on revising IAS 24 *Related Party Disclosures* in 2003 and 2009. Individual Board members gave greater weight to some factors than to others.

BC2 In July 2001 the Board announced that, as part of its initial agenda of technical projects, it would undertake a project to improve a number of standards, including IAS 24. The project was undertaken in the light of queries and criticisms raised in relation to the standards by securities regulators, professional accountants and other interested parties. The objectives of the Improvements project were to reduce or eliminate alternatives, redundancies and conflicts within existing standards, to deal with some convergence issues and to make other improvements. In May 2002 the Board published its proposals in an exposure draft of *Improvements to International Accounting Standards* (the 2002 ED), with a comment deadline of 16 September 2002. The Board received over 160 comment letters on the exposure draft. After reviewing the responses, the Board issued a revised version of IAS 24 in December 2003.

BC3 In February 2007 the Board published an exposure draft *State-controlled Entities and the Definition of a Related Party* (the 2007 ED), proposing:

(a) an exemption from the disclosure requirements in IAS 24 for transactions between entities that are controlled, jointly controlled or significantly influenced by a state ('state-controlled entities'*); and

(b) amendments to the definition of a related party.

BC4 The Board received 72 comment letters on the 2007 ED. After considering those comments, in December 2008 the Board published revised proposals in an exposure draft *Relationships with the State* (the 2008 ED). The 2008 ED:

(a) presented revised proposals for state-controlled entities; and

(b) proposed one further amendment to the definition of a related party.

BC5 The Board received 75 comment letters on the 2008 ED. After reviewing the responses, the Board issued a revised version of IAS 24 in November 2009.

BC6 Because the Board's intention was not to reconsider the fundamental approach to related party disclosures established by IAS 24, this Basis for Conclusions discusses only the following requirements in IAS 24:

(a) management compensation (paragraphs BC7–BC10);

(b) related party disclosures in separate financial statements (paragraphs BC11–BC17);

* In finalising the revised version of IAS 24 in 2009, the Board replaced the term 'state' with 'government'.

(c) definition of a related party (paragraphs BC18–BC32);

(d) government-related entities (paragraphs BC33–BC48); and

(e) other minor changes made in 2009 (paragraph BC49).

Management compensation

BC7 The version of IAS 24 issued by the Board's predecessor in 1984 had no exemption for the disclosure of key management personnel compensation. In developing the 2002 ED, the Board proposed that the disclosure of management compensation, expense allowances and similar items paid in the ordinary course of business should not be required because:

(a) the approval processes for key management personnel compensation in some jurisdictions remove the rationale for related party disclosures;

(b) privacy issues arise in some jurisdictions where accountability mechanisms other than disclosure in financial statements exist; and

(c) requiring these disclosures placed weight on the determination of 'key management personnel' and 'compensation', which was likely to prove contentious. In addition, comparability of these disclosures would be unlikely until measurement requirements are developed for all forms of compensation.

BC8 However, some respondents to the 2002 ED objected to the proposed exemption because they were concerned that information relating to management compensation is relevant to users' information needs and that an exemption based on 'items paid in the ordinary course of business' could lead to abuse. Establishing a disclosure exemption on such a criterion without a definition of the terms could lead to exempting other transactions with management from being disclosed, because they could all be structured as 'compensation paid in the ordinary course of an entity's operations'. Respondents argued that such an exemption could lead to abuse because it could potentially apply to any transactions with management.

BC9 The Board was persuaded by the respondents' views on the 2002 ED and decided that the Standard should require disclosure of key management personnel compensation because:

(a) the principle underpinning the requirements in IAS 24 is that transactions with related parties should be disclosed, and key management personnel are related parties of an entity.

(b) key management personnel compensation is relevant to decisions made by users of financial statements when it represents a material amount. The structure and amount of compensation are major drivers in the implementation of the business strategy.

(c) the benefit of this information to users of financial statements largely outweighs the potential lack of comparability arising from the absence of recognition and measurement requirements for all forms of compensation.

BC10 The Board believes that although some jurisdictions have processes for approving compensation for key management personnel in an attempt to ensure an arm's length result, it is clear that some jurisdictions do not. Furthermore, although approval processes for management compensation may involve other parties such as shareholders or investors, key management personnel may still have a significant input. In addition, the Board noted that disclosing key management personnel compensation would improve transparency and comparability, thereby enabling users of financial statements to make a better assessment of the impact of such compensation on the entity's financial position and profit or loss. The Board also noted that the definition of key management personnel and the guidance on compensation in IAS 19 *Employee Benefits* are sufficient to enable entities to disclose the relevant information.

Related party disclosures in separate financial statements

BC11 The version of IAS 24 issued by the Board's predecessor in 1984 exempted disclosures about related party transactions in:

(a) parents' financial statements when they are made available or published with the consolidated statements; and

(b) financial statements of a wholly-owned subsidiary if its parent is incorporated in the same country and provides consolidated financial statements in that country.

BC12 In the 2002 ED the Board proposed to continue exempting separate financial statements of parents and financial statements of wholly-owned subsidiaries from disclosures about any related parties in specified circumstances. It proposed that disclosure of related party transactions and outstanding balances in the separate financial statements of a parent or the financial statements of a wholly-owned subsidiary would not be required, but only if those statements were made available or published with consolidated financial statements for the group.

BC13 The Board proposed to retain this exemption so that entities that are required by law to produce financial statements available for public use in accordance with International Financial Reporting Standards (IFRSs) in addition to the group's consolidated financial statements would not be unduly burdened. The Board noted that in some circumstances, users can find sufficient information for their purposes regarding a subsidiary from either its financial statements or the group's consolidated financial statements. In addition, the users of financial statements of a subsidiary often have, or can obtain access to, more information. The Board also noted that users should be aware that amounts recognised in the financial statements of a wholly-owned subsidiary can be affected significantly by the subsidiary's relationship with its parent.

BC14 However, respondents to the 2002 ED objected to this exemption, on the grounds that disclosure of related party transactions and outstanding balances is essential information for external users, who need to be aware of the level of support provided by related parties. The respondents also argued that financial statements prepared in accordance with IFRSs could be presented on a stand-alone basis. Therefore, financial statements prepared on the basis of this proposed exemption would not achieve a fair presentation without related party disclosures.

BC15 The Board was persuaded by those arguments and decided to require the disclosure of related party transactions and outstanding balances in separate financial statements of a parent, investor or venturer in addition to the disclosure requirements in IAS 27 *Consolidated and Separate Financial Statements*, IAS 28 *Investments in Associates* and IAS 31 *Interests in Joint Ventures*.

BC16 The Board noted that the financial statements of an entity that is part of a consolidated group may include the effects of extensive intragroup transactions. Indeed, potentially all of the revenues and expenses for such an entity may derive from related party transactions. The Board concluded that the disclosures required by IAS 24 are essential to understanding the financial position and financial performance of such an entity and therefore should be required for separate financial statements presented in accordance with IAS 27.

BC17 The Board also believed that disclosure of such transactions is essential because the external users need to be aware of the interrelationships between related parties, including the level of support provided by related parties, to assist external users in their economic decisions.

Definition of a related party

BC18 The definition of a related party in IAS 24 was widely considered to be too complex and difficult to apply in practice. The Board noted that the existing definition of a related party had weaknesses: it was cumbersome and included several cross-references that made it difficult to read (and to translate). Therefore, the 2007 and 2008 EDs proposed revised definitions.

BC19 In revising the definition, the Board adopted the following approach:

(a) When an entity assesses whether two parties are related, it would treat significant influence as equivalent to the relationship that exists between an entity and a member of its key management personnel. However, those relationships are not as close as a relationship of control or joint control.

(b) If two entities are both subject to control (or joint control) by the same entity or person, the two entities are related to each other.

(c) If one entity (or person) controls (or jointly controls) a second entity and the first entity (or person) has significant influence over a third entity, the second and third entities are related to each other.

(d) Conversely, if two entities are both subject to significant influence by the same entity (or person), the two entities are not related to each other.

(e) If the revised definition treats one party as related to a second party, the definition should also treat the second party as related to the first party, by symmetry.

BC20 The new definition was not intended to change the meaning of a related party except in the three respects detailed in paragraphs BC21–BC26. The 2008 ED proposed other amendments to the definition for one additional case that had been inadvertently omitted from the 2007 ED and the elimination of further inconsistencies (paragraphs BC27–BC29). In finalising the amendments in 2009, the Board also removed the term 'significant voting power' from the definition of a related party (paragraphs BC30 and BC31).

An associate of a subsidiary's controlling investor

BC21 First, the Board considered the relationship between an associate and a subsidiary of an investor that has significant influence over the associate. The Board observed that when an associate prepares individual or separate financial statements, its investor is a related party. If the investor has a subsidiary, that subsidiary is also related to the associate, because the subsidiary is part of the group that has significant influence over the associate. Although the definition in the 2003 version of IAS 24 incorporated such relationships, the Board concluded that the revised definition should state this more clearly.

BC22 In contrast, when a subsidiary prepares individual or separate financial statements, an associate of the subsidiary's controlling investor was not a related party as defined in the 2003 version of IAS 24. The subsidiary does not have significant influence over the associate, nor is it significantly influenced by the associate.

BC23 However, the Board decided that, for the same reasons that the parties described in paragraph BC21 are related, the parties described in paragraph BC22 are also related. Thus, the Board amended the definition of a related party to include the relationship discussed in paragraph BC22.

BC24 Furthermore, the Board decided that in the situations described in paragraphs BC21 and BC22, if the investor is a person who has significant influence over one entity and control or joint control over another entity, sufficient influence exists to warrant concluding that the two entities are related.

Two associates of a person

BC25 Secondly, the Board considered the relationship between associates of the investor. IAS 24 does not define associates as related to each other if the investor is an entity. This is because there is insufficient influence through the common investment in two associates. However, the Board noted a discrepancy in that if a person significantly influences one entity and a close member of that person's family significantly influences another entity, those entities were treated as related

parties of each other. The Board amended the definition to exclude the entities described in the latter scenario, thereby ensuring a consistent treatment of associates.

Investments of members of key management personnel

BC26 Thirdly, IAS 24 treats some investees of the key management personnel of a reporting entity as related to that entity. However, the definition in the 2003 version of IAS 24 did not include the reciprocal of this—ie for the financial statements of the investee, the other entity managed by the key management personnel was not a related party. To eliminate this inconsistency, the Board amended the definition so that for both sets of financial statements the entities are related parties.

Joint control

BC27 Respondents to the 2007 ED pointed out that one case had been excluded from the restructured definition without being explicitly stated as a change to IAS 24. When a person has joint control over a reporting entity and a close member of that person's family has joint control or significant influence over the other entity, the 2003 version of IAS 24 defined the other entity as related to the reporting entity.

BC28 The Board noted that joint control is generally regarded as influence that is stronger than significant influence. Therefore, the Board concluded that the relationship described in paragraph BC27 should continue to be treated as a related party relationship.

BC29 The definition in the 2003 version of IAS 24 did not include the reciprocal of the case described in paragraph BC27, nor did it deal with cases when a person or a third entity has joint control or significant influence over the two entities. The definition proposed in the 2007 ED would not have rectified these omissions. The Board decided to include these cases in the definition, to treat similar relationships in a consistent manner. In summary, whenever a person or entity has both joint control over a second entity and joint control or significant influence over a third entity, the amendments described in this paragraph and paragraph BC27 treat the second and third entities as related to each other.

Removal of 'significant voting power'

BC30 Respondents to the 2007 and 2008 EDs raised concerns about the term 'significant voting power' in the definition of a related party. They identified anomalies in its use such as when significant voting power created a related party relationship only when that power is held by individuals, not when that power is held by an entity. A further anomaly arose because two entities were classified as related to each other when a third person was a member of the key management personnel of one and had significant voting power in the other; however, they were not treated as related when a third person had significant voting power in both entities.

BC31 In response to these comments, the Board deleted the reference to 'significant voting power' because it was undefined, used inconsistently and created unnecessary complexity. The Board concluded that if the effect of 'significant voting power' was considered to be the same as 'significant influence', its deletion would have no effect because 'significant influence' is in the definition. On the other hand, if the effect of 'significant voting power' was considered to be different from that of 'significant influence', IAS 24 did not explain what that difference was.

Other minor changes to the definition of a related party

BC32 The revisions to IAS 24 in 2009 included the following other minor changes:

(a) The definition of a **related party** is amended:

(i) to replace references to 'individual' with 'person';

(ii) to clarify that an associate includes subsidiaries of an associate and a joint venture includes subsidiaries of the joint venture; and

(iii) to clarify that two entities are not related parties simply because a member of key management personnel of one entity has significant influence over the other entity.

(b) The definition of a **close member of the family** is amended:

(i) to replace references to 'individual' with 'person'; and

(ii) to delete 'may' from the list of examples to state that close members of a person's family include (rather than 'may include') that person's spouse or domestic partner and children.

Government-related entities

Exemption (paragraph 25)

BC33 The version of IAS 24 that preceded its revision in 2003 did not require 'state-controlled' entities to disclose transactions with other such entities. The revised version of IAS 24 issued in 2003 omitted this exemption because at the time the Board concluded that the disclosure requirements would not be a burden for those entities.

BC34 Subsequently concerns were raised that in environments where government control is pervasive, compliance with IAS 24 was problematic. To address those concerns, the 2007 ED proposed an exemption from the disclosure requirements now in paragraph 18 of IAS 24 for government-related entities. In developing that proposal, the Board noted the following:

(a) It can be difficult to identify other government-related entities, particularly in jurisdictions with a large number of such entities. Such entities might not even be aware that an entity with which they have transactions is a related party.

(b) For these transactions, the cost of meeting the requirements in IAS 24 was not always offset by the benefit of increased information for users of financial statements. More specifically:

(i) extensive disclosures were required for transactions that are unaffected by the relationship;

(ii) if some entities are not aware that their transactions are with other government-related entities, the disclosures provided would be incomplete; and

(iii) transactions that are affected by the relationship might well be obscured by excessive disclosures about unaffected transactions.

(c) Some governments establish subsidiaries, joint ventures and associates to compete with each other. In this case, transactions between such entities are likely to be conducted as if they are unrelated parties.

BC35 Respondents to the 2007 ED generally supported an exemption for government-related entities. However, they expressed concerns about the complexity of the specific proposal and asked the Board to clarify various aspects of it. After considering all comments received, the Board proposed a revised exemption for those entities in the 2008 ED.

BC36 Respondents to the 2008 ED generally supported the revised proposal, but some argued that the exemption should not apply to transactions:

(a) between members of a group that is controlled by a government (paragraph BC37); and

(b) between government-related entities that are related for a reason in addition to their relationship with the same government (paragraph BC38).

BC37 Some respondents reasoned that the exemption should not apply to transactions between members of a group that is controlled by a government, for example between a government-related entity and its parent or its fellow subsidiaries. Those respondents noted that the relationship within such a group might sometimes be closer and more influential than between government-related entities in an environment where government control is pervasive. However, for the following reasons the Board concluded that the exemption should also apply within such groups:

(a) Sometimes, requiring disclosure in such cases would negate the purpose of the exemption and could lead to significant differences in the level of disclosure when the substance of the relationships and transactions could be very similar. For example, suppose one government controls all entities directly but another government has similar entities and controls them all through a single holding company. The entities controlled by the first government would all qualify for the exemption but those controlled by the second government would not.

(b) Requiring disclosure in such cases would place considerable pressure on the definition of the boundary between government and entities controlled by the government. For example, suppose a government controls entities through an intermediate institution. It would be necessary to determine whether that institution is an entity controlled by the government (in which case the exemption would not apply) or part of the government (in which case the exemption would apply). This may be answered easily if the institution is a company incorporated under normal company law that simply happens to have the government as a controlling shareholder. It may be less clear if the institution is, for example, a government agency or department.

BC38 The Board identified only one case when government-related entities might be related to each other for reasons other than their relationships with the same government: a government might control both a post-employment benefit plan and the sponsoring employer. However, the main transactions between such a plan and the sponsoring employer are (a) employer contributions and (b) investments by the plan in the employer or in assets used by the employer. IAS 19 already requires a sponsoring employer to disclose most, if not all, of the information that IAS 24 would require if the exemption did not apply. Thus the Board concluded that no significant loss of disclosure would arise from applying the exemption in these cases.

BC39 Paragraph BC34 explains why the Board provided an exemption from the disclosure requirements in paragraph 18 of IAS 24 for government-related entities. It was beyond the scope of the project to consider whether similar exemptions would be appropriate in other circumstances.

BC40 Some respondents to the 2008 ED noted that many financial institutions had recently become government-related entities when governments took significant and sometimes controlling equity interests in them during the global financial crisis. They queried whether the exemption was appropriate in such cases. In finalising the amendments in 2009, the Board identified no reason to treat such entities differently from other government-related entities. The Board noted that in addition to the disclosure requirements in IAS 24, IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* requires the reporting entity to disclose information about the receipt of government grants or assistance.

BC41 Respondents to the 2008 ED noted that the proposed definition of 'state' was similar to the definition of 'government' in IAS 20. To avoid confusion and provide consistency, the Board adopted the latter definition when finalising the amendments to IAS 24 in 2009. The Board decided that it need not provide a more comprehensive definition or additional guidance on how to determine what is meant by 'government'. In the Board's view, a more detailed definition could not capture every conceivable government structure across every jurisdiction. In addition, judgement is required by the reporting entity when applying the definition because every jurisdiction has its own way of organising government-related activities.

Disclosure requirements when the exemption applies (paragraph 26)

BC42 The Board considered whether the disclosure requirements in paragraph 26:

(a) met the objective of IAS 24 (paragraphs BC43–BC46); and

(b) were operational (paragraphs BC47 and BC48).

BC43 The objective of IAS 24 is to provide 'disclosures necessary to draw attention to the possibility that [the entity's] financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances, including commitments, with such parties'. To meet that objective, paragraph 26 requires some disclosure when the exemption applies. Those disclosures are intended to put users on notice that related party transactions have occurred and to give an indication of their extent. The Board did not intend to require the reporting entity to identify **every** government-related entity, or to quantify in detail **every** transaction with such entities, because such a requirement would negate the exemption.

BC44 Some respondents to the 2008 ED were concerned that qualitative disclosure of individually significant related party transactions alone would not meet the objective of IAS 24 and that combining individually significant transactions with collectively significant transactions would not provide sufficient transparency. The Board concluded that it should require an entity to disclose:

(a) the nature and amount of each individually significant transaction; and

(b) quantitative or qualitative information about other types of transactions that are collectively, but not individually, significant.

BC45 The Board noted that this requirement should not be too onerous for the reporting entity because:

(a) individually significant transactions should be a small subset, by number, of total related party transactions;

(b) the reporting entity should know what those transactions are; and

(c) reporting such items on an exceptional basis takes into account cost-benefit considerations.

BC46 The Board also noted that more disclosure of individually significant transactions would better meet the objective of IAS 24 because this approach focuses on transactions that, through their nature or size, are of more interest to users and are more likely to be affected by the related party relationship.

BC47 Some respondents raised concerns about whether the reporting entity would be able to identify whether the counterparty to individually significant or collectively significant transactions is a related party because it is controlled, jointly controlled or significantly influenced by the same government. The problem of identifying all such counterparties was one of the primary reasons for the exemption.

BC48 However, as discussed in paragraph BC43, it was not the Board's intention to require the reporting entity to identify every government–related entity, or to quantify every transaction with such entities. Moreover, individually significant transactions are likely to attract more scrutiny by management. The Board concluded that management will know, or will apply more effort in establishing, who the counterparty to an individually significant transaction is and will have, or be able to obtain, background information on the counterparty.

Other minor changes made in 2009

BC49 The revisions to IAS 24 in 2009 included the following other changes:

(a) The list of examples of **related party transactions** is amended to include in paragraph 21(i) commitments to do something if a particular event occurs or does not occur in the future, including executory contracts. The Board concluded that commitments were one type of transaction, but to avoid doubt decided to make explicit reference to them.

(b) Paragraph 3 relating to the **scope** of IAS 24 is amended to clarify that the Standard applies to individual, as well as separate and consolidated, financial statements because individual financial statements relate to something different from the defined term in IAS 27.

(c) Paragraph 34 of IFRS 8 *Operating Segments* is amended. The Board recognised that in applying the requirements in IFRS 8 it may not be practicable or meaningful to regard all government-related entities as a single customer, especially for environments in which government control is pervasive.

(d) A consequential amendment to the Basis for Conclusions on IAS 19 draws attention to the new definition of a related party. The definition of a qualifying insurance policy in IAS 19 refers to this definition.

Appendix
Amendments to the Basis for Conclusions on HKAS 19 *Employee Benefits*

This appendix contains amendments to the Basis for Conclusions on other IFRSs accompanying the equivalent converged HKFRSs that are necessary in order to ensure consistency with IAS 24 (as revised in 2009) and the related amendments to other IFRSs. In the amended paragraphs, new text is underlined and deleted text is struck through.

* * *

The amendments contained in this appendix when this Basis for Conclusions was issued have been incorporated into the text of the relevant Basis for Conclusions.

Dissenting opinion on IAS 24

Dissent of Robert P Garnett

DO1 Mr Garnett disagrees with the Board's decision to exempt only government-related entities from the requirements of paragraph 18 to disclose information about all transactions with related parties. He also disagrees with the decision not to require all entities to provide information about each individually significant transaction with a related party as set out in paragraph 26(b)(i).

DO2 The Basis for Conclusions sets out clearly the need to remove the unnecessary burden of collecting data for all transactions, entered into and priced on normal business terms, because the counterparty was identified as a related party. It also explains the need to inform investors of individually significant transactions with related parties. Mr Garnett agrees with the explanations in paragraphs BC33–BC48.

DO3 Paragraph 25, however, restricts these changes to entities that are controlled, jointly controlled or significantly influenced by the same government. Mr Garnett sees no reason to make such a distinction, other than to provide limited relief to certain entities.

Illustrative examples

The following examples accompany, but are not part of, IAS 24 Related Party Disclosures. *They illustrate:*

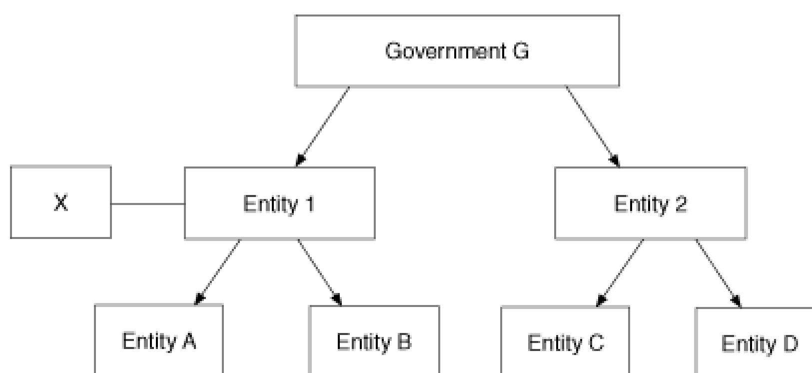
- *the partial exemption for government-related entities; and*
- *how the definition of a related party would apply in specified circumstances.*

In the examples, references to 'financial statements' relate to the individual, separate or consolidated financial statements.

Partial exemption for government-related entities

Example 1 – Exemption from disclosure (paragraph 25)

IE1 Government G directly or indirectly controls Entities 1 and 2 and Entities A, B, C and D. Person X is a member of the key management personnel of Entity 1.



IE2 For Entity A's financial statements, the exemption in paragraph 25 applies to:

(a) transactions with Government G; and

(b) transactions with Entities 1 and 2 and Entities B, C and D.

However, that exemption does not apply to transactions with Person X.

Disclosure requirements when exemption applies (paragraph 26)

IE3 In Entity A's financial statements, an example of disclosure to comply with paragraph 26(b)(i) for **individually** significant transactions could be:

Example of disclosure for individually significant transaction carried out on ***non-market terms***

On 15 January 20X1 Entity A, a utility company in which Government G indirectly owns 75 per cent of outstanding shares, sold a 10 hectare piece of land to another government-related utility company for CU5 million.* On 31 December 20X0 a plot of land in a similar location, of a similar size and with similar characteristics, was sold for CU3 million. There had not been any appreciation or depreciation of the land in the intervening period. See note X [of the financial statements] for disclosure of government assistance as required by IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* and notes Y and Z [of the financial statements] for compliance with other relevant IFRSs.

* In these examples monetary amounts are denominated in 'currency units (CU)'.

*Example of disclosure for individually significant transaction because of **size** of transaction*

In the year ended December 20X1 Government G provided Entity A, a utility company in which Government G indirectly owns 75 per cent of outstanding shares, with a loan equivalent to 50 per cent of its funding requirement, repayable in quarterly instalments over the next five years. Interest is charged on the loan at a rate of 3 per cent, which is comparable to that charged on Entity A's bank loans.* See notes Y and Z [of the financial statements] for compliance with other relevant IFRSs.

Example of disclosure of collectively significant transactions

In Entity A's financial statements, an example of disclosure to comply with paragraph 26(b)(ii) for **collectively** significant transactions could be:

Government G, indirectly, owns 75 per cent of Entity A's outstanding shares. Entity A's significant transactions with Government G and other entities controlled, jointly controlled or significantly influenced by Government G are [a large portion of its sales of goods and purchases of raw materials] or [about 50 per cent of its sales of goods and about 35 per cent of its purchases of raw materials].

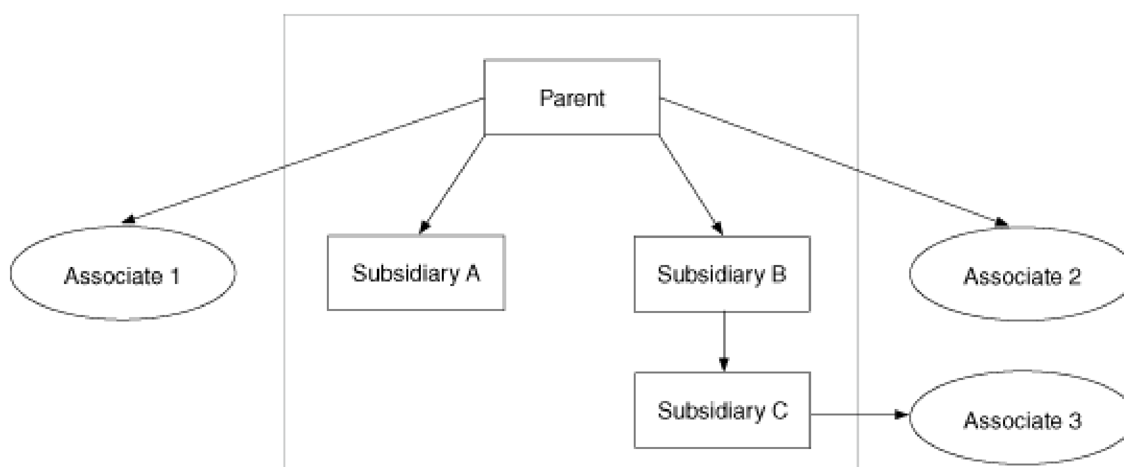
The company also benefits from guarantees by Government G of the company's bank borrowing. See note X [of the financial statements] for disclosure of government assistance as required by IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* and notes Y and Z [of the financial statements] for compliance with other relevant IFRSs.

Definition of a related party

*The references are to subparagraphs of the definition of a **related party** in paragraph 9 of IAS 24.*

Example 2 – Associates and subsidiaries

IE4 Parent entity has a controlling interest in Subsidiaries A, B and C and has significant influence over Associates 1 and 2. Subsidiary C has significant influence over Associate 3.



* If the reporting entity had concluded that this transaction constituted government assistance it would have needed to consider the disclosure requirements in IAS 20.

IE5 For Parent's separate financial statements, Subsidiaries A, B and C and Associates 1, 2 and 3 are related parties. [*Paragraph 9(b)(i) and (ii)*]

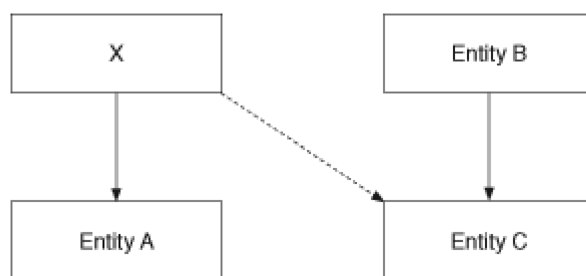
IE6 For Subsidiary A's financial statements, Parent, Subsidiaries B and C and Associates 1, 2 and 3 are related parties. For Subsidiary B's separate financial statements, Parent, Subsidiaries A and C and Associates 1, 2 and 3 are related parties. For Subsidiary C's financial statements, Parent, Subsidiaries A and B and Associates 1, 2 and 3 are related parties. [*Paragraph 9(b)(i) and (ii)*]

IE7 For the financial statements of Associates 1, 2 and 3, Parent and Subsidiaries A, B and C are related parties. Associates 1, 2 and 3 are not related to each other. [*Paragraph 9(b)(ii)*]

IE8 For Parent's consolidated financial statements, Associates 1, 2 and 3 are related to the Group. [*Paragraph 9(b)(ii)*]

Example 3 – Key management personnel

IE9 A person, X, has a 100 per cent investment in Entity A and is a member of the key management personnel of Entity C. Entity B has a 100 per cent investment in Entity C.



IE10 For Entity C's financial statements, Entity A is related to Entity C because X controls Entity A and is a member of the key management personnel of Entity C. [*Paragraph 9(b)(vi)–(a)(iii)*]

IE11 For Entity C's financial statements, Entity A is also related to Entity C if X is a member of the key management personnel of Entity B and not of Entity C. [*Paragraph 9(b)(vi)–(a)(iii)*]

IE12 Furthermore, the outcome described in paragraphs IE10 and IE11 will be the same if X has joint control over Entity A. [*Paragraph 9(b)(vi)–(a)(iii)*] (If X had only significant influence over Entity A and not control or joint control, then Entities A and C would not be related to each other.)

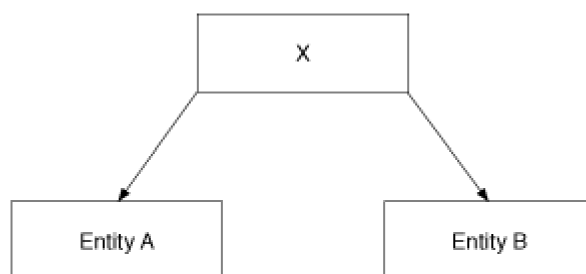
IE13 For Entity A's financial statements, Entity C is related to Entity A because X controls A and is a member of Entity C's key management personnel. [*Paragraph 9(b)(vii)–(a)(i)*]

IE14 Furthermore, the outcome described in paragraph IE13 will be the same if X has joint control over Entity A. The outcome will also be the same if X is a member of key management personnel of Entity B and not of Entity C. [*Paragraph 9(b)(vii)–(a)(i)*]

IE15 For Entity B's consolidated financial statements, Entity A is a related party of the Group if X is a member of key management personnel of the Group. [*Paragraph 9(b)(vi)–(a)(iii)*]

Example 4 – Person as investor

IE16 A person, X, has an investment in Entity A and Entity B.



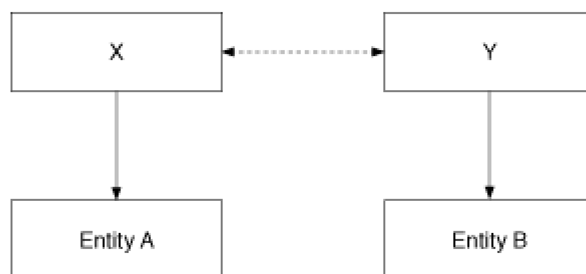
IE17 For Entity A's financial statements, if X controls or jointly controls Entity A, Entity B is related to Entity A when X has control, joint control or significant influence over Entity B. [*Paragraph 9(b)(vi)–(a)(i) and 9(b)(vii)–(a)(i)*]

IE18 For Entity B's financial statements, if X controls or jointly controls Entity A, Entity A is related to Entity B when X has control, joint control or significant influence over Entity B. [*Paragraph 9(b)(vi)–(a)(i) and 9(b)(vi)–(a)(ii)*]

IE19 If X has significant influence over both Entity A and Entity B, Entities A and B are not related to each other.

Example 5 – Close members of the family holding investments

IE20 A person, X, is the domestic partner of Y. X has an investment in Entity A and Y has an investment in Entity B.



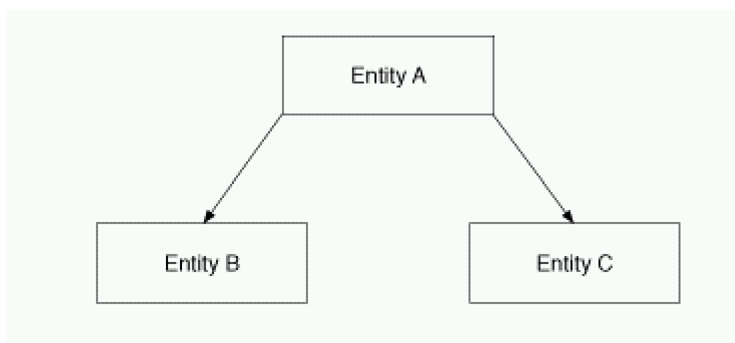
IE21 For Entity A's financial statements, if X controls or jointly controls Entity A, Entity B is related to Entity A when Y has control, joint control or significant influence over Entity B. [*Paragraph 9(b)(vi)–(a)(i) and 9(b)(vii)–(a)(i)*]

IE22 For Entity B's financial statements, if X controls or jointly controls Entity A, Entity A is related to Entity B when Y has control, joint control or significant influence over Entity B. [*Paragraph 9(b)(vi)–(a)(i) and 9(b)(vi)–(a)(ii)*]

IE23 If X has significant influence over Entity A and Y has significant influence over Entity B, Entities A and B are not related to each other.

Example 6 – Entity with joint control

IE24 Entity A has both (i) joint control over Entity B and (ii) joint control or significant influence over Entity C.



IE25 For Entity B's financial statements, Entity C is related to Entity B. [*Paragraph 9(b)(iii) and (iv)*]

IE26 Similarly, for Entity C's financial statements, Entity B is related to Entity C. [*Paragraph 9(b)(iii) and (iv)*]

Table of Concordance

This table shows how the contents of the superseded version of HKAS 24 and the revised version of HKAS 24 correspond. Paragraphs are treated as corresponding if they broadly address the same matter even though the guidance may differ.

Superseded HKAS 24 paragraph	Revised HKAS 24 paragraph
1	1
2	2
3	3
4	4
5	5
6	6
7	7
8	8
9	9
10	10
11	11
None	12
12	13
13	14
14	15
15	16
16	17
17	18
18	19
19	20
20	21
20	22
21	23

22	24
None	25
None	26
None	27
23	28
23A	None
24	29

Hong Kong Accounting Standard 24

Related Party Disclosures

This HKAS 24 is applicable for annual periods beginning on or after 1 January 2005 but before 1 January 2011. HKAS 24 (Revised) issued in November 2009 is applicable for annual periods beginning on or after 1 January 2011 and supersedes this HKAS 24.

HKAS 19
Revised November 2009

Effective for annual periods
beginning on or after 1 January 2005

Hong Kong Accounting Standard 19

Employee Benefits

Hong Kong Institute of
Certified Public Accountants
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Contents

paragraphs

HONG KONG ACCOUNTING STANDARD 19
EMPLOYEE BENEFITS

INTRODUCTION	**IN1-IN12**
INTRODUCTION TO FEBRUARY 2005 AMENDMENT	**IN1-IN4**
OBJECTIVE	
SCOPE	**1-6**
DEFINITIONS	**7**
SHORT-TERM EMPLOYEE BENEFITS	**8-23**
Recognition and Measurement	**10-22**
All short-term employee benefits	10
Short-term compensated absences	11-16
Profit-sharing and bonus plans	17-22
Disclosure	**23**
POST-EMPLOYMENT BENEFITS: DISTINCTION BETWEEN DEFINED CONTRIBUTION PLANS AND DEFINED BENEFIT PLANS	**24-42**
Multi-employer plans	**29-33~~5~~**
Defined benefit plans that share risks between various entities under common control	**34-34B**
State plans	**36-38**
Insured benefits	**39-42**
POST-EMPLOYMENT BENEFITS: DEFINED CONTRIBUTION PLANS	**43-47**
Recognition and measurement	**44-45**
Disclosure	**46-47**
POST-ENPLOYMENT BENEFITS: DEFINED BENEFIT PLANS	**48-119**
Recognition and measurement	**49-62**
Accounting for the constructive obligation	52-53
~~Balance sheet~~Statement of financial position	54-60
~~Income statement~~Profit or loss	61-62
Recognition and measurement: present value of defined benefit obligations and current service cost	**63-101**
Actuarial valuation method	64-66
Attributing benefit to periods of service	67-71
Actuarial assumptions	72-77
Actuarial assumptions: discount rate	78-82
Actuarial assumptions: salaries, benefits and medical costs	83-91
Actuarial gains and losses	92-95
Past service cost	96-101
Recognition and measurement: plan assets	**102-107**
Fair value of plan assets	102-104

Reimbursements	104A-104D
Return on plan assets	105-107
Business combinations	**108**
Curtailments and settlements	**109-115**
Presentation	**116-119**
Offset	116-117
Current / non-current distinction	118
Financial components of post-employment benefit costs	119
Disclosure	**120-125**
OTHER LONG-TERM EMPLOYEE BENEFITS	**126-131**
Recognition and measurement	**128-130**
Disclosure	**131**
TERMINATION BENEFITS	**132-143**
Recognition	**133-138**
Measurement	**139-140**
Disclosure	**141-143**
TRANSITIONAL PROVISIONS	**153-156**
EFFECTIVE DATE	**157-161~~0~~**

APPENDICES

A. Illustrative example

B. Illustrative disclosures

C. Illustration of the application of paragraph 58A

D. Amendments to other Standards

E. Comparison with International Accounting Standards

BASIS FOR CONCLUSIONS

DISSENTING OPINIONS

Hong Kong Accounting Standard 19 *Employee Benefits* (HKAS 19) is set out in paragraphs 1-161~~0~~. All the paragraphs have equal authority. HKAS 19 shall be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Standards*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

IN1 The Standard prescribes the accounting and disclosure by employers for employee benefits. The Standard does not deal with reporting by employee benefit plans (see HKAS 26 *Accounting and Reporting by Retirement Benefit Plans*).

IN2 The Standard identifies four categories of employee benefits:

(a) short-term employee benefits, such as wages, salaries and social security contributions, paid annual leave and paid sick leave, profit-sharing and bonuses (if payable within twelve months of the end of the period) and non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees;

(b) post-employment benefits such as pensions, other retirement benefits, post-employment life insurance and post-employment medical care;

(c) other long-term employee benefits, including long-service leave or sabbatical leave, jubilee or other long-service benefits, long-term disability benefits and, if they are payable twelve months or more after the end of the period, profit-sharing, bonuses and deferred compensation; and

(d) termination benefits.

IN3 The Standard requires an entity to recognise short-term employee benefits when an employee has rendered service in exchange for those benefits.

IN4 Post-employment benefit plans are classified as either defined contribution plans or defined benefit plans. The Standard gives specific guidance on the classification of multi-employer plans, state plans and plans with insured benefits.

IN5 Under defined contribution plans, an entity pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods. The Standard requires an entity to recognise contributions to a defined contribution plan when an employee has rendered service in exchange for those contributions.

IN6 All other post-employment benefit plans are defined benefit plans. Defined benefit plans may be unfunded, or they may be wholly or partly funded. The Standard requires an entity to:

(a) account not only for its legal obligation, but also for any constructive obligation that arises from the entity's practices;

(b) determine the present value of defined benefit obligations and the fair value of any plan assets with sufficient regularity that the amounts recognised in the financial statements do not differ materially from the amounts that would be determined at the end of the reporting period;

(c) use the Projected Unit Credit Method to measure its obligations and costs;

(d) attribute benefit to periods of service under the plan's benefit formula, unless an employee's service in later years will lead to a materially higher level of benefit than in earlier years;

(e) use unbiased and mutually compatible actuarial assumptions about demographic variables (such as employee turnover and mortality) and financial variables (such as future increases in salaries, changes in medical costs and certain changes in state benefits). Financial assumptions should be based on market expectations, at the end of the reporting period, for the period over which the obligations are to be settled;

(f) determine the discount rate by reference to market yields at the end of the reporting period on high quality corporate bonds (or, in countries where there is no deep market in such bonds, government bonds) of a currency and term consistent with the currency and term of the post-employment benefit obligations;

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(g) deduct the fair value of any plan assets from the carrying amount of the obligation. Certain reimbursement rights that do not qualify as plan assets are treated in the same way as plan assets, except that they are presented as a separate asset, rather than as a deduction from the obligation;

(h) limit the carrying amount of an asset so that it does not exceed the net total of:

(i) any unrecognised past service cost and actuarial losses; plus

(ii) the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan;

(i) recognise past service cost on a straight-line basis over the average period until the amended benefits become vested;

(j) recognise gains or losses on the curtailment or settlement of a defined benefit plan when the curtailment or settlement occurs. The gain or loss should comprise any resulting change in the present value of the defined benefit obligation and of the fair value of the plan assets and the unrecognised part of any related actuarial gains and losses and past service cost; and

(k) recognise a specified portion of the net cumulative actuarial gains and losses that exceed the greater of:

(i) 10% of the present value of the defined benefit obligation (before deducting plan assets); and

(ii) 10% of the fair value of any plan assets.

The portion of actuarial gains and losses to be recognised for each defined benefit plan is the excess that fell outside the 10% ‘corridor’ at the end of the previous reporting period, divided by the expected average remaining working lives of the employees participating in that plan.

The Standard also permits systematic methods of faster recognition, provided that the same basis is applied to both gains and losses and the basis is applied consistently from period to period. Such permitted methods include immediate recognition of all actuarial gains and losses in profit or loss. In addition, the Standard permits an entity to recognise all actuarial gains and losses in the period in which they occur in other comprehensive income.

IN7 The Standard requires a simpler method of accounting for other long-term employee benefits than for post-employment benefits: actuarial gains and losses and past service cost are recognised immediately.

IN8 Termination benefits are employee benefits payable as a result of either: an entity’s decision to terminate an employee’s employment before the normal retirement date; or an employee’s decision to accept voluntary redundancy in exchange for those benefits. The event which gives rise to an obligation is the termination rather than employee service. Therefore, an entity should recognise termination benefits when, and only when, the entity is demonstrably committed to either:

(a) terminate the employment of an employee or group of employees before the normal retirement date; or

(b) provide termination benefits as a result of an offer made in order to encourage voluntary redundancy.

IN9 An entity is demonstrably committed to a termination when, and only when, the entity has a detailed formal plan (with specified minimum contents) for the termination and is without realistic possibility of withdrawal.

IN10 Where termination benefits fall due more than 12 months after the reporting period, they should be discounted. In the case of an offer made to encourage voluntary redundancy, the measurement of termination benefits should be based on the number of employees expected to accept the offer.

IN11 [Deleted]

IN12 The Standard is effective for accounting periods beginning on or after 1 January 2005. Earlier application is encouraged.

IN13 [Deleted]

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Introduction to February 2005 Amendment

IN1 The amendment to HKAS 19 *Employee Benefits* issued in February 2005, effective for annual periods beginning on or after 1 January 2006 (now incorporated in the body of this Standard) introduces an additional recognition option for actuarial gains and losses arising in post-employment defined benefit plans. Actuarial gains and losses are defined in HKAS 19 as experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred) and the effects of changes in actuarial assumptions. They include changes in the fair value of plan assets other than those explained by the expected return. Before this amendment, HKAS 19 required actuarial gains and losses to be recognised in profit or loss either in the period in which they occur, or on a deferred basis.

IN2 The Hong Kong Institute of Certified Public Accountants (Institute) has reservations about aspects of HKAS 19, including concerns about deferred recognition of actuarial gains and losses. The Institute believes that deferred recognition is inconsistent with the Institute's *Framework for the Preparation and Presentation of Financial Statements* because it results in amounts presented in the balance sheet that do not meet the definition of a liability or an asset. The Institute notes the intention of the International Accounting Standards Board (IASB) to undertake a major project on accounting for post-employment benefits.

IN3 The Institute also notes that the UK standard on post-employment benefits, FRS 17 *Retirement Benefits*, requires recognition of all actuarial gains and losses as they occur, outside profit or loss in a statement of total recognised gains and losses. The Institute does not necessarily regard this as an ideal solution, but notes that FRS 17 produces transparent information about defined benefit plans in the financial statements. The Institute believes that, pending (a) a comprehensive reconsideration of the accounting for post-employment benefits by the IASB and (b) the development of a new format for the income statement by the IASB, an option similar to the approach in FRS 17 should be available as an alternative to deferred recognition or immediate recognition in profit or loss.

IN4 The other features of the amendment are:

(a) clarification that a contractual agreement between a multi-employer plan and participating employers that determines how a surplus is to be distributed or a deficit funded will give rise to an asset or liability.

(b) accounting requirements for group defined benefit plans in the separate or individual financial statements of entities within a group.

(c) additional disclosures that:

(i) provide information about trends in the assets and liabilities in a defined benefit plan and the assumptions underlying the components of the defined benefit cost; and

(ii) bring the disclosures in HKAS 19 closer to those required by the US standard SFAS 132 *Employers' Disclosures about Pensions and Other Postretirement Benefits*, which was revised in December 2003.

Hong Kong Accounting Standard 19

Employee Benefits

Objective

The objective of this Standard is to prescribe the accounting and disclosure for employee benefits. The Standard requires an entity to recognise:

(a) a liability when an employee has provided service in exchange for employee benefits to be paid in the future; and

(b) an expense when the entity consumes the economic benefit arising from service provided by an employee in exchange for employee benefits.

Scope

1 **This Standard shall be applied by an employer in accounting for all employee benefits, except those to which HKFRS 2** *Share-based Payment* **applies.**

2 This Standard does not deal with reporting by employee benefit plans (see HKAS 26 *Accounting and Reporting by Retirement Benefit Plans*).

3 The employee benefits to which this Standard applies include those provided:

(a) under formal plans or other formal agreements between an entity and individual employees, groups of employees or their representatives;

(b) under legislative requirements, or through industry arrangements, whereby entities are required to contribute to national, state, industry or other multi-employer plans; or

(c) by those informal practices that give rise to a constructive obligation. Informal practices give rise to a constructive obligation where the entity has no realistic alternative but to pay employee benefits. An example of a constructive obligation is where a change in the entity's informal practices would cause unacceptable damage to its relationship with employees.

4 Employee benefits include:

(a) short-term employee benefits, such as wages, salaries and social security contributions, paid annual leave and paid sick leave, profit sharing and bonuses (if payable within twelve months of the end of the period) and non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees;

(b) post-employment benefits such as pensions, other retirement benefits, post-employment life insurance and post-employment medical care;

(c) other long-term employee benefits, including long-service leave or sabbatical leave, jubilee or other long-service benefits, long-term disability benefits and, if they are not payable wholly within twelve months after the end of the period, profit sharing, bonuses and deferred compensation; and

(d) termination benefits.

Because each category identified in (a)–(d) above has different characteristics, this Standard establishes separate requirements for each category.

5 Employee benefits include benefits provided to either employees or their dependants and may be settled by payments (or the provision of goods or services) made either directly to the employees, to their spouses, children or other dependants or to others, such as insurance companies.

6 An employee may provide services to an entity on a full time, part time, permanent, casual or temporary basis. For the purpose of this Standard, employees include directors and other management personnel.

Definitions

7 The following terms are used in this Standard with the meanings specified:

Employee benefits **are all forms of consideration given by an entity in exchange for service rendered by employees.**

Short-term employee benefits **are employee benefits (other than termination benefits) ~~which fall due wholly~~that are due to be settled within twelve months after the end of the period in which the employees render the related service.**

Post-employment benefits **are employee benefits (other than termination benefits) which are payable after the completion of employment.**

Post-employment benefit plans **are formal or informal arrangements under which an entity provides post-employment benefits for one or more employees.**

Defined contribution plans **are post-employment benefit plans under which an entity pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.**

Defined benefit plans **are post-employment benefit plans other than defined contribution plans.**

Multi-employer plans **are defined contribution plans (other than state plans) or defined benefit plans (other than state plans) that:**

(a) pool the assets contributed by various entities that are not under common control; and

(b) use those assets to provide benefits to employees of more than one entity, on the basis that contribution and benefit levels are determined without regard to the identity of the entity that employs the employees concerned.

Other long-term employee benefits **are employee benefits (other than post-employment benefits and termination benefits) ~~which do not fall due wholly~~that are not due to be settled within twelve months after the end of the period in which the employees render the related service.**

Termination benefits **are employee benefits payable as a result of either:**

(a) an entity's decision to terminate an employee's employment before the normal retirement date; or

(b) an employee's decision to accept voluntary redundancy in exchange for those benefits.

Vested employee benefits **are employee benefits that are not conditional on future employment.**

The *present value of a defined benefit obligation* **is the present value, without deducting any plan assets, of expected future payments required to settle the obligation resulting from employee service in the current and prior periods.**

Current service cost **is the increase in the present value of the defined benefit obligation resulting from employee service in the current period.**

Interest cost **is the increase during a period in the present value of a defined benefit obligation which arises because the benefits are one period closer to settlement.**

Plan assets **comprise:**

(a) **assets held by a long-term employee benefit fund; and**

(b) **qualifying insurance policies.**

Assets held by a long-term employee benefit fund **are assets (other than non-transferable financial instruments issued by the reporting entity) that:**

(a) **are held by an entity (a fund) that is legally separate from the reporting entity and exists solely to pay or fund employee benefits; and**

(b) **are available to be used only to pay or fund employee benefits, are not available to the reporting entity's own creditors (even in bankruptcy), and cannot be returned to the reporting entity, unless either:**

(i) **the remaining assets of the fund are sufficient to meet all the related employee benefit obligations of the plan or the reporting entity; or**

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

A *qualifying insurance policy* **is an insurance policy[*] issued by an insurer that is not a related party (as defined in HKAS 24** *Related Party Disclosures***) of the reporting entity, 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.**

Fair value **is the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction.**

The *return on plan assets* **is interest, dividends and other revenue derived from the plan assets, together with realised and unrealised gains or losses on the plan assets, less any costs of administering the plan (other than those included in the actuarial assumptions need to measure the defined benefit obligation) and less any tax payable by the plan itself.**

Actuarial gains and losses **comprise:**

(a) **experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred); and**

(b) **the effects of changes in actuarial assumptions.**

Past service cost **is the ~~increase~~ change in the present value of the defined benefit obligation for employee service in prior periods, resulting in the current period from the introduction of, or changes to, post-employment benefits or other long-term employee benefits. Past service cost may be either positive (when~~re~~ benefits are introduced or ~~improved~~changed so that the present value of the defined benefit obligation increases) or negative (when~~re~~ existing benefits are ~~reduced~~changed so that the present value of the defined benefit obligation decreases).**

[*] A qualifying insurance policy is not necessarily an insurance contract, as defined in HKFRS 4 *Insurance Contracts*.

Short-term employee benefits

8 Short-term employee benefits include items such as:

(a) wages, salaries and social security contributions;

(b) short-term compensated absences (such as paid annual leave and paid sick leave) where the compensation for the absences ~~are expected to occur~~is due to be settled within twelve months after the end of the period in which the employees render the related employee service;

(c) profit sharing and bonuses payable within twelve months after the end of the period in which the employees render the related service; and

(d) non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees.

9 Accounting for short-term employee benefits is generally straightforward because no actuarial assumptions are required to measure the obligation or the cost and there is no possibility of any actuarial gain or loss. Moreover, short-term employee benefit obligations are measured on an undiscounted basis.

Recognition and measurement

All Short-term employee benefits

10 When an employee has rendered service to an entity during an accounting period, the entity shall recognise the undiscounted amount of short-term employee benefits expected to be paid in exchange for that service:

(a) as a liability (accrued expense), after deducting any amount already paid. If the amount already paid exceeds the undiscounted amount of the benefits, an entity shall recognise that excess as an asset (prepaid expense) to the extent that the prepayment will lead to, for example, a reduction in future payments or a cash refund; and

(b) as an expense, unless another Standard requires or permits the inclusion of the benefits in the cost of an asset (see, for example, HKAS 2, *Inventories***, and HKAS 16,** *Property, Plant and Equipment***).**

Paragraphs 11, 14 and 17 explain how an entity shall apply this requirement to short-term employee benefits in the form of compensated absences and profit sharing and bonus plans.

Short-term compensated absences

11 An entity shall recognise the expected cost of short-term employee benefits in the form of compensated absences under paragraph 10 as follows:

(a) in the case of accumulating compensated absences, when the employees render service that increases their entitlement to future compensated absences; and

(b) in the case of non-accumulating compensated absences, when the absences occur.

12 An entity may compensate employees for absence for various reasons including vacation, sickness and short-term disability, maternity or paternity, jury service and military service. Entitlement to compensated absences falls into two categories:

(a) accumulating; and

(b) non-accumulating.

13 Accumulating compensated absences are those that are carried forward and can be used in future periods if the current period's entitlement is not used in full. Accumulating compensated absences may be either vesting (in other words, employees are entitled to a cash payment for unused entitlement on leaving the entity) or non-vesting (when employees are not entitled to a cash payment for unused entitlement on leaving). An obligation arises as employees render service that increases their entitlement to future compensated absences. The obligation exists, and is recognised, even if the compensated absences are non-vesting, although the possibility that employees may leave before they use an accumulated non-vesting entitlement affects the measurement of that obligation.

14 An entity shall measure the expected cost of accumulating compensated absences as the additional amount that the entity expects to pay as a result of the unused entitlement that has accumulated at the ~~balance sheet date~~end of the reporting period.

15 The method specified in the previous paragraph measures the obligation at the amount of the additional payments that are expected to arise solely from the fact that the benefit accumulates. In many cases, an entity may not need to make detailed computations to estimate that there is no material obligation for unused compensated absences. For example, a sick leave obligation is likely to be material only if there is a formal or informal understanding that unused paid sick leave may be taken as paid vacation.

Example illustrating paragraphs 14 and 15

An entity has 100 employees, who are each entitled to five working days of paid sick leave for each year. Unused sick leave may be carried forward for one calendar year. Sick leave is taken first out of the current year's entitlement and then out of any balance brought forward from the previous year (a LIFO basis). At 31 December 20X1, the average unused entitlement is two days per employee. The entity expects, based on past experience which is expected to continue, that 92 employees will take no more than five days of paid sick leave in 20X2 and that the remaining eight employees will take an average of six and a half days each.

The entity expects that it will pay an additional 12 days of sick pay as a result of the unused entitlement that has accumulated at 31 December 20X1 (one and a half days each, for eight employees). Therefore, the entity recognises a liability equal to 12 days of sick pay.

16 Non-accumulating compensated absences do not carry forward: they lapse if the current period's entitlement is not used in full and do not entitle employees to a cash payment for unused entitlement on leaving the entity. This is commonly the case for sick pay (to the extent that unused past entitlement does not increase future entitlement), maternity or paternity leave and compensated absences for jury service or military service. An entity recognises no liability or expense until the time of the absence, because employee service does not increase the amount of the benefit.

Profit-sharing and bonus plans

17 An entity shall recognise the expected cost of profit sharing and bonus payments under paragraph 10 when, and only when:

(a) the entity has a present legal or constructive obligation to make such payments as a result of past events; and

(b) a reliable estimate of the obligation can be made.

A present obligation exists when, and only when, the entity has no realistic alternative but to make the payments.

18 Under some profit sharing plans, employees receive a share of the profit only if they remain with the entity for a specified period. Such plans create a constructive obligation as employees render service that increases the amount to be paid if they remain in service until the end of the specified period. The measurement of such constructive obligations reflects the possibility that some employees may leave without receiving profit sharing payments.

Example illustrating paragraph 18

A profit sharing plan requires an entity to pay a specified proportion of its profit for the year to employees who serve throughout the year. If no employees leave during the year, the total profit sharing payments for the year will be 3% of profit. The entity estimates that staff turnover will reduce the payments to 2.5% of profit.

The entity recognises a liability and an expense of 2.5% of profit.

19 An entity may have no legal obligation to pay a bonus. Nevertheless, in some cases, an entity has a practice of paying bonuses. In such cases, the entity has a constructive obligation because the entity has no realistic alternative but to pay the bonus. The measurement of the constructive obligation reflects the possibility that some employees may leave without receiving a bonus.

20 An entity can make a reliable estimate of its legal or constructive obligation under a profit sharing or bonus plan when, and only when:

(a) the formal terms of the plan contain a formula for determining the amount of the benefit;

(b) the entity determines the amounts to be paid before the financial statements are authorised for issue; or

(c) past practice gives clear evidence of the amount of the entity's constructive obligation.

21 An obligation under profit sharing and bonus plans results from employee service and not from a transaction with the entity's owners. Therefore, an entity recognises the cost of profit sharing and bonus plans not as a distribution of net profit but as an expense.

22 If profit sharing and bonus payments are not due wholly within twelve months after the end of the period in which the employees render the related service, those payments are other long-term employee benefits (see paragraphs 126 - 131).

Disclosure

23. Although this Standard does not require specific disclosures about short-term employee benefits, other Standards may require disclosures. For example, HKAS 24 requires disclosures about employee benefits for key management personnel. HKAS 1 *Presentation of Financial Statements* requires disclosure of employee benefits expense.

Post-employment benefits: distinction between defined contribution plans and defined benefit plans

24 Post-employment benefits include, for example:

(a) retirement benefits, such as pensions; and

(b) other post-employment benefits, such as post-employment life insurance and post-employment medical care.

Arrangements whereby an entity provides post-employment benefits are post-employment benefit plans. An entity applies this Standard to all such arrangements whether or not they involve the establishment of a separate entity to receive contributions and to pay benefits.

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25 Post-employment benefit plans are classified as either defined contribution plans or defined benefit plans, depending on the economic substance of the plan as derived from its principal terms and conditions. Under defined contribution plans:

(a) the entity's legal or constructive obligation is limited to the amount that it agrees to contribute to the fund. Thus, the amount of the post-employment benefits received by the employee is determined by the amount of contributions paid by an entity (and perhaps also the employee) to a post-employment benefit plan or to an insurance company, together with investment returns arising from the contributions; and

(b) in consequence, actuarial risk (that benefits will be less than expected) and investment risk (that assets invested will be insufficient to meet expected benefits) fall on the employee.

26 Examples of cases where an entity's obligation is not limited to the amount that it agrees to contribute to the fund are when the entity has a legal or constructive obligation through:

(a) a plan benefit formula that is not linked solely to the amount of contributions;

(b) a guarantee, either indirectly through a plan or directly, of a specified return on contributions; or

(c) those informal practices that give rise to a constructive obligation. For example, a constructive obligation may arise where an entity has a history of increasing benefits for former employees to keep pace with inflation even where there is no legal obligation to do so.

27 Under defined benefit plans:

(a) the entity's obligation is to provide the agreed benefits to current and former employees; and

(b) actuarial risk (that benefits will cost more than expected) and investment risk fall, in substance, on the entity. If actuarial or investment experience are worse than expected, the entity's obligation may be increased.

28 Paragraphs 29 - 42 below explain the distinction between defined contribution plans and defined benefit plans in the context of multi-employer plans, state plans and insured benefits.

Multi-employer plans

29. An entity shall classify a multi-employer plan as a defined contribution plan or a defined benefit plan under the terms of the plan (including any constructive obligation that goes beyond the formal terms). Where a multi-employer plan is a defined benefit plan, an entity shall:

(a) account for its proportionate share of the defined benefit obligation, plan assets and cost associated with the plan in the same way as for any other defined benefit plan; and

(b) disclose the information required by paragraph 120A.

30. When sufficient information is not available to use defined benefit accounting for a multi-employer plan that is a defined benefit plan, an entity shall:

(a) account for the plan under paragraphs 44 - 46 as if it were a defined contribution plan;

(b) disclose:

(i) the fact that the plan is a defined benefit plan; and

(ii) the reason why sufficient information is not available to enable the entity to account for the plan as a defined benefit plan; and

(c) to the extent that a surplus or deficit in the plan may affect the amount of future contributions, disclose in addition:

(i) any available information about that surplus or deficit;

(ii) the basis used to determine that surplus or deficit; and

(iii) the implications, if any, for the entity.

31 One example of a defined benefit multi-employer plan is one where:

(a) the plan is financed on a pay-as-you-go basis such that: contributions are set at a level that is expected to be sufficient to pay the benefits falling due in the same period; and future benefits earned during the current period will be paid out of future contributions; and

(b) employees' benefits are determined by the length of their service and the participating entities have no realistic means of withdrawing from the plan without paying a contribution for the benefits earned by employees up to the date of withdrawal. Such a plan creates actuarial risk for the entity: if the ultimate cost of benefits already earned at the ~~balance sheet date~~end of the reporting period is more than expected, the entity will have to either increase its contributions or persuade employees to accept a reduction in benefits. Therefore, such a plan is a defined benefit plan.

32 Where sufficient information is available about a multi-employer plan which is a defined benefit plan, an entity accounts for its proportionate share of the defined benefit obligation, plan assets and post-employment benefit cost associated with the plan in the same way as for any other defined benefit plan. However, in some cases, an entity may not be able to identify its share of the underlying financial position and performance of the plan with sufficient reliability for accounting purposes. This may occur if:

(a) the entity does not have access to information about the plan that satisfies the requirements of this Standard; or

(b) the plan exposes the participating entities to actuarial risks associated with the current and former employees of other entities, with the result that there is no consistent and reliable basis for allocating the obligation, plan assets and cost to individual entities participating in the plan.

In those cases, an entity accounts for the plan as if it were a defined contribution plan and discloses the additional information required by paragraph 30.

32A There may be a contractual agreement between the multi-employer plan and its participants that determines how the surplus in the plan will be distributed to the participants (or the deficit funded). A participant in a multi-employer plan with such an agreement that accounts for the plan as a defined contribution plan in accordance with paragraph 30 shall recognise the asset or liability that arises from the contractual agreement and the resulting income or expense in profit or loss.

Example illustrating paragraph 32A
An entity participates in a multi-employer defined benefit plan that does not prepare plan valuations on an HKAS 19 basis. It therefore accounts for the plan as if it were a defined contribution plan. A non-HKAS 19 funding valuation shows a deficit of 100 million in the plan. The plan has agreed under contract a schedule of contributions with the participating employers in the plan that will eliminate the deficit over the next five years. The entity's total contributions under the contract are 8 million. *The entity recognises a liability for the contributions adjusted for the time value of money and an equal expense in profit or loss.*

32B HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets* requires an entity to ~~recognise, or~~ disclose information about~~, certain~~ some contingent liabilities. In the context of a multi-employer plan, a contingent liability may arise from, for example:

(a) actuarial losses relating to other participating entities because each entity that participates in a multi-employer plan shares in the actuarial risks of every other participating entity; or

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(b) any responsibility under the terms of a plan to finance any shortfall in the plan if other entities cease to participate.

33 Multi-employer plans are distinct from group administration plans. A group administration plan is merely an aggregation of single employer plans combined to allow participating employers to pool their assets for investment purposes and reduce investment management and administration costs, but the claims of different employers are segregated for the sole benefit of their own employees. Group administration plans pose no particular accounting problems because information is readily available to treat them in the same way as any other single employer plan and because such plans do not expose the participating entities to actuarial risks associated with the current and former employees of other entities. The definitions in this Standard require an entity to classify a group administration plan as a defined contribution plan or a defined benefit plan in accordance with the terms of the plan (including any constructive obligation that goes beyond the formal terms).

Defined benefit plans that share risks between various entities under common control

34 Defined benefit plans that share risks between various entities under common control, for example, a parent and its subsidiaries, are not multi-employer plans.

34A An entity participating in such a plan shall obtain information about the plan as a whole measured in accordance with HKAS 19 on the basis of assumptions that apply to the plan as a whole. If there is a contractual agreement or stated policy for charging the net defined benefit cost for the plan as a whole measured in accordance with HKAS 19 to individual group entities, the entity shall, in its separate or individual financial statements, recognise the net defined benefit cost so charged. If there is no such agreement or policy, the net defined benefit cost shall be recognised in the separate or individual financial statements of the group entity that is legally the sponsoring employer for the plan. The other group entities shall, in their separate or individual financial statements, recognise a cost equal to their contribution payable for the period.

34B Participation in such a plan is a related party transaction for each individual group entity. An entity shall therefore, in its separate or individual financial statements, make the following disclosures:

(a) the contractual agreement or stated policy for charging the net defined benefit cost or the fact that there is no such policy.

(b) the policy for determining the contribution to be paid by the entity.

(c) if the entity accounts for an allocation of the net defined benefit cost in accordance with paragraph 34A, all the information about the plan as a whole in accordance with paragraphs 120-121.

(d) if the entity accounts for the contribution payable for the period in accordance with paragraph 34A, the information about the plan as a whole required in accordance with paragraphs 120A(b)-(e), (j), (n), (o), (q) and 121. The other disclosures required by paragraph 120A do not apply.

35. [Deleted]

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State plans

36 An entity shall account for a state plan in the same way as for a multi-employer plan (see paragraphs 29 and 30).

37 State plans are established by legislation to cover all entities (or all entities in a particular category, for example a specific industry) and are operated by national or local government or by another body (for example an autonomous agency created specifically for this purpose) which is not subject to control or influence by the reporting entity. Some plans established by an entity provide both compulsory benefits which substitute for benefits that would otherwise be covered under a state plan and additional voluntary benefits. Such plans are not state plans.

38 State plans are characterised as defined benefit or defined contribution in nature based on the entity's obligation under the plan. Many state plans are funded on a pay-as-you go basis: contributions are set at a level that is expected to be sufficient to pay the required benefits falling due in the same period; future benefits earned during the current period will be paid out of future contributions. Nevertheless, in most state plans, the entity has no legal or constructive obligation to pay those future benefits: its only obligation is to pay the contributions as they fall due and if the entity ceases to employ members of the state plan, it will have no obligation to pay the benefits earned by its own employees in previous years. For this reason, state plans are normally defined contribution plans. However, in the rare cases when a state plan is a defined benefit plan, an entity applies the treatment prescribed in paragraphs 29 and 30.

Insured benefits

39 An entity may pay insurance premiums to fund a post-employment benefit plan. The entity shall treat such a plan as a defined contribution plan unless the entity will have (either directly, or indirectly through the plan) a legal or constructive obligation to either:

(a) pay the employee benefits directly when they fall due; or

(b) pay further amounts if the insurer does not pay all future employee benefits relating to employee service in the current and prior periods.

If the entity retains such a legal or constructive obligation, the entity shall treat the plan as a defined benefit plan.

40 The benefits insured by an insurance contract need not have a direct or automatic relationship with the entity's obligation for employee benefits. Post-employment benefit plans involving insurance contracts are subject to the same distinction between accounting and funding as other funded plans.

41 Where an entity funds a post-employment benefit obligation by contributing to an insurance policy under which the entity (either directly, indirectly through the plan, through the mechanism for setting future premiums or through a related party relationship with the insurer) retains a legal or constructive obligation, the payment of the premiums does not amount to a defined contribution arrangement. It follows that the entity:

(a) accounts for a qualifying insurance policy as a plan asset (see paragraph 7); and

(b) recognises other insurance policies as reimbursement rights (if the policies satisfy the criteria in paragraph 104A).

42 Where an insurance policy is in the name of a specified plan participant or a group of plan participants and the entity does not have any legal or constructive obligation to cover any loss on the policy, the entity has no obligation to pay benefits to the employees and the insurer has sole responsibility for paying the benefits. The payment of fixed premiums under such contracts is, in substance, the settlement of the employee benefit obligation, rather than an investment to meet the obligation. Consequently, the entity no longer has an asset or a liability. Therefore, an entity treats such payments as contributions to a defined contribution plan.

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Post-employment benefits: defined contribution plans

43 Accounting for defined contribution plans is straightforward because the reporting entity's obligation for each period is determined by the amounts to be contributed for that period. Consequently, no actuarial assumptions are required to measure the obligation or the expense and there is no possibility of any actuarial gain or loss. Moreover, the obligations are measured on an undiscounted basis, except where they do not fall due wholly within twelve months after the end of the period in which the employees render the related service.

Recognition and measurement

44 When an employee has rendered service to an entity during a period, the entity shall recognise the contribution payable to a defined contribution plan in exchange for that service:

(a) as a liability (accrued expense), after deducting any contribution already paid. If the contribution already paid exceeds the contribution due for service before the ~~balance sheet date~~end of the reporting period, an entity shall recognise that excess as an asset (prepaid expense) to the extent that the prepayment will lead to, for example, a reduction in future payments or a cash refund; and

(b) as an expense, unless another Standard requires or permits the inclusion of the contribution in the cost of an asset (see, for example, HKAS 2, *Inventories***, and HKAS 16,** *Property, Plant and Equipment***).**

45 Where contributions to a defined contribution plan do not fall due wholly within twelve months after the end of the period in which the employees render the related service, they shall be discounted using the discount rate specified in paragraph 78.

Disclosure

46 An entity shall disclose the amount recognised as an expense for defined contribution plans.

47 Where required by HKAS 24 an entity discloses information about contributions to defined contribution plans for key management personnel.

Post-employment benefits: defined benefit plans

48 Accounting for defined benefit plans is complex because actuarial assumptions are required to measure the obligation and the expense and there is a possibility of actuarial gains and losses. Moreover, the obligations are measured on a discounted basis because they may be settled many years after the employees render the related service.

Recognition and measurement

49 Defined benefit plans may be unfunded, or they may be wholly or partly funded by contributions by an entity, and sometimes its employees, into an entity, or fund, that is legally separate from the reporting entity and from which the employee benefits are paid. The payment of funded benefits when they fall due depends not only on the financial position and the investment performance of the fund but also on an entity's ability (and willingness) to make good any shortfall in the fund's assets. Therefore, the entity is, in substance, underwriting the actuarial and investment risks associated with the plan. Consequently, the expense recognised for a defined benefit plan is not necessarily the amount of the contribution due for the period.

50 Accounting by an entity for defined benefit plans involves the following steps:

(a) using actuarial techniques to make a reliable estimate of the amount of benefit that employees have earned in return for their service in the current and prior periods. This requires an entity to determine how much benefit is attributable to the current and prior periods (see paragraphs 67 - 71) and to make estimates (actuarial assumptions) about demographic variables (such as employee turnover and mortality) and financial variables (such as future increases in salaries and medical costs) that will influence the cost of the benefit (see paragraphs 72 - 91);

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(b) discounting that benefit using the Projected Unit Credit Method in order to determine the present value of the defined benefit obligation and the current service cost (see paragraphs 64 - 66);

(c) determining the fair value of any plan assets (see paragraphs 102 -104);

(d) determining the total amount of actuarial gains and losses and the amount of those actuarial gains and losses to be recognised (see paragraphs 92 - 95);

(e) where a plan has been introduced or changed, determining the resulting past service cost (see paragraphs 96 - 101); and

(f) where a plan has been curtailed or settled, determining the resulting gain or loss (see paragraphs 109 - 115).

Where an entity has more than one defined benefit plan, the entity applies these procedures for each material plan separately.

51 In some cases, estimates, averages and computational shortcuts may provide a reliable approximation of the detailed computations illustrated in this Standard.

Accounting for the constructive obligation

52 An entity shall account not only for its legal obligation under the formal terms of a defined benefit plan, but also for any constructive obligation that arises from the entity's informal practices. Informal practices give rise to a constructive obligation where the entity has no realistic alternative but to pay employee benefits. An example of a constructive obligation is where a change in the entity's informal practices would cause unacceptable damage to its relationship with employees.

53 The formal terms of a defined benefit plan may permit an entity to terminate its obligation under the plan. Nevertheless, it is usually difficult for an entity to cancel a plan if employees are to be retained. Therefore, in the absence of evidence to the contrary, accounting for post-employment benefits assumes that an entity which is currently promising such benefits will continue to do so over the remaining working lives of employees.

~~Balance sheet~~Statement of financial position

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~~end of the reporting period (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~~end of the reporting period date of plan assets (if any) out of which the obligations are to be settled directly (see paragraphs 102 - 104).

55 The present value of the defined benefit obligation is the gross obligation, before deducting the fair value of any plan assets.

56 An entity shall determine the present value of defined benefit obligations and the fair value of any plan assets with sufficient regularity that the amounts recognised in the financial statements do not differ materially from the amounts that would be determined at the ~~balance sheet date~~end of the reporting period.

57 This Standard encourages, but does not require, an entity to involve a qualified actuary in the measurement of all material post-employment benefit obligations. For practical reasons, an entity may request a qualified actuary to carry out a detailed valuation of the obligation before the ~~balance sheet date~~end of the reporting period. Nevertheless, the results of that valuation are updated for any material transactions and other material changes in circumstances

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(including changes in market prices and interest rates) up to the ~~balance sheet date~~end of the reporting period.

58 **The amount determined under paragraph 54 may be negative (an asset). An entity shall measure the resulting asset at the lower of:**

(a) **the amount determined under paragraph 54; and**

(b) **total of:**

(i) **any cumulative unrecognised net actuarial losses and past service cost (see paragraphs 92, 93 and 96); and**

(ii) **the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan. The present value of these economic benefits shall be determined using the discount rate specified in paragraph 78.**

58A **The application of paragraph 58 shall not result in a gain being recognised solely as a result of an actuarial loss or past service cost in the current period or in a loss being recognised solely as a result of an actuarial gain in the current period. The entity shall therefore recognise immediately under paragraph 54 the following, to the extent that they arise while the defined benefit asset is determined in accordance with paragraph 58(b):**

(a) **net actuarial losses of the current period and past service cost of the current period to the extent that they exceed any reduction in the present value of the economic benefits specified in paragraph 58(b)(ii). If there is no change or an increase in the present value of the economic benefits, the entire net actuarial losses of the current period and past service cost of the current period shall be recognised immediately under paragraph 54.**

(b) **net actuarial gains of the current period after the deduction of past service cost of the current period to the extent that they exceed any increase in the present value of the economic benefits specified in paragraph 58(b)(ii). If there is no change or a decrease in the present value of the economic benefits, the entire net actuarial gains of the current period after the deduction of past service cost of the current period shall be recognised immediately under paragraph 54.**

58B Paragraph 58A applies to an entity only if it has, at the beginning or end of the accounting period, a surplus[*] in a defined benefit plan and cannot, based on the current terms of the plan, recover that surplus fully through refunds or reductions in future contributions. In such cases, past service cost and actuarial losses that arise in the period, the recognition of which is deferred under paragraph 54, will increase the amount specified in paragraph 58(b)(i). If that increase is not offset by an equal decrease in the present value of economic benefits that qualify for recognition under paragraph 58(b)(ii), there will be an increase in the net total specified by paragraph 58(b) and, hence, a recognised gain. Paragraph 58A prohibits the recognition of a gain in these circumstances. The opposite effect arises with actuarial gains that arise in the period, the recognition of which is deferred under paragraph 54, to the extent that the actuarial gains reduce cumulative unrecognised actuarial losses. Paragraph 58A prohibits the recognition of a loss in these circumstances. For examples of the application of this paragraph, see Appendix C.

59 An asset may arise where a defined benefit plan has been overfunded or in certain cases where actuarial gains are recognised. An entity recognises an asset in such cases because:

(a) the entity controls a resource, which is the ability to use the surplus to generate future benefits;

(b) that control is a result of past events (contributions paid by the entity and service rendered by the employee); and

(c) future economic benefits are available to the entity in the form of a reduction in future contributions or a cash refund, either directly to the entity or indirectly to another plan in deficit.

[*] A surplus is an excess of the fair value of the plan assets over the present value of the defined benefit obligation.

60 The limit in paragraph 58(b) does not over-ride the delayed recognition of certain actuarial losses (see paragraphs 92 and 93) and certain past service cost (see paragraph 96), other than as specified in paragraph 58A. However, that limit does over-ride the transitional option in paragraph 155(b). Paragraph 120A(f)(iii) requires an entity to disclose any amount not recognised as an asset because of the limit in paragraph 58(b).

Example illustrating paragraph 60

A defined benefit plan has the following characteristics:

Present value of the obligation	1,100
Fair value of plan assets	(1,190)
	(90)
Unrecognised actuarial losses	(110)
Unrecognised past service cost	(70)
Unrecognised increase in the liability on initial adoption of the Standard under paragraph 155(b)	(50)
Negative amount determined under paragraph 54	(320)
Present value of available future refunds and reductions in future contributions	90

The limit under paragraph 58(b) is computed as follows:

Unrecognised actuarial losses	*110*
Unrecognised past service cost	*70*
Present value of available future refunds and reductions in future contributions	*90*
Limit	*270*

270 is less than 320. Therefore, the entity recognises an asset of 270 and discloses that the limit reduced the carrying amount of the asset by 50 (see paragraph120A(f)(iii)).

Profit or loss

61 An entity shall recognise the net total of the following amounts in profit or loss, except to the extent that another Standard requires or permits their inclusion in the cost of an asset:

(a) current service cost (see paragraphs 63 - 91);

(b) interest cost (see paragraph 82);

(c) the expected return on any plan assets (see paragraphs 105 - 107) and on any reimbursement rights (see paragraph 104A);

(d) actuarial gains and losses, as required in accordance with the entity's accounting policy (see paragraphs 92 -93D);

(e) past service cost (see paragraph 96);

(f) the effect of any curtailments or settlements (see paragraphs 109 and 110); and

(g) the effect of the limit in paragraph 58(b), unless it is recognised outside profit or loss in accordance with paragraph 93C.

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62 Other Standards require the inclusion of certain employee benefit costs within the cost of assets such as inventories or property, plant and equipment (see HKAS 2 and HKAS 16). Any post-employment benefit costs included in the cost of such assets include the appropriate proportion of the components listed in paragraph 61.

Recognition and measurement: present value of defined benefit obligations and current service cost

63 The ultimate cost of a defined benefit plan may be influenced by many variables, such as final salaries, employee turnover and mortality, medical cost trends and, for a funded plan, the investment earnings on the plan assets. The ultimate cost of the plan is uncertain and this uncertainty is likely to persist over a long period of time. In order to measure the present value of the post-employment benefit obligations and the related current service cost, it is necessary to:

(a) apply an actuarial valuation method (see paragraphs 64 - 66);

(b) attribute benefit to periods of service (see paragraphs 67 - 71); and

(c) make actuarial assumptions (see paragraphs 72 - 91).

Actuarial valuation method

64 An entity shall use the Projected Unit Credit Method to determine the present value of its defined benefit obligations and the related current service cost and, where applicable, past service cost.

65 The Projected Unit Credit Method (sometimes known as the accrued benefit method pro-rated on service or as the benefit/years of service method) sees each period of service as giving rise to an additional unit of benefit entitlement (see paragraphs 67 - 71) and measures each unit separately to build up the final obligation (see paragraphs 72 - 91).

Example illustrating paragraph 65

A lump sum benefit is payable on termination of service and equal to 1% of final salary for each year of service. The salary in year 1 is 10,000 and is assumed to increase at 7% (compound) each year. The discount rate used is 10% per year. The following table shows how the obligation builds up for an employee who is expected to leave at the end of year 5, assuming that there are no changes in actuarial assumptions. For simplicity, this example ignores the additional adjustment needed to reflect the probability that the employee may leave the entity at an earlier or later date.

Year	*1*	*2*	*3*	*4*	*5*
Benefit attributed to:					
- prior years	*0*	*131*	*262*	*393*	*524*
- current year					
(1% of final salary)	*131*	*131*	*131*	*131*	*131*
- current and prior years	*131*	*262*	*393*	*524*	*655*
Opening Obligation	-	*89*	*196*	*324*	*476*
Interest at 10%	-	*9*	*20*	*33*	*48*
Current Service Cost	*89*	*98*	*108*	*119*	*131*
Closing Obligation	*89*	*196*	*324*	*476*	*655*

Note:
1. The opening obligation is the present value of benefit attributed to prior years.
2. The current service cost is the present value of benefit attributed to the current year.
3. The closing obligation is the present value of benefit attributed to current and prior years.

66 An entity discounts the whole of a post-employment benefit obligation, even if part of the obligation falls due within twelve months of the ~~balance sheet date~~reporting period.

Attributing benefit to periods of service

67 In determining the present value of its defined benefit obligations and the related current service cost and, where applicable, past service cost, an entity shall attribute benefit to periods of service under the plan's benefit formula. However, if an employee's service in later years will lead to a materially higher level of benefit than in earlier years, an entity shall attribute benefit on a straight-line basis from:

(a) the date when service by the employee first leads to benefits under the plan (whether or not the benefits are conditional on further service); until

(b) the date when further service by the employee will lead to no material amount of further benefits under the plan, other than from further salary increases.

68 The Projected Unit Credit Method requires an entity to attribute benefit to the current period (in order to determine current service cost) and the current and prior periods (in order to determine the present value of defined benefit obligations). An entity attributes benefit to periods in which the obligation to provide post-employment benefits arises. That obligation arises as employees render services in return for post-employment benefits which an entity expects to pay in future reporting periods. Actuarial techniques allow an entity to measure that obligation with sufficient reliability to justify recognition of a liability.

Examples illustrating paragraph 68

1. A defined benefit plan provides a lump-sum benefit of 100 payable on retirement for each year of service.

A benefit of 100 is attributed to each year. The current service cost is the present value of 100. The present value of the defined benefit obligation is the present value of 100, multiplied by the number of years of service up to the ~~balance sheet date~~end of the reporting period.

If the benefit is payable immediately when the employee leaves the entity, the current service cost and the present value of the defined benefit obligation reflect the date at which the employee is expected to leave. Thus, because of the effect of discounting, they are less than the amounts that would be determined if the employee left at the ~~balance sheet date~~end of the reporting period.

2. A plan provides a monthly pension of 0.2% of final salary for each year of service. The pension is payable from the age of 65.

Benefit equal to the present value, at the expected retirement date, of a monthly pension of 0.2% of the estimated final salary payable from the expected retirement date until the expected date of death is attributed to each year of service. The current service cost is the present value of that benefit. The present value of the defined benefit obligation is the present value of monthly pension payments of 0.2% of final salary, multiplied by the number of years of service up to the ~~balance sheet date~~end of the reporting period. The current service cost and the present value of the defined benefit obligation are discounted because pension payments begin at the age of 65.

69 Employee service gives rise to an obligation under a defined benefit plan even if the benefits are conditional on future employment (in other words they are not vested). Employee service before the vesting date gives rise to a constructive obligation because, ~~at each successive balance sheet date~~at the end of each successive reporting period, the amount of future service that an employee will have to render before becoming entitled to the benefit is reduced. In measuring its defined benefit obligation, an entity considers the probability that some employees may not satisfy any vesting requirements. Similarly, although certain post-employment benefits, for example post-employment medical benefits, become payable only if a specified event occurs when an employee is no longer employed, an obligation is created when the employee renders service that will provide entitlement to the benefit if the specified event occurs. The probability that the specified event will occur affects the measurement of the obligation, but does not determine whether the obligation exists.

Examples illustrating paragraph 69

1. A plan pays a benefit of 100 for each year of service. The benefits vest after ten years of service.

   A benefit of 100 is attributed to each year. In each of the first ten years, the current service cost and the present value of the obligation reflect the probability that the employee may not complete ten years of service.

2. A plan pays a benefit of 100 for each year of service, excluding service before the age of 25. The benefits vest immediately.

   No benefit is attributed to service before the age of 25 because service before that date does not lead to benefits (conditional or unconditional). A benefit of 100 is attributed to each subsequent year.

70 The obligation increases until the date when further service by the employee will lead to no material amount of further benefits. Therefore, all benefit is attributed to periods ending on or before that date. Benefit is attributed to individual accounting periods under the plan's benefit formula. However, if an employee's service in later years will lead to a materially higher level of benefit than in earlier years, an entity attributes benefit on a straight-line basis until the date when further service by the employee will lead to no material amount of further benefits. That is because the employee's service throughout the entire period will ultimately lead to benefit at that higher level.

Examples illustrating paragraph 70

1. A plan pays a lump-sum benefit of 1,000 that vests after ten years of service. The plan provides no further benefit for subsequent service.

   A benefit of 100 (1,000 divided by ten) is attributed to each of the first ten years. The current service cost in each of the first ten years reflects the probability that the employee may not complete ten years of service. No benefit is attributed to subsequent years.

2. A plan pays a lump-sum retirement benefit of 2,000 to all employees who are still employed at the age of 55 after twenty years of service, or who are still employed at the age of 65, regardless of their length of service.

   For employees who join before the age of 35, service first leads to benefits under the plan at the age of 35 (an employee could leave at the age of 30 and return at the age of 33, with no effect on the amount or timing of benefits). Those benefits are conditional on further service. Also, service beyond the age of 55 will lead to no material amount of further benefits. For these employees, the entity attributes benefit of 100 (2,000 divided by 20) to each year from the age of 35 to the age of 55.

   For employees who join between the ages of 35 and 45, service beyond twenty years will lead to no material amount of further benefits. For these employees, the entity attributes benefit of 100 (2,000 divided by 20) to each of the first twenty years.

   For an employee who joins at the age of 55, service beyond ten years will lead to no material amount of further benefits. For this employee, the entity attributes benefit of 200 (2,000 divided by 10) to each of the first ten years.

   For all employees, the current service cost and the present value of the obligation reflect the probability that the employee may not complete the necessary period of service.

Continued…

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Examples illustrating paragraph 70

3. A post-employment medical plan reimburses 40% of an employee's post-employment medical costs if the employee leaves after more than ten and less than twenty years of service and 50% of those costs if the employee leaves after twenty or more years of service.

   Under the plan's benefit formula, the entity attributes 4% of the present value of the expected medical costs (40% divided by ten) to each of the first ten years and 1% (10% divided by ten) to each of the second ten years. The current service cost in each year reflects the probability that the employee may not complete the necessary period of service to earn part or all of the benefits. For employees expected to leave within ten years, no benefit is attributed.

4. A post-employment medical plan reimburses 10% of an employee's post-employment medical costs if the employee leaves after more than ten and less than twenty years of service and 50% of those costs if the employee leaves after twenty or more years of service.

   Service in later years will lead to a materially higher level of benefit than in earlier years. Therefore, for employees expected to leave after twenty or more years, the entity attributes benefit on a straight-line basis under paragraph 68. Service beyond twenty years will lead to no material amount of further benefits. Therefore, the benefit attributed to each of the first twenty years is 2.5% of the present value of the expected medical costs (50% divided by twenty).

   For employees expected to leave between ten and twenty years, the benefit attributed to each of the first ten years is 1% of the present value of the expected medical costs. For these employees, no benefit is attributed to service between the end of the tenth year and the estimated date of leaving.

   For employees expected to leave within ten years, no benefit is attributed.

71 Where the amount of a benefit is a constant proportion of final salary for each year of service, future salary increases will affect the amount required to settle the obligation that exists for service before the ~~balance sheet date~~end of the reporting period, but do not create an additional obligation. Therefore:

(a) for the purpose of paragraph 67(b), salary increases do not lead to further benefits, even though the amount of the benefits is dependent on final salary; and

(b) the amount of benefit attributed to each period is a constant proportion of the salary to which the benefit is linked.

Example illustrating paragraph 71

Employees are entitled to a benefit of 3% of final salary for each year of service before the age of 55.

Benefit of 3% of estimated final salary is attributed to each year up to the age of 55. This is the date when further service by the employee will lead to no material amount of further benefits under the plan. No benefit is attributed to service after that age.

Actuarial assumptions

72 Actuarial assumptions shall be unbiased and mutually compatible.

73 Actuarial assumptions are an entity's best estimates of the variables that will determine the ultimate cost of providing post-employment benefits. Actuarial assumptions comprise:

(a) demographic assumptions about the future characteristics of current and former employees (and their dependants) who are eligible for benefits. Demographic assumptions deal with matters such as:

  (i) mortality, both during and after employment;

  (ii) rates of employee turnover, disability and early retirement;

  (iii) the proportion of plan members with dependants who will be eligible for benefits; and

  (iv) claim rates under medical plans; and

(b) financial assumptions, dealing with items such as:

  (i) the discount rate (see paragraphs 78 - 82);

  (ii) future salary and benefit levels (see paragraphs 83 - 87);

  (iii) in the case of medical benefits, future medical costs, including, where material, the cost of administering claims and benefit payments (see paragraphs 88 - 91); and

  (iv) the expected rate of return on plan assets (see paragraphs 105-107).

74 Actuarial assumptions are unbiased if they are neither imprudent nor excessively conservative.

75 Actuarial assumptions are mutually compatible if they reflect the economic relationships between factors such as inflation, rates of salary increase, the return on plan assets and discount rates. For example, all assumptions which depend on a particular inflation level (such as assumptions about interest rates and salary and benefit increases) in any given future period assume the same inflation level in that period.

76 An entity determines the discount rate and other financial assumptions in nominal (stated) terms, unless estimates in real (inflation-adjusted) terms are more reliable, for example, in a hyper-inflationary economy (see HKAS 29 *Financial Reporting in Hyperinflationary Economies*), or where the benefit is index-linked and there is a deep market in index-linked bonds of the same currency and term.

77 Financial assumptions shall be based on market expectations, at the ~~balance sheet date~~end of the reporting period, for the period over which the obligations are to be settled.

Actuarial assumptions: discount rate

78 The rate used to discount post-employment benefit obligations (both funded and unfunded) shall be determined by reference to market yields at the ~~balance sheet date~~end of the reporting period on high quality corporate bonds. In countries where there is no deep market in such bonds, the market yields (at the ~~balance sheet date~~end of the reporting period) on government bonds shall be used. The currency and term of the corporate bonds or government bonds shall be consistent with the currency and estimated term of the post-employment benefit obligations.

79 One actuarial assumption which has a material effect is the discount rate. The discount rate reflects the time value of money but not the actuarial or investment risk. Furthermore, the discount rate does not reflect the entity-specific credit risk borne by the entity's creditors, nor does it reflect the risk that future experience may differ from actuarial assumptions.

80 The discount rate reflects the estimated timing of benefit payments. In practice, an entity often achieves this by applying a single weighted average discount rate that reflects the estimated timing and amount of benefit payments and the currency in which the benefits are to be paid.

81 In some cases, there may be no deep market in bonds with a sufficiently long maturity to match the estimated maturity of all the benefit payments. In such cases, an entity uses current market rates of the appropriate term to discount shorter term payments, and estimates the discount rate for longer maturities by extrapolating current market rates along the yield curve. The total present value of a defined benefit obligation is unlikely to be particularly sensitive to the

discount rate applied to the portion of benefits that is payable beyond the final maturity of the available corporate or government bonds.

82 Interest cost is computed by multiplying the discount rate as determined at the start of the period by the present value of the defined benefit obligation throughout that period, taking account of any material changes in the obligation. The present value of the obligation will differ from the liability recognised in the ~~balance sheet~~statement of financial position because the liability is recognised after deducting the fair value of any plan assets and because some actuarial gains and losses, and some past service cost, are not recognised immediately. [Appendix A illustrates the computation of interest cost, among other things.]

Actuarial assumptions: salaries, benefits and medical costs

83 Post-employment benefit obligations shall be measured on a basis that reflects:

(a) estimated future salary increases;

(b) the benefits set out in the terms of the plan (or resulting from any constructive obligation that goes beyond those terms) at the ~~balance sheet date~~end of the reporting period; and

(c) estimated future changes in the level of any state benefits that affect the benefits payable under a defined benefit plan, if, and only if, either:

(i) those changes were enacted before the ~~balance sheet date~~end of the reporting period; or

(ii) past history, or other reliable evidence, indicates that those state benefits will change in some predictable manner, for example, in line with future changes in general price levels or general salary levels.

84 Estimates of future salary increases take account of inflation, seniority, promotion and other relevant factors, such as supply and demand in the employment market.

85 If the formal terms of a plan (or a constructive obligation that goes beyond those terms) require an entity to change benefits in future periods, the measurement of the obligation reflects those changes. This is the case when, for example:

(a) the entity has a past history of increasing benefits, for example, to mitigate the effects of inflation, and there is no indication that this practice will change in the future; or

(b) actuarial gains have already been recognised in the financial statements and the entity is obliged, by either the formal terms of a plan (or a constructive obligation that goes beyond those terms) or legislation, to use any surplus in the plan for the benefit of plan participants (see paragraph 98(c)).

86 Actuarial assumptions do not reflect future benefit changes that are not set out in the formal terms of the plan (or a constructive obligation) at the ~~balance sheet date~~end of the reporting period. Such changes will result in:

(a) past service cost, to the extent that they change benefits for service before the change; and

(b) current service cost for periods after the change, to the extent that they change benefits for service after the change.

87 Some post-employment benefits are linked to variables such as the level of state retirement benefits or state medical care. The measurement of such benefits reflects expected changes in such variables, based on past history and other reliable evidence.

88 Assumptions about medical costs shall take account of estimated future changes in the cost of medical services, resulting from both inflation and specific changes in medical costs.

89 Measurement of post-employment medical benefits requires assumptions about the level and frequency of future claims and the cost of meeting those claims. An entity estimates future medical costs on the basis of historical data about the entity's own experience, supplemented

where necessary by historical data from other entities, insurance companies, medical providers or other sources. Estimates of future medical costs consider the effect of technological advances, changes in health care utilisation or delivery patterns and changes in the health status of plan participants.

90 The level and frequency of claims is particularly sensitive to the age, health status and sex of employees (and their dependants) and may be sensitive to other factors such as geographical location. Therefore, historical data is adjusted to the extent that the demographic mix of the population differs from that of the population used as a basis for the historical data. It is also adjusted where there is reliable evidence that historical trends will not continue.

91 Some post-employment health care plans require employees to contribute to the medical costs covered by the plan. Estimates of future medical costs take account of any such contributions, based on the terms of the plan at the ~~balance sheet date~~end of the reporting period (or based on any constructive obligation that goes beyond those terms). Changes in those employee contributions result in past service cost or, where applicable, curtailments. The cost of meeting claims may be reduced by benefits from state or other medical providers (see paragraphs 83(c) and 87).

Actuarial gains and losses

92 In measuring its defined benefit liability in accordance with paragraph 54, an entity shall, subject to paragraph 58A, recognise a portion (as specified in paragraph 93) of its actuarial gains and losses as income or expense if the net cumulative unrecognised actuarial gains and losses at the end of the previous reporting period exceeded the greater of:

(a) 10% of the present value of the defined benefit obligation at that date (before deducting plan assets); and

(b) 10% of the fair value of any plan assets at that date.

These limits shall be calculated and applied separately for each defined benefit plan.

93 The portion of actuarial gains and losses to be recognised for each defined benefit plan is the excess determined in accordance with paragraph 92, divided by the expected average remaining working lives of the employees participating in that plan. However, an entity may adopt any systematic method that results in faster recognition of actuarial gains and losses, provided that the same basis is applied to both gains and losses and the basis is applied consistently from period to period. An entity may apply such systematic methods to actuarial gains and losses even if they are within the limits specified in paragraph 92.

93A If, as permitted by paragraph 93, an entity adopts a policy of recognising actuarial gains and losses in the period in which they occur, it may recognise them ~~outside profit or loss~~in other comprehensive income, in accordance with paragraphs 93B-93D, providing ~~it does so for:~~

(a) all of its defined benefit plans; and

(b) all of its actuarial gains and losses.

93B Actuarial gains and losses recognised ~~outside profit or loss~~in other comprehensive income as permitted by paragraph 93A shall be presented in ~~a~~ the statement of comprehensive income.~~changes in equity titled 'statement of recognised income and expense' that comprises only the items specified in paragraph 96 of HKAS 1. The entity shall not present the actuarial gains and losses in a statement of changes in equity in the columnar format referred to in paragraph 101 of HKAS 1 or any other format that includes the items specified in paragraph 97 of HKAS 1.~~

93C An entity that recognises actuarial gains and losses in accordance with paragraph 93A shall also recognise any adjustments arising from the limit in paragraph 58(b) in other comprehensive income~~outside profit or loss in the statement of recognised income and expense.~~

93D Actuarial gains and losses and adjustments arising from the limit in paragraph 58(b) that have been recognised ~~directly in the statement of recognised income and expense~~in other comprehensive income shall be recognised immediately in retained earnings. They shall not be ~~recognised in~~reclassified to profit or loss in a subsequent period.

94 Actuarial gains and losses may result from increases or decreases in either the present value of a defined benefit obligation or the fair value of any related plan assets. Causes of actuarial gains and losses include, for example:

(a) unexpectedly high or low rates of employee turnover, early retirement or mortality or of increases in salaries, benefits (if the formal or constructive terms of a plan provide for inflationary benefit increases) or medical costs;

(b) the effect of changes in estimates of future employee turnover, early retirement or mortality or of increases in salaries, benefits (if the formal or constructive terms of a plan provide for inflationary benefit increases) or medical costs;

(c) the effect of changes in the discount rate; and

(d) differences between the actual return on plan assets and the expected return on plan assets (see paragraphs 105–107).

95 In the long term, actuarial gains and losses may offset one another. Therefore, estimates of post-employment benefit obligations may be viewed as a range (or ‘corridor’) around the best estimate. An entity is permitted, but not required, to recognise actuarial gains and losses that fall within that range. This Standard requires an entity to recognise, as a minimum, a specified portion of the actuarial gains and losses that fall outside a 'corridor' of plus or minus 10%. [Appendix A illustrates the treatment of actuarial gains and losses, among other things] The Standard also permits systematic methods of faster recognition, provided that those methods satisfy the conditions set out in paragraph 93. Such permitted methods include, for example, immediate recognition of all actuarial gains and losses, both within and outside the 'corridor'. Paragraph 155(b)(iii) explains the need to consider any unrecognised part of the transitional liability in accounting for subsequent actuarial gains.

Past service cost

96 In measuring its defined benefit liability under paragraph 54, an entity shall, subject to paragraph 58A, recognise past service cost as an expense on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits are already vested immediately following the introduction of, or changes to, a defined benefit plan, an entity shall recognise past service cost immediately.

97 Past service cost arises when an entity introduces a defined benefit plan that attributes benefits to past service or changes the benefits payable for past service under an existing defined benefit plan. Such changes are in return for employee service over the period until the benefits concerned are vested. Therefore, the entity recognises past service cost ~~is recognised~~ over that period, regardless of the fact that the cost refers to employee service in previous periods. The entity measures ~~P~~past service cost ~~is measured~~ as the change in the liability resulting from the amendment (see paragraph 64). Negative past service cost arise when an entity changes the benefits attributable to past service so that the present value of the defined benefit obligation decreases.

Example illustrating paragraph 97

An entity operates a pension plan that provides a pension of 2% of final salary for each year of service. The benefits become vested after five years of service. On 1 January 20X5 the entity improves the pension to 2.5% of final salary for each year of service starting from 1 January 20X1. At the date of the improvement, the present value of the additional benefits for service from 1 January 20X1 to 1 January 20X5 is as follows:

Employees with more than five years' service at 1/1/X5	150
Employees with less than five years' service at 1/1/X5 (average period until vesting: three years)	120
	270

The entity recognises 150 immediately because those benefits are already vested. The entity recognises 120 on a straight-line basis over three years from 1 January 20X5.

98 Past service cost excludes:

(a) the effect of differences between actual and previously assumed salary increases on the obligation to pay benefits for service in prior years (there is no past service cost because actuarial assumptions allow for projected salaries);

(b) underestimates and overestimates of discretionary pension increases whenre an entity has a constructive obligation to grant such increases (there is no past service cost because actuarial assumptions allow for such increases);

(c) estimates of benefit improvements that result from actuarial gains that have ~~already~~ been recognised in the financial statements if the entity is obliged, by either the formal terms of a plan (or a constructive obligation that goes beyond those terms) or legislation, to use any surplus in the plan for the benefit of plan participants, even if the benefit increase has not yet been formally awarded (the resulting increase in the obligation is an actuarial loss and not past service cost, see paragraph 85(b));

(d) the increase in vested benefits when, in the absence of new or improved benefits, employees complete vesting requirements (there is no past service cost because the entity recognised the estimated cost of benefits ~~was recognised~~ as current service cost as the service was rendered); and

(e) the effect of plan amendments that reduce benefits for future service (a curtailment).

99 An entity establishes the amortisation schedule for past service cost when the benefits are introduced or changed. It would be impracticable to maintain the detailed records needed to identify and implement subsequent changes in that amortisation schedule. Moreover, the effect is likely to be material only where there is a curtailment or settlement. Therefore, an entity amends the amortisation schedule for past service cost only if there is a curtailment or settlement.

100 Where an entity reduces benefits payable under an existing defined benefit plan, the resulting reduction in the defined benefit liability is recognised as (negative) past service cost over the average period until the reduced portion of the benefits becomes vested.

101 Where an entity reduces certain benefits payable under an existing defined benefit plan and, at the same time, increases other benefits payable under the plan for the same employees, the entity treats the change as a single net change.

Recognition and measurement: plan assets

Fair value of plan assets

102 The fair value of any plan assets is deducted in determining the amount recognised in the ~~balance sheet~~statement of financial position 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).

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Reimbursements

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 of comprehensive income, 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.

Example illustrating paragraphs 104A-104C	
Present value of obligation	1,241
Unrecognised actuarial gains	17
Liability recognised in ~~balance sheet~~ statement of financial position	1,258 ====
Rights under insurance policies that exactly match the amount and timing of some of the benefits payable under the plan. Those benefits have a present value of 1,092.	1,092 ====

The unrecognised actuarial gains of 17 are the net cumulative actuarial gains on the obligation and on the reimbursement rights.

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).

Return on plan assets

105 The expected return on plan assets is one component of the expense recognised in ~~the income statement~~profit or loss. The difference between the expected return on plan assets and the actual return on plan assets is an actuarial gain or loss; it is included with the actuarial gains and losses on the defined benefit obligation in determining the net amount that is compared with the limits of the 10% 'corridor' specified in paragraph 92.

106 The expected return on plan assets is based on market expectations, at the beginning of the period, for returns over the entire life of the related obligation. The expected return on plan assets reflects changes in the fair value of plan assets held during the period as a result of actual contributions paid into the fund and actual benefits paid out of the fund.

Example illustrating paragraph 106

At 1 January 20X1, the fair value of plan assets was 10,000 and net cumulative unrecognised actuarial gains were 760. On 30 June 20X1, the plan paid benefits of 1,900 and received contributions of 4,900. At 31 December 20X1, the fair value of plan assets was 15,000 and the present value of the defined benefit obligation was 14,792. Actuarial losses on the obligation for 20X1 were 60.

At 1 January 20X1, the reporting entity made the following estimates, based on market prices at that date:

	%
Interest and dividend income, after tax payable by the fund	9.25
Realised and unrealised gains on plan assets (after tax)	2.00
Administration costs	(1.00)
Expected rate of return	10.25

For 20X1, the expected and actual return on plan assets are as follows:

Return on 10,000 held for 12 months at 10.25%	1,025
Return on 3,000 held for six months at 5% (equivalent to 10.25% annually, compounded every six months)	150
Expected return on plan assets for 20X1	1,175
Fair value of plan assets at 31 December 20X1	15,000
Less fair value of plan assets at 1 January 20X1	(10,000)
Less contributions received	(4,900)
Add benefits paid	*1,900*
Actual return on plan assets	*2,000*

The difference between the expected return on plan assets (1,175) and the actual return on plan assets (2,000) is an actuarial gain of 825. Therefore, the cumulative net unrecognised actuarial gains are 1,525 (760 plus 825 less 60). Under paragraph 92, the limits of the corridor are set at 1,500 (greater of: (i) 10% of 15,000 and (ii) 10% of 14,792). In the following year (20X2), the entity recognises in ~~the income statement~~profit or loss an actuarial gain of 25 (1,525 less 1,500) divided by the expected average remaining working life of the employees concerned.

The expected return on plan assets for 20X2 will be based on market expectations at 1/1/X2 for returns over the entire life of the obligation.

107 In determining the expected and actual return on plan assets, an entity deducts expected administration costs, other than those included in the actuarial assumptions used to measure the obligation.

Business combinations

108 In a business combination, an entity recognises assets and liabilities arising from post-employment benefits at the present value of the obligation less the fair value of any plan assets (see HKFRS 3 *Business Combinations*). The present value of the obligation includes all of the following, even if the acquiree had not yet recognised them at the acquisition date:

(a) actuarial gains and losses that arose before the acquisition date (whether or not they fell inside the 10% 'corridor');

(b) past service cost that arose from benefit changes, or the introduction of a plan, before the acquisition date; and

(c) amounts that, under the transitional provisions of paragraph 155(b), the acquiree had not recognised.

Curtailments and settlements

109 An entity shall recognise gains or losses on the curtailment or settlement of a defined benefit plan when the curtailment or settlement occurs. The gain or loss on a curtailment or settlement shall comprise:

(a) any resulting change in the present value of the defined benefit obligation;

(b) any resulting change in the fair value of the plan assets;

(c) any related actuarial gains and losses and past service cost that, under paragraphs 92 and 96, had not previously been recognised.

110 Before determining the effect of a curtailment or settlement, an entity shall remeasure the obligation (and the related plan assets, if any) using current actuarial assumptions (including current market interest rates and other current market prices).

111 A curtailment occurs when an entity either:

(a) is demonstrably committed to make a ~~material~~ significant reduction in the number of employees covered by a plan; or

(b) amends the terms of a defined benefit plan ~~such~~ so that a ~~material~~ significant element of future service by current employees will no longer qualify for benefits, or will qualify only for reduced benefits.

A curtailment may arise from an isolated event, such as the closing of a plant, discontinuance of an operation or termination or suspension of a plan, or a reducation in the extent to which future salary increases are linked to the benefits payable for past service. ~~An event is material enough to qualify as a curtailment if the recognition of a curtailment gain or loss would have a material effect on the financial statements.~~ Curtailments are often linked with a restructuring. ~~Therefore~~When this is the case, an entity accounts for a curtailment at the same time as for a related restructuring.

111A When a plan amendment reduces benefits, only the effect of the reduction for future service is a curtailment. The effect of any reduction for past service is a negative past service cost.

112 A settlement occurs when an entity enters into a transaction that eliminates all further legal or constructive obligation for part or all of the benefits provided under a defined benefit plan, for example, when a lump-sum cash payment is made to, or on behalf of, plan participants in exchange for their rights to receive specified post-employment benefits.

113 In some cases, an entity acquires an insurance policy to fund some or all of the employee benefits relating to employee service in the current and prior periods. The acquisition of such a policy is not a settlement if the entity retains a legal or constructive obligation (see paragraph 39) to pay further amounts if the insurer does not pay the employee benefits specified in the insurance policy. Paragraphs 104A - D deal with the recognition and measurement of reimbursement rights under insurance policies that are not plan assets.

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114 A settlement occurs together with a curtailment if a plan is terminated such that the obligation is settled and the plan ceases to exist. However, the termination of a plan is not a curtailment or settlement if the plan is replaced by a new plan that offers benefits that are, in substance, identical.

115 Where a curtailment relates to only some of the employees covered by a plan, or where only part of an obligation is settled, the gain or loss includes a proportionate share of the previously unrecognised past service cost and actuarial gains and losses (and of transitional amounts remaining unrecognised under paragraph 155(b)). The proportionate share is determined on the basis of the present value of the obligations before and after the curtailment or settlement, unless another basis is more rational in the circumstances. For example, it may be appropriate to apply any gain arising on a curtailment or settlement of the same plan to first eliminate any unrecognised past service cost relating to the same plan.

Example illustrating paragraph 115

An entity discontinues ~~a business~~an operating segment and employees of the discontinued segment will earn no further benefits. This is a curtailment without a settlement. Using current actuarial assumptions (including current market interest rates and other current market prices) immediately before the curtailment, the entity has a defined benefit obligation with a net present value of 1,000, plan assets with a fair value of 820 and net cumulative unrecognised actuarial gains of 50. The entity had first adopted the Standard one year before. This increased the net liability by 100, which the entity chose to recognise over five years (see paragraph 155(b)). The curtailment reduces the net present value of the obligation by 100 to 900.

Of the previously unrecognised actuarial gains and transitional amounts, 10% (100/1,000) relates to the part of the obligation that was eliminated through the curtailment. Therefore, the effect of the curtailment is as follows:

	Before curtailment	*Curtailment gain*	*After curtailment*
Net present value of obligation	*1,000*	*(100)*	*900*
Fair value of plan assets	*(820)*	*-*	*(820)*
	180	*(100)*	*80*
Unrecognised actuarial gains	*50*	*(5)*	*45*
Unrecognised transitional amount (100 x 4/5)	*(80)*	*8*	*(72)*
Net liability recognised in ~~balance sheet~~statement of financial position	*150*	*(97)*	*53*

Presentation

Offset

116 An entity shall offset an asset relating to one plan against a liability relating to another plan when, and only when, the entity:

(a) has a legally enforceable right to use a surplus in one plan to settle obligations under the other plan; and

(b) intends either to settle the obligations on a net basis, or to realise the surplus in one plan and settle its obligation under the other plan simultaneously.

117 The offsetting criteria are similar to those established for financial instruments in HKAS 32 *Financial Instruments: Presentation.*

Current/non-current distinction

118 Some entities distinguish current assets and liabilities from non-current assets and liabilities. This Standard does not specify whether an entity ~~shall~~ should distinguish current and non-current portions of assets and liabilities arising from post-employment benefits.

Financial components of post-employment benefit costs

119 This Standard does not specify whether an entity shall present current service cost, interest cost and the expected return on plan assets as components of a single item of income or expense ~~on the face of~~in the ~~income statement~~statement of comprehensive income.

Disclosure

120 An entity shall disclose information that enables users of financial statements to evaluate the nature of its defined benefit plans and the financial effects of changes in those plans during the period.

120A An entity shall disclose the following information about defined benefit plans:

(a) the entity's accounting policy for recognising actuarial gains and losses.

(b) a general description of the type of plan.

(c) a reconciliation of opening and closing balances of the present value of the defined benefit obligation showing separately, if applicable, the effects during the period attributable to each of the following:

(i) current service cost,

(ii) interest cost,

(iii) contributions by plan participants,

(iv) actuarial gains and losses,

(v) foreign currency exchange rate changes on plans measured in a currency different from the entity's presentation currency,

(vi) benefits paid,

(vii) past service cost,

(viii) business combinations,

(ix) curtailments and

(x) settlements.

(d) an analysis of the defined benefit obligation into amounts arising from plans that are wholly unfunded and amounts arising from plans that are wholly or partly funded.

(e) a reconciliation of the opening and closing balances of the fair value of plan assets and of the opening and closing balances of any reimbursement right recognised as an asset in accordance with paragraph 104A showing separately, if applicable, the effects during the period attributable to each of the following:

(i) expected return on plan assets,

(ii) actuarial gains and losses,

(iii) foreign currency exchange rate changes on plans measured in a currency different from the entity's presentation currency,

(iv) contributions by the employer,

(v) contributions by plan participants,

(vi) benefits paid,

(vii) business combinations and

(viii) settlements.

(f) a reconciliation of the present value of the defined benefit obligation in (c) and the fair value of the plan assets in (e) to the assets and liabilities recognised in the ~~balance sheet~~statement of financial position, showing at least:

(i) the net actuarial gains or losses not recognised in the ~~balance sheet~~statement of financial position (see paragraph 92);

(ii) the past service cost not recognised in the ~~balance sheet~~statement of financial position (see paragraph 96);

(iii) any amount not recognised as an asset, because of the limit in paragraph 58(b);

(iv) the fair value at the ~~balance sheet date~~end of the reporting period of any reimbursement right recognised as an asset in accordance with paragraph 104A (with a brief description of the link between the reimbursement right and the related obligation); and

(v) the other amounts recognised in the ~~balance sheet~~statement of financial position.

(g) the total expense recognised in profit or loss for each of the following, and the line item(s) in which they are included:

(i) current service cost;

(ii) interest cost;

(iii) expected return on plan assets;

(iv) expected return on any reimbursement right recognised as an asset in accordance with paragraph 104A;

(v) actuarial gains and losses;

(vi) past service cost;

(vii) the effect of any curtailment or settlement; and

(viii) the effect of the limit in paragraph 58(b).

(h) the total amount recognised in ~~the statement of recognised income and expense~~other comprehensive income for each of the following:

(i) actuarial gains and losses; and

(ii) the effect of the limit in paragraph 58(b).

(i) for entities that recognise actuarial gains and losses in ~~the statement of recognised income and expense~~other comprehensive income in accordance with paragraph 93A, the cumulative amount of actuarial gains and losses recognised in ~~the statement of recognised income and expense~~other comprehensive income.

(j) for each major category of plan assets, which shall include, but is not limited to, equity instruments, debt instruments, property, and all other assets, the percentage or amount that each major category constitutes of the fair value of the total plan assets.

(k) the amounts included in the fair value of plan assets for:

(i) each category of the entity's own financial instruments; and

(ii) any property occupied by, or other assets used by, the entity.

(l) a narrative description of the basis used to determine the overall expected rate of return on assets, including the effect of the major categories of plan assets.

(m) the actual return on plan assets, as well as the actual return on any reimbursement right recognised as an asset in accordance with paragraph 104A.

(n) the principal actuarial assumptions used as at the ~~balance sheet date~~end of the reporting period, including, when applicable:

(i) the discount rates;

(ii) the expected rates of return on any plan assets for the periods presented in the financial statements;

(iii) the expected rates of return for the periods presented in the financial statements on any reimbursement right recognised as an asset in accordance with paragraph 104A;

(iv) the expected rates of salary increases (and of changes in an index or other variable specified in the formal or constructive terms of a plan as the basis for future benefit increases);

(v) medical cost trend rates; and

(vi) any other material actuarial assumptions used.

An entity shall disclose each actuarial assumption in absolute terms (for example, as an absolute percentage) and not just as a margin between different percentages or other variables.

(o) the effect of an increase of one percentage point and the effect of a decrease of one percentage point in the assumed medical cost trend rates on:

(i) the aggregate of the current service cost and interest cost components of net periodic post-employment medical costs; and

(ii) the accumulated post-employment benefit obligation for medical costs.

For the purposes of this disclosure, all other assumptions shall be held constant. For plans operating in a high inflation environment, the disclosure shall be the effect of a percentage increase or decrease in the assumed medical cost trend rate of a significance similar to one percentage point in a low inflation environment.

(p) the amounts for the current annual period and previous four annual periods of:

(i) the present value of the defined benefit obligation, the fair value of the plan assets and the surplus or deficit in the plan; and

(ii) the experience adjustments arising on:

(a) the plan liabilities expressed either as (1) an amount or (2) a percentage of the plan liabilities at the ~~balance sheet date~~end of the reporting period and

(b) the plan assets expressed either as (1) an amount or (2) a percentage of the plan assets at the ~~balance sheet date~~end of the reporting period.

(q) the employer's best estimate, as soon as it can reasonably be determined, of contributions expected to be paid to the plan during the annual period beginning after the ~~balance sheet date~~reporting period.

121 Paragraph 120A(b) requires a general description of the type of plan. Such a description distinguishes, for example, flat salary pension plans from final salary pension plans and from post-employment medical plans. The description of the plan shall include informal practices that give rise to constructive obligations included in the measurement of the defined benefit obligation in accordance with paragraph 52. Further detail is not required.

122 When an entity has more than one defined benefit plan, disclosures may be made in total, separately for each plan, or in such groupings as are considered to be the most useful. It may be useful to distinguish groupings by criteria such as the following:

(a) the geographical location of the plans, for example, by distinguishing domestic plans from foreign plans; or

(b) whether plans are subject to materially different risks, for example, by distinguishing flat salary pension plans from final salary pension plans and from post-employment medical plans.

When an entity provides disclosures in total for a grouping of plans, such disclosures are provided in the form of weighted averages or of relatively narrow ranges.

123 Paragraph 30 requires additional disclosures about multi-employer defined benefit plans that are treated as if they were defined contribution plans.

124 Where required by HKAS 24, an entity discloses information about:

(a) related party transactions with post-employment benefit plans; and

(b) post-employment benefits for key management personnel.

125 Where required by HKAS 37, an entity discloses information about contingent liabilities arising from post-employment benefit obligations.

Other long-term employee benefits

126 Other long-term employee benefits include, for example:

(a) long-term compensated absences such as long-service or sabbatical leave;

(b) jubilee or other long-service benefits;

(c) long-term disability benefits;

(d) profit sharing and bonuses payable twelve months or more after the end of the period in which the employees render the related service; and

(e) deferred compensation paid twelve months or more after the end of the period in which it is earned.

127 The measurement of other long-term employee benefits is not usually subject to the same degree of uncertainty as the measurement of post-employment benefits. Furthermore, the introduction of, or changes to, other long-term employee benefits rarely causes a material amount of past service cost. For these reasons, this Standard requires a simplified method of accounting for other long-term employee benefits. This method differs from the accounting required for post-employment benefits as follows:

(a) actuarial gains and losses are recognised immediately and no 'corridor' is applied; and

(b) all past service cost is recognised immediately.

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Recognition and measurement

128 The amount recognised as a liability for other long-term employee benefits shall be the net total of the following amounts:

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

(b) minus the fair value at the ~~balance sheet~~end of the reporting period ~~date~~ of plan assets (if any) out of which the obligations are to be settled directly (see paragraphs 102 - 104).

In measuring the liability, an entity shall apply paragraphs 49 - 91, excluding paragraphs 54 and 61. An entity shall apply paragraph 104A in recognising and measuring any reimbursement right.

129 For other long-term employee benefits, an entity shall recognise the net total of the following amounts as expense or (subject to paragraph 58) income, except to the extent that another Standard requires or permits their inclusion in the cost of an asset:

(a) current service cost (see paragraphs 63 - 91);

(b) interest cost (see paragraph 82);

(c) the expected return on any plan assets (see paragraphs 105-107) and on any reimbursement right recognised as an asset (see paragraph 104A);

(d) actuarial gains and losses, which shall all be recognised immediately;

(e) past service cost, which shall all be recognised immediately; and

(f) the effect of any curtailments or settlements (see paragraphs 109 and 110).

130 One form of other long-term employee benefit is long-term disability benefit. If the level of benefit depends on the length of service, an obligation arises when the service is rendered. Measurement of that obligation reflects the probability that payment will be required and the length of time for which payment is expected to be made. If the level of benefit is the same for any disabled employee regardless of years of service, the expected cost of those benefits is recognised when an event occurs that causes a long-term disability.

Disclosure

131 Although this Standard does not require specific disclosures about other long-term employee benefits, other Standards may require disclosures, for example, where~~n~~ the expense resulting from such benefits is material and so would require disclosure in accordance with HKAS 1. When required by HKAS 24, an entity discloses information about other long-term employee benefits for key management personnel.

Termination benefits

132 This Standard deals with termination benefits separately from other employee benefits because the event which gives rise to an obligation is the termination rather than employee service.

Recognition

133 An entity shall recognise termination benefits as a liability and an expense when, and only when, the entity is demonstrably committed to either:

(a) terminate the employment of an employee or group of employees before the normal retirement date; or

(b) provide termination benefits as a result of an offer made in order to encourage voluntary redundancy.

134 An entity is demonstrably committed to a termination when, and only when, the entity has a detailed formal plan for the termination and is without realistic possibility of withdrawal. The detailed plan shall include, as a minimum:

(a) the location, function, and approximate number of employees whose services are to be terminated;

(b) the termination benefits for each job classification or function; and

(c) the time at which the plan will be implemented. Implementation shall begin as soon as possible and the period of time to complete implementation shall be such that material changes to the plan are not likely.

135 An entity may be committed, by legislation, by contractual or other agreements with employees or their representatives or by a constructive obligation based on business practice, custom or a desire to act equitably, to make payments (or provide other benefits) to employees when it terminates their employment. Such payments are termination benefits. Termination benefits are typically lump-sum payments, but sometimes also include:

(a) enhancement of retirement benefits or of other post-employment benefits, either indirectly through an employee benefit plan or directly; and

(b) salary until the end of a specified notice period if the employee renders no further service that provides economic benefits to the entity.

136 Some employee benefits are payable regardless of the reason for the employee's departure. The payment of such benefits is certain (subject to any vesting or minimum service requirements) but the timing of their payment is uncertain. Although such benefits are described in some countries as termination indemnities, or termination gratuities, they are post-employment benefits, rather than termination benefits and an entity accounts for them as post-employment benefits. Some entities provide a lower level of benefit for voluntary termination at the request of the employee (in substance, a post-employment benefit) than for involuntary termination at the request of the entity. The additional benefit payable on involuntary termination is a termination benefit.

137 Termination benefits do not provide an entity with future economic benefits and are recognised as an expense immediately.

138 Where an entity recognises termination benefits, the entity may also have to account for a curtailment of retirement benefits or other employee benefits (see paragraph 109).

Measurement

139 Where termination benefits fall due more than 12 months after the ~~balance sheet date~~reporting period, they shall be discounted using the discount rate specified in paragraph 78.

140 In the case of an offer made to encourage voluntary redundancy, the measurement of termination benefits shall be based on the number of employees expected to accept the offer.

Disclosure

141 Where there is uncertainty about the number of employees who will accept an offer of termination benefits, a contingent liability exists. As required by HKAS 37 an entity discloses information about the contingent liability unless the possibility of an outflow in settlement is remote.

142 As required by HKAS 1, an entity discloses the nature and amount of an expense if it is material. Termination benefits may result in an expense needing disclosure in order to comply with this requirement.

143 Where required by HKAS 24 an entity discloses information about termination benefits for key management personnel.

144-152 [Not used]

Transitional provisions

153 This section specifies the transitional treatment for defined benefit plans. Where an entity first adopts this Standard for other employee benefits, the entity applies HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

153A Paragraphs 154 to 156 of this Standard apply only when an entity had not previously applied SSAP 34 (May 2003). For an entity that had previously applied SSAP 34 (May 2003), there is in effect no transition from SSAP 34 (May 2003) to this Standard. If an entity had previously applied the transitional provisions in SSAP 34 (May 2003), the entity shall continue to apply the transitional provisions set out in that SSAP to the unrecognised transitional liability brought forward as at the date of first adoption of this Standard.

154 On first adopting this Standard, an entity shall determine its transitional liability for defined benefit plans at that date as:

(a) the present value of the obligation (see paragraph 64) at the date of adoption;

(b) minus the fair value, at the date of adoption, of plan assets (if any) out of which the obligations are to be settled directly (see paragraphs 102 - 104);

(c) minus any past service cost that, under paragraph 96, shall be recognised in later periods.

155 If the transitional liability is more than the liability that would have been recognised at the same date under the entity's previous accounting policy, the entity shall make an irrevocable choice to recognise that increase as part of its defined benefit liability under paragraph 54:

(a) immediately, under HKAS 8; or

(b) as an expense on a straight-line basis over up to five years from the date of adoption. If an entity chooses (b), the entity shall:

(i) apply the limit described in paragraph 58(b) in measuring any asset recognised in the ~~balance sheet~~statement of financial position;

(ii) disclose at the end of each ~~balance sheet date~~reporting period: (1) the amount of the increase that remains unrecognised; and (2) the amount recognised in the current period;

(iii) limit the recognition of subsequent actuarial gains (but not negative past service cost) as follows. If an actuarial gain is to be recognised under paragraphs 92 and 93, an entity shall recognise that actuarial gain only to the extent that the net cumulative unrecognised actuarial gains (before recognition of that actuarial gain) exceed the unrecognised part of the transitional liability; and

(iv) include the related part of the unrecognised transitional liability in determining any subsequent gain or loss on settlement or curtailment.

If the transitional liability is less than the liability that would have been recognised at the same date under the entity's previous accounting policy, the entity shall recognise that decrease immediately under HKAS 8.

156 On the initial adoption of the Standard, the effect of the change in accounting policy includes all actuarial gains and losses that arose in earlier periods even if they fall inside the 10% 'corridor' specified in paragraph 92.

Example illustrating paragraphs 154 to 156

At 31 December 1998, an entity's ~~balance sheet~~statement of financial position includes a pension liability of 100. The entity adopts the Standard as of 1 January 1999, when the present value of the obligation under the Standard is 1,300 and the fair value of plan assets is 1,000. On 1 January 1993, the entity had improved pensions (cost for non-vested benefits: 160; and average remaining period at that date until vesting: 10 years).

The transitional effect is as follows:

Present value of the obligation	*1,300*
Fair value of plan assets	*(1,000)*
Less: past service cost to be recognised in later periods (160 x 4/10)	*(64)*
Transitional liability	*236*
Liability already recognised	*(100)*
Increase in liability	*136*

The entity may choose to recognise the increase of 136 either immediately or over up to 5 years. The choice is irrevocable.

At 31 December 1999, the present value of the obligation under the Standard is 1,400 and the fair value of plan assets is 1,050. Net cumulative unrecognised actuarial gains since the date of adopting the Standard are 120. The expected average remaining working life of the employees participating in the plan was eight years. The entity has adopted a policy of recognising all actuarial gains and losses immediately, as permitted by paragraph 93.

The effect of the limit in paragraph 155(b)(iii) is as follows.

Net cumulative unrecognised actuarial gains	*120*
Unrecognised part of transitional liability (136 x 4/5)	*(109)*
Maximum gain to be recognised (paragraph 155(b)(iii))	11

Effective date

157 This Standard becomes operative for financial statements covering periods beginning on or after 1 January 2005. Earlier application is encouraged.

158 This Standard supersedes SSAP 34 *Employee Benefits* (revised in May 2003).

159 [Not used]

159A [Not used]

159B An entity shall apply the amendments in paragraphs 32A, 34-34B, 61 and 120-121 for annual periods beginning on or after 1 January 2006. Earlier application is encouraged. If an entity applies these amendments for a period beginning before 1 January 2006, it shall disclose that fact.

159C The option in paragraphs 93A-93D may be used for annual periods ending on or after 16 December 2004 if an entity decides to early adopt this Standard for a period beginning before 1 January 2005. An entity using the option for annual periods beginning before 1 January 2006 shall also apply the amendments in paragraphs 32A, 34-34B, 61 and 120-121.

159D Paragraphs 7, 8(b), 32B, 97, 98 and 111 were amended and paragraph 111A was added by *Improvements to HKFRSs* issued in October 2008. An entity shall apply the amendments in paragraphs 7, 8(b) and 32B for annual periods beginning on or after 1 January 2009. Earlier application is permitted. If an entity applies the amendments for an earlier period it shall disclose that fact. An entity shall apply the amendments in paragraphs 97, 98, 111 and 111A to changes in benefits that occur on or after 1 January 2009.

160 HKAS 8 applies when an entity changes its accounting policies to reflect the changes specified in paragraphs 159B ~~and~~ -159D~~C~~. In applying those changes retrospectively, as required by HKAS 8, the entity treats those changes as if they had been applied at the same time as the rest of this Standard~~, except~~. The exception is that an entity may disclose the amounts required by paragraph 120A(p) as the amounts are determined for each annual period prospectively from the first annual period presented in the financial statements in which the entity first applies the amendments in paragraph 120A.

161 HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraphs 93A–93D, 106 (Example) and 120A. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies HKAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.

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Appendix A

Illustrative example

The appendix accompanies, but is not part of, IAS 19.

Extracts from ~~income statements and balance sheets~~statements of comprehensive income and statements of financial position are provided to show the effects of the transactions described below. These extracts do not necessarily conform with all the disclosure and presentation requirements of other Standards.

Background information

The following information is given about a funded defined benefit plan. To keep interest computations simple, all transactions are assumed to occur at the year end. The present value of the obligation and the fair value of the plan assets were both 1,000 at 1 January 20X1. Net cumulative unrecognised actuarial gains at that date were 140.

	20X1	*20X2*	*20X3*
Discount rate at start of year	10.0%	9.0%	8.0%
Expected rate of return on plan assets at start of year	12.0%	11.1%	10.3%
Current service cost	130	140	150
Benefits paid	150	180	190
Contributions paid	90	100	110
Present value of obligation at 31 December	1,141	1,197	1,295
Fair value of plan assets at 31 December	1,092	1,109	1,093
Expected average remaining working lives of employees (years)	10	10	10

In 20X2, the plan was amended to provide additional benefits with effect from 1 January 20X2. The present value as at 1 January 20X2 of additional benefits for employee service before 1 January 20X2 was 50 for vested benefits and 30 for non-vested benefits. As at 1 January 20X2, the entity estimated that the average period until the non-vested benefits would become vested was three years; the past service cost arising from additional non-vested benefits is therefore recognised on a straight-line basis over three years. The past service cost arising from additional vested benefits is recognised immediately (paragraph 96 of the Standard). The entity has adopted a policy of recognising actuarial gains and losses under the minimum requirements of paragraph 93.

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Changes in the present value of the obligation and in the fair value of the plan assets

The first step is to summarise the changes in the present value of the obligation and in the fair value of the plan assets and use this to determine the amount of the actuarial gains or losses for the period. These are as follows:

	20X1	*20X2*	*20X3*
Present value of obligation, 1 January	1,000	1,141	1,197
Interest cost	100	103	96
Current service cost	130	140	150
Past service cost - non-vested benefits	-	30	-
Past service cost - vested benefits	-	50	-
Benefits paid	(150)	(180)	(190)
Actuarial (gain) loss on obligation (balancing figure)	61	(87)	42
Present value of obligation, 31 December	1,141	1,197	1,295
Fair value of plan assets, 1 January	1,000	1,092	1,109
Expected return on plan assets	120	121	114
Contributions	90	100	110
Benefits paid	(150)	(180)	(190)
Actuarial gain (loss) on plan assets (balancing figure)	32	(24)	(50)
Fair value of plan assets, 31 December	1,092	1,109	1,093

Limits of the 'corridor'

The next step is to determine the limits of the corridor and then compare these with the cumulative unrecognised actuarial gains and losses in order to determine the net actuarial gain or loss to be recognised in the following period. Under paragraph 92 of the Standard, the limits of the 'corridor' are set at the greater of:

(a) 10% of the present value of the obligation before deducting plan assets; and

(b) 10% of the fair value of any plan assets.

These limits, and the recognised and unrecognised actuarial gains and losses, are as follows:

	20X1	*20X2*	*20X3*
Net cumulative unrecognised actuarial gains (losses) at 1 January	140	107	170
Limits of 'corridor' at 1 January	100	114	120
Excess [A]	40	-	50

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Average expected remaining working lives (years) [B]	10	10	10
Actuarial gain (loss) to be recognised [A/B]	4	-	5
Unrecognised actuarial gains (losses) at 1 January	140	107	170
Actuarial gain (loss) for year - obligation	(61)	87	(42)
Actuarial gain (loss) for year - plan assets	32	(24)	(50)
Subtotal	111	170	78
Actuarial (gain) loss recognised	(4)	-	(5)
Unrecognised actuarial gains (losses) at 31 December	107	170	73

Amounts recognised in the ~~balance sheet~~statement of financial position and profit or loss, and related analyses

The final step is to determine the amounts to be recognised in the ~~balance sheet~~statement of financial position and profit or loss, and the related analyses to be disclosed in accordance with paragraph 120A(f), (g) and (m) of the Standard (the analyses required to be disclosed in accordance with paragraph 120A(c) and (e) are given in the section of this Appendix 'Changes in the present value of the obligation and in the fair value of the plan assets'). These are as follows.

	20X1	*20X2*	*20X3*
Present value of the obligation	1,141	1,197	1,295
Fair value of plan assets	(1,092)	(1,109)	(1,093)
	49	88	202
Unrecognised actuarial gains (losses)	107	170	73
Unrecognised past service cost—non-vested benefits	-	(20)	(10)
Liability recognised in ~~balance sheet~~statement of financial position	**156**	**238**	**265**
Current service cost	130	140	150
Interest cost	100	103	96
Expected return on plan assets	(120)	(121)	(114)
Net actuarial (gain) loss recognised in year	(4)	-	(5)
Past service cost—non-vested benefits	-	10	10
Past service cost—vested benefits	-	50	-
Expense recognised in profit or loss	**106**	**182**	**137**

Actual return on plan assets			
Expected return on plan assets	120	121	114
Actuarial gain (loss) on plan assets	32	(24)	(50)
Actual return on plan assets	152	97	64

Note: see example illustrating paragraphs 104A-104C for presentation of reimbursements.

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Appendix B

Illustrative disclosures

This appendix accompanies, but is not part of, IAS 19. Extracts from notes show how the required disclosures may be aggregated in the case of a large multi-national group that provides a variety of employee benefits. These extracts do not necessarily conform with all the disclosure and presentation requirements of IAS 19 and other Standards. In particular, they do not illustrate the disclosure of:

(a) *accounting policies for employee benefits (see IAS 1* Presentation of Financial Statements*). Paragraph 120A(a) of the Standard requires this disclosure to include the entity's accounting policy for recognising actuarial gains and losses.*

(b) *a general description of the type of plan (paragraph 120A(b)).*

(c) *amounts recognised in other comprehensive income (paragraph 120A(h) and (i)).*

(~~c~~d) *a narrative description of the basis used to determine the overall expected rate of return on assets (paragraph 120A(l)).*

(~~d~~e) *employee benefits granted to directors and key management personnel (see IAS 24* Related Party Disclosures*).*

(~~e~~f) *share-based employee benefits (see HKFRS 2* Share-based Payment*).*

Employee benefit obligations

The amounts recognised in the ~~balance sheet~~statement of financial position are as follows:

	Defined benefit pension plans		Post-employment medical benefits	
	20X2	*20X1*	*20X2*	*20X1*
Present value of funded obligations	20,300	17,400	-	-
Fair value of plan assets	(18,420)	(17,280)	-	-
	1,880	120	-	-
Present value of unfunded obligations	2,000	1,000	7,337	6,405
Unrecognised actuarial gains (losses)	(1,605)	840	(2,707)	(2,607)
Unrecognised past service cost	(450)	(650)	-	-
Net liability	1,825	1,310	4,630	3,798
Amounts in the ~~balance sheet~~statement of financial position:				
liabilities	1,825	1,400	4,630	3,798
assets	-	(90)	-	-
Net liability	1,825	1,310	4,630	3,798

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The pension plan assets include ordinary shares issued by [name of reporting entity] with a fair value of 317 (20X1: 281). Plan assets also include property occupied by [name of reporting entity] with a fair value of 200 (20X1:185).

The amounts recognised in profit or loss are as follows:

	Defined benefit pension plans		Post-employment medical benefits	
	20X2	*20X1*	*20X2*	*20X1*
Current service cost	850	750	479	411
Interest on obligation	950	1000	803	705
Expected return on plan assets	(900)	(650)		
Net actuarial losses (gains) recognised in year	(70)	(20)	150	140
Past service cost	200	200		
Losses (gains) on curtailments and settlements	175	(390)		
Total, included in 'employee benefits expense'	1,205	890	1,432	1,256
Actual return on plan assets	600	2,250	-	-

Changes in the present value of the defined benefit obligation are as follows:

	Defined benefit pension plans		Post-employment medical benefits	
	20X2	*20X1*	*20X2*	*20X1*
Opening defined benefit obligation	18,400	11,600	6,405	5,439
Service cost	850	750	479	411
Interest cost	950	1,000	803	705
Actuarial losses (gains)	2,350	950	250	400
Losses (gains) on curtailments	(500)	-		
Liabilities extinguished on settlements	-	(350)		
Liabilities assumed in a business combination	-	5,000		
Exchange differences on foreign plans	900	(150)		
Benefits paid	(650)	(400)	(600)	(550)
Closing defined benefit obligation	22,300	18,400	7,337	6,405

Changes in the fair value of plan assets are as follows:

	Defined benefit pension plans	
	20X2	*20X1*
Opening fair value of plan assets	17,280	9,200
Expected return	900	650
Actuarial gains and losses	(300)	1,600
Assets distributed on settlements	(400)	-
Contributions by employer	700	350
Assets acquired in a business combination	-	6,000
Exchange differences on foreign plans	890	(120)
Benefits paid	(650)	(400)
	18,420	17,280

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The group expects to contribute 900 to its defined benefit pension plans in 20X3.

The major categories of plan assets as a percentage of total plan assets are as follows:	*20X2*	*20X1*
European equities	30%	35%
North American equities	16%	15%
European bonds	31%	28%
North American bonds	18%	17%
Property	5%	5%

Principal actuarial assumptions at the ~~balance sheet date~~end of the reporting period (expressed as weighted averages):

	20X2	*20X1*
Discount rate at 31 December	5.0%	6.5%
Expected return on plan assets at 31 December	5.4%	7.0%
Future salary increases	5%	4%
Future pension increases	3%	2%
Proportion of employees opting for early retirement	30%	30%
Annual increase in healthcare costs	8%	8%
Future changes in maximum state healthcare benefits	3%	2%

Assumed healthcare cost trend rates have a significant effect on the amounts recognised in profit or loss. A one percentage point change in assumed healthcare cost trend rates would have the following effects:

	One percentage point increase	One percentage point decrease
Effect on the aggregate of the service cost and interest cost	190	(150)
Effect on defined benefit obligation	1,000	(900)

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Amounts for the current and previous four periods are as follows:

Defined benefit pension plans

	20X2	*20X1*	*20X0*	*20W9*	*20W8*
Defined benefit obligation	(22,300)	(18,400)	(11,600)	(10,582)	(9,144)
Plan assets	18,420	17,280	9,200	8,502	10,000
Surplus/(deficit)	(3,880)	(1,120)	(2,400)	(2,080)	856
Experience adjustments on plan liabilities	(1,111)	(768)	(69)	543	(642)
Experience adjustments on plan assets	(300)	1,600	(1,078)	(2,890)	2,777

Post-employment medical benefits

	20X2	*20X1*	*20X0*	*20W9*	*20W8*
Defined benefit obligation	7,337	6,405	5,439	4,923	4,221
Experience adjustments on plan liabilities	(232)	829	490	(174)	(103)

The group also participates in an industry-wide defined benefit plan that provides pensions linked to final salaries and is funded on a pay-as-you-go basis. It is not practicable to determine the present value of the group's obligation or the related current service cost as the plan computes its obligations on a basis that differs materially from the basis used in [name of reporting entity]'s financial statements. [describe basis] On that basis, the plan's financial statements to 30 June 20X0 show an unfunded liability of 27,525. The unfunded liability will result in future payments by participating employers. The plan has approximately 75,000 members, of whom approximately 5,000 are current or former employees of [name of reporting entity] or their dependants. The expense recognised in ~~the income statement~~profit or loss, which is equal to contributions due for the year, and is not included in the above amounts, was 230 (20X1: 215). The group's future contributions may be increased substantially if other entities withdraw from the plan.

Appendix C

Illustration of the application of paragraph 58A

The appendix accompanies, but is not part of, IAS 19.

The issue

Paragraph 58 of the Standard imposes a ceiling on the defined benefit asset that can be recognised.

58 The amount determined under paragraph 54 may be negative (an asset). An entity shall measure the resulting asset at the lower of:

(a) the amount determined under paragraph 54 [ie the surplus/deficit in the plan plus (minus) any unrecognised losses (gains)]; **and**

(b) the total of:

(i) any cumulative unrecognised net actuarial losses and past service cost (see paragraphs 92, 93 and 96); and

(ii) the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan. The present value of these economic benefits shall be determined using the discount rate specified in paragraph 78.

Without paragraph 58A (see below), paragraph 58(b)(i) has the following consequence: sometimes deferring the recognition of an actuarial loss (gain) in determining the amount specified by paragraph 54 leads to a gain (loss) being recognised in ~~the income statement~~profit or loss.

The following example illustrates the effect of applying paragraph 58 without paragraph 58A. The example assumes that the entity's accounting policy is not to recognise actuarial gains and losses within the 'corridor' and to amortise actuarial gains and losses outside the 'corridor'. (Whether the 'corridor' is used is not significant. The issue can arise whenever there is deferred recognition under paragraph 54.)

Example 1

	A	**B**	**C**	**D =A+C**	**E =B+C**	**F =lower of D and E**	**G**
Year	Surplus in plan	Economic benefits available (paragraph 58(b)(ii))	Losses unrecognised under paragraph 54	Paragraph 54	Paragraph 58(b)	Asset ceiling, ie recognised asset	Gain recognised in year 2
1	100	0	0	100	0	0	-
2	70	0	30	100	30	30	30

At the end of year 1, there is a surplus of 100 in the plan (column A in the table above), but no economic benefits are available to the entity either from refunds or reductions in future contributions[*] (column B). There are no unrecognised gains and losses under paragraph 54 (column C). So, if there were no asset ceiling, an asset of 100 would be recognised, being the amount specified by paragraph 54 (column D). The asset ceiling in paragraph 58 restricts the asset to nil (column F).

In year 2 there is an actuarial loss in the plan of 30 that reduces the surplus from 100 to 70 (column A) the recognition of which is deferred under paragraph 54 (column C). So, if there were no asset ceiling, an asset of 100 (column D) would be recognised. The asset ceiling without paragraph 58A would be 30 (column E). An asset of 30 would be recognised (column F), giving rise to a gain in income (column G) even though all that has happened is that a surplus from which the entity cannot benefit has decreased.

A similarly counter-intuitive effect could arise with actuarial gains (to the extent that they reduce cumulative unrecognised actuarial losses).

[*] based on the current terms of the plan.

Paragraph 58A

Paragraph 58A prohibits the recognition of gains (losses) that arise solely from past service cost and actuarial losses (gains).

58A The application of paragraph 58 shall not result in a gain being recognised solely as a result of an actuarial loss or past service cost in the current period or in a loss being recognised solely as a result of an actuarial gain in the current period. The entity shall therefore recognise immediately under paragraph 54 the following, to the extent that they arise while the defined benefit asset is determined in accordance with paragraph 58(b):

(a) net actuarial losses of the current period and past service cost of the current period to the extent that they exceed any reduction in the present value of the economic benefits specified in paragraph 58(b)(ii). If there is no change or an increase in the present value of the economic benefits, the entire net actuarial losses of the current period and past service cost of the current period shall be recognised immediately under paragraph 54.

(b) net actuarial gains of the current period after the deduction of past service cost of the current period to the extent that they exceed any increase in the present value of the economic benefits specified in paragraph 58(b)(ii). If there is no change or a decrease in the present value of the economic benefits, the entire net actuarial gains of the current period after the deduction of past service cost of the current period shall be recognised immediately under paragraph 54.

Examples

The following examples illustrate the result of applying paragraph 58A. As above, it is assumed that the entity's accounting policy is not to recognise actuarial gains and losses within the 'corridor' and to amortise actuarial gains and losses outside the 'corridor'. For the sake of simplicity the periodic amortisation of unrecognised gains and losses outside the corridor is ignored in the examples.

Example 1 continued – Adjustment when there are actuarial losses and no change in the economic benefits available

	A	**B**	**C**	**D=A+C**	**E=B+C**	**F= lower of D and E**	**G**
Year	Surplus in plan	Economic benefits available (paragraph 58(b)(ii))	Losses unrecognised under paragraph 54	Paragraph 54	Paragraph 58(b)	Asset ceiling, ie recognised asset	Gain recognised in year 2
1	100	0	0	100	0	0	–
2	70	0	0	70	0	0	0

The facts are as in example 1 above. Applying paragraph 58A, there is no change in the economic benefits available to the entity[*] so the entire actuarial loss of 30 is recognised immediately under paragraph 54 (column D). The asset ceiling remains at nil (column F) and no gain is recognised.

In effect, the actuarial loss of 30 is recognised immediately, but is offset by the reduction in the effect of the asset ceiling.

	~~Balance sheet~~Statement of financial position asset under paragraph 54 (column D above)	**Effect of the asset ceiling**	**Asset ceiling (column F above)**
Year 1	100	(100)	0
Year 2	70	(70)	0
Gain/(loss)	(30)	30	0

[*] The term 'economic benefits available to the entity' is used to refer to those economic benefits that qualify for recognition under paragraph 58(b)(ii).

In the above example, there is no change in the present value of the economic benefits available to the entity. The application of paragraph 58A becomes more complex when there are changes in present value of the economic benefits available, as illustrated in the following examples.

Example 2 - Adjustment when there are actuarial losses and a decrease in the economic benefits available

	A	**B**	**C**	**D =A+C**	**E =B+C**	**F =lower of D and E**	**G**
Year	Surplus in plan	Economic benefits available (paragraph 58(b)(ii))	Losses unrecognised under paragraph 54	Paragraph 54	Paragraph 58(b)	Asset ceiling, ie recognised asset	Gain recognised in year 2
1	60	30	40	100	70	70	-
2	25	20	50	75	70	70	0

At the end of year 1, there is a surplus of 60 in the plan (column A) and economic benefits available to the entity of 30 (column B). There are unrecognised losses of 40 under paragraph 54* (column C). So, if there were no asset ceiling, an asset of 100 would be recognised (column D). The asset ceiling restricts the asset to 70 (column F).

In year 2, an actuarial loss of 35 in the plan reduces the surplus from 60 to 25 (column A). The economic benefits available to the entity fall by 10 from 30 to 20 (column B). Applying paragraph 58A, the actuarial loss of 35 is analysed as follows:

Actuarial loss equal to the reduction in economic benefits	10
Actuarial loss that exceeds the reduction in economic benefits	25

In accordance with paragraph 58A, 25 of the actuarial loss is recognised immediately under paragraph 54 (column D). The reduction in economic benefits of 10 is included in the cumulative unrecognised losses that increase to 50 (column C). The asset ceiling, therefore, also remains at 70 (column E) and no gain is recognised.

In effect, an actuarial loss of 25 is recognised immediately, but is offset by the reduction in the effect of the asset ceiling.

	~~Balance sheet~~Statement of financial position asset under paragraph 54 (column D above)	**Effect of the asset ceiling**	**Asset ceiling (column F above)**
Year 1	100	(30)	70
Year 2	75	(5)	70
Gain/(loss)	(25)	25	0

* The application of paragraph 58A allows the recognition of some actuarial gains and losses to be deferred under paragraph 54 and, hence, to be included in the calculation of the asset ceiling. For example, cumulative unrecognised actuarial losses that have built up while the amount specified by paragraph 58(b) is not lower than the amount specified by paragraph 54 will not be recognised immediately at the point that the amount specified by paragraph 58(b) becomes lower. Instead their recognition will continue to be deferred in line with the entity's accounting policy. The cumulative unrecognised losses in this example are losses the recognition of which is deferred even though paragraph 58A applies.

Example 3 - Adjustment when there are actuarial gains and a decrease in the economic benefits available to the entity

	A	**B**	**C**	**D =A+C**	**E =B+C**	**F =lower of D and E**	**G**
Year	Surplus in plan	Economic benefits available (paragraph 58(b)(ii))	Losses unrecognised under paragraph 54	Paragraph 54	Paragraph 58(b)	Asset ceiling, ie recognised asset	Gain recognised in year 2
1	60	30	40	100	70	70	-
2	110	25	40	150	65	65	(5)

At the end of year 1 there is a surplus of 60 in the plan (column A) and economic benefits available to the entity of 30 (column B). There are unrecognised losses of 40 under paragraph 54 that arose before the asset ceiling had any effect (column C). So, if there were no asset ceiling, an asset of 100 would be recognised (column D). The asset ceiling restricts the asset to 70 (column F).

In year 2, an actuarial gain of 50 in the plan increases the surplus from 60 to 110 (column A). The economic benefits available to the entity decrease by 5 (column B). Applying paragraph 58A, there is no increase in economic benefits available to the entity. Therefore, the entire actuarial gain of 50 is recognised immediately under paragraph 54 (column D) and the cumulative unrecognised loss under paragraph 54 remains at 40 (column C). The asset ceiling decreases to 65 because of the reduction in economic benefits. That reduction is not an actuarial loss as defined by IAS 19 and therefore does not qualify for deferred recognition.

In effect, an actuarial gain of 50 is recognised immediately, but is (more than) offset by the increase in the effect of the asset ceiling.

	~~Balance sheet~~Statement of financial position asset under paragraph 54 (column D above)	**Effect of the asset ceiling**	**Asset ceiling (column F above)**
Year 1	100	(30)	70
Year 2	150	(85)	65
Gain/(loss)	50	(55)	(5)

In both examples 2 and 3 there is a reduction in economic benefits available to the entity. However, in example 2 no loss is recognised whereas in example 3 a loss is recognised. This difference in treatment is consistent with the treatment of changes in the present value of economic benefits before paragraph 58A was introduced. The purpose of paragraph 58A is solely to prevent gains (losses) being recognised because of past service cost or actuarial losses (gains). As far as is possible, all other consequences of deferred recognition and the asset ceiling are left unchanged.

Example 4 - Adjustment in a period in which the asset ceiling ceases to have an effect

	A	**B**	**C**	**D =A+C**	**E =B+C**	**F =lower of D and E**	**G**
Year	Surplus in plan	Economic benefits available (paragraph 58(b)(ii))	Losses unrecognised under paragraph 54	Paragraph 54	Paragraph 58(b)	Asset ceiling, ie recognised asset	Gain recognised in year 2
1	60	25	40	100	65	65	-
2	(50)	0	115	65	115	65	0

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At the end of year 1 there is a surplus of 60 in the plan (column A) and economic benefits are available to the entity of 25 (column B). There are unrecognised losses of 40 under paragraph 54 that arose before the asset ceiling had any effect (column C). So, if there were no asset ceiling, an asset of 100 would be recognised (column D). The asset ceiling restricts the asset to 65 (column F).

In year 2, an actuarial loss of 110 in the plan reduces the surplus from 60 to a deficit of 50 (column A). The economic benefits available to the entity decrease from 25 to 0 (column B). To apply paragraph 58A it is necessary to determine how much of the actuarial loss arises while the defined benefit asset is determined in accordance with paragraph 58(b). Once the surplus becomes a deficit, the amount determined by paragraph 54 is lower than the net total under paragraph 58(b). So, the actuarial loss that arises while the defined benefit asset is determined in accordance with paragraph 58(b) is the loss that reduces the surplus to nil, ie 60. The actuarial loss is, therefore, analysed as follows:

Actuarial loss that arises while the defined benefit asset is measured under paragraph 58(b):

Actuarial loss that equals the reduction in economic benefits	25
Actuarial loss that exceeds the reduction in economic benefits	35
	60
Actuarial loss that arises while the defined benefits asset is measured under paragraph 54	50
Total actuarial loss	110

In accordance with paragraph 58A, 35 of the actuarial loss is recognised immediately under paragraph 54 (column D); 75 (25+50) of the actuarial loss is included in the cumulative unrecognised losses which increase to 115 (column C). The amount determined under paragraph 54 becomes 65 (column D) and under paragraph 58(b) becomes 115 (column E). The recognised asset is the lower of the two, ie 65 (column F), and no gain or loss is recognised (column G).

In effect, an actuarial loss of 35 is recognised immediately, but is offset by the reduction in the effect of the asset ceiling.

	~~Balance sheet~~ Statement of financial position asset under paragraph 54 (column D above)	**Effect of the asset ceiling**	**Asset ceiling (column F (above)**
Year 1	100	(35)	65
Year 2	65	0	65
Gain/(loss)	(35)	35	0

Notes

1 In applying paragraph 58A in situations when there is an increase in the present value of the economic benefits available to the entity, it is important to remember that the present value of the economic benefits available cannot exceed the surplus in the plan.*

2 In practice, benefit improvements often result in a past service cost and an increase in expected future contributions due to increased current service costs of future years. The increase in expected future contributions may increase the economic benefits available to the entity in the form of anticipated reductions in those future contributions. The prohibition against recognising a gain solely as a result of past service cost in the current period does not prevent the recognition of a gain because of an increase in economic benefits. Similarly, a change in actuarial assumptions that causes an actuarial loss may also increase expected future contributions and, hence, the economic benefits available to the entity in the form of anticipated reductions in future contributions. Again, the prohibition against recognising a gain solely as a result of an actuarial loss in the current period does not prevent the recognition of a gain because of an increase in economic benefits.

* The example following paragraph 60 of HKAS 19 is corrected so that the present value of available future refunds and reductions in contributions equals the surplus in the plan of 90 (rather than 100), with a further correction to make the limit 270 (rather than 280).

Appendix D~~E~~

Amendments to other pronouncements

The amendments in this appendix shall be applied for annual periods beginning on or after 1 January 2005. If an entity applies this Standard for an earlier period, these amendments shall be applied for that earlier period.

* * *

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

Appendix E~~D~~

Comparison with International Accounting Standards

This comparison appendix, which was prepared as at December 2004 and deals only with significant differences in the standards extant, is produced for information only and does not form part of the standards in HKAS 19.

The International Accounting Standard comparable with HKAS 19 is IAS 19 *Employee Benefits*.

There are no major textual differences between HKAS 19 and IAS 19.

HKAS 19 BC
Revised November 2009

Basis for Conclusions on
Hong Kong Accounting Standard 19

Employee Benefits

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

HKAS 19 is based on IAS 19 *Employee Benefits*. In approving HKAS 19, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IAS 19. Accordingly, there are no significant differences between HKAS 19 and IAS 19. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IAS 19 referred to below generally correspond with those in HKAS 19.

Contents

paragraphs

BASIS FOR CONCLUSIONS ON HKAS 19 *EMPLOYEE BENEFITS*

BACKGROUND	**BC1-BC2**
SUMMARY OF CHANGES TO IAS 19	**BC3**
SUMMARY OF CHANGES TO E54	**BC4**
DEFINITIONS	**BC4A-BC4C**
DEFINED CONTRIBUTION PLANS	**BC5-BC6**
MULTI-EMPLOYER PLANS AND STATE PLANS	**BC7-BC10K**
Multi-employer plans: amendment issued by the IASB in December 2004	**BC9A-BC10**
Application of IAS 19 in the separate or individual financial statements of entities in a consolidated group: amendment issued by the IASB in December 2004	**BC10A-BC10K**
DEFINIED BENEFIT PLANS	**BC11-BC85E**
Recognition and measurement: balance sheet	**BC11-BC14**
Measurement date	**BC15-BC16**
Actuarial valuation method	**BC17-BC22**
Attributing benefit to periods of service	**BC23-BC25**
Actuarial assumptions: discount rate	**BC26-BC34**
Actuarial assumptions: salaries, benefits and medical costs	**BC35-BC37**
Actuarial gains and losses	**BC38-BC48**
An additional option for the recognition of actuarial gains and losses: amendment adopted by the IASB in December 2004	**BC48A-BC48EE**
Past service cost	**BC49-BC62B**
Recognition and measurement: an additional minimum liability	**BC63-BC65**
Plan assets	**BC66-BC75E**
Plan assets – revised definition ~~adopted~~ issued in 2000	BC68A-BC68L
Plan assets – measurement	BC69-BC75
Reimbursements	BC75A-BC75E
Limit on the recognition of an asset	**BC76-BC78**
Asset ceiling – amendment ~~adopted~~ issued in May 2002	**BC78A-BC78F**
Curtailments and settlements	**BC79-BC80**
Presentation and disclosure	**BC81-BC85**
Disclosures: amendment issued by the IASB in December 2004	**BC85A-BC85E**
BENEFITS OTHER THAN POST-EMPLOYMENT BENEFITS	**BC86-BC94**
Compensated absences	**BC86-BC88**
Death-in-service benefits	**BC89**
Other Long-term employee benefits	**BC90**
Termination benefits	**BC91-BC93**
TRANSITION AND EFFECTIVE DATE	**BC95-BC97~~6~~**
~~APPENDIX~~ **~~Amendments resulting from other Basis for Conclusions~~**	

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Basis for Conclusions

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

*The original text has been marked up to reflect the revision of IAS 39 ~~(as revised~~*Financial Instruments: Recognition and Measurement *in 2003~~)~~ and ~~subsequently~~ the issue of IFRS 2* Share-based Payment *in 2004 and* Improvements to IFRSs *in May 2008; new text is underlined and deleted text is struck through. The terminology has not been amended to reflect the changes made by IAS 1* Presentation of Financial Statements *(as revised in 2007)*

For greater clarity and for consistency with other IFRSs, paragraph numbers have been prefixed BC.

This appendix gives the Board's reasons for rejecting certain alternative solutions. Individual Board members gave greater weight to some factors than to others. Paragraphs BC9A–BC9D, BC10A–BC10K, BC48A–BC48EE and BC85A–BC85E are added in relation to the amendment to IAS 19 issued in December 2004. Paragraphs BC4A-BC4C, BC62A, BC62B and BC97 were added by Improvements to IFRSs *issued in May 2008.*

Background

BC1 The IASC Board (the 'Board') approved IAS 19 *Accounting for Retirement Benefits in the Financial Statements of Employers*, in 1983. Following a limited review, the Board approved a revised Standard IAS 19 *Retirement Benefit Costs* ('the old IAS 19'), in 1993. The Board began a more comprehensive review of IAS 19 in November 1994. In August 1995, the IASC Staff published an Issues Paper on *Retirement Benefit and Other Employee Benefit Costs*. In October 1996, the Board approved E54 *Employee Benefits*, with a comment deadline of 31 January 1997. The Board received more than 130 comment letters on E54 from over 20 countries. The Board approved IAS 19 *Employee Benefits* ('the new IAS 19') in January 1998.

BC2 The Board believes that the new IAS 19 is a significant improvement over the old IAS 19. Nevertheless, the Board believes that further improvement may be possible in due course. In particular, several Board members believe that it would be preferable to recognise all actuarial gains and losses immediately in a statement of financial performance. However, the Board believes that such a solution is not feasible for actuarial gains and losses until the Board makes further progress on various issues relating to the reporting of financial performance. When the Board makes further progress with those issues, it may decide to revisit the treatment of actuarial gains and losses.

Summary of changes to IAS 19

BC3 The most significant feature of the new IAS 19 is a market based approach to measurement. The main consequences are that the discount rate is based on market yields at the balance sheet date and any plan assets are measured at fair value. In summary, the main changes from the old IAS 19 are the following:

(a) there is a revised definition of defined contribution plans and related guidance (see paragraphs BC5 and BC6 below), including more detailed guidance than the old IAS 19 on multi-employer plans and state plans (see paragraphs BC7-BC10 below) and on insured plans;

(b) there is improved guidance on the balance sheet treatment of liabilities and assets arising from defined benefit plans (see paragraphs BC11-BC14 below).

(c) defined benefit obligations should be measured with sufficient regularity that the amounts recognised in the financial statements do not differ materially from the amounts that would be determined at the balance sheet date (see paragraphs BC15 and BC16 below);

(d) projected benefit methods are eliminated and there is a requirement to use the accrued benefit method known as the Projected Unit Credit Method (see paragraphs BC17-BC22 below). The use of an accrued benefit method makes it essential to give detailed guidance on the attribution of benefit to individual periods of service (see paragraphs BC23-BC25 below);

(e) the rate used to discount post-employment benefit obligations and other long-term employee benefit obligations (both funded and unfunded) should be determined by reference to market yields at the balance sheet date on high quality corporate bonds. In countries where there is no deep market in such bonds, the market yields (at the balance sheet date) on government bonds should be used. The currency and term of the corporate bonds or government bonds should be consistent with the currency and estimated term of the post-employment benefit obligations (see paragraphs BC26-BC34 below);

(f) defined benefit obligations should consider all benefit increases that are set out in the terms of the plan (or result from any constructive obligation that goes beyond those terms) at the balance sheet date (see paragraphs BC35-BC37 below);

(g) an entity should recognise, as a minimum, a specified portion of those actuarial gains and losses (arising from both defined benefit obligations and any related plan assets) that fall outside a 'corridor'. An entity is permitted, but not required, to adopt certain systematic methods of faster recognition. Such methods include, among others, immediate recognition of all actuarial gains and losses (see paragraphs BC38-BC48 below);

(h) an entity should recognise past service cost on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits are already vested immediately, an entity should recognise past service cost immediately (see paragraphs BC49-BC62 below);

(i) plan assets should be measured at fair value. Fair value is estimated by discounting expected future cash flows only if no market price is available (see paragraphs BC66-BC75 below);

(j) amounts recognised by the reporting entity as an asset should not exceed the net total of:

  (i) any unrecognised actuarial losses and past service cost; and

  (ii) the present value of any economic benefits available in the form of refunds from the plan or reductions in contributions to the plan (see paragraphs BC76-BC78 below);

(k) curtailment and settlement losses should be recognised not when it is probable that the settlement or curtailment will occur, but when the settlement or curtailment occurs (see paragraphs BC79 and BC80 below);

(l) improvements have been made to the disclosure requirements (see paragraphs BC81-BC85 below);

(m) the new IAS 19 deals with all employee benefits, whereas IAS 19 deals only with retirement benefits and certain similar post-employment benefits (see paragraphs BC86-BC94 below); and

(n) the transitional provisions for defined benefit plans are amended (see paragraphs BC95-BC96 below).

The Board rejected a proposal to require recognition of an 'additional minimum liability' in certain cases (see paragraphs BC63-BC65 below).

Summary of changes to E54

BC4 The new IAS 19 makes the following principal changes to the proposals in E54:

(a) an entity should attribute benefit to periods of service following the plan's benefit formula, but the straight-line basis should be used if employee service in later years leads to a materially higher level of benefit than in earlier years (see paragraphs BC23-BC25 below);

(b) actuarial assumptions should include estimates of benefit increases not if there is reliable evidence that they will occur, but only if the increases are set out in the terms of the plan (or result from any constructive obligation that goes beyond those terms) at the balance sheet date (see paragraphs BC35-BC37 below);

(c) actuarial gains and losses that fall outside the 10% 'corridor' need not be recognised immediately as proposed in E54. The minimum amount that an entity should recognise for each defined benefit plan is the part that fell outside the 'corridor' as at the end of the previous reporting period, divided by the expected average remaining working lives of the employees participating in that plan. The new IAS 19 also permits certain systematic methods of faster recognition. Such methods include, among others, immediate recognition of all actuarial gains and losses (see paragraphs BC38-BC48 below);

(d) E54 set out two alternative treatments for past service cost and indicated that the Board would eliminate one of these treatments after considering comments on the Exposure Draft. One treatment was immediate recognition of all past service cost. The other treatment was immediate recognition for former employees, with amortisation for current employees over the remaining working lives of the current employees. The new IAS 19 requires that an entity should recognise past service cost on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits are already vested immediately an entity should recognise past service cost immediately (see paragraphs BC49-BC59 below);

(e) the effect of 'negative plan amendments' should not be recognised immediately (as proposed in E54) but treated in the same way as past service cost (see paragraphs BC60-BC62 below);

(f) non-transferable securities issued by the reporting entity have been excluded from the definition of plan assets (see paragraphs BC67 and BC68 below);

(g) plan assets should be measured at fair value rather than market value, as defined in E54 (see paragraphs BC69 and BC70 below);

(h) plan administration costs (not just investment administration costs, as proposed in E54) are to be deducted in determining the return on plan assets (see paragraph BC75 below);

(i) the limit on the recognition of plan assets has been changed in two respects from the proposals in E54. The limit does not override the corridor for actuarial losses or the deferred recognition of past service cost. Also, the limit refers to **available** refunds or reductions in future contributions. E54 referred to the **expected** refunds or reductions in future contributions (see paragraphs BC76-BC78 below);

(j) unlike E54, the new IAS 19 does not specify whether an income statement should present interest cost and the expected return on plan assets in the same line item as current service cost. The new IAS 19 requires an entity to disclose the line items in which they are included;

(k) improvements have been made to the disclosure requirements (see paragraphs BC81-BC85 below);

(l) the guidance in certain areas (particularly termination benefits, curtailments and settlements, profit sharing and bonus plans and various references to constructive obligations) has been conformed to the proposals in E59, *Provisions, Contingent Liabilities and Contingent Assets*. Also, the Board has added explicit guidance on the measurement of termination benefits, requiring discounting for termination benefits not payable within one year (see paragraphs BC91-BC93 below); and

(m) on initial adoption of the new IAS 19, there is a transitional option to recognise an increase in defined benefit liabilities over not more than five years. The new IAS 19 is operative for financial statements covering periods beginning on or after 1 January 1999, rather than 2001 as proposed in E54 (see paragraphs BC95-BC96 below).

Definitions

BC4A The IASB identified a perceived inconsistency in the definitions when a compensated absence that is due to the employee but is not expected to occur for more than twelve months is neither an ‘other long-term employee benefit’ nor a ‘short-term compensated absence’ as previously defined in paragraphs 7 and 8(b). The IASB decided to amend those definitions and replace the term ‘fall due’ to remove this potential gap as part of the *Improvements to IFRSs* issued in May 2008.

BC4B Noting respondents’ comments on the exposure draft of proposed *Improvements to International Financial Reporting Standards* published in 2007, the IASB concluded that the critical factor in distinguishing between long-term and short-term benefits is the timing of the expected settlement. Therefore, the IASB clarified that other long-term benefits are those that are not *due to be settled* within twelve months after the end of the period in which the employees rendered the service.

BC4C The IASB noted that this distinction between short-term and long-term benefits is consistent with the current/non-current liability distinction in IAS 1 *Presentation of Financial Statements.* However, the fact that for presentation purposes a long-term benefit may be split into current and non-current portions does not change how the entire long-term benefit would be measured.

Defined contribution plans (paragraphs 24-47 of the standard)

BC5 The old IAS 19 defined:

(a) **defined contribution plans** as retirement benefit plans under which amounts to be paid as retirement benefits are determined by reference to contributions to a fund together with investment earnings thereon; and

(b) **defined benefit plans** as retirement benefit plans under which amounts to be paid as retirement benefits are determined by reference to a formula usually based on employees' remuneration and/or years of service.

The Board considers these definitions unsatisfactory because they focus on the benefit receivable by the employee, rather than on the cost to the entity. The definitions in paragraph 7 of the new IAS 19 focus on the downside risk that the cost to the entity may increase. The definition of defined contribution plans does not exclude the upside potential that the cost to the entity may be less than expected.

BC6 The new IAS 19 does not change the accounting for defined contribution plans, which is straightforward because there is no need for actuarial assumptions and an entity has no possibility of any actuarial gain or loss. The new IAS 19 gives no guidance equivalent to paragraphs 20 (past service costs in defined contribution plans) and 21 (curtailment of defined contribution plans) of the old IAS 19. The Board believes that these issues are not relevant to defined contribution plans.

Multi-employer plans and state plans (paragraphs 29-38 of the Standard)

BC7 An entity may not always be able to obtain sufficient information from multi-employer plans to use defined benefit accounting. The Board considered three approaches to this problem:

(a) use defined contribution accounting for some and defined benefit accounting for others;

(b) use defined contribution accounting for all multi-employer plans, with additional disclosure where the multi-employer plan is a defined benefit plan; or

(c) use defined benefit accounting for those multi-employer plans that are defined benefit plans. However, where sufficient information is not available to use defined benefit accounting, an entity should disclose that fact and use defined contribution accounting.

BC8 The Board believes that there is no conceptually sound, workable, and objective way to draw a distinction so that an entity could use defined contribution accounting for some multi-employer defined benefit plans and defined benefit accounting for others. Also, the Board believes that it is misleading to use defined contribution accounting for multi-employer plans that are defined benefit plans. This is illustrated by the case of French banks that used defined contribution accounting for defined benefit pension plans operated under industry-wide collective agreements on a pay-as-you-go basis. Demographic trends made these plans unsustainable and a major reform in 1993 replaced these by defined contribution arrangements for future service. At this point, the banks were compelled to quantify their obligations. Those obligations had previously existed, but had not been recognised as liabilities.

BC9 The Board concluded that an entity should use defined benefit accounting for those multi-employer plans that are defined benefit plans. However, where sufficient information is not available to use defined benefit accounting, an entity should disclose that fact and use defined contribution accounting. The Board agreed to apply the same principle to state plans. The new IAS 19 notes that most state plans are defined contribution plans.

Multi-employer plans: amendment issued by the IASB in December 2004

BC9A In April 2004 the International Financial Reporting Interpretations Committee(IFRIC) published a draft Interpretation, D6 *Multi-employer Plans,* which proposed the following guidance on how multi-employer plans should apply defined benefit accounting, if possible:

(a) the plan should be measured in accordance with IAS 19 using assumptions appropriate for the plan as a whole

(b) the plan should be allocated to plan participants so that they recognise an asset or liability that reflects the impact of the surplus or deficit on the future contributions from the participant.

BC9B The concerns raised by respondents to D6 about the availability of the information about the plan as a whole, the difficulties in making an allocation as proposed and the resulting lack of usefulness of the information provided by defined benefit accounting were such that the IFRIC decided not to proceed with the proposals.

BC9C The International Accounting Standards Board (IASB), when discussing group plans (see paragraphs BC10A-BC10K) noted that, if there were a contractual agreement between a multi-employer plan and its participants on how a surplus would be distributed or deficit funded, the same principle that applied to group plans should apply to multi-employer plans, ie the participants should recognise an asset or liability. In relation to the funding of a deficit, the IASB regarded this principle as consistent with the recognition of a provision in accordance with IAS 37.

BC9D The IASB therefore decided to clarify in IAS 19 that, if a participant in a defined benefit multi-employer plan:

(a) accounts for that participation on a defined contribution basis in accordance with paragraph 30 of IAS 19 because it had insufficient information to apply defined benefit accounting but

(b) has a contractual agreement that determined how a surplus would be distributed or a deficit funded,

it recognises the asset or liability arising from that contractual agreement.

BC10 In response to comments on E54, the Board considered a proposal to exempt wholly owned subsidiaries (and their parents) participating in group defined benefit plans from the recognition and measurement requirements in their individual non-consolidated financial statements, on cost-benefit grounds. The Board concluded that such an exemption would not be appropriate.

Application of IAS 19 in the separate or individual financial statements of entities in a consolidated group: amendment issued by the IASB in December 2004

BC10A Some constituents asked the IASB to consider whether entities participating in a group defined benefit plan should, in their separate or individual financial statements, either have an unqualified exemption from defined benefit accounting or be able to treat the plan as a multi-employer plan.

BC10B In developing the exposure draft, the IASB did not agree that an unqualified exemption from defined benefit accounting for group defined benefit plans in the separate or individual financial statements of group entities was appropriate. In principle, the requirements of International Financial Reporting Standards (IFRSs) should apply to separate or individual financial statements in the same way as they apply to any other financial statements. Following that principle would mean amending IAS 19 to allow group entities that participate in a plan that meets the definition of a multi-employer plan, except that the participants are under common control, to be treated as participants in a multi-employer plan in their separate or individual financial statements.

BC10C However, in the exposure draft, the IASB concluded that entities within a group should always be presumed to be able to obtain the necessary information about the plan as a whole. This implies that, in accordance with the requirements for multi-employer plans, defined benefit accounting should be applied if there is a consistent and reliable basis for allocating the assets and obligations of the plan.

BC10D In the exposure draft, the IASB acknowledged that entities within a group might not be able to identify a consistent and reliable basis for allocating the plan that results in the entity recognising an asset or liability that reflects the extent to which a surplus or deficit in the plan would affect their future contributions. This is because there may be uncertainty in the terms of the plan about how surpluses will be used or deficits funded across the consolidated group. However, the IASB concluded that entities within a group should always be able to make at least a consistent and *reasonable* allocation, for example on the basis of a percentage of pensionable pay.

BC10E The IASB then considered whether, for some group entities, the benefits of defined benefit accounting using a consistent and *reasonable* basis of allocation were worth the costs involved in obtaining the information. The IASB decided that this was not the case for entities that meet criteria similar to those in IAS 27 *Consolidated and Separate Financial Statements* for the exemption from preparing consolidated financial statements.

BC10F The exposure draft therefore proposed that:

(a) entities that participate in a plan that would meet the definition of a multi-employer plan except that the participants are under common control, and that meet the criteria set out in paragraph 34 of IAS 19 as proposed to be amended in the exposure draft, should be treated as if they were participants in a multi-employer plan. This means that if there is no consistent and reliable basis for allocating the assets and liabilities of the plan, the entity should use defined contribution accounting and provide additional disclosures.

(b) all other entities that participate in a plan that would meet the definition of a multi-employer plan except that the participants are under common control should be required to apply defined benefit accounting by making a consistent and reasonable allocation of the assets and liabilities of the plan.

BC10G Respondents to the exposure draft generally supported the proposal to extend the requirements in IAS 19 on multi-employer plans to group entities. However, many disagreed with the criteria proposed in the exposure draft, for the following reasons:

(a) the proposed amendments and the interaction with D6 were unclear.

(b) the provisions for multi-employer accounting should be extended to a listed parent company.

(c) the provisions for multi-employer accounting should be extended to group entities with listed debt.

(d) the provisions for multi-employer plan accounting should be extended to all group entities, including partly-owned subsidiaries.

(e) there should be a blanket exemption from defined benefit accounting for all group entities.

BC10H The IASB agreed that the proposed requirements for group plans were unnecessarily complex. The IASB also concluded that it would be better to treat group plans separately from multi-employer plans because of the difference in information available to the participants: in a group plan information about the plan as a whole should generally be available. The IASB further noted that, if the parent wishes to comply with IFRSs in its separate financial statements or wishes its subsidiaries to comply with IFRSs in their individual financial statements, then it must obtain and provide the necessary information for the purposes of disclosure, at least.

BC10I The IASB noted that, if there were a contractual agreement or stated policy on charging the net defined benefit cost to group entities, that agreement or policy would determine the cost for each entity. If there is no such contractual agreement or stated policy, the entity that is the sponsoring employer by default bears the risk relating to the plan. The IASB therefore concluded that a group plan should be allocated to the individual entities within a group in accordance with any contractual agreement or stated policy. If there is no such agreement or policy, the net defined benefit cost is allocated to the sponsoring employer. The other group entities recognise a cost equal to any contribution collected by the sponsoring employer.

BC10J This approach has the advantages of (a) all group entities recognising the cost they have to bear for the defined benefit promise and (b) being simple to apply.

BC10K The IASB also noted that participation in a group plan is a related party transaction. As such, disclosures are required to comply with IAS 24 *Related Party Disclosures*. Paragraph 20 of IAS 24 requires an entity to disclose the nature of the related party relationship as well as information about the transactions and outstanding balances necessary for an understanding of the potential effect of the relationship on the financial statements. The IASB noted that information about each of (a) the policy on charging the defined benefit cost, (b) the policy on charging current contributions and (c) the status of the plan as a whole was required to give an understanding of the potential effect of the participation in the group plan on the entity's separate or individual financial statements.

Defined benefit plans

Recognition and measurement: balance sheet (paragraphs 49-60 of the Standard)

BC11 Paragraph 54 of the new IAS 19 summarises the recognition and measurement of liabilities arising from defined benefit plans and paragraphs 55-107 of the new IAS 19 describe various aspects of recognition and measurement in greater detail. Although the old IAS 19 did not deal explicitly with the recognition of retirement benefit obligations as a liability, it is likely that most entities would recognise a liability for retirement benefit obligations at the same time under both Standards. However, the two Standards differ in the measurement of the resulting liability.

BC12 Paragraph 54 of the new IAS 19 is based on the definition of, and recognition criteria for, a liability in IASC's *Framework for the Preparation and Presentation of Financial Statements* (the *'Framework'*). The *Framework* defines a liability *as a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits*. The *Framework* states that an item which meets the definition of a liability should be recognised if:

(a) it is probable that any future economic benefit associated with the item will flow from the entity; and

(b) the item has a cost or value that can be measured with reliability.

BC13 The Board believes that:

(a) an entity has an obligation under a defined benefit plan when an employee has rendered service in return for the benefits promised under the plan. Paragraphs 67-71 of the new IAS 19 deal with the attribution of benefit to individual periods of service in order to determine whether an obligation exists;

(b) an entity should use actuarial assumptions to determine whether the entity will pay those benefits in future reporting periods (see paragraphs 72-91 of the Standard); and

(c) actuarial techniques allow an entity to measure the obligation with sufficient reliability to justify recognition of a liability.

BC14 The Board believes that an obligation exists even if a benefit is not vested, in other words if the employee's right to receive the benefit is conditional on future employment. For example, consider an entity that provides a benefit of 100 to employees who remain in service for two years. At the end of the first year, the employee and the entity are not in the same position as at the beginning of the first year, because the employee will only need to work for one year, instead of two, before becoming entitled to the benefit. Although there is a possibility that the benefit may not vest, that difference is an obligation and, in the Board's view, should result in the recognition of a liability at the end of the first year. The measurement of that obligation at its present value reflects the entity's best estimate of the probability that the benefit may not vest.

Measurement date (paragraphs 56 and 57 of the Standard)

BC15 Some national standards permit entities to measure the present value of defined benefit obligations at a date up to three months before the balance sheet date. However, the Board decided that entities should measure the present value of defined benefit obligations, and the fair value of any plan assets, at the balance sheet date. Therefore, if an entity carries out a detailed valuation of the obligation at an earlier date, the results of that valuation should be updated to take account of any significant transactions and other significant changes in circumstances up to the balance sheet date.

BC16 In response to comments on E54, the Board has clarified that full actuarial valuation is not required at the balance sheet date, provided that an entity determines the present value of defined benefit obligations and the fair value of any plan assets with sufficient regularity that the amounts recognised in the financial statements do not differ materially from the amounts that would be determined at the balance sheet date.

Actuarial valuation method (paragraphs 64-66 of the Standard)

BC17 The old IAS 19 permitted both accrued benefit valuation methods (benchmark treatment) and projected benefit valuation methods (allowed alternative treatment). The two groups of methods are based on fundamentally different, and incompatible, views of the objectives of accounting for employee benefits:

(a) **accrued benefit methods** (sometimes known as 'benefit', 'unit credit' or 'single premium' methods) determine the present value of employee benefits attributable to service to date; but

(b) **projected benefit methods** (sometimes described as 'cost', 'level contribution' or 'level premium' methods) project the estimated total obligation at retirement and then calculate a level funding cost, taking into account investment earnings, that will provide the total benefit at retirement.

The differences between the two groups of methods were discussed in more detail in the Issues Paper published in August 1995.

BC18 The two methods may have similar effects on the income statement, but only by chance or if the number and age distribution of participating employees remains relatively stable over time. There can be significant differences in the measurement of liabilities under the two groups of methods. For these reasons, the Board believes that a requirement to use a single group of methods will significantly enhance comparability.

BC19 The Board considered whether it should continue to permit projected benefit methods as an allowed alternative treatment while introducing a new requirement to disclose information equivalent to the use of an accrued benefit method. However, the Board believes that disclosure cannot rectify inappropriate accounting in the balance sheet and income statement. The Board concluded that projected benefit methods are not appropriate, and should be eliminated, because such methods:

(a) focus on future events (future service) as well as past events, whereas accrued benefit methods focus only on past events;

(b) generate a liability which does not represent a measure of any real amount and can be described only as the result of cost allocations; and

(c) do not attempt to measure fair value and cannot, therefore, be used in a business combination, as required by IAS 22 *Business Combinations*[1]. If an entity uses an accrued benefit method in a business combination, it would not be feasible for the entity to use a projected benefit method to account for the same obligation in subsequent periods.

BC20 The old IAS 19 did not specify which forms of accrued benefit valuation method should be permitted under the benchmark treatment. The new IAS 19 requires a single accrued benefit method: the most widely used accrued benefit method, which is known as the Projected Unit Credit Method (sometimes known as the 'accrued benefit method pro-rated on service' or as the 'benefit/years of service method').

BC21 The Board acknowledges that the elimination of projected benefit methods, and of accrued benefit methods other than the Projected Unit Credit Method, has cost implications. However, with modern computing power, it will be only marginally more expensive to run a valuation on two different bases and the advantages of improved comparability will outweigh the additional cost.

BC22 An actuary may sometimes, for example in the case of a closed fund, recommend a method other than the Projected Unit Credit Method for funding purposes. Nevertheless, the Board agreed to require the use of the Projected Unit Credit Method in all cases because that method is more consistent with the accounting objectives laid down in the new IAS 19.

Attributing benefit to periods of service (paragraphs 67-71 of the Standard)

BC23 As explained in paragraph BC13 above, the Board believes that an entity has an obligation under a defined benefit plan when an employee has rendered service in return for the benefits promised under the plan. The Board considered three alternative methods of accounting for a defined benefit plan which attributes different amounts of benefit to different periods:

(a) apportion the entire benefit on a straight-line basis over the entire period to the date when further service by the employee will lead to no material amount of further benefits under the plan, other than from further salary increases;

(b) apportion benefit under the plan's benefit formula. However, a straight-line basis should be used if the plan's benefit formula attributes a materially higher benefit to later years; or

(c) apportion the benefit that vests at each interim date on a straight-line basis over the period between that date and the previous interim vesting date.

The three methods are illustrated by the following two examples.

[1] IAS 22 was withdrawn in 2004 and replaced by IFRS 3 *Business Combinations*.

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Example 1

A plan provides a benefit of 400 if an employee retires after more than ten and less than twenty years of service and a further benefit of 100 (500 in total) if an employee retires after twenty or more years of service.

The amounts attributed to each year are as follows:

	Years 1-10	*Years 11-20*
Method (a)	*25*	*25*
Method (b) `	*40*	*10*
Method (c)	*40*	*10*

Example 2

A plan provides a benefit of 100 if an employee retires after more than ten and less than twenty years of service and a further benefit of 400 (500 in total) if an employee retires after twenty or more years of service.

The amounts attributed to each year are as follows:

	Years 1-10	*Years 11-20*
Method (a)	*25*	*25*
Method (b)	*25*	*25*
Method (c)	*10*	*40*

Note: this plan attributes a higher benefit to later years, whereas the plan in Example 1 attributes a higher benefit to earlier years.

BC24 In approving E54, the Board adopted method (a) on the grounds that this method was the most straight-forward and that there were no compelling reasons to attribute different amounts of benefit to different years, as would occur under either of the other methods.

BC25 A significant minority of commentators on E54 favoured following the benefit formula (or alternatively, if the final Standard were to retain straight-line attribution, the recognition of a minimum liability based on the benefit formula). The Board agreed with these comments and decided to require method (b).

Actuarial assumptions: discount rate (paragraphs 78-82 of the Standard)

BC26 One of the most important issues in measuring defined benefit obligations is the selection of the criteria used to determine the discount rate. According to the old IAS 19, the discount rate assumed in determining the actuarial present value of promised retirement benefits reflected the long term rates, or an approximation thereto, at which such obligations are expected to be settled. The Board rejected the use of such a rate because it is not relevant for an entity that does not contemplate settlement and it is an artificial construct, as there may be no market for settlement of such obligations.

BC27 Some believe that, for funded benefits, the discount rate should be the expected rate of return on the plan assets actually held by a plan, on the grounds that the return on plan assets represents faithfully the expected ultimate cash outflow (i.e. future contributions). The Board rejected this approach because the fact that a fund has chosen to invest in certain kinds of asset does not affect the nature or amount of the obligation. In particular, assets with a higher expected return carry more risk and an entity should not recognise a smaller liability merely because the plan has chosen to invest in riskier assets with a higher expected return.

Therefore, the measurement of the obligation should be independent of the measurement of any plan assets actually held by a plan.

BC28 The most significant decision is whether the discount rate should be a risk-adjusted rate (one that attempts to capture the risks associated with the obligation). Some argue that the most appropriate risk-adjusted rate is given by the expected return on an appropriate portfolio of plan assets that would, over the long term, provide an effective hedge against such an obligation. An appropriate portfolio might include:

(a) fixed-interest securities for obligations to former employees to the extent that the obligations are not linked, in form or in substance, to inflation;

(b) index-linked securities for index-linked obligations to former employees; and

(c) equity securities for benefit obligations towards current employees that are linked to final pay. This is based on the view that the long-term performance of equity securities is correlated with general salary progression in the economy as a whole and hence with the final-pay element of a benefit obligation.

It is important to note that the portfolio actually held need not necessarily be an appropriate portfolio in this sense. Indeed, in some countries, regulatory constraints may prevent plans from holding an appropriate portfolio. For example, in some countries, plans are required to hold a certain proportion of their assets in the form of fixed-interest securities. Furthermore, if an appropriate portfolio is a valid reference point, it is equally valid for both funded and unfunded plans.

BC29 Those who support using the interest rate on an appropriate portfolio as a risk-adjusted discount rate argue that:

(a) portfolio theory suggests that the expected return on an asset (or the interest rate inherent in a liability) is related to the undiversifiable risk associated with that asset (or liability). Undiversifiable risk reflects not the variability of the returns (payments) in **absolute** terms but the **correlation** of the returns (or payments) with the returns on other assets. If cash inflows from a portfolio of assets react to changing economic conditions over the long term in the same way as the cash outflows of a defined benefit obligation, the undiversifiable risk of the obligation (and hence the appropriate discount rate) must be the same as that of the portfolio of assets;

(b) an important aspect of the economic reality underlying final salary plans is the correlation between final salary and equity returns that arises because they both reflect the same long-term economic forces. Although the correlation is not perfect, it is sufficiently strong that ignoring it will lead to systematic over-statement of the liability. Also, ignoring this correlation will result in misleading volatility due to short term fluctuations between the rate used to discount the obligation and the discount rate that is implicit in the fair value of the plan assets. These factors will deter entities from operating defined benefit plans and lead to switches from equities to fixed interest investments. Where defined benefit plans are largely funded by equities, this could have a serious impact on share prices. This switch will also increase the cost of pensions. There will be pressure on companies to remove the apparent (but non-existent) shortfall;

(c) if an entity settled its obligation by purchasing an annuity, the insurance company would determine the annuity rates by looking to a portfolio of assets that provides cash inflows that substantially offset all the cash flows from the benefit obligation as those cash flows fall due. Therefore, the expected return on an appropriate portfolio measures the obligation at an amount that is close to its market value. In practice, it is not possible to settle a final pay obligation by buying annuities since no insurance company would insure a final pay decision that remained at the discretion of the person insured. However, evidence can be derived from the purchase/sale of businesses that include a final salary pension scheme. In this situation the vendor and purchaser would negotiate a price for the pension obligation by reference to its present value, discounted at the rate of return on an appropriate portfolio;

(d) although investment risk is present even in a well-diversified portfolio of equity securities, any general decline in securities would, in the long-term, be reflected in declining salaries. Since employees accepted that risk by agreeing to a final salary

plan, the exclusion of that risk from the measurement of the obligation would introduce a systematic bias into the measurement; and

(e) time-honoured funding practices in some countries use the expected return on an appropriate portfolio as the discount rate. Although funding considerations are distinct from accounting issues, the long history of this approach calls for careful scrutiny of any other proposed approach.

BC30 Those who oppose a risk-adjusted rate argue that:

(a) it is incorrect to look at returns on assets in determining the discount rate for liabilities;

(b) if a sufficiently strong correlation between asset returns and final pay actually existed, a market for final salary obligations would develop, yet this has not happened. Furthermore, where any such apparent correlation does exist, it is not clear whether the correlation results from shared characteristics of the portfolio and the obligations or from changes in the contractual pension promise;

(c) the return on equity securities does not correlate with other risks associated with defined benefit plans, such as variability in mortality, timing of retirement, disability and adverse selection;

(d) in order to evaluate a liability with uncertain cash flows, an entity would normally use a discount rate lower than the risk-free rate, yet the expected return on an appropriate portfolio is higher than the risk-free rate;

(e) the assertion that final salary is strongly correlated with asset returns implies that final salary will tend to decrease if asset prices fall, yet experience shows that salaries tend not to decline;

(f) the notion that equities are not risky in the long-term, and the associated notion of long-term value, are based on the fallacious view that the market always bounces back after a crash. Shareholders do not get credit in the market for any additional long-term value if they sell their shares today. Even if some correlation exists over long periods, benefits must be paid as they become due. An entity that funds its obligations with equity securities runs the risk that equity prices may be down when benefits must be paid. Also, the hypothesis that the real return on equities is uncorrelated with inflation does not mean that equities offer a risk-free return, even in the long term; and

(g) the expected long-term rate of return on an appropriate portfolio cannot be determined sufficiently objectively in practice to provide an adequate basis for an accounting standard. The practical difficulties include specifying the characteristics of the appropriate portfolio, selecting the time horizon for estimating returns on the portfolio and estimating those returns.

BC31 The Board has not identified clear evidence that the expected return on an appropriate portfolio of assets provides a relevant and reliable indication of the risks associated with a defined benefit obligation, or that such a rate can be determined with reasonable objectivity. Therefore, the Board decided that the discount rate should reflect the time value of money but should not attempt to capture those risks. Furthermore, the discount rate should not reflect the entity's own credit rating, as otherwise an entity with a lower credit rating would recognise a smaller liability. The rate that best achieves these objectives is the yield on high quality corporate bonds. In countries where there is no deep market in such bonds, the yield on government bonds should be used.

BC32 Another issue is whether the discount rate should be the long-term average rate, based on past experience over a number of years, or the current market yield at the balance sheet date for an obligation of the appropriate term. Those who support a long-term average rate argue that:

(a) a long-term approach is consistent with the transaction-based historical cost approach that is either required or permitted in other International Accounting Standards;

(b) point in time estimates pursue a level of precision that is not attainable in practice and lead to volatility in reported profit that may not be a faithful representation of changes in the obligation but may simply reflect an unavoidable inability to predict accurately the future events that are anticipated in making period-to-period measures;

(c) for an obligation based on final salary, neither market annuity prices nor simulation by discounting expected future cash flows can determine an unambiguous annuity price; and

(d) over the long term, a suitable portfolio of plan assets may provide a reasonably effective hedge against an employee benefit obligation that increases in line with salary growth. However, there is much less assurance that, at a given measurement date, market interest rates will match the salary growth built into the obligation.

BC33 The Board decided that the discount rate should be determined by reference to market yields at the balance sheet date as:

(a) there is no rational basis for expecting efficient market prices to drift towards any assumed long-term average, because prices in a market of sufficient liquidity and depth incorporate all publicly available information and are more relevant and reliable than an estimate of long-term trends by any individual market participant;

(b) the cost of benefits attributed to service during the current period should reflect prices of that period;

(c) if expected future benefits are defined in terms of projected future salaries that reflect current estimates of future inflation rates, the discount rate should be based on current market interest rates (in nominal terms), as these also reflect current market expectations of inflation rates; and

(d) if plan assets are measured at a current value (i.e. fair value), the related obligation should be discounted at a current discount rate in order to avoid introducing irrelevant volatility through a difference in the measurement basis.

BC34 The reference to market yields at the balance sheet date does not mean that short-term discount rates should be used to discount long-term obligations. The new IAS 19 requires that the discount rate should reflect market yields (at the balance sheet date) on bonds with an expected term consistent with the expected term of the obligations.

Actuarial assumptions: salaries, benefits and medical costs (paragraphs 83-91 of the Standard)

BC35 Some argue that estimates of future increases in salaries, benefits and medical costs should not affect the measurement of assets and liabilities until they are granted, on the grounds that:

(a) future increases are future events; and

(b) such estimates are too subjective.

BC36 The Board believes that the assumptions are used not to determine whether an obligation exists, but to measure an existing obligation on a basis which provides the most relevant measure of the estimated outflow of resources. If no increase is assumed, this is an implicit assumption that no change will occur and it would be misleading to assume no change if an entity expects a change. The new IAS 19 maintains the existing requirement that measurement should take account of estimated future salary increases. The Board also believes that increases in future medical costs can be estimated with sufficient reliability to justify incorporation of those estimated increases in the measurement of the obligation.

BC37 E54 proposed that measurement should also assume future benefit increases if there is reliable evidence that those benefit increases will occur. In response to comments, the Board concluded that future benefit increases do not give rise to a present obligation and that there would be no reliable or objective way of deciding which future benefit increases were reliable enough to be incorporated in actuarial assumptions. Therefore, the new IAS 19 requires that future benefit increases should be assumed only if they are set out in the terms of the plan (or result from any constructive obligation that goes beyond the formal terms) at the balance sheet date.

Actuarial gains and losses (paragraphs 92-95 of the Standard)

BC38 The Board considered five methods of accounting for actuarial gains and losses:

(a) deferred recognition in both the balance sheet and the income statement over the average expected remaining working life of the employees concerned (see paragraph BC39 below);

(b) immediate recognition both in the balance sheet and outside the income statement in equity (IAS 1 *Presentation of Financial Statements* sets out requirements for the presentation or disclosure of such movements in equity)* (see paragraphs BC40 and BC41 below);

(c) a 'corridor' approach, with immediate recognition in both the balance sheet and the income statement for amounts falling outside a 'corridor' (see paragraph BC42 below);

(d) a modified 'corridor' approach with deferred recognition of items within the 'corridor' and immediate recognition for amounts falling outside the 'corridor' (see paragraph BC43 below); and

(e) deferred recognition for amounts falling outside a 'corridor' (see paragraphs BC44-BC46 below).

BC39 The old IAS 19 required a deferred recognition approach: actuarial gains and losses were recognised as an expense or as income systematically over the expected remaining working lives of those employees. Arguments for this approach are that:

(a) immediate recognition (even when reduced by a 'corridor') can cause volatile fluctuations in liability and expense and implies a degree of accuracy which can rarely apply in practice. This volatility may not be a faithful representation of changes in the obligation but may simply reflect an unavoidable inability to predict accurately the future events that are anticipated in making period-to-period measures; and

(b) in the long term, actuarial gains and losses may offset one another. Actuarial assumptions are projected over many years, for example until the expected date of death of the last pensioner, and are, accordingly, long-term in nature. Departures from the assumptions do not normally denote definite changes in the underlying assets or liability, but are indicators which, if not reversed, may accumulate to denote such changes in the future. They are not a gain or loss of the period but a fine tuning of the cost that emerges over the long-term; and

(c) the immediate recognition of actuarial gains and losses in the income statement would cause unacceptable volatility.

BC40 Arguments for an immediate recognition approach are that:

(a) deferred recognition and 'corridor' approaches are complex, artificial and difficult to understand. They add to cost by requiring enterprises to keep complex records. They also require complex provisions to deal with curtailments, settlements and transitional matters. Also, as such approaches are not used for other uncertain assets and liabilities, it is not clear why they should be used for post-employment benefits;

(b) it requires less disclosure because all actuarial gains and losses are recognised;

(c) it represents faithfully the entity's financial position. An entity will report an asset only when a plan is in surplus and a liability only when a plan has a deficit. Paragraph 95 of the *Framework* notes that the application of the matching concept does not allow the recognition of items in the balance sheet which do not meet the definition of assets or liabilities. Deferred actuarial losses do not represent future benefits and hence do not meet the *Framework*'s definition of an asset, even if offset against a related liability. Similarly, deferred actuarial gains do not meet the *Framework*'s definition of a liability;

* IAS 1 (as revised in 2007) requires non-owner transactions to be presented separately from owner transactions in a statement of comprehensive income.

(d) the balance sheet treatment is consistent with the proposals in the Financial Instruments Steering Committee's March 1997 Discussion Paper *Accounting for Financial Assets and Liabilities*;

(e) it generates income and expense items that are not arbitrary and that have information content;

(f) it is not reasonable to assume that all actuarial gains or losses will be offset in future years; on the contrary, if the original actuarial assumptions are still valid, future fluctuations will, on average, offset each other and thus will not offset past fluctuations;

(g) deferred recognition attempts to avoid volatility. However, a financial measure should be volatile if it purports to represent faithfully transactions and other events that are themselves volatile. Moreover, concerns about volatility could be addressed adequately by using a second performance statement or a statement of changes in equity;

(h) immediate recognition is consistent with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Under IAS 8 the effect of changes in accounting estimates should be included in net profit or loss for the period if the change affects the current period only but not future periods. Actuarial gains and losses are not an estimate of future events, but result from events before the balance sheet date that resolve a past estimate (experience adjustments) or from changes in the estimated cost of employee service before the balance sheet date (changes in actuarial assumptions);

(i) any amortisation period (or the width of a 'corridor') is arbitrary. In addition, the amount of benefit remaining at a subsequent date is not objectively determinable and this makes it difficult to carry out an impairment test on any expense that is deferred; and

(j) in some cases, even supporters of amortisation or the 'corridor' may prefer immediate recognition. One possible example is where plan assets are stolen. Another possible example is a major change in the basis of taxing pension plans (such as the abolition of dividend tax credits for UK pension plans in 1997). However, although there might be agreement on extreme cases, it would prove very difficult to develop objective and non-arbitrary criteria for identifying such cases.

BC41 The Board found the immediate recognition approach attractive. However, the Board believes that it is not feasible to use this approach for actuarial gains and losses until the Board resolves substantial issues about performance reporting. These issues include:

(a) whether financial performance includes those items that are recognised directly in equity;

(b) the conceptual basis for determining whether items are recognised in the income statement or directly in equity;

(c) whether net cumulative actuarial losses should be recognised in the income statement, rather than directly in equity; and

(d) whether certain items reported initially in equity should subsequently be reported in the income statement ('recycling').

When the Board makes further progress with those issues, it may decide to revisit the treatment of actuarial gains and losses.

BC42 E54 proposed a 'corridor approach'. Under this approach, an entity does not recognise actuarial gains and losses to the extent that the cumulative unrecognised amounts do not exceed 10% of the present value of the obligation (or, if greater, 10% of the fair value of plan assets). Arguments for such approaches are that they:

(a) acknowledge that estimates of post-employment benefit obligations are best viewed as a range around the best estimate. As long as any new best estimate of the liability stays within that range, it would be difficult to say that the liability has really changed. However, once the new best estimate moves outside that range, it is not reasonable to assume that actuarial gains or losses will be offset in future years. If the original

actuarial assumptions are still valid, future fluctuations will, on average, offset each other and thus will not offset past fluctuations;

(b) are easy to understand, do not require entities to keep complex records and do not require complex provisions to deal with settlements, curtailments and transitional matters;

(c) result in the recognition of an actuarial loss only when the liability (net of plan assets) has increased in the current period and an actuarial gain only when the (net) liability has decreased. By contrast, amortisation methods sometimes result in the recognition of an actuarial loss even if the (net) liability is unchanged or has decreased in the current period, or an actuarial gain even if the (net) liability is unchanged or has increased;

(d) represent faithfully transactions and other events that are themselves volatile. Paragraph 34 of the *Framework* notes that it may be relevant to recognise items and to disclose the risk of error surrounding their recognition and measurement despite inherent difficulties either in identifying the transactions and other events to be measured or in devising and applying measurement and presentation techniques that can convey messages that correspond with those transactions and events; and

(e) are consistent with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Under IAS 8 the effect of changes in accounting estimates is included in net profit or loss for the period if the change affects the current period only but not future periods. Actuarial gains and losses are not an estimate of future events, but arise from events before the balance sheet date that resolve a past estimate (experience adjustments) or from changes in the estimated cost of employee service before the balance sheet date (changes in actuarial assumptions).

BC43 Some commentators on E54 argued that an entity should, over a period, recognise actuarial gains and losses within the 'corridor'. Otherwise, certain gains and losses would be deferred permanently, even though it would be more appropriate to recognise them (for example, to recognise gains and losses that persist for a number of years without reversal or to avoid a cumulative effect on the income statement where the net liability returns ultimately to the original level). However, the Board concluded that such a requirement would add complexity for little benefit.

BC44 The 'corridor' approach was supported by fewer than a quarter of the commentators on E54. In particular, the vast majority of preparers argued that the resulting volatility would not be a realistic portrayal of the long-term nature of post-employment benefit obligations. The Board concluded that there was not sufficient support from its constituents for such a significant change in current practice.

BC45 Approximately one third of the commentators on E54 supported the deferred recognition approach. Approximately another third of the respondents proposed a version of the corridor approach which applies deferred recognition to amounts falling outside the corridor. It results in less volatility than the corridor alone or deferred recognition alone. In the absence of any compelling conceptual reasons for choosing between these two approaches, the Board concluded that the latter approach would be a pragmatic means of avoiding a level of volatility that many of its constituents consider to be unrealistic.

BC46 In approving the final Standard, the Board decided to specify the minimum amount of actuarial gains or losses to be recognised, but permit any systematic method of faster recognition, provided that the same basis is applied to both gains and losses and the basis is applied consistently from period to period. The Board was persuaded by the following arguments:

(a) both the extent of volatility reduction and the mechanism adopted to effect it are essentially practical issues. From a conceptual point of view, the Board found the immediate recognition approach attractive. Therefore, the Board saw no reason to preclude entities from adopting faster methods of recognising actuarial gains and losses. In particular, the Board did not wish to discourage entities from adopting a consistent policy of recognising all actuarial gains and losses immediately. Similarly, the Board did not wish to discourage national standard setters from requiring immediate recognition; and

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(b) where mechanisms are in place to reduce volatility, the amount of actuarial gains and losses recognised during the period is largely arbitrary and has little information content. Also, the new IAS 19 requires an entity to disclose both the recognised and unrecognised amounts. Therefore, although there is some loss of comparability in allowing entities to use different mechanisms, the needs of users are not likely to be compromised if faster (and systematic) recognition methods are permitted.

BC47 The Board noted that changes in the fair value of any plan assets are, in effect, the results of changing estimates by market participants and are, therefore, inextricably linked with changes in the present value of the obligation. Consequently, the Board decided that changes in the fair value of plan assets are actuarial gains and losses and should be treated in the same way as the changes in the related obligation.

BC48 The width of a 'corridor' (i.e. the point at which it becomes necessary to recognise gains and losses) is arbitrary. To enhance comparability, the Board decided that the width of the 'corridor' should be consistent with the current requirement in those countries that have already adopted a 'corridor' approach, notably the USA. The Board noted that a significantly narrower 'corridor' would suffer from the disadvantages of the 'corridor', without being large enough to generate the advantages. On the other hand, a significantly wider 'corridor' would lack credibility.

An additional option for the recognition of actuarial gains and losses: amendment adopted by the IASB in December 2004

BC48A In 2004 the IASB published an exposure draft proposing an additional option for the recognition of actuarial gains and losses. The proposed option allowed an entity that recognised actuarial gains and losses in full in the period in which they occurred to recognise them outside profit or loss in a statement of recognised income and expense.

BC48B The argument for immediate recognition of actuarial gains and losses is that they are economic events of the period. Recognising them when they occur provides a faithful representation of those events. It also results in a faithful representation of the plan in the balance sheet. In contrast, when recognition is deferred, the information provided is partial and potentially misleading. Furthermore, any net cumulative deferred actuarial losses can give rise to a debit item in the balance sheet that does not meet the definition of an asset. Similarly, any net cumulative deferred actuarial gains can give rise to a credit item in the balance sheet that does not meet the definition of a liability.

BC48C The arguments put forward for deferred recognition of actuarial gains and losses are, as noted above:

(a) immediate recognition can cause volatile fluctuations in the balance sheet and income statement. It implies a degree of accuracy of measurement that rarely applies in practice. As a result, the volatility may not be a faithful representation of changes in the defined benefit asset or liability, but may simply reflect an unavoidable inability to predict accurately the future events that are anticipated in making period-to-period measurements.

(b) in the long term, actuarial gains and losses may offset one another.

(c) whether or not the volatility resulting from immediate recognition reflects economic events of the period, it is too great to be acceptable in the financial statements. It could overwhelm the profit or loss and financial position of other business operations.

BC48D The IASB does not accept arguments (a) and (b) as reasons for deferred recognition. It believes that the defined benefit asset or liability can be measured with sufficient reliability to justify its recognition. Recognition in a transparent manner of the current best estimate of the events of the period and the resulting asset and liability provides better information than non-recognition of an arbitrary amount of that current best estimate. Further, it is not reasonable to assume that existing actuarial gains and losses will be offset in future years. This implies an ability to predict future market prices.

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BC48E The IASB also does not accept argument (c) in relation to the balance sheet. If the post-employment benefit amounts are large and volatile, the post-employment plan must be large and risky compared with other business operations. However, the IASB accepts that requiring actuarial gains and losses to be recognised in full in profit or loss in the period in which they occur is not appropriate at this time because the IASB has yet to develop fully the appropriate presentation of profit or loss and other items of recognised income and expense.

BC48F The IASB noted that the UK standard FRS 17 *Retirement Benefits* requires recognition of actuarial gains and losses in full as they occur outside profit or loss in a statement of total recognised gains and losses.

BC48G The IASB does not believe that immediate recognition of actuarial gains and losses outside profit or loss is necessarily ideal. However, it provides more transparent information than deferred recognition. The IASB therefore decided to propose such an option pending further developments on the presentation of profit or loss and other items of recognised income and expense.

BC48H IAS 1 ~~*Presentation of Financial Statements*~~ (as revised in 2003) requires income and expense recognised outside profit or loss to be presented in a statement of changes in equity.* The statement of changes in equity must present the total income and expense for the period, being the profit or loss for the period and each item of income and expense for the period that, as required or permitted by other ~~Standards or Interpretations~~IFRSs, is recognised directly in equity ~~(IAS 1 paragraph 96(a)-(c))~~. IAS 1 also permits these items, together with the effect of changes in accounting policies and the correction of errors, to be the only items shown in the statement of changes in equity.

BC48I To emphasise its view that actuarial gains and losses are items of income or expense, the IASB decided that actuarial gains and losses that are recognised outside profit or loss must be presented in the form of a statement of changes in equity that excludes transactions with equity holders acting in their capacity as equity holders. The IASB decided that this statement should be titled 'the statement of recognised income and expense'.

BC48J The responses from the UK to the exposure draft strongly supported the proposed option. The responses from outside the UK were divided. The main concerns expressed were:

(a) the option is not a conceptual improvement compared with immediate recognition of actuarial gains and losses in profit or loss.

(b) the option prejudges issues relating to IAS 1 that should be resolved in the project on reporting comprehensive income.

(c) adding options to Standards is not desirable and obstructs comparability.

(d) the IASB should not tinker with IAS 19 before undertaking a comprehensive review of the Standard.

(e) the option could lead to divergence from US GAAP.

(f) deferred recognition is preferable to immediate recognition.

BC48K The IASB agrees that actuarial gains and losses are items of income and expense. However, it believes that it would be premature to require their immediate recognition in profit or loss before a comprehensive review of both accounting for post-employment benefits and reporting comprehensive income. The requirement that actuarial gains and losses that are recognised outside profit or loss must be recognised in a statement of recognised income and expense does not prejudge any of the discussions the IASB is yet to have on reporting comprehensive income. Rather, the IASB is allowing an accounting treatment currently accepted by a national standard-setter (the UK ASB) to continue, pending the comprehensive review of accounting for post-employment benefits and reporting comprehensive income.

* IAS 1 *Presentation of Financial Statements* (as revised in 2007) requires non-owner transactions to be presented separately from owner transactions in a statement of comprehensive income.

BC48L The IASB also agrees that adding options to Standards is generally undesirable because of the resulting lack of comparability between entities. However, IAS 19 permits an entity to choose *any* systematic method of recognition for actuarial gains and losses that results in faster recognition than the minimum required by the Standard. Furthermore, the amount to be recognised under any deferral method will depend on when that method was first applied, ie when an entity first adopted IAS 19 or started a defined benefit plan. There is, therefore, little or no comparability because of the existing options in IAS 19.

BC48M The IASB further agrees that a fundamental review of accounting for post-employment benefits is needed. However, such a review is likely to take some time to complete. In the meantime, the IASB believes that it would be wrong to prohibit a method of recognising actuarial gains and losses that is accepted by a national standard-setter and provides more transparent information about the costs and risks of running a defined benefit plan.

BC48N The IASB agrees that the new option could lead to divergence from US GAAP. However, although IAS 19 and US GAAP share the same basic approach, they differ in several respects. The IASB has decided not to address these issues now. Furthermore, the option is just that. No entity is obliged to create such divergence.

BC48O Lastly, as discussed above, the IASB does not agree that deferred recognition is better than immediate recognition of actuarial gains and losses. The amounts recognised under a deferral method are opaque and not representationally faithful, and the inclusion of deferral methods creates a complex difficult standard.

BC48P The IASB considered whether actuarial gains and losses that have been recognised outside profit or loss should be recognised in profit or loss in a later period (ie recycled). The IASB noted that there is not a consistent policy on recycling in IFRSs and that recycling in general is an issue to be resolved in its project on reporting comprehensive income. Furthermore, it is difficult to see a rational basis on which actuarial gains and losses could be recycled. The exposure draft therefore proposed prohibiting recycling of actuarial gains and losses that have been recognised in the statement of recognised income and expense.

BC48Q Most respondents supported not recycling actuarial gains and losses. However, many argued in favour of recycling, for the following reasons:

(a) all income and expense should be recognised in profit or loss at some time.

(b) a ban on recycling is a new approach in IFRSs and should not be introduced before a fundamental review of reporting comprehensive income.

(c) to ban recycling could encourage abuse in setting over-optimistic actuarial assumptions.

BC48R The IASB notes that most items under IFRSs that are recognised outside profit or loss are recycled, but not all. Revaluation gains and losses on property, plant and equipment and intangibles are not recycled. The question of recycling therefore remains open in IFRSs. The IASB does not believe that a general decision on the matter should be made in the context of these amendments. The decision in these amendments not to recycle actuarial gains and losses is made because of the pragmatic inability to identify a suitable basis and does not prejudge the wider debate that will take place in the project on reporting comprehensive income.

BC48S In the meantime, the IASB acknowledges the concern of some respondents that some items of income or expense will not be recognised in profit or loss in any period. The IASB has therefore required disclosure of the cumulative amounts recognised in the statement of recognised income and expense so that users of the financial statements can assess the effect of this policy.

BC48T The IASB also notes the argument that to ban recycling could lead to abuse in setting over-optimistic assumptions. A lower cost could be recognised in profit or loss with resulting experience losses being recognised in the statement of recognised income and expense. Some of the new disclosures help to counter such concerns, for example, the narrative description of the basis for the expected rate of return and the five-year history of experience gains and losses. The IASB also notes that under a deferred recognition approach, if over-optimistic assumptions are used, a lower cost is recognised immediately in profit or loss and the resulting experience losses are recognised only gradually over the next 10-15 years. The

incentive for such abuse is just as great under deferred recognition as it is under immediate recognition outside profit or loss.

BC48U The IASB also considered whether actuarial gains and losses recognised outside profit or loss should be recognised immediately in a separate component of equity and transferred to retained earnings at a later period. Again the IASB concluded that there is no rational basis for a transfer to retained earnings in later periods. Hence, the exposure draft proposed that actuarial gains and losses that are recognised outside profit or loss should be recognised in retained earnings immediately.

BC48V A small majority of the respondents supported this proposal. The arguments put forward against immediate recognition in retained earnings were:

(a) the IASB should not set requirements on the component of equity in which items should be recognised before a fundamental review of the issue.

(b) retained earnings should be the cumulative total of profit or loss less amounts distributed to owners.

(c) the volatility of the amounts means that separate presentation would be helpful.

(d) the impact on distributions needs to be considered.

(e) actuarial gains and losses are temporary in nature and hence should be excluded from retained earnings.

BC48W In IFRSs, the phrase 'retained earnings' is not defined and the IASB has not discussed what it should mean. In particular, retained earnings is not defined as the cumulative total of profit or loss less amounts distributed to owners. As with recycling, practice varies under IFRSs. Some amounts that are recognised outside profit or loss are required to be presented in a separate component of equity, for example exchange gains and losses on foreign subsidiaries. Other such amounts are not, for example gains and losses on available-for-sale financial assets.

BC48X The IASB does not believe that it is appropriate to introduce a definition of retained earnings in the context of these amendments to IAS 19. The proposal in the exposure draft was based on practical considerations. As with recycling, there is no rational basis for transferring actuarial gains and losses from a separate component in equity into retained earnings at a later date. As discussed above, the IASB has added a requirement to disclose the cumulative amount recognised in the statement of recognised income and expense to provide users with further information.

BC48Y Consideration of the implications of IFRSs on the ability of an entity to make distributions to equity holders is not within the IASB's remit. In addition, the IASB does not agree that even if actuarial gains and losses were temporary in nature this would justify excluding them from retained earnings.

BC48Z Finally, the IASB considered whether, if actuarial gains and losses are recognised when they occur, entities should be required to present separately in retained earnings an amount equal to the defined benefit asset or liability. Such a presentation is required by FRS 17. The IASB noted that such a presentation is not required by IFRSs for any other item, however significant its size or volatility, and that entities can provide the information if they wish. The IASB therefore decided not to require such a presentation.

BC48AA IAS 19 limits the amount of a surplus that can be recognised as an asset ('the asset ceiling') to the present value of any economic benefits available to an entity in the form of refunds from the plan or reductions in future contributions to the plan.[*] The IASB considered whether the effect of this limit should be recognised outside profit or loss, if that is the entity's accounting policy for actuarial gains and losses, or treated as an adjustment of the other components of the defined benefit cost and recognised in profit or loss.

BC48BB The IASB decided that the effect of the limit is similar to an actuarial gain or loss because it arises from a remeasurement of the benefits available to an entity from a surplus in the plan. The IASB therefore concluded that, if the entity's accounting policy is to recognise actuarial gains and losses as they occur outside profit or loss, the effect of the limit should also be recognised outside profit or loss in the statement of recognised income and expense.

[*] The limit also includes unrecognised actuarial gains and losses and past service costs.

BC48CC Most respondents supported this proposal. The arguments opposing the proposal were:

(a) the adjustment arising from the asset ceiling is not necessarily caused by actuarial gains and losses and should not be treated in the same way.

(b) it is not consistent with FRS 17, which allocates the change in the recoverable surplus to various events and hence to different components of the defined benefit cost.

BC48DD The IASB agrees that the adjustment from the asset ceiling is not necessarily caused by actuarial gains and losses. The asset ceiling effectively imposes a different measurement basis for the asset to be recognised (present value of refunds and reductions in future contributions) from that used to derive the actuarial gains and losses and other components of the defined benefit cost (fair value of plan assets less projected unit credit value of plan liabilities). Changes in the recognised asset arise from changes in the present value of refunds and reductions in future contributions. Such changes can be caused by events of the same type as those that cause actuarial gains and losses, for example changes in interest rates or assumptions about longevity, or by events that do not cause actuarial gains and losses, for example trustees agreeing to a refund in exchange for benefit enhancements or a management decision to curtail the plan.

BC48EE Because the asset ceiling imposes a different measurement basis for the asset to be recognised, the IASB does not believe it is possible to allocate the effect of the asset ceiling to the components of the defined benefit cost other than on an arbitrary basis. The IASB reaffirmed its view that the adjustment arising from the asset ceiling should, therefore, be regarded as a remeasurement and similar to an actuarial gain or loss. This treatment also has the advantages of (a) being simple and (b) giving transparent information because the cost of the defined benefit promise (ie the service costs and interest cost) remains unaffected by the funding of the plan.

Past service cost (paragraphs 96-101 of the Standard)

BC49 E54 included two alternative treatments for past service cost. The first approach was similar to that used in the old IAS 19 (amortisation for current employees and immediate recognition for former employees). The second approach was immediate recognition of all past service cost.

BC50 Those who support the first approach argue that:

(a) an entity introduces or improves employee benefits for current employees in order to generate future economic benefits in the form of reduced employee turnover, improved productivity, reduced demands for increases in cash compensation and improved prospects for attracting additional qualified employees;

(b) although it may not be feasible to improve benefits for current employees without also improving benefits for former employees, it would be impracticable to assess the resulting economic benefits for an entity and the period over which those benefits will flow to the entity; and

(c) immediate recognition is too revolutionary. It would also have undesirable social consequences because it would deter companies from improving benefits.

BC51 Those who support immediate recognition of all past service cost argue that:

(a) amortisation of past service cost is inconsistent with the view of employee benefits as an exchange between an entity and its employees for services rendered: past service cost relates to past events and affects the employer's present obligation arising from employees' past service. Although an entity may improve benefits in the expectation of future benefits, an obligation exists and should be recognised;

(b) deferred recognition of the liability reduces comparability; an entity that retrospectively improves benefits relating to past service will report lower liabilities than an entity that granted identical benefits at an earlier date, yet both have identical benefit obligations. Also, deferred recognition encourages entities to increase pensions instead of salaries;

(c) past service cost does not give an entity control over a resource and thus does not meet the *Framework*'s definition of an asset. Therefore, it is not appropriate to defer recognition of the expense; and

(d) there is not likely to be a close relationship between cost - the only available measure of the effect of the amendment - and any related benefits in the form of increased loyalty.

BC52 Under the old IAS 19, past service cost for current employees was recognised as an expense systematically over the expected remaining working lives of the employees concerned. Similarly, under the first approach set out in E54, past service cost was to be amortised over the average expected remaining working lives of the employees concerned. However, E54 also proposed that the attribution period for current service cost should end when the employee's entitlement to receive all significant benefits due under the plan is no longer conditional on further service. Some commentators on E54 felt that these two provisions were inconsistent.

BC53 In the light of comments received, the Board concluded that past service cost should be amortised over the average period until the amended benefits become vested, because:

(a) once the benefits become vested, there is clearly a liability that should be recognised; and

(b) although non-vested benefits give rise to an obligation, any method of attributing non-vested benefits to individual periods is essentially arbitrary. In determining how that obligation builds up, no single method is demonstrably superior to all others.

BC54 Some argue that a 'corridor' approach should be used for past service cost because the use of a different accounting treatment for past service cost than for actuarial gains and losses may create an opportunity for accounting arbitrage. However, the purpose of the 'corridor' is to deal with the inevitable imprecision in the measurement of defined benefit obligations. Past service cost results from a management decision, rather than inherent measurement uncertainty. Consequently, the Board rejected the 'corridor' approach for past service cost.

BC55 The Board rejected proposals that:

(a) past service cost should (as under the old IAS 19) be recognised over a shorter period where plan amendments provide an entity with economic benefits over that shorter period: for example, when plan amendments were made regularly, the old IAS 19 stated that the additional cost may be recognised as an expense or income systematically over the period to the next expected plan amendment. The Board believes that the actuarial assumptions should allow for such regular plan amendments and that subsequent differences between the assumed increase and the actual increase are actuarial gains or losses, not a past service cost;

(b) past service cost should be recognised over the remaining life expectancy of the participants if all or most plan participants are inactive. The Board believes that it is not clear that the past service cost will lead to economic benefits to the entity over that period; and

(c) even if past service cost is generally recognised on a delayed basis, past service cost should not be recognised immediately if the past service cost results from legislative changes (such as a new requirement to equalise retirement ages for men and women) or from decisions by trustees who are not controlled, or influenced, by the entity's management. The Board decided that such a distinction would not be practicable.

BC56 The old IAS 19, did not specify the basis upon which an entity should amortise the unrecognised balance of past service cost. The Board agreed that any amortisation method is arbitrary and decided to require straight-line amortisation, as that is the simplest method to apply and understand. To enhance comparability, the Board decided to require a single method and not to permit alternative methods, such as methods that assign:

(a) an equal amount of past service cost to each expected year of employee service; or

(b) past service cost to each period in proportion to estimated total salaries in that period.

Paragraph 99 confirms that the amortisation schedule is not amended for subsequent changes in the average remaining working life, unless there is a curtailment or settlement.

BC57 Unlike the old IAS 19 the new IAS 19 treats past service cost for current employees differently from actuarial gains. This means that some benefit improvements may be funded out of

actuarial gains that have not yet been recognised in the financial statements. Some argue that the resulting past service cost should not be recognised because:

(a) the cost of the improvements does not meet the *Framework*'s definition of an expense, as there is no outflow or depletion of any asset which was previously recognised in the balance sheet; and

(b) in some cases, benefit improvements may have been granted only because of actuarial gains.

The Board decided to require the same accounting treatment for all past service cost (i.e. recognise over the average period until the amended benefits become vested) whether or not they are funded out of an actuarial gain that is already recognised in the entity's balance sheet.

BC58 Some commentators on E54 argued that the recognition of actuarial gains should be limited if there is unamortised past service cost. The Board rejected this proposal because it would introduce additional complexity for limited benefit. Other commentators would prohibit the recognition of actuarial gains that are earmarked for future benefit improvements. However, the Board believes that if such earmarking is set out in the formal (or constructive) terms of the plan, the benefit improvements should be included in the actuarial assumptions. In other cases, there is insufficient linkage between the actuarial gains and the benefit improvements to justify an exceptional treatment.

BC59 The old IAS 19 did not specify the balance sheet treatment for past service cost. Some argue that an entity should recognise past service cost immediately both as an addition to the liability and as an asset (prepaid expense) on the grounds that deferred recognition of the liability offsets a liability against an asset (unamortised past service cost) that cannot be used to settle the liability. However, the Board decided that an entity should recognise past service cost for current employees as an addition to the liability gradually over a period, because:

(a) past service cost does not give an entity control over a resource and thus does not meet the Framework's definition of an asset;

(b) separate presentation of a liability and a prepaid expense may confuse users; and

(c) although non-vested benefits give rise to an obligation, any method of attributing non-vested benefits to individual periods is essentially arbitrary. In determining how that obligation builds up, no single method is demonstrably superior to all others.

BC60 The old IAS 19 appeared to treat plan amendments that reduce benefits as negative past service cost (i.e. amortisation for current employees, immediate recognition for former employees). However, some argue that this results in the recognition of deferred income that conflicts with the *Framework*. They also argue that there is only an arbitrary distinction between amendments that should be treated in this way and curtailments or settlements. Therefore, E54 proposed that:

(a) plan amendments are:

   (i) a curtailment if the amendment reduces benefits for future service; and

   (ii) a settlement if the amendment reduces benefits for past service; and

(b) any gain or loss on the curtailment or settlement should be recognised immediately when the curtailment or settlement occurs.

BC61 Some commentators on E54 argued that such 'negative plan amendments' should be treated as negative past service cost by being recognised as deferred income and amortised into the income statement over the working lives of the employees concerned. The basis for this view is that 'negative' amendments reduce employee morale in the same way that 'positive' amendments increase morale. Also, a consistent treatment avoids the abuses that might occur if an entity could improve benefits in one period (and recognise the resulting expense over an extended period) and then reduce the benefits (and recognise the resulting income immediately). The Board agreed with this view. Therefore, the new IAS 19 treats both 'positive' and 'negative' plan amendments in the same way.

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BC62 The distinction between negative past service cost and curtailments would be important if:

(a) a material amount of negative past service cost were amortised over a long period (this is unlikely, as the new IAS 19 requires that negative past service cost should be amortised until the time when those (reduced) benefits that relate to prior service are vested); or

(b) unrecognised past service cost or actuarial gains exist. For a curtailment these would be recognised immediately, whereas they would not be affected directly by negative past service cost.

~~The Board believes that the distinction between negative past service cost and curtailments is unlikely to have any significant effect in practice and that any attempt to deal with exceptional cases would result in excessive complexity.~~*

BC62A In 2007 the IFRIC reported that practices differ for the recognition of gains or losses on plan amendments that reduce existing benefits, and that such differences in practices can lead to substantial differences in amounts that entities recognise in profit or loss. The IFRIC asked the IASB to clarify when entities should account for those plan amendments as a curtailment instead of as negative past service costs.

BC62B As part of *Improvements to IFRSs* issued in May 2008, the IASB made the distinction between curtailments and negative past service costs clearer. In particular, the Board clarified how a reduction in the extent to which future salary increases are linked to the benefits payable for past service should be treated. The Board noted that an employee is entitled to future salary increases after the reporting date only as a result of future service. Therefore, if a change to a benefit plan affects the extent to which future salary increases after the reporting date are linked to benefits payable for past service, all of the effect of that change on the present value of the defined benefit obligation should be treated as a curtailment, not a negative past service cost. This is consistent with the treatment of a change related to future service.

Recognition and measurement: an additional minimum liability

BC63 The Board considered whether it should require an entity to recognise an additional minimum liability where:

(a) an entity's immediate obligation if it discontinued a plan at the balance sheet date would be greater than the present value of the liability that would otherwise be recognised in the balance sheet;

(b) vested post-employment benefits are payable at the date when an employee leaves the entity. Consequently, because of the effect of discounting, the present value of the vested benefit would be greater if an employee left immediately after the balance sheet date than if the employee completes the expected period of service; or

(c) the present value of vested benefits exceeds the amount of the liability that would otherwise be recognised in the balance sheet. This could occur where a large proportion of the benefits are fully vested and an entity has not recognised actuarial losses or past service cost.

BC64 One example of a requirement for an entity to recognise an additional minimum liability is in the US Standard SFAS 87 *Employers' Accounting for Pensions*: the minimum liability is based on current salaries and excludes the effect of deferring certain past service cost and actuarial gains and losses. If the minimum liability exceeds the obligation measured on the normal projected salary basis (with deferred recognition of certain income and expense), the excess is recognised as an intangible asset (not exceeding the amount of any unamortised past service cost, with any further excess deducted directly from equity) and as an additional minimum liability.

BC65 The Board believes that such additional measures of the liability are potentially confusing and do not provide relevant information. They would also conflict with the *Framework*'s going concern assumption and with its definition of a liability. The new IAS 19 does not require the recognition of an additional minimum liability. Certain of the circumstances discussed in the

* Text deleted as a consequence of amendments by *Improvements to IFRSs* issued in May 2008.

preceding two paragraphs may give rise to contingent liabilities requiring disclosure under IAS 10 *Events After the Balance Sheet Date*. *

Plan assets (paragraphs 102-107 of the Standard)

BC66 The new IAS 19 requires explicitly that defined benefit obligations should be recognised as a liability after deducting plan assets (if any) out of which the obligations are to be settled directly (see paragraph 54 of the Standard). This is already widespread, and probably universal, practice. The Board believes that plan assets reduce (but do not extinguish) an entity's own obligation and result in a single, net, liability. Although the presentation of that net liability as a single amount in the balance sheet differs conceptually from the offsetting of separate assets and liabilities, the Board decided in issuing IAS 19 in 1998 that the definition of plan assets should be consistent with the offsetting criteria in IAS 32 *Financial Instruments: Disclosure and Presentation*.‡ IAS 32 states that a financial asset and a financial liability should be offset and the net amount reported in the balance sheet when an entity:

(a) has a legally enforceable right to set off the recognised amounts; and

(b) intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

BC67 IAS 19 (revised 1998) defined plan assets as assets (other than non-transferable financial instruments issued by the reporting entity) held by an entity (a fund) that satisfies all of the following conditions:

(a) the entity is legally separate from the reporting entity;

(b) the assets of the fund are to be used only to settle the employee benefit obligations, are not available to the entity's own creditors and cannot be returned to the entity (or can be returned to the entity only if the remaining assets of the fund are sufficient to meet the plan's obligations); and

(c) to the extent that sufficient assets are in the fund, the entity will have no legal or constructive obligation to pay the related employee benefits directly.

BC67A In issuing IAS 19 in 1998, the Board considered whether the definition of plan assets should include a fourth condition: that the entity does not control the fund. The Board concluded that control is not relevant in determining whether the assets in a fund reduce an entity's own obligation.

BC68 In response to comments on E54, the Board decided to modify the definition of plan assets to exclude non-transferable financial instruments issued by the reporting entity. If this were not done, an entity could reduce its liabilities, and increase its equity, by issuing non-transferable equity instruments to a defined benefit plan.

Plan assets - revised definition adopted in 2000

BC68A In 1999, the Board began a limited scope project to consider the accounting for assets held by a fund that satisfies parts (a) and (b) of the definition set out in paragraph BC67 above, but does not satisfy condition (c) because the entity retains a legal or constructive obligation to pay the benefits directly. IAS 19 (revised 1998) did not address assets held by such funds.

BC68B The Board considered two main approaches to such funds:

(a) a **net** approach - the entity recognises its entire obligation as a liability after deducting the fair value of the assets held by the fund; and

(b) a **gross** approach - the entity recognises its entire obligation as a liability and recognises its rights to a refund from the fund as a separate asset.

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* In September 2007 the IASB amended the title of IAS 10 from *Events after the Balance Sheet Date* to *Events After the Reporting Period* as a consequence of the revision of IAS 1 *Presentation of Financial Statements* in 2007.
† In 2005 the IASB amended IAS 32 as *Financial Instruments: Presentation.*

BC68C Supporters of a net approach made one or more of the following arguments:

(a) a gross presentation would be misleading, because:

(i) where conditions (a) and (b) of the definition in paragraph BC67 above are met, the entity does not control the assets held by the fund; and

(ii) even if the entity retains a legal obligation to pay the entire amount of the benefits directly, this legal obligation is a matter of form rather than substance;

(b) a gross presentation would be an unnecessary change from current practice, which generally permits a net presentation. It would introduce excessive complexity into the Standard, for limited benefit to users, given that paragraph 120A(c) already requires disclosure of the gross amounts;

(c) a gross approach may lead to measurement difficulties because of the interaction with the 10% corridor for the obligation.

(i) One possibility would be to measure the assets at fair value, with all changes in fair value recognised immediately. This might seem inconsistent with the treatment of plan assets, because changes in the fair value of plan assets are one component of the actuarial gains and losses to which the corridor is applied under IAS 19. In other words, this approach would deny entities the opportunity of offsetting gains and losses on the assets against gains and losses on the liability.

(ii) A second possibility would be to defer changes in the fair value of the assets to the extent that there are unrecognised actuarial gains and losses on the obligations. However, the carrying amount of the assets would then have no easily describable meaning. It would probably also require complex and arbitrary rules to match the gains and losses on the assets with gains and losses on the obligation.

(iii) A third possibility would be to measure the assets at fair value, but to aggregate the changes in fair value with actuarial gains and losses on the liability. In other words, the assets would be treated in the same way as plan assets, except the balance sheet presentation would be gross rather than net. However, this would mean that changes in the fair value of the assets could affect the measurement of the obligation; and

(d) a net approach might be viewed as analogous to the treatment of joint and several liabilities under paragraph 29 of IAS 37. An entity recognises a provision for the part of the obligation for which an outflow of resources embodying economic benefits is probable. The part of the obligation that is expected to be met by other parties is treated as a contingent liability.

BC68D Supporters of a gross approach advocated that approach for one or more of the following reasons:

(a) paragraph BC66 above gives an explanation for presenting defined benefit obligations net of plan assets. The explanation focuses on whether offsetting is appropriate. Part (c) of the 1998 definition focuses on offsetting. This suggests that assets that satisfy parts (a) and (b) of the definition, but fail part (c) of the definition, should be treated in the same way as plan assets for recognition and measurement purposes, but should be shown gross on the face of the balance sheet without offsetting;

(b) if offsetting is allowed when condition (c) is not met, this would seem to be equivalent to permitting a net presentation for 'in-substance defeasance' and other analogous cases where IAS 32 indicates explicitly that offsetting is inappropriate. The Board has rejected 'in-substance defeasance' for financial instruments (see IAS 39, Application Guidance, paragraph AG59) and there is no obvious reason to permit it in accounting for defined benefit plans. In these cases, the entity retains an obligation that should be recognised as a liability and the entity's right to reimbursement from the plan is a source of economic benefits that should be recognised as an asset. Offsetting would be permitted if the conditions in paragraph ~~33~~42 of IAS 32 are satisfied;

(c) the Board decided in IAS 37 to require a gross presentation for reimbursements related to provisions, even though this was not previously general practice. There is no conceptual reason to require a different treatment for employee benefits;

(d) although some consider that a gross approach requires an entity to recognise assets that it does not control, others believe that this view is incorrect. A gross approach requires the entity to recognise an asset representing its right to receive reimbursement from the fund that holds those assets. It does not require the entity to recognise the underlying assets of the fund;

(e) in a plan with plan assets that meet the definition adopted in 1998, the employees' first claim is against the fund - they have no claim against the entity if sufficient assets are in the fund. In the view of some, the fact that employees must first claim against the fund is more than just a difference in form - it changes the substance of the obligation; and

(f) defined benefit plans might be regarded under SIC-12, *Consolidation - Special Purpose Entities*, as special purpose entities that the entity controls - and should consolidate. As the offsetting criterion in IAS 19 is consistent with offsetting criteria in other International Accounting Standards, it is relatively unimportant whether the pension plan is consolidated in cases where the obligation and the plan assets qualify for offset. If the assets are presented as a deduction from the related benefit obligations in cases where condition (c) is not met, it could become important to assess whether the entity should consolidate the plan.

BC68E Some argued that a net approach should be permitted when an entity retains an obligation to pay the entire amount of the benefits directly, but the obligation is considered unlikely to have any substantive effect in practice. The Board concluded that it would not be practicable to establish guidance of this kind that could be applied in a consistent manner.

BC68F The Board also considered the possibility of adopting a "linked presentation" that UK Financial Reporting Standard FRS 5 *Reporting the Substance of Transactions*, requires for non-recourse finance. Under FRS 5, the face of the balance sheet presents both the gross amount of the asset and, as a direct deduction, the related non-recourse debt. Supporters of this approach argued that it portrays the close link between related assets and liabilities without compromising general offsetting requirements. Opponents of the linked presentation argued that it creates a form of balance sheet presentation that IASC has not used previously and may cause confusion. The Board decided not to adopt the linked presentation.

BC68G The Board concluded that a net presentation is justified where there are restrictions (including restrictions that apply on bankruptcy of the reporting entity) on the use of the assets so that the assets can be used only to pay or fund employee benefits. Accordingly, the Board decided to modify the definition of plan assets set out in paragraph BC67 above by:

(a) emphasising that the creditors of the entity should not have access to the assets held by the fund, even on bankruptcy of the reporting entity; and

(b) deleting condition (c), so that the existence of a legal or constructive obligation to pay the employee benefits directly does not preclude a net presentation, and modifying condition (b) to explicitly permit the fund to reimburse the entity for paying the long-term employee benefits.

BC68H When an entity retains a direct obligation to the employees, the Board acknowledges that the net presentation is inconsistent with the derecognition requirements for financial instruments in IAS 39 and with the offsetting requirements in IAS 32. However, in the Board's view, the restrictions on the use of the assets create a sufficiently strong link with the employee benefit obligations that a net presentation is more relevant than a gross presentation, even if the entity retains a direct obligation to the employees.

BC68I The Board believes that such restrictions are unique to employee benefit plans and does not intend to permit this net presentation for other liabilities if the conditions in IAS 32 and IAS 39 are not met. Accordingly, condition (a) in the new definition refers to the reason for the existence of the fund. The Board believes that an arbitrary restriction of this kind is the only practical way to permit a pragmatic exception to IASC's general offsetting criteria without permitting an unacceptable extension of this exception to other cases.

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BC68J In some plans that exist in some countries, an entity is entitled to receive a reimbursement of employee benefits from a separate fund but the entity has discretion to delay receipt of the reimbursement or to claim less than the full reimbursement. Some argue that this element of discretion weakens the link between the benefits and the reimbursement so much that a net presentation is not justifiable. They believe that the definition of plan assets should exclude assets held by such funds and that a gross approach should be used in such cases. The Board concluded that the link between the benefits and the reimbursement is strong enough in such cases that a net approach is still appropriate.

BC68K The Board's proposal for extending the definition of plan assets was set out in Exposure Draft E67 *Pension Plan Assets*, published in July 2000. The vast majority of the 39 respondents to E67 supported the proposal.

BC68L A number of respondents to E67 proposed a further extension of the definition to include certain insurance policies that have similar economic effects to funds whose assets qualify as plan assets under the revised definition proposed in E67. Accordingly, the Board decided to extend the definition of plan assets to include certain insurance policies (now described in IAS 19 as qualifying insurance policies)[∅] that satisfy the same conditions as other plan assets. These decisions were implemented in a revised IAS 19, approved by the Board in October 2000.

Plan Assets - Measurement

BC69 The old IAS 19 stated that plan assets are valued at fair value, but did not define fair value. However, other International Accounting Standards define fair value as 'the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction'. This may imply that no deduction is made for the estimated costs necessary to sell the asset (in other words, it is a mid-market value, with no adjustment for transaction costs). However, some argue that a plan will eventually have to dispose of its assets in order to pay benefits. Therefore, the Board concluded in E54 that plan assets should be measured at market value. Market value was defined, as in IAS 25 *Accounting for Investments**, as the amount obtainable from the sale of an asset in an active market.

BC70 Some commentators on E54 felt that the proposal to measure plan assets at market value would not be consistent with IAS 22 *Business Combinations*[‡], and with the measurement of financial assets as proposed in the discussion paper, *Accounting for Financial Assets and Financial Liabilities*, published by IASC's Financial Instruments Steering Committee in March 1997. Therefore, the Board decided that plan assets should be measured at fair value.

BC71 Some argue that concerns about volatility in reported profit should be countered by permitting or requiring entities to measure plan assets at a market-related value that reflects changes in fair value over an arbitrary period, such as five years. The Board believes that the use of market-related values would add excessive and unnecessary complexity and that the combination of the 'corridor' approach to actuarial gains and losses with deferred recognition outside the 'corridor' is sufficient to deal with concerns about volatility.

BC72 The old IAS 19 stated that, when fair values were estimated by discounting future cash flows, the long-term rate of return reflected the average rate of total income (interest, dividends and appreciation in value) expected to be earned on the plan assets during the time period until benefits are paid. It was not clear whether the old IAS 19 allowed a free choice between market values and discounted cash flows, or whether discounted cash flows could be used only when no market value was available. The Board decided that plan assets should be measured by techniques such as discounting expected future cash flows only when no market value is available.

BC73 Some believe that plan assets should be measured on the following basis, which is required by IAS 25 *Accounting for Investments* [†]:

(a) long term investments are carried in the balance sheet at either cost, revalued amounts or, in the case of marketable equity securities, the lower of cost and market value determined on a portfolio basis. The carrying amount of a long-term investment

[∅] The definition of a qualifying insurance policy refers to a related party as defined by IAS 24 *Related Party Disclosures*. IAS 24 (as revised in 2009) amended the definition of a related party.

* superseded by IAS 39 *Financial Instruments: Recognition and Measurement* and IAS 40 *Investment Property*.

[‡] IAS 22 was withdrawn in 2004 and replaced with IFRS 3 Business Combinations.

[†] superseded by IAS 39 *Financial Instruments: Recognition and Measurement* and IAS 40 *Investment Property*.

is reduced to recognise a decline other than temporary in the value of the investment; and

(b) current investments are carried in the balance sheet at either market value or the lower of cost and market value.

The Board rejected this basis because it is not consistent with the basis used for measuring the related obligations.

BC74 The Board decided that there should not be a different basis for measuring investments that have a fixed redemption value and that match the obligations of the plan, or specific parts thereof. IAS 26 *Accounting and Reporting by Retirement Benefit Plans*, permits such investments to be measured on an amortised cost basis.

BC75 In response to comments on E54, the Board decided that all plan administration costs (not just investment administration costs, as proposed in E54), should be deducted in determining the return on plan assets. The IASB concluded that if the actuarial assumptions used to measure the defined benefit obligation include an allowance for plan administration costs, the deduction of such costs in calculating the return on plan assets would result in double-counting them. Therefore, as part of *Improvements to IFRSs* issued in May 2008, the IASB amended the definition of the return on plan assets to require the deduction of plan administration costs only to the extent that such costs have not been reflected in the measurement of the defined benefit obligation.

Reimbursements (paragraphs 104A-104D of the Standard)

BC75A Paragraph 41 of IAS 19 states that an entity recognises its rights under an insurance policy as an asset if the policy is held by the entity itself. IAS 19 (revised 1998) did not address the measurement of these insurance policies. The entity's rights under the insurance policy might be regarded as a financial asset. However, rights and obligations arising under insurance contracts are excluded from the scope of IAS 39 Financial Instruments: Recognition and Measurement. Also, IAS 39 does not apply to "employers' ~~assets and liabilities~~ rights and obligations under employee benefit plans, to which IAS 19 *Employee Benefits*, applies". Paragraphs 39-42 of IAS 19 discuss insured benefits in distinguishing defined contribution plans and defined benefit plans, but this discussion does not deal with measurement.

BC75B In reviewing the definition of plan assets (see paragraphs BC68A-BC68L above), the Board decided to review the treatment of insurance policies that an entity holds in order to fund employee benefits. Even under the revised definition adopted in 2000, the entity's rights under an insurance policy that is not a qualifying insurance policy (as defined in the 2000 revision to IAS 19) are not plan assets.

BC75C In 2000, the Board decided to introduce recognition and measurement requirements for reimbursements under such insurance policies (see paragraphs 104A-104D). The Board based these requirements on the treatment of reimbursements under paragraphs 53-58 of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.* In particular, the Standard requires an entity to recognise a right to reimbursement of post-employment benefits as a separate asset, rather than as a deduction from the related obligations. In all other respects (for example, the use of the 'corridor'), the Standard requires an entity to treat such reimbursement rights in the same way as plan assets. This requirement reflects the close link between the reimbursement right and the related obligation.

BC75D Paragraph 104 states that where plan assets include insurance policies that exactly match the amount and timing of some or all of the benefits payable under the plan, the plan's rights under those insurance policies are measured at the same amount as the related obligations. Paragraph 104D extends that conclusion to insurance policies that are assets of the entity itself.

BC75E IAS 37 states that the amount recognised for the reimbursement should not exceed the amount of the provision. Paragraph 104A of the Standard contains no similar restriction, because the asset limit in paragraph 58 already applies to prevent the recognition of an asset that exceeds the available economic benefits.

Limit on the recognition of an asset (paragraphs 58-60 of the Standard)

BC76 In certain cases, paragraph 54 of the new IAS 19 would require an entity to recognise an asset. E54 proposed that the amount of the asset recognised should not exceed the aggregate of the present values of:

(a) any refunds expected from the plan; and

(b) any expected reduction in future contributions arising from the surplus.

In approving E54, the Board took the view that an entity should not recognise an asset at an amount that exceeds the present value of the future benefits that are expected to flow to the entity from that asset. This view is consistent with the Board's proposal that assets should not be carried at more than their recoverable amount (see E55, *Impairment of Assets*). The old IAS 19 contained no such restriction.

BC77 On reviewing the responses to E54, the Board concluded that the limit on the recognition of an asset should not over-ride the treatments of actuarial losses or past service cost in order not to defeat the purpose of these treatments. Consequently, the limit is likely to come into play only where:

(a) an entity has chosen the transitional option to recognise the effect of adopting the new IAS 19 over up to five years, but has funded the obligation more quickly; or

(b) 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.

BC78 Some commentators argued that the limit in E54 was not operable because it would require an entity to make extremely subjective forecasts of expected refunds or reductions in contributions. In response to these comments, the Board agreed that the limit should reflect the available refunds or reductions in contributions.

Asset ceiling - amendment adopted in May 2002

BC78A In May 2002, the Board agreed on an amendment to the limit on the recognition of an asset (the asset ceiling) in paragraph 58 of the Standard. The objective of the amendment was to prevent gains (losses) being recognised solely as a result of the deferred recognition of past service cost and actuarial losses (gains).

BC78B The asset ceiling is specified in paragraph 58 of IAS 19, which requires a defined benefit asset to be measured at the lower of:

(a) the amount determined under paragraph 54; and

(b) the total of:

(i) any cumulative unrecognised net actuarial losses and past service cost; and

(ii) the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

BC78C The problem arises when an entity defers recognition of actuarial losses or past service cost in determining the amount specified in paragraph 54 but is required to measure the defined benefit asset at the net total specified in paragraph 58(b). Paragraph 58(b)(i) could result in the entity recognising an increased asset because of actuarial losses or past service cost in the period. The increase in the asset would be reported as a gain in income. Examples illustrating the issue are given in Appendix C.

BC78D The Board agreed that recognising gains (losses) arising from past service cost and actuarial losses (gains) is not representationally faithful. Further, the Board holds the view that this issue demonstrates that IAS 19 can give rise to serious problems. The Board intends to undertake a comprehensive review of the aspects of IAS 19 that cause concern, including the interaction of the asset ceiling and the options to defer recognition of certain gains and losses. In the meantime, the Board regards as an improvement a limited amendment to prevent their interaction giving rise to unfaithful representations of events.

BC78E Paragraph 58A, therefore, prevents gains (losses) from being recognised solely as a result of the deferred recognition of past service cost or actuarial losses (gains).

BC78F Some Board members and respondents to the exposure draft of this amendment suggested that the issue be dealt with by removing paragraph 58(b)(i). Paragraph 58(b)(i) is the component of the asset ceiling that gives rise to the problem: losses that are unrecognised under paragraph 54 are added to the amount that can be recognised as an asset. However, deleting paragraph 58(b)(i) effectively removes the option of deferred recognition of actuarial losses for all entities that have a defined benefit asset. Removing this option would have wide reaching implications for the deferred recognition approach in IAS 19 that can be considered fully only within the context of the comprehensive review noted above.

Curtailments and settlements (paragraphs 109-115 of the Standard)

BC79 Under the old IAS 19, curtailment and settlement **gains** were recognised when the curtailment or settlement **occurred**, but **losses** were recognised when it was **probable** that the curtailment or settlement would occur. The Board concluded that management's intent to curtail or settle a defined benefit plan is not a sufficient basis to recognise a loss. The new IAS 19 requires that curtailment and settlement losses, as well as gains, should be recognised when the curtailment or settlement occurs. The guidance on the recognition of curtailments and settlements has been conformed to the proposals in E59, *Provisions, Contingent Liabilities and Contingent Assets*.

BC80 Under some national standards:

(a) the gain or loss on a curtailment includes any unamortised past service cost (on the grounds that a curtailment eliminates the previously expected motivational effect of the benefit improvement), but excludes unrecognised actuarial gains or losses (on the grounds that the entity is still exposed to actuarial risk); and

(b) the gain or loss on a settlement includes any unrecognised actuarial gains or losses (on the grounds that the entity is no longer exposed to actuarial risk), but excludes unamortised past service cost (on the grounds that the previously expected motivational effect of the benefit improvement is still present).

The Board considers that this approach has some conceptual merit, but it leads to considerable complexity. The new IAS 19 requires that the gain or loss on a curtailment or settlement should include the related unrecognised actuarial gains and losses and past service cost. This is consistent with the old IAS 19.

Presentation and disclosure (paragraphs 116-125 of the Standard)

BC81 The Board decided not to specify whether an entity should distinguish current and non-current portions of assets and liabilities arising from post-employment benefits, because such a distinction may sometimes be arbitrary.

BC82 Information about defined benefit plans is particularly important to users of financial statements because other information published by an entity will not allow users to estimate the nature and extent of defined benefit obligations and to assess the risks associated with those obligations. The disclosure requirements are based on the following principles:

(a) the most important information about employee benefits is information about the uncertainty attaching to measures of employee benefit obligations and costs and about the potential consequences of such uncertainty for future cash flows;

(b) employee benefit arrangements are often complex, and this makes it particularly important for disclosures to be clear, concise and relevant;

(c) given the wide range of views on the treatment of actuarial gains and losses and past service cost, the required disclosures should highlight their impact on the income statement and the impact of any unrecognised actuarial gains and losses and unamortised past service cost on the balance sheet; and

(d) the benefits derived from information should exceed the cost of providing it.

BC83 The Board agreed the following changes to the disclosure requirements proposed in E54:

(a) the description of a defined benefit plan need only be a general description of the type of plan: for example, flat salary pension plans should be distinguished from final salary plans and from post-employment medical plans. Further detail would not be required;

(b) an entity should disclose the amounts, if any, included in the fair value of plan assets not only for each category of the reporting entity's own financial instruments, but also for any property occupied by, or other assets used by, the entity;

(c) an entity should disclose not just the expected return on plan assets, but also the actual return on plan assets;

(d) an entity should disclose a reconciliation of the movements in the net liability (or asset) recognised in its balance sheet; and

(e) an entity should disclose any amount not recognised as an asset because of the new limit in paragraph 58(b) of the Standard.

BC84 Some commentators on E54, especially preparers, felt that the disclosures were excessive. A particular concern expressed by several respondents was aggregation: how should an entity aggregate information about many different plans in a concise, meaningful and cost-effective way? Two disclosures that seemed to cause special concern were the analysis of the overall charge in the income statement and the actuarial assumptions. In particular, a number of commentators felt that the requirement to disclose expected rates of salary increases would cause difficulties with employees. However, the Board concluded that all the disclosures were essential.

BC85 The Board considered whether smaller or non-public entities could be exempted from any of the disclosure requirements. However, the Board concluded that any such exemptions would either prevent disclosure of essential information or do little to reduce the cost of the disclosures.

Disclosures: amendment issued by the IASB in December 2004

BC85A From a review of national standards on accounting for post-employment benefits, the IASB identified the following disclosures that it proposed should be added to IAS 19:

(a) reconciliations showing the changes in plan assets and defined benefit obligations. The IASB believed that these reconciliations give clearer information about the plan. Unlike the reconciliation previously required by IAS 19 that showed the changes in the recognised net liability or asset, the new reconciliations include amounts whose recognition has been deferred. The reconciliation previously required was eliminated.

(b) information about plan assets. The IASB believed that more information is needed about the plan assets because, without such information, users cannot assess the level of risk inherent in the plan. The exposure draft proposed:

(i) disclosure of the percentage that the major classes of assets held by the plan constitute of the total fair value of the plan assets;

(ii) disclosure of the expected rate of return for each class of asset; and

(iii) a narrative description of the basis used to determine the overall expected rate of return on assets.

(c) information about the sensitivity of defined benefit plans to changes in medical cost trend rates. The IASB believed that this is necessary because the effects of changes in a plan's medical cost trend rate are difficult to assess. The way in which healthcare cost assumptions interact with caps, cost-sharing provisions, and other factors in the plan precludes reasonable estimates of the effects of those changes. The IASB also noted that the disclosure of a change of one percentage point would be appropriate for plans operating in low inflation environments but would not provide useful information for plans operating in high inflation environments.

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(d) information about trends in the plan. The IASB believed that information about trends is important so that users have a view of the plan over time, not just at the balance sheet date. Without such information, users may misinterpret the future cash flow implications of the plan. The exposure draft proposed disclosure of five-year histories of the plan liabilities, plan assets, the surplus or deficit and experience adjustments.

(e) information about contributions to the plan. The IASB believed that this will provide useful information about the entity's cash flows in the immediate future that cannot be determined from the other disclosures about the plan. It proposed the disclosure of the employer's best estimate, as soon as it can reasonably be determined, of contributions expected to be paid to the plan during the next fiscal year beginning after the balance sheet date.

(f) information about the nature of the plan. The IASB proposed an addition to paragraph 121 of IAS 19 to ensur`e that the description of the plan is complete and includes all the terms of the plan that are used in the determination of the defined benefit obligation.

BC85B The proposed disclosures were generally supported by respondents to the exposure draft, except for the expected rate of return for each major category of plan assets, sensitivity information about medical cost trend rates and the information about trends in the plan.

BC85C In relation to the expected rate of return for each major category of plan assets, respondents argued that the problems of aggregation for entities with many plans in different geographical areas were such that this information would not be useful. The IASB accepted this argument and decided not to proceed with the proposed disclosure. However, the IASB decided to specify that the narrative description of the basis for the overall expected rate of return should include the effect of the major categories of plan assets.

BC85D Respondents also expressed concerns that the sensitivity information about medical cost trend rates gave undue prominence to that assumption, even though medical costs might not be significant compared with other defined benefit costs. The IASB noted that the sensitivity information need be given only if the medical costs are material and that IAS 1 requires information to be given about all key assumptions and key sources of estimation uncertainty.

BC85E Finally, some respondents argued that requiring five-year histories would give rise to information overload and was unnecessary because the information was available from previous financial statements. The IASB reconfirmed its view that the trend information was useful and noted that it was considerably easier for an entity to take the information from previous financial statements and present it in the current financial statements than it would be for users to find the figures for previous periods. However, the IASB agreed that as a transitional measure entities should be permitted to build up the trend information over time.

Benefits other than Post-Employment Benefits

Compensated absences (paragraphs 11-16 of the Standard)

BC86 Some argue that an employee's entitlement to future compensated absences does not create an obligation if that entitlement is conditional on future events other than future service. However, the Board believes that an obligation arises as an employee renders service which increases the employee's entitlement (conditional or unconditional) to future compensated absences; for example, accumulating paid sick leave creates an obligation because any unused entitlement increases the employee's entitlement to sick leave in future periods. The probability that the employee will be sick in those future periods affects the measurement of that obligation, but does not determine whether that obligation exists.

BC87 The Board considered three alternative approaches to measuring the obligation that results from unused entitlement to accumulating compensated absences:

(a) recognise the entire unused entitlement as a liability, on the basis that any future payments are made first out of unused entitlement and only subsequently out of entitlement that will accumulate in future periods (a FIFO approach);

(b) recognise a liability to the extent that future payments for the employee group as a whole are expected to exceed the future payments that would have been expected in the absence of the accumulation feature (a group LIFO approach); or

(c) recognise a liability to the extent that future payments for individual employees are expected to exceed the future payments that would have been expected in the absence of the accumulation feature (an individual LIFO approach).

These methods are illustrated by the following example.

Example

An entity has 100 employees, who are each entitled to five working days of paid sick leave for each year. Unused sick leave may be carried forward for one year. Such leave is taken first out of the current year's entitlement and then out of any balance brought forward from the previous year (a LIFO basis). At 31 December 20X1, the average unused entitlement is two days per employee. The entity expects, based on past experience which is expected to continue, that 92 employees will take no more than four days of paid sick leave in 20X2 and that the remaining 8 employees will take an average of six and a half days each.

Method (a) *The entity recognises a liability equal to the undiscounted amount of 200 days of sick pay (two days each, for 100 employees). It is assumed that the first 200 days of paid sick leave result from the unused entitlement.*

Method (b) *The entity recognises no liability because paid sick leave for the employee group as a whole is not expected to exceed the entitlement of five days each in 20X2.*

Method (c) *The entity recognises a liability equal to the undiscounted amount of 12 days of sick pay (one and a half days each, for 8 employees).*

BC88 The Board selected method (c), the individual LIFO approach, because that method measures the obligation at the present value of the additional future payments that are expected to arise solely from the accumulation feature. The new IAS 19 notes that, in many cases, the resulting liability will not be material.

Death-in-service benefits

BC89 E54 gave guidance on cases where death-in-service benefits are not insured externally and are not provided through a post-employment benefit plan. The Board concluded that such cases will be rare. Accordingly, the Board agreed to delete the guidance on death-in-service benefits.

Other long-term employee benefits (paragraphs 126-131 of the Standard)

BC90 The Board decided, for simplicity, not to permit or require a 'corridor' approach for other long-term employee benefits, as such benefits do not present measurement difficulties to the same extent as post-employment benefits. For the same reason, the Board decided to require immediate recognition of all past service cost for such benefits and not to permit any transitional option for such benefits.

Termination benefits (paragraphs 132-143 of the Standard)

BC91 Under some national standards, termination benefits are not recognised until employees have accepted the offer of the termination benefits. However, the Board decided that the communication of an offer to employees (or their representatives) creates an obligation and that obligation should be recognised as a liability if there is a detailed formal plan. The detailed formal plan both makes it probable that there will be an outflow of resources embodying economic benefits and also enables the obligation to be measured reliably.

BC92 Some argue that a distinction should be made between:

(a) termination benefits resulting from an explicit contractual or legal requirement; and

(b) termination benefits resulting from an offer to encourage voluntary redundancy.

The Board believes that such a distinction is irrelevant; an entity offers termination benefits to encourage voluntary redundancy because the entity already has a constructive obligation. The communication of an offer enables an entity to measure the obligation reliably. E54 proposed some limited flexibility to allow that communication to take place shortly after the balance sheet date. However, in response to comments on E54, and for consistency with E59, *Provisions, Contingent Liabilities and Contingent Assets*, the Board decided to remove that flexibility.

BC93 Termination benefits are often closely linked with curtailments and settlements and with restructuring provisions. Therefore, the Board decided that there is a need for recognition and measurement principles to be similar. The guidance on the recognition of termination benefits (and of curtailments and settlements) has been conformed to the proposals in E59 *Provisions, Contingent Liabilities and Contingent Assets*. The Board agreed to add explicit guidance (not given in E54) on the measurement of termination benefits, requiring discounting for termination benefits not payable within one year.

Equity compensation benefits (paragraphs 144-152 of the Standard)

~~BC94 The Board decided that the new IAS 19 should not:~~

~~(a) include recognition and measurement requirements for equity compensation benefits, in view of the lack of international consensus on the recognition and measurement of the resulting obligations and costs; or~~

~~(b) require disclosure of the fair value of employee share options, in view of the lack of international consensus on the fair value of many employee share options.~~*

Transition and effective date (paragraphs 153-158 of the Standard)

BC95 The Board recognises that the new IAS 19 will lead to significant changes for some entities. E54 proposed to mitigate this problem by delaying the effective date of the new IAS 19 until 3 years after its approval. In response to comments on E54, the Board introduced a transitional option to amortise an increase in defined benefit liabilities over not more than five years. In consequence, the Board decided that it was not necessary to delay the effective date.

BC96 E54 proposed no specific transitional provisions. Consequently, an entity applying the new IAS 19 for the first time would have been required to compute the effect of the 'corridor' retrospectively. Some commentators felt that this would be impracticable and would not generate useful information. The Board agreed with these comments. Accordingly, the new IAS 19 confirms that, on initial adoption, an entity does not compute the effect of the 'corridor' retrospectively.

BC97 The IASB concluded that the amendments to paragraphs 7, 8(b) and 32B simply clarified the existing requirements and thus should be applied retrospectively. The amendments to the paragraphs concerning the distinction between negative past service costs and curtailments are to be applied prospectively. The IASB concluded that the cost of analysing past plan amendments using the clarified definitions and restating them would exceed the benefits.

* Paragraphs 144-152 of IAS 19 were deleted by IFRS 2 *Share-based Payment.*

Dissenting opinions

Dissent of Patricia L O' Malley from the issue in May 2002 of *Employee Benefits: The Asset Ceiling* (Amendment to IAS 19)

DO1 Ms O'Malley dissents from this amendment of IAS 19. In her view, the perceived problem being addressed is an inevitable result of the interaction of two fundamentally inconsistent notions in IAS 19. The corridor approach allowed by IAS 19 permits the recognition of amounts on the balance sheet that do not meet the *Framework*'s definition of assets. The asset ceiling then imposes a limitation on the recognition of some of those assets based on a recoverability notion. A far preferable limited amendment would be to delete the asset ceiling in paragraph 58. This would resolve the identified problem and at least remove the internal inconsistency in IAS 19.

DO2 It is asserted that the amendment to the standard will result in a more representationally faithful portrayal of economic events. Ms O'Malley believes that it is impossible to improve the representational faithfulness of a standard that permits recording an asset relating to a pension plan that actually has a deficiency, or a liability in respect of a plan that actually has a surplus.

Dissent of James J Leisenring and Tatsumi Yamada from the issue in December 2004 of *Actuarial Gains and Losses, Group Plans and Disclosures* (Amendment to IAS 19)

Mr Leisenring

DO1 Mr Leisenring dissents from the issue of the Amendment to IAS 19 Employee Benefits—*Actuarial Gains and Losses, Group Plans and Disclosures.*

DO2 Mr Leisenring dissents because he disagrees with the deletion of the last sentence in paragraph 34 and the addition of paragraphs 34A and 34B. He believes that group entities that give a defined benefit promise to their employees should account for that defined benefit promise in their separate or individual financial statements. He further believes that separate or individual financial statements that purport to be prepared in accordance with IFRSs should comply with the same requirements as other financial statements that are prepared in accordance with IFRSs. He therefore disagrees with the removal of the requirement for group entities to treat defined benefit plans that share risks between entities under common control as defined benefit plans and the introduction instead of the requirements of paragraph 34A.

DO3 Mr Leisenring notes that group entities are required to give disclosures about the plan as a whole but does not believe that disclosures are an adequate substitute for recognition and measurement in accordance with the requirements of IAS 19.

Mr Yamada

DO4 Mr Yamada dissents from the issue of the Amendment to IAS 19 Employee Benefits—*Actuarial Gains and Losses, Group Plans and Disclosures*.

DO5 Mr Yamada agrees that an option should be added to IAS 19 that allows entities that recognise actuarial gains and losses in full in the period in which they occur to recognise them outside profit or loss in a statement of recognised income and expense, even though under the existing IAS 19 they can be recognised in profit or loss in full in the period in which they occur. He agrees that the option provides more transparent information than the deferred recognition options commonly chosen under IAS 19. However, he also believes that all items of income and expense should be recognised in profit or loss in some period. Until they have been so recognised, they should be included in a component of equity separate from retained earnings. They should be transferred from that separate component of equity into retained earnings when they are recognised in profit or loss. Mr Yamada does not, therefore, agree with the requirements of paragraph 93D.

DO6 Mr Yamada acknowledges the difficulty in finding a rational basis for recognising actuarial gains and losses in profit or loss in periods after their initial recognition in a statement of recognised income and expense when the plan is ongoing. He also acknowledges that, under IFRSs, some gains and losses are recognised directly in a separate component of equity and are not subsequently recognised in profit or loss. However, Mr Yamada does not believe that this justifies expanding this treatment to actuarial gains and losses.

DO7 The cumulative actuarial gains and losses could be recognised in profit or loss when a plan is wound up or transferred outside the entity. The cumulative amount recognised in a separate component of equity would be transferred to retained earnings at the same time. This would be consistent with the treatment of exchange gains and losses on subsidiaries that have a measurement currency different from the presentation currency of the group.

DO8 Therefore, Mr Yamada believes that the requirements of paragraph 93D mean that the option is not an improvement to financial reporting because it allows gains and losses to be excluded permanently from profit or loss and yet be recognised immediately in retained earnings.

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Hong Kong Financial Reporting Standard 8

Operating Segments

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CONTENTS

paragraphs

INTRODUCTION **IN1–IN18**

INTERNATIONAL FINANCIAL REPORTING STANDARD 8
OPERATING SEGMENTS

CORE PRINCIPLE **1**

SCOPE **2–4**

OPERATING SEGMENTS **5–10**

REPORTABLE SEGMENTS **11–19**

Aggregation criteria **12**

Quantitative thresholds **13–19**

DISCLOSURE **20–24**

General information **22**

Information about profit or loss, assets and liabilities **23–24**

MEASUREMENT **25–30**

Reconciliations **28**

Restatement of previously reported information **29–30**

ENTITY-WIDE DISCLOSURES **31–34**

Information about products and services **32**

Information about geographical areas **33**

Information about major customers **34**

TRANSITION AND EFFECTIVE DATE **35–36A**

WITHDRAWAL OF HKAS 14 **37**

APPENDICES

A Defined term

B Amendments to other HKFRSs

BASIS FOR CONCLUSIONS

DISSENTING OPINIONS

IMPLEMENTATION GUIDANCE

Hong Kong Financial Reporting Standard 8 *Operating Segments* (HKFRS 8) is set out in paragraphs 1-37 and Appendices A and B. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. HKFRS 8 should be read in the context of its core principle and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Statements*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

Reasons for issuing the HKFRS

IN1 Hong Kong Financial Reporting Standard 8 *Operating Segments* sets out requirements for disclosure of information about an entity's operating segments and also about the entity's products and services, the geographical areas in which it operates, and its major customers.

IN2 Achieving convergence of accounting standards around the world is one of the prime objectives of the International Accounting Standards Board (IASB). In pursuit of that objective, the IASB and the Financial Accounting Standards Board (FASB) in the United States have undertaken a joint short-term project with the objective of reducing differences between International Financial Reporting Standards (IFRSs) and US generally accepted accounting principles (US GAAP) that are capable of resolution in a relatively short time and can be addressed outside major projects. One aspect of that project involves the two boards considering each other's recent standards with a view to adopting high quality financial reporting solutions. International Financial Reporting Standard (IFRS) 8 *Operating Segments* arises from the IASB's consideration of FASB Statement No. 131 *Disclosures about Segments of an Enterprise and Related Information* (SFAS 131) issued in 1997, compared with IAS 14 *Segment Reporting*, which was issued in substantially its present form by the IASB's predecessor body, the International Accounting Standards Committee, in 1997.

IN3 The HKFRS, which is adopted from IFRS 8 under the Institute's policy of convergence with IFRSs, achieves convergence with the requirements of SFAS 131, except for minor differences listed in paragraph BC60 of the Basis for Conclusions. The wording of the HKFRS is the same as that of SFAS 131 except for changes necessary to make the terminology consistent with that in other HKFRSs.

Main features of the HKFRS

IN4 The HKFRS specifies how an entity should report information about its operating segments in annual financial statements and, as a consequential amendment to HKAS 34 *Interim Financial Reporting*, requires an entity to report selected information about its operating segments in interim financial reports. It also sets out requirements for related disclosures about products and services, geographical areas and major customers.

IN5 The HKFRS requires an entity to report financial and descriptive information about its reportable segments. Reportable segments are operating segments or aggregations of operating segments that meet specified criteria. Operating segments are components of an entity about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. Generally, financial information is required to be reported on the same basis as is used internally for evaluating operating segment performance and deciding how to allocate resources to operating segments.

IN6 The HKFRS requires an entity to report a measure of operating segment profit or loss and of segment assets. It also requires an entity to report a measure of segment liabilities and particular income and expense items if such measures are regularly provided to the chief operating decision maker. It requires reconciliations of total reportable segment revenues, total profit or loss, total assets, liabilities and other amounts disclosed for reportable segments to corresponding amounts in the entity's financial statements.

IN7 The HKFRS requires an entity to report information about the revenues derived from its products or services (or groups of similar products and services), about the countries in which it earns revenues and holds assets, and about major customers,

regardless of whether that information is used by management in making operating decisions. However, the HKFRS does not require an entity to report information that is not prepared for internal use if the necessary information is not available and the cost to develop it would be excessive.

IN8 The HKFRS also requires an entity to give descriptive information about the way the operating segments were determined, the products and services provided by the segments, differences between the measurements used in reporting segment information and those used in the entity's financial statements, and changes in the measurement of segment amounts from period to period.

IN9 An entity shall apply this HKFRS for annual periods beginning on or after 1 January 2009. Earlier application is permitted. If an entity applies this HKFRS for an earlier period, it shall disclose that fact.

Changes from previous requirements

IN10 The HKFRS replaces HKAS 14 *Segment Reporting*. The main changes from HKAS 14 are described below.

Identification of segments

IN11 The requirements of the HKFRS are based on the information about the components of the entity that management uses to make decisions about operating matters. The HKFRS requires identification of operating segments on the basis of internal reports that are regularly reviewed by the entity's chief operating decision maker in order to allocate resources to the segment and assess its performance. HKAS 14 required identification of two sets of segments–one based on related products and services, and the other on geographical areas. HKAS 14 regarded one set as primary segments and the other as secondary segments.

IN12 A component of an entity that sells primarily or exclusively to other operating segments of the entity is included in the HKFRS's definition of an operating segment if the entity is managed that way. HKAS 14 limited reportable segments to those that earn a majority of their revenue from sales to external customers and therefore did not require the different stages of vertically integrated operations to be identified as separate segments.

Measurement of segment information

IN13 The HKFRS requires the amount reported for each operating segment item to be the measure reported to the chief operating decision maker for the purposes of allocating resources to the segment and assessing its performance. HKAS 14 required segment information to be prepared in conformity with the accounting policies adopted for preparing and presenting the financial statements of the consolidated group or entity.

IN14 HKAS 14 defined segment revenue, segment expense, segment result, segment assets and segment liabilities. The HKFRS does not define these terms, but requires an explanation of how segment profit or loss, segment assets and segment liabilities are measured for each reportable segment.

Disclosure

IN15 The HKFRS requires an entity to disclose the following information:

(a) factors used to identify the entity's operating segments, including the basis of organisation (for example, whether management organises the entity around differences in products and services, geographical areas, regulatory environments, or a combination of factors and whether segments have been

aggregated), and

(b) types of products and services from which each reportable segment derives its revenues.

IN16 HKAS 14 required the entity to disclose specified items of information about its primary segments. The HKFRS requires an entity to disclose specified amounts about each reportable segment, if the specified amounts are included in the measure of segment profit or loss and are reviewed by or otherwise regularly provided to the chief operating decision maker.

IN17 The HKFRS requires an entity to report interest revenue separately from interest expense for each reportable segment unless a majority of the segment's revenues are from interest and the chief operating decision maker relies primarily on net interest revenue to assess the performance of the segment and to make decisions about resources to be allocated to the segment. HKAS 14 did not require disclosure of interest income and expense.

IN18 The HKFRS requires an entity, including an entity with a single reportable segment, to disclose information for the entity as a whole about its products and services, geographical areas, and major customers. This requirement applies, regardless of the entity's organisation, if the information is not included as part of the disclosures about segments. HKAS 14 required the disclosure of secondary segment information for either industry or geographical segments, to supplement the information given for the primary segments.

Hong Kong Financial Reporting Standard 8
Operating Segments

Core principle

1 **An entity shall disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates.**

Scope

2 This HKFRS shall apply to:

(a) the separate or individual financial statements of an entity:

(i) whose debt or equity instruments are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets), or

(ii) that files, or is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and

(b) the consolidated financial statements of a group with a parent:

(i) whose debt or equity instruments are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets), or

(ii) that files, or is in the process of filing, the consolidated financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market.

3 If an entity that is not required to apply this HKFRS chooses to disclose information about segments that does not comply with this HKFRS, it shall not describe the information as segment information.

4 If a financial report contains both the consolidated financial statements of a parent that is within the scope of this HKFRS as well as the parent's separate financial statements, segment information is required only in the consolidated financial statements.

Operating segments

5 An operating segment is a component of an entity:

(a) that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same entity),

(b) whose operating results are regularly reviewed by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and

(c) for which discrete financial information is available.

An operating segment may engage in business activities for which it has yet to earn revenues, for example, start-up operations may be operating segments before earning revenues.

6 Not every part of an entity is necessarily an operating segment or part of an operating segment. For example, a corporate headquarters or some functional departments may not earn revenues or may earn revenues that are only incidental to the activities of the entity and would not be operating segments. For the purposes of this HKFRS, an entity's post-employment benefit plans are not operating segments.

7 The term "chief operating decision maker" identifies a function, not necessarily a manager with a specific title. That function is to allocate resources to and assess the performance of the operating segments of an entity. Often the chief operating decision maker of an entity is its chief executive officer or chief operating officer but, for example, it may be a group of executive directors or others.

8 For many entities, the three characteristics of operating segments described in paragraph 5 clearly identify its operating segments. However, an entity may produce reports in which its business activities are presented in a variety of ways. If the chief operating decision maker uses more than one set of segment information, other factors may identify a single set of components as constituting an entity's operating segments, including the nature of the business activities of each component, the existence of managers responsible for them, and information presented to the board of directors.

9 Generally, an operating segment has a segment manager who is directly accountable to and maintains regular contact with the chief operating decision maker to discuss operating activities, financial results, forecasts, or plans for the segment. The term "segment manager" identifies a function, not necessarily a manager with a specific title. The chief operating decision maker also may be the segment manager for some operating segments. A single manager may be the segment manager for more than one operating segment. If the characteristics in paragraph 5 apply to more than one set of components of an organisation but there is only one set for which segment managers are held responsible, that set of components constitutes the operating segments.

10 The characteristics in paragraph 5 may apply to two or more overlapping sets of components for which managers are held responsible. That structure is sometimes referred to as a matrix form of organisation. For example, in some entities, some managers are responsible for different product and service lines worldwide, whereas other managers are responsible for specific geographical areas. The chief operating decision maker regularly reviews the operating results of both sets of components, and financial information is available for both. In that situation, the entity shall determine which set of components constitutes the operating segments by reference to the core principle.

Reportable segments

11 **An entity shall report separately information about each operating segment that:**

(a) **has been identified in accordance with paragraphs 5-10 or results from aggregating two or more of those segments in accordance with paragraph 12, and**

(b) **exceeds the quantitative thresholds in paragraph 13.**

Paragraphs 14-19 specify other situations in which separate information about an operating segment shall be reported.

Aggregation criteria

12 Operating segments often exhibit similar long-term financial performance if they have similar economic characteristics. For example, similar long-term average gross margins for two operating segments would be expected if their economic characteristics were similar. Two or more operating segments may be aggregated into a single operating segment if aggregation is consistent with the core principle of this HKFRS, the segments have similar economic characteristics, and the segments are similar in each of the following respects:

(a) the nature of the products and services;

(b) the nature of the production processes;

(c) the type or class of customer for their products and services;

(d) the methods used to distribute their products or provide their services; and

(e) if applicable, the nature of the regulatory environment, for example, banking, insurance or public utilities.

Quantitative thresholds

13 An entity shall report separately information about an operating segment that meets any of the following quantitative thresholds:

(a) Its reported revenue, including both sales to external customers and intersegment sales or transfers, is 10 per cent or more of the combined revenue, internal and external, of all operating segments.

(b) The absolute amount of its reported profit or loss is 10 per cent or more of the greater, in absolute amount, of (i) the combined reported profit of all operating segments that did not report a loss and (ii) the combined reported loss of all operating segments that reported a loss.

(c) Its assets are 10 per cent or more of the combined assets of all operating segments.

Operating segments that do not meet any of the quantitative thresholds may be considered reportable, and separately disclosed, if management believes that information about the segment would be useful to users of the financial statements.

14 An entity may combine information about operating segments that do not meet the quantitative thresholds with information about other operating segments that do not meet the quantitative thresholds to produce a reportable segment only if the operating segments have similar economic characteristics and share a majority of the aggregation criteria listed in paragraph 12.

15 If the total external revenue reported by operating segments constitutes less than 75 per cent of the entity's revenue, additional operating segments shall be identified as reportable segments (even if they do not meet the criteria in paragraph 13) until at least 75 per cent of the entity's revenue is included in reportable segments.

16 Information about other business activities and operating segments that are not reportable shall be combined and disclosed in an "all other segments" category separately from other reconciling items in the reconciliations required by paragraph 28. The sources of the revenue included in the "all other segments" category shall be described.

17 If management judges that an operating segment identified as a reportable segment in the immediately preceding period is of continuing significance, information about that segment shall continue to be reported separately in the current period even if it no longer meets the criteria for reportability in paragraph 13.

18 If an operating segment is identified as a reportable segment in the current period in accordance with the quantitative thresholds, segment data for a prior period presented for comparative purposes shall be restated to reflect the newly reportable segment as a separate segment, even if that segment did not satisfy the criteria for reportability in paragraph 13 in the prior period, unless the necessary information is not available and the cost to develop it would be excessive.

19 There may be a practical limit to the number of reportable segments that an entity separately discloses beyond which segment information may become too detailed. Although no precise limit has been determined, as the number of segments that are reportable in accordance with paragraphs 13-18 increases above ten, the entity should consider whether a practical limit has been reached.

Disclosure

20 An entity shall disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates.

21 To give effect to the principle in paragraph 20, an entity shall disclose the following for each period for which a statement of comprehensive income is presented:

(a) general information as described in paragraph 22;

(b) information about reported segment profit or loss, including specified revenues and expenses included in reported segment profit or loss, segment assets, segment liabilities and the basis of measurement, as described in paragraphs 23-27; and

(c) reconciliations of the totals of segment revenues, reported segment profit or loss, segment assets, segment liabilities and other material segment items to corresponding entity amounts as described in paragraph 28.

Reconciliations of the amounts in the statement of financial position ~~balance sheet amounts~~ for reportable segments to the amounts in the entity's statement of financial position ~~balance sheet amounts~~ are required for each date at which a ~~balance sheet~~ statement of financial position is presented. Information for prior periods shall be restated as described in paragraphs 29 and 30.

General information

22 An entity shall disclose the following general information:

(a) factors used to identify the entity's reportable segments, including the basis of organisation (for example, whether management has chosen to organise the entity around differences in products and services, geographical areas, regulatory environments, or a combination of factors and whether operating segments have been aggregated), and

(b) types of products and services from which each reportable segment derives its revenues.

Information about profit or loss, assets and liabilities

23[†] An entity shall report a measure of profit or loss ~~and total assets~~ for each reportable segment. An entity shall report a measure of total assets and liabilities for each reportable segment if such ~~an~~ amounts ~~is~~are regularly provided to the chief operating decision maker. An entity shall also disclose the following about each reportable segment if the specified amounts are included in the measure of segment profit or loss reviewed by the chief operating decision maker; or are otherwise regularly provided to the chief operating decision maker; even if not included in that measure of segment profit or loss:

(a) revenues from external customers;

(b) revenues from transactions with other operating segments of the same entity;

(c) interest revenue;

(d) interest expense;

(e) depreciation and amortisation;

(f) material items of income and expense disclosed in accordance with paragraph ~~86~~97 of HKAS 1 *Presentation of Financial Statements* (as revised in 2007);

(g) the entity's interest in the profit or loss of associates and joint ventures accounted for by the equity method;

(h) income tax expense or income; and

(i) material non-cash items other than depreciation and amortisation.

An entity shall report interest revenue separately from interest expense for each reportable segment unless a majority of the segment's revenues are from interest and the chief operating decision maker relies primarily on net interest revenue to assess the performance of the segment and make decisions about resources to be allocated to the segment. In that situation, an entity may report that segment's interest revenue net of its interest expense and disclose that it has done so.

24 An entity shall disclose the following about each reportable segment if the specified amounts are included in the measure of segment assets reviewed by the chief operating decision maker or are otherwise regularly provided to the chief operating decision maker, even if not included in the measure of segment assets:

(a) the amount of investment in associates and joint ventures accounted for by the equity method, and

(b) the amounts of additions to non-current assets[*] other than financial instruments, deferred tax assets, post-employment benefit assets (see HKAS 19 *Employee Benefits* paragraphs 54-58) and rights arising under insurance contracts.

[†] Amendments effective for annual periods beginning on or after 1 January 2010.

[*] For assets classified according to a liquidity presentation, non-current assets are assets that include amounts expected to be recovered more than twelve months after the reporting period.

Measurement

25 The amount of each segment item reported shall be the measure reported to the chief operating decision maker for the purposes of making decisions about allocating resources to the segment and assessing its performance. Adjustments and eliminations made in preparing an entity's financial statements and allocations of revenues, expenses, and gains or losses shall be included in determining reported segment profit or loss only if they are included in the measure of the segment's profit or loss that is used by the chief operating decision maker. Similarly, only those assets and liabilities that are included in the measures of the segment's assets and segment's liabilities that are used by the chief operating decision maker shall be reported for that segment. If amounts are allocated to reported segment profit or loss, assets or liabilities, those amounts shall be allocated on a reasonable basis.

26 If the chief operating decision maker uses only one measure of an operating segment's profit or loss, the segment's assets or the segment's liabilities in assessing segment performance and deciding how to allocate resources, segment profit or loss, assets and liabilities shall be reported at those measures. If the chief operating decision maker uses more than one measure of an operating segment's profit or loss, the segment's assets or the segment's liabilities, the reported measures shall be those that management believes are determined in accordance with the measurement principles most consistent with those used in measuring the corresponding amounts in the entity's financial statements.

27 An entity shall provide an explanation of the measurements of segment profit or loss, segment assets and segment liabilities for each reportable segment. At a minimum, an entity shall disclose the following:

(a) the basis of accounting for any transactions between reportable segments.

(b) the nature of any differences between the measurements of the reportable segments' profits or losses and the entity's profit or loss before income tax expense or income and discontinued operations (if not apparent from the reconciliations described in paragraph 28). Those differences could include accounting policies and policies for allocation of centrally incurred costs that are necessary for an understanding of the reported segment information.

(c) the nature of any differences between the measurements of the reportable segments' assets and the entity's assets (if not apparent from the reconciliations described in paragraph 28). Those differences could include accounting policies and policies for allocation of jointly used assets that are necessary for an understanding of the reported segment information.

(d) the nature of any differences between the measurements of the reportable segments' liabilities and the entity's liabilities (if not apparent from the reconciliations described in paragraph 28). Those differences could include accounting policies and policies for allocation of jointly utilised liabilities that are necessary for an understanding of the reported segment information.

(e) the nature of any changes from prior periods in the measurement methods used to determine reported segment profit or loss and the effect, if any, of those changes on the measure of segment profit or loss.

(f) the nature and effect of any asymmetrical allocations to reportable segments. For example, an entity might allocate depreciation expense to a segment without allocating the related depreciable assets to that segment.

Reconciliations

28 An entity shall provide reconciliations of all of the following:

(a) the total of the reportable segments' revenues to the entity's revenue.

(b) the total of the reportable segments' measures of profit or loss to the entity's profit or loss before tax expense (tax income) and discontinued operations. However, if an entity allocates to reportable segments items such as tax expense (tax income), the entity may reconcile the total of the segments' measures of profit or loss to the entity's profit or loss after those items.

(c) the total of the reportable segments' assets to the entity's assets.

(d) the total of the reportable segments' liabilities to the entity's liabilities if segment liabilities are reported in accordance with paragraph 23.

(e) the total of the reportable segments' amounts for every other material item of information disclosed to the corresponding amount for the entity.

All material reconciling items shall be separately identified and described. For example, the amount of each material adjustment needed to reconcile reportable segment profit or loss to the entity's profit or loss arising from different accounting policies shall be separately identified and described.

Restatement of previously reported information

29 If an entity changes the structure of its internal organisation in a manner that causes the composition of its reportable segments to change, the corresponding information for earlier periods, including interim periods, shall be restated unless the information is not available and the cost to develop it would be excessive. The determination of whether the information is not available and the cost to develop it would be excessive shall be made for each individual item of disclosure. Following a change in the composition of its reportable segments, an entity shall disclose whether it has restated the corresponding items of segment information for earlier periods.

30 If an entity has changed the structure of its internal organisation in a manner that causes the composition of its reportable segments to change and if segment information for earlier periods, including interim periods, is not restated to reflect the change, the entity shall disclose in the year in which the change occurs segment information for the current period on both the old basis and the new basis of segmentation, unless the necessary information is not available and the cost to develop it would be excessive.

Entity-wide disclosures

31 Paragraphs 32-34 apply to all entities subject to this HKFRS including those entities that have a single reportable segment. Some entities' business activities are not organised on the basis of differences in related products and services or differences in geographical areas of operations. Such an entity's reportable segments may report revenues from a broad range of essentially different products and services, or more than one of its reportable segments may provide essentially the same products and services. Similarly, an entity's reportable segments may hold assets in different geographical areas and report revenues from customers in different geographical areas, or more than one of its reportable segments may operate in the same geographical area. Information required by paragraphs 32-34 shall be provided only if it is not provided as part of the reportable segment information required by this HKFRS.

Information about products and services

32 An entity shall report the revenues from external customers for each product and service, or each group of similar products and services, unless the necessary information is not available and the cost to develop it would be excessive, in which case that fact shall be disclosed. The amounts of revenues reported shall be based on the financial information used to produce the entity's financial statements.

Information about geographical areas

33 An entity shall report the following geographical information, unless the necessary information is not available and the cost to develop it would be excessive:

(a) revenues from external customers (i) attributed to the entity's country of domicile and (ii) attributed to all foreign countries in total from which the entity derives revenues. If revenues from external customers attributed to an individual foreign country are material, those revenues shall be disclosed separately. An entity shall disclose the basis for attributing revenues from external customers to individual countries.

(b) non-current assets[*] other than financial instruments, deferred tax assets, post-employment benefit assets, and rights arising under insurance contracts (i) located in the entity's country of domicile and (ii) located in all foreign countries in total in which the entity holds assets. If assets in an individual foreign country are material, those assets shall be disclosed separately.

The amounts reported shall be based on the financial information that is used to produce the entity's financial statements. If the necessary information is not available and the cost to develop it would be excessive, that fact shall be disclosed. An entity may provide, in addition to the information required by this paragraph, subtotals of geographical information about groups of countries.

Information about major customers

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 HKFRS, 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~~ including government agencies and similar bodies whether local, national or international) and entities known to the reporting entity to be under the control of that government ~~shall be~~ are considered a single customer. In assessing this, the reporting entity shall consider the extent of economic integration between those entities.

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[*] For assets classified according to a liquidity presentation, non-current assets are assets that include amounts expected to be recovered more than twelve months after the reporting period.

[▲] Amendment effective for annual periods beginning on or after 1 January 2011.

Transition and effective date

35 An entity shall apply this HKFRS in its annual financial statements for periods beginning on or after 1 January 2009. Earlier application is permitted. If an entity applies this HKFRS in its financial statements for a period before 1 January 2009, it shall disclose that fact.

35A[⌖] Paragraph 23 was amended by *Improvements to HKFRSs* issued in May 2009. An entity shall apply that amendment for annual periods beginning on or after 1 January 2010. Earlier application is permitted. If an entity applies the amendment for an earlier period it shall disclose that fact.

36[⌖] Segment information for prior years that is reported as comparative information for the initial year of application (including application of the amendment to paragraphs 23 made in May 2009) shall be restated to conform to the requirements of this HKFRS, unless the necessary information is not available and the cost to develop it would be excessive.

36A HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraph 23(f). An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies HKAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.

36B[†] HKAS 24 *Related Party Disclosures* (as revised in 2009) amended paragraph 34 for annual periods beginning on or after 1 January 2011. If an entity applies HKAS 24 (revised 2009) for an earlier period, it shall apply the amendment to paragraph 34 for that earlier period.

Withdrawal of HKAS 14

37 This HKFRS supersedes HKAS 14 *Segment Reporting*.

[⌖] Amendments effective for annual periods beginning on or after 1 January 2010.
[†] Amendment effective for annual periods beginning on or after 1 January 2011.

Appendix A
Defined term

This appendix is an integral part of the HKFRS.

operating segment

An operating segment is a component of an entity:

(a) that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same entity),

(b) whose operating results are regularly reviewed by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and

(c) for which discrete financial information is available.

Appendix B
Amendments to other HKFRSs

The amendments in this appendix shall be applied for annual periods beginning on or after 1 January 2009. If an entity applies this HKFRS for an earlier period, these amendments shall be applied for that earlier period. In the amended paragraphs, new text is underlined and deleted text is struck through.

* * *

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

Basis for Conclusions on
Hong Kong Financial Reporting Standard 8

Operating Segments

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

Basis for Conclusions
HKFRS 8 *Operating Segments*

HKFRS 8 is based on IFRS 8 *Operating Segments*. In approving HKFRS 8, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IFRS 8. Accordingly, there are no significant differences between HKFRS 8 and IFRS 8. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IFRS 8 referred to below generally correspond with those in HKFRS 8.

CONTENTS

	paragraphs
BASIS FOR CONCLUSIONS ON IFRS 8 OPERATING SEGMENTS	
INTRODUCTION	**BC1–BC8**
Differences between IAS 14 and SFAS 131	**BC4–BC5**
Academic research findings	**BC6**
Meetings with users	**BC7–BC8**
ADOPTION OF MANAGEMENT APPROACH	**BC9–BC17**
SCOPE OF THE STANDARD	**BC18–BC23**
ASPECTS OF THE MANAGEMENT APPROACH	**BC24–BC47**
Specific measurement requirements for some items	**BC24–BC26**
Matrix form of organisations	**BC27**
Quantitative thresholds	**BC28–BC29**
Interaction of aggregation criteria and quantitative thresholds	**BC30**
Inclusion of US guidance	**BC31–BC33A**
Information about segment assets	**BC34–BC35**
Information about segment liabilities	**BC36–BC38**
Level of reconciliations	**BC39–BC42**
Lack of a competitive harm exemption	**BC43–BC45**
Adoption of the term 'impracticable'	**BC46–BC47**
ENTITY-WIDE DISCLOSURES	**BC48–BC58**
Geographical information	**BC48–BC50**
Exemption from entity-wide disclosures	**BC51–BC53**
Country of domicile	**BC54–BC55**
Subtotal for tangible non-current assets	**BC56–BC57**
Information about major customers	**BC58**
INTERIM FINANCIAL INFORMATION	**BC59**
DIFFERENCES FROM SFAS 131	**BC60**
TRANSITIONAL PROVISIONS	**BC61–BC62**
DISSENTING OPINIONS ON IFRS 8	

APPENDICES

A Background information and basis for conclusions of the US Financial Accounting Standards Board on SFAS 131

B Amendments to Basis for Conclusions on other IFRSs

Basis for Conclusions on IFRS 8 *Operating Segments*

This Basis for Conclusions and its appendices accompany, but are not part of, IFRS 8.

Introduction

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching the conclusions in IFRS 8 *Operating Segments*. Individual Board members gave greater weight to some factors than to others.

BC2 In September 2002 the Board decided to add a short-term convergence project to its active agenda. The project is being conducted jointly with the United States standard-setter, the Financial Accounting Standards Board (FASB). The objective of the project is to reduce differences between IFRSs and US generally accepted accounting principles (US GAAP) that are capable of resolution in a relatively short time and can be addressed outside major projects.

BC3 As part of the project, the Board identified differences between IAS 14 *Segment Reporting* and the US standard SFAS 131 *Disclosures about Segments of an Enterprise and Related Information*, reviewed academic research findings on segment reporting, in particular relating to the implementation of SFAS 131, and had meetings with users of financial statements.

Differences between IAS 14 and SFAS 131

BC4 The requirements of SFAS 131 are based on the way that management regards an entity, focusing on information about the components of the business that management uses to make decisions about operating matters. In contrast, IAS 14 requires the disaggregation of the entity's financial statements into segments based on related products and services, and on geographical areas.

BC5 The requirements of SFAS 14 *Financial Reporting for Segments of a Business Enterprise*, the predecessor to SFAS 131, were similar to those of IAS 14. In particular, both standards required the accounting policies underlying the disaggregated information to be the same as those underlying the entity information, since segment information was regarded as a disaggregation of the entity information. The approach to segment disclosures in SFAS 14 was criticised for not providing information about segments based on the structure of an entity's internal organisation that could enhance a user's ability to predict actions or reactions of management that could significantly affect the entity's future cash flow prospects.

Academic research findings

BC6 Most of the academic research findings on segment reporting indicated that application of SFAS 131 resulted in more useful information than its predecessor, SFAS 14. According to the research, the management approach of SFAS 131:

(a) increased the number of reported segments and provided more information;

(b) enabled users to see an entity through the eyes of management;

(c) enabled an entity to provide timely segment information for external interim reporting with relatively low incremental cost;

(d) enhanced consistency with the management discussion and analysis or other annual report disclosures; and

(e) provided various measures of segment performance.

Meetings with users

BC7 The Board discussed segment reporting at several meetings with users of financial statements. Most of the users supported the management approach of SFAS 131 for the reasons mentioned in the previous paragraph. In particular, they supported an approach that would enable more segment information to be provided in interim financial reports.

BC8 Consequently the Board decided to adopt the US approach and published its proposals as an exposure draft in ED 8 *Operating Segments* in January 2006. The deadline for comments was 19 May 2006. The Board received 182 comment letters. After reviewing the responses, the Board issued IFRS 8 in November 2006.

Adoption of management approach

BC9 In the Basis for Conclusions on ED 8, the Board noted that the primary benefits of adopting the management approach in SFAS 131 are that:

(a) entities will report segments that correspond to internal management reports;

(b) entities will report segment information that will be more consistent with other parts of their annual reports;

(c) some entities will report more segments; and

(d) entities will report more segment information in interim financial reports.

In addition, the Board noted that the proposed IFRS would reduce the cost of providing disaggregated information for many entities because it uses segment information that is generated for management's use.

BC10 Most respondents to the Exposure Draft supported the adoption of the management approach. They considered the management approach appropriate, and superior to the approach of IAS 14. These respondents observed that the management approach for segment reporting allows users to review an entity's operations from the same perspective as management. They noted that although the IAS 14 approach would enhance comparability by requiring entities to report segment information that is consistent with IFRSs, the disclosures will not necessarily correspond to segment information that is reported to management and is used for making decisions.

BC11 Other respondents disagreed with the management approach. They argued that convergence should instead be achieved by changing SFAS 131 to IAS 14. In their view the latter approach is superior because it provides comparability of information across entities by defining measures of segment revenue, segment expense, segment result, segment assets and segment liabilities.

BC12 Yet other respondents agreed with the management approach for the identification of segment assets, but disagreed with the management approach for the measurement of the various segment disclosures. In particular, they doubted whether the publication of internally reported amounts would generate significant benefit for investors if those amounts differ from IFRS amounts.

BC13 The Board noted that if IFRS amounts could be prepared reliably and on a timely basis for segments identified using the management approach, that approach would provide the most useful information. However, the Board observed that IFRS amounts for segments cannot always be prepared on a sufficiently timely basis for interim reporting.

BC14 The Board also noted the requirements in the IFRS for an explanation of the measurements of segment profit or loss and segment assets and for reconciliations of the segment amounts to the amounts recognised in the entity's financial statements. The Board was satisfied that users would be able to understand and judge appropriately the basis on which the segment amounts were determined.

BC15 The Board concluded that the advantages of the management approach, in particular the ability of entities to prepare segment information on a sufficiently timely basis for inclusion in interim financial reports, outweighed any disadvantages arising from the potential for segments to be reported in accordance with non-IFRS accounting policies.

BC16 Given the Board's support for the principles of the management approach required by SFAS 131 and the objectives of the short-term convergence project, the Board decided that the simplest and most complete way to achieve convergence would be to use the text of SFAS 131 for the IFRS.

BC17 The FASB's thinking behind the management approach of SFAS 131 is presented in its Background Information and Basis for Conclusions. Because the Board has adopted that approach, the FASB's Background Information and Basis for Conclusions are reproduced in Appendix A to this Basis for Conclusions. The few differences from SFAS 131 that the Board has included in the IFRS are noted in paragraph BC60 below.

Scope of the standard

BC18 In ED 8, the Board proposed extending the scope of the IFRS to all entities that have public accountability rather than just entities whose securities are publicly traded. The Board noted that it was premature to adopt the proposed definition of public accountability that is being considered in a separate Board project on small and medium-sized entities (SMEs). However, the Board decided that the scope of the standard should be extended to include entities that hold assets in a fiduciary capacity for a broad group of outsiders. The Board concluded that the SMEs project is the most appropriate context in which to decide whether to extend the scope of the requirements on segment reporting to other entities.

BC19 Some respondents to ED 8 commented that the scope of the IFRS should not be extended until the Board has reached a conclusion on the definitions of "fiduciary capacity" and "public accountability" in the SMEs project. They argued that the terms needed clarification and definition.

BC20 The Board accepted these concerns and decided that the IFRS should not apply to entities that hold assets in a fiduciary capacity. However, the Board decided that publicly accountable entities should be within the scope of the IFRS, and that a future amendment of the scope of the IFRS should be proposed to include publicly accountable entities once the definition has been properly developed in the SMEs project. The proposed amendment will therefore be exposed at the same time as the exposure draft of the proposed IFRS for SMEs.

BC21 A number of respondents to ED 8 suggested that the scope exemption of paragraph 6 of IAS 14 should be included in the IFRS. This paragraph provided an exemption from segment reporting in the separate financial statements of the parent when a financial report contains both consolidated financial statements and the parent's separate financial statements. The Board agreed that on practical grounds such an exemption was appropriate.

BC22 In ED 8 the Board proposed that if an entity not required to apply the IFRS chooses to disclose segment information in financial statements that comply with IFRSs, that entity would be required to comply with the requirements of the IFRS. Respondents commented that this was unnecessarily restrictive. For example, they observed that

requiring full compliance with the IFRS would prevent an entity outside its scope from voluntarily disclosing sales information for segments without also disclosing segment profit or loss. The Board concluded that an entity should be able to provide segment information on a voluntary basis without triggering the need to comply fully with the IFRS, so long as the disclosure is not referred to as segment information.

BC23 A respondent to ED 8 asked for clarification on whether the scope of the proposed IFRS included the consolidated financial statements of a group whose parent has no listed financial instruments, but includes a listed minority interest* or a subsidiary with listed debt. The Board decided that such consolidated financial statements should not be included in the scope and that the scope should be clarified accordingly. The Board also noted that the same clarification should be made to the scope of IAS 33 *Earnings per Share*.

Aspects of the management approach

Specific measurement requirements for some items

BC24 In ED 8, the Board invited comments on whether the proposed IFRS should depart from the management approach in SFAS 131 by setting measurement requirements for specified items. Some respondents to ED 8 supported an approach that would define the measurement of the key terms such as segment revenues, segment expenses, segment results, segment assets and segment liabilities in order to enhance comparability between reporting entities. Other respondents disagreed with any departure from SFAS 131 on the grounds that defined measurements for specified items would eliminate the major benefits of the management approach.

BC25 The IFRS requires the entity to explain the measurements of segment profit or loss and segment assets and liabilities and to provide reconciliations of the total segment amounts to the amounts recognised in the entity's financial statements. The Board believes that such reconciliations will enable users to understand and judge the basis on which the segment amounts were determined. The Board also noted that to define the measurement of such amounts would be a departure from the requirements of SFAS 131 that would involve additional time and cost for entities and would be inconsistent with the management perspective on segment information.

BC26 Therefore, the Board decided not to require defined measures of segment revenues, segment expenses, segment result, segment assets and segment liabilities.

Matrix form of organisations

BC27 In ED 8 the Board proposed that when more than one set of segments could be identified, for example when entities use a matrix form of organisation, the components based on products and services should be the basis for the operating segments. Some respondents noted that matrix organisational structures are commonly used for large complex organisations and that mandating the use of components based on products and services was inconsistent with the management approach. The Board agreed with this view. Accordingly, the IFRS requires the identification of operating segments to be made by reference to the core principle of the IFRS.

Quantitative thresholds

BC28 In ED 8 the Board proposed quantitative thresholds for identifying reportable segments. Some respondents argued that such requirements represent adoption of a

* In January 2008 the IASB issued an amended IAS 27 *Consolidated and Separate Financial Statements*, which amended 'minority interest' to 'non-controlling interests'.

rule-based, rather than a principle-based, approach. In addition, some respondents commented that the inclusion of a 10 per cent threshold could create a precedent for determining materiality in other areas.

BC29 The Board considered an approach whereby any material operating segment would be required to be disclosed separately. However, the Board was concerned that there might be uncertainty about the meaning of materiality in relation to disclosure. Furthermore, such a requirement would be a significant change from the wording of SFAS 131. Thus, the Board was concerned that the change would be from an easily understandable and familiar set of words that converges with SFAS 131 to a potentially confusing principle. Accordingly, the Board decided to retain the quantitative thresholds.

Interaction of aggregation criteria and quantitative thresholds

BC30 One respondent commented that the ranking of the aggregation criteria for operating segments and the quantitative thresholds for determining reportable segments was unclear in ED 8. However, the flow chart in paragraph IG7 of the implementation guidance indicates that the aggregation criteria take precedence over the quantitative thresholds. The Board also noted that the wording in SFAS 131 was clear because the paragraph on aggregation refers to aggregation into a "single operating segment". The quantitative thresholds then determine which operating segments are reportable segments. The term "operating" has been inserted in paragraph 12 of the IFRS.

Inclusion of US guidance

BC31 The Board discussed the extent to which the IFRS should address the practical problems that have arisen from applying SFAS 131 in the US. The Board considered the FASB *Q&A 131 Segment Information: Guidance on Applying Statement 131* and Emerging Issues Task Force (EITF) 04-10 *Determining Whether to Aggregate Operating Segments that do not Meet the Quantitative Threshold*.

BC32 EITF 04-10 addresses the issue of whether to aggregate operating segments that do not meet the quantitative thresholds. It requires quantitative thresholds to be aggregated only if aggregation is consistent with the objective and core principles of SFAS 131, the segments have similar economic characteristics, and the segments share a majority of the aggregation criteria listed in paragraph 17(a)-(e) of SFAS 131. The Board agreed with the approach adopted in EITF 04-10 and concluded that the same requirement should be included in the IFRS.

BC33 FASB *Q&A 131-Segment Information: Guidance on Applying Statement 131* is an implementation guide that provides the views of the FASB staff on certain questions on SFAS 131. Because it was not issued by the FASB itself, the Board decided not to include this material in the IFRS.

Information about segment assets

BC34 Several respondents noted that, whilst a measure of segment profit or loss can be expected in every entity's internal reporting, a measure of segment assets is not always available, particularly in service industries or other industries with low utilisation of physical assets. Respondents suggested that in such circumstances a measure of segment assets should be disclosed only if those amounts were regularly provided to the chief operating decision maker.

BC35[†] ~~The Board noted that requiring disclosure of a measure of segment assets only when such a measure is reviewed by the chief operating decision maker would create divergence from SFAS 131. The Board also supported a minimum disclosure of segment profit or loss and segment assets. The Board therefore concluded that measures of segment profit or loss and total segment assets should be disclosed for all segments regardless of whether those measures are reviewed by the chief operating decision maker.~~[*]

BC35A[†] After IFRS 8 was issued, the Board was informed that the reasons originally set out in paragraph BC35 contradict long-standing interpretations published in the US for the application of SFAS 131 and create an unintended difference from practice in the US under SFAS 131. After reconsideration and discussion of the interaction between the disclosure and measurement requirements in the IFRS (paragraphs 23 and 25), the Board concluded that those reasons no longer reflected its thinking. Therefore, the Board amended paragraph 23 by *Improvements to IFRSs* issued in April 2009 to clarify that a measure of segment assets should be disclosed only if that amount is regularly provided to the chief operating decision maker.

Information about segment liabilities

BC36 ED 8 did not propose disclosure of segment liabilities because there is no such requirement in SFAS 131. The reasons for this are set out in paragraph 96 of the Basis for Conclusions on SFAS 131, included as Appendix A to this Basis for Conclusions.

BC37 Some respondents proposed adding a requirement for each entity to disclose information about segment liabilities, if such information is regularly provided to the chief operating decision maker. They argued that information about segment liabilities would be helpful to users. Other respondents favoured information about net segment assets rather than gross segment assets.

BC38 The Board noted that if segment liabilities are considered in assessing the performance of, and allocating resources to, the segments of an entity, such disclosure would be consistent with the management approach. The Board also noted support for this disclosure from some commentators, particularly users of financial statements. Accordingly the Board decided to require disclosure of a measure of segment liabilities if those amounts are regularly provided to the chief operating decision maker notwithstanding that such a requirement would create divergence from SFAS 131.

Level of reconciliations

BC39 ED 8 proposed that an entity should provide reconciliations of total reportable segment amounts for specified items to amounts the entity recognised in accordance with IFRSs. It did not propose such reconciliations for individual reportable segments.

BC40 Several respondents expressed concern about the level of detail provided by the proposed reconciliations. They argued that if the IFRS allows segment information to be measured on the basis of management information, it should require reconciliations for individual reportable segments between the segment amounts and the equivalent amounts measured in accordance with an entity's IFRS accounting policies. They added that reconciling only total reportable segment amounts to amounts presented in the financial statements does not provide useful information.

[†] Amendments effective for annual periods beginning on or after 1 January 2010.

[*] Paragraph BC35 was deleted and paragraph BC35A added as a consequence of *Improvements to IFRSs* issued in April 2009.

BC41 Other respondents supported the proposed reconciliations on the grounds that more detailed reconciliations would not be more understandable to users and might be confusing. They believed that the additional costs to reporting entities were not justified.

BC42 The Board noted that a requirement to provide reconciliations at the individual reportable segment level would effectively lead to two complete segment reports–one according to internal measures and the other according to IFRSs. The Board concluded that the cost of providing two sets of segment information would outweigh the benefits.

Lack of a competitive harm exemption

BC43 The Board discussed whether entities should be exempt from aspects of the IFRS if disclosure could cause competitive damage or erosion of shareholder value. The Board considered an alternative approach whereby entities could be required to provide reasons for non-disclosure on a "comply or explain" basis.

BC44 The Board concluded that a "competitive harm" exemption would be inappropriate because it would provide a means for broad non-compliance with the IFRS. The Board noted that entities would be unlikely to suffer competitive harm from the required disclosures since most competitors have sources of detailed information about an entity other than its financial statements.

BC45 Respondents also commented that the requirements of the IFRS would place small listed companies at a disadvantage to non-listed companies, which are outside the scope of the IFRS. The Board noted that the relative advantage/disadvantage of an entity being publicly listed is not a matter for the Board to consider.

Adoption of the term 'impracticable'

BC46 Some respondents to ED 8 expressed concern that entities were to be allowed not to give entity-wide disclosures about products and services and geographical areas if "…the necessary information is not available and the cost to develop it would be excessive." They argued that the test to be applied for non-disclosure should be that of impracticability as defined in IAS 1 *Presentation of Financial Statements*.

BC47 The Board noted that the wording in ED 8 ensures convergence with SFAS 131. Using the term "impracticable" as defined in IAS 1 would change the requirement and create divergence from SFAS 131. Therefore, the Board decided to retain the wording of ED 8.

Entity-wide disclosures

Geographical information

BC48 The IFRS requires an entity to disclose geographical information about non-current assets, excluding specified items. The Board considered comments made by some respondents who advocated country-by-country disclosure, others who requested specific items of geographical information to be disclosed, and some who expressed reservations with the proposed requirement relating to disclosure of country of domicile.

BC49 A coalition of over 300 organisations from more than 50 countries known as the Publish What You Pay campaign requested that the scope of the IFRS should be extended to require additional disclosure on a country-by-country basis. The objective of such additional disclosure would be to promote greater transparency in the management of amounts paid by the oil, gas and mining industries to governments in

developing or transitional countries that are resource-rich. The view of these campaigners was that publication of specific payments made by those companies to governments is in the interest of all users of financial statements.

BC50 Because the IFRS is being developed in a short-term convergence project to converge with SFAS 131, the Board decided that issues raised by the Publish What You Pay campaign relating to country-by-country disclosures should not be addressed in the IFRS. The Board was of the view that such issues merit further discussion with bodies that are currently engaged in similar issues, for example the United Nations, International Public Sector Accounting Standards Board, International Monetary Fund, World Bank, regional development banks and Financial Stability Forum.

Exemption from entity-wide disclosures

BC51 Several respondents suggested different geographical disclosures from those proposed in ED 8. For example, some preferred disclosures by geographical areas rather than by individual country. Others favoured geographical disclosure of profit or loss as well as non-current assets. Several respondents expressed the view that disclosure of total assets would be more relevant than non-current assets. Some took the view that disclosures should be made of both current and non-current assets. Other respondents recommended that financial assets should be disclosed as well as non-current assets. Some respondents expressed the view that disclosure of non-current assets should not be required if those amounts are not reviewed by the chief operating decision maker.

BC52 In developing ED 8, the Board decided to adopt the requirements in SFAS 131. Paragraphs 104-107 of the Basis for Conclusions on SFAS 131 provide the rationale for the geographical disclosures required.

BC53 None of the suggested alternative disclosures was broadly supported by the user responses. The Board noted that entities that wish to give additional information are free to do so. The Board therefore concluded that the disclosure requirement taken from SFAS 131 should not be changed.

Country of domicile

BC54 Some respondents asserted that disclosures relating to the country of domicile were inappropriate for many entities. They expressed the view that such information would be relevant when a large proportion of an entity's business is carried out in its country of domicile. They noted, however, that in many circumstances the country of domicile represents a small proportion of the entity's business and in these cases the information required would not be relevant. In addition, they argued that SFAS 131 had been designed for entities in the US, for whom the "country of domicile" is in itself a significant geographical area. These respondents suggested that disclosures should instead be required about the country of principal activities.

BC55 The IFRS requires disclosures for any country that is individually material. The Board noted that identifying the country of principal activities may be difficult and subjective. Accordingly, the Board decided not to require entities to identify the country of principal activities.

Subtotal for tangible non-current assets

BC56 Paragraphs 14 and 15 of the Basis for Conclusions on ED 8 highlighted a potential difference from SFAS 131. SFAS 131 requires disclosure of "long-lived assets" excluding intangible assets, whereas ED 8 proposed disclosure of "non-current assets" including intangible assets. The Board reconsidered whether, in the interest of convergence, the IFRS should require disclosure of the subtotal of tangible non-current assets.

BC57 The Board concluded that a separate disclosure of a subtotal of tangible non-current assets was unnecessary on the grounds that the incremental benefit does not justify such disclosure. However, the Board noted that entities that wish to provide that information are free to do so.

Information about major customers

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.

Interim financial information

BC59 The Board decided that the changes to IAS 34 *Interim Financial Reporting* proposed in ED 8 should be amended to clarify that interim disclosure of information on segment profit or loss items is required only if the specified amounts are included in the measure of segment profit or loss reviewed by the chief operating decision maker. The Board reached this conclusion because it noted that such disclosure is consistent with the management approach.

Differences from SFAS 131

BC60 In developing the IFRS, the Board included the following differences from SFAS 131:

(a) The FASB *Guidance on Applying Statement 131* indicates that the FASB staff believe that “long-lived assets”, as that phrase is used in paragraph 38 of SFAS 131, implies hard assets that cannot be readily removed, which would appear to exclude intangibles. Non-current assets in the IFRS include intangibles (see paragraphs BC56 and BC57).

(b) SFAS 131 does not require disclosure of a measure of segment liabilities. The IFRS requires disclosure of segment liabilities if such a measure is regularly provided to the chief operating decision maker (see paragraphs BC36-BC38).

(c) SFAS 131 requires an entity with a matrix form of organisation to determine operating segments based on products and services. The IFRS requires such an entity to determine operating segments by reference to the core principle of the IFRS (see paragraph BC27).

Transitional provisions

BC61 Under its transitional provisions, SFAS 131 was not required to be applied to interim financial statements in the initial year of its application. However, in the second year of application, comparative information relating to interim periods in the initial year of application was required. The Basis for Conclusions on SFAS 131 explained that the reason for these transitional requirements was that some of the information that is required to be reported for interim periods is based on information reported in the most recent annual financial statements. Interim segment information would not be as meaningful without a full set of annual segment information to use as a comparison and to provide an understanding of the basis on which it is provided.

BC62 The Board did not agree with the transitional provision for interim financial statements in SFAS 131. The Board noted that the IFRS is not effective until 2009, giving entities adequate time to prepare. Furthermore, the Board was aware that some entities adopting IFRSs for the first time may wish to present comparative information in accordance with the IFRS rather than IAS 14.

Dissenting opinions on IFRS 8

Dissent of Gilbert Gélard and James J Leisenring

DO1 Messrs Gélard and Leisenring dissent from the issue of the IFRS because it does not require a defined measure of segment profit or loss to be disclosed and does not require the measure of profit or loss reported to be consistent with the attribution of assets to reportable segments.

DO2 By not defining segment profit or loss, the IFRS allows the reporting of any measure of segment profit or loss as long as that measure is reviewed by the chief operating decision maker. Items of revenue and expense directly attributable to a segment need not be included in the reported profit or loss of that segment, and allocation of items not directly attributable to any given segment is not required. Messrs Gélard and Leisenring believe that the IFRS should require amounts directly incurred by or directly attributable to a segment to be included in that segment's profit or loss, and measurement of a segment's profit or loss to be consistent with the attribution of assets to the segment.

DO3 Messrs Gélard and Leisenring support the disclosure of information to enable users of financial statements to evaluate the activities of an entity and the economic environment in which it operates. However, they believe that the IFRS will not meet this objective, even with the required disclosures and reconciliation to the entity's annual financial statements, because it does not define segment profit or loss and does not require consistent attribution of assets and profit or loss to segments.

DO4 Messrs Gélard and Leisenring support the management approach for defining reportable segments and support requiring disclosure of selected segment information in interim financial reports. They believe, however, that the definitions of segment revenue, expense, result, assets and liabilities in paragraph 16 of IAS 14 *Segment Reporting* should be retained in the IFRS and applied to segments identified by the management approach. They believe that proper external reporting of segment information should not permit the use of non-GAAP measures because they might mislead users.

DO5 Messrs Gélard and Leisenring also believe that the changes from IAS 14 are not justified by the need for convergence with US GAAP. IAS 14 is a disclosure standard and therefore does not affect the reconciliation of IFRS amounts to US GAAP, though additional disclosure from what is required now by IAS 14 might be needed to comply with US GAAP.

Dissenting opinions on IFRS 8

Dissent of Stephen Cooper from the amendment issued in April 2009

DO1 Mr Cooper dissents from the amendment to IFRS 8 *Operating Segments* made by *Improvements to IFRSs* issued in April 2009.

DO2 In his view the changes are unnecessary considering that the provisions in the *Framework* regarding materiality already enable a reporting entity not to disclose segment assets when those assets are small relative to segment profit and not relevant to the understanding of the business. Mr Cooper believes that allowing a reporting entity not to disclose segment assets merely because this is not reported to the chief operating decision maker weakens IFRS 8, and may result in segment assets not being disclosed even when they are important to understanding the performance and financial position of that business.

Appendix A

Background information and basis for conclusions of the US Financial Accounting Standards Board on SFAS 131

CONTENTS

	paragraphs
Introduction	**41**
Background Information	**42–56**
Defining Operating Segments of an Enterprise	**57–80**
Reportable Segments	71–72
Aggregation of Similar Operating Segments	73–74
Quantitative Thresholds	75–78
Vertically Integrated Enterprises	79–80
Accounting Principles and Allocations	**81–91**
Information to Be Disclosed about Segments	**92–100**
Interim Period Information	98–99
Restatement of Previously Reported Information	100
Enterprise-Wide Disclosures	**101–108**
Information about Products and Services	103
Information about Geographic Areas	104–107
Information about Major Customers	108
Competitive Harm	**109–111**
Cost-Benefit Considerations	**112–114**
Applicability to Nonpublic Enterprises and Not-for-Profit Organisations	**115–118**
Effective Date and Transition	**119–120**

Background information and basis for conclusions of the US Financial Accounting Standards Board on SFAS 131

Introduction

41. This appendix summarises considerations that were deemed significant by Board members in reaching the conclusions in this Statement. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

Background Information

42. FASB Statement No. 14, *Financial Reporting for Segments of a Business Enterprise*, was issued in 1976. That Statement required that business enterprises report segment information on two bases: by industry and by geographic area. It also required disclosure of information about export sales and major customers.

43. The Board concluded at the time it issued Statement 14 that information about components of an enterprise, the products and services that it offers, its foreign operations, and its major customers is useful for understanding and making decisions about the enterprise as a whole. Financial statement users observe that the evaluation of the prospects for future cash flows is the central element of investment and lending decisions. The evaluation of prospects requires assessment of the uncertainty that surrounds both the timing and the amount of the expected cash flows to the enterprise, which in turn affect potential cash flows to the investor or creditor. Users also observe that uncertainty results in part from factors related to the products and services an enterprise offers and the geographic areas in which it operates.

44. In its 1993 position paper, *Financial Reporting in the 1990s and Beyond*, the Association for Investment Management and Research (AIMR) said:

> [Segment data] is vital, essential, fundamental, indispensable, and integral to the investment analysis process. Analysts need to know and understand how the various components of a multifaceted enterprise behave economically. One weak member of the group is analogous to a section of blight on a piece of fruit; it has the potential to spread rot over the entirety. Even in the absence of weakness, different segments will generate dissimilar streams of cash flows to which are attached disparate risks and which bring about unique values. Thus, without disaggregation, there is no sensible way to predict the overall amounts, timing, or risks of a complete enterprise's future cash flows. There is little dispute over the analytic usefulness of disaggregated financial data. [pages 59 and 60]

45. Over the years, financial analysts consistently requested that financial statement data be disaggregated to a much greater degree than it is in current practice. Many analysts said that they found Statement 14 helpful but inadequate. In its 1993 position paper, the AIMR emphasized that:

> There is no disagreement among AIMR members that segment information is totally vital to their work. There also is general agreement among them that the current segment reporting standard, Financial Accounting Standard No. 14, is inadequate. Recent work by a subcommittee of the [Financial Accounting Policy Committee] has confirmed that a substantial majority of analysts seek and, when it is available, use quarterly segment data. [page 5]

46. The Canadian Institute of Chartered Accountants (CICA) published a Research Study, *Financial Reporting for Segments*, in August 1992. An FASB Research Report, *Reporting Disaggregated Information*, was published in February 1993. In March 1993, the FASB and the Accounting Standards Board (AcSB) of the CICA agreed to pursue their projects jointly.

47. In May 1993, the FASB and the AcSB jointly issued an Invitation to Comment, *Reporting Disaggregated Information by Business Enterprises*. That Invitation to Comment identified certain issues related to disclosure of information about segments, solicited comments on those issues, and asked readers to identify additional issues. The boards received 129 comment letters from U.S. and Canadian respondents.

48. In late 1993, the FASB and the AcSB formed the Disaggregated Disclosures Advisory Group to advise and otherwise support the two boards in their efforts to improve disaggregated disclosures. The members of the group included financial statement issuers, auditors, financial analysts, and academics from both the United States and Canada. In January 1994, the FASB and the AcSB began discussing changes to Statement 14 and *CICA Handbook* Section 1700, “Segmented Information.” The two boards met with and otherwise actively solicited the views of analysts and preparers of financial statements about possible improvements to the current segment reporting requirements. FASB and AcSB members and staff also discussed disaggregated disclosures at meetings of several groups of analysts, including the AIMR’s Financial Accounting Policy Committee.

49. In 1991, the AICPA formed the Special Committee on Financial Reporting (the Special Committee) to make recommendations to improve the relevance and usefulness of business reporting. The Special Committee, which comprised financial statement auditors and preparers, established focus groups of credit analysts and equity analysts to assist in formulating its recommendations. The Special Committee issued its report, *Improving Business Reporting–A Customer Focus*, in 1994. That report listed improvements in disclosures of business segment information as its first recommendation and included the following commentary:

> ... for users analyzing a company involved in diverse businesses, financial information about business segments often is as important as information about the company as a whole. Users suggest that standard setters assign the highest priority to improving segment reporting because of its importance to their work and the perceived problems with current reporting of segment information. [page 68]

50. The report of the Special Committee listed the following as among the most important improvements needed:

    (a) Disclosure of segment information in interim financial reports

    (b) Greater number of segments for some enterprises

    (c) More information about segments

    (d) Segmentation that corresponds to internal management reports

    (e) Consistency of segment information with other parts of an annual report.

    Similar recommendations had been made in each of the last 20 years in evaluations of corporate reporting conducted by the AIMR.

51. The two boards reached tentative conclusions about an approach to segment reporting that was substantially different from the approach in Statement 14 and Section 1700. Key characteristics of the new approach were that (a) information would be provided about segments of the enterprise that corresponded to the structure of the enterprise’s internal organization, that is, about the divisions, departments, subsidiaries, or other internal units that the chief operating decision maker uses to make operating decisions and to assess an enterprise’s performance, (b) specific amounts would be allocated to segments only if they were allocated in reports used by the chief operating decision maker for evaluation of segment performance, and (c) accounting policies used to produce the disaggregated information would be the same as those used in the reports used by the chief operating decision maker in allocating resources and assessing segment performance.

52. In February 1995, the staffs of the FASB and the CICA distributed a paper, "Tentative Conclusions on Financial Reporting for Segments" (Tentative Conclusions), to selected securities analysts, the FASB Task Force on Consolidations and Related Matters, the Disaggregated Disclosures Advisory Group, the FASB's Emerging Issues Task Force, the Financial Accounting Standards Advisory Council, the AcSB's list of Associates,[1] and members of representative organizations that regularly work with the boards. The paper also was announced in FASB and CICA publications and was sent to anyone who requested a copy. Board and staff members discussed the Tentative Conclusions with various analyst and preparer groups. Approximately 80 comment letters were received from U.S. and Canadian respondents.

53. In January 1996, the FASB and the AcSB issued virtually identical Exposure Drafts, *Reporting Disaggregated Information about a Business Enterprise*. The FASB received 221 comment letters and the AcSB received 73 comment letters in response to the Exposure Drafts. A field test of the proposals was conducted in March 1996. A public meeting was held in Toronto in October 1996 to discuss results and concerns with field test participants. Other interested parties attended a public meeting in Norwalk in October 1996 to discuss their concerns about the proposals in the Exposure Drafts. The FASB decided that it could reach an informed decision on the project without holding a public hearing.

54. The FASB and the AcSB exchanged information during the course of redeliberating the proposals in their respective Exposure Drafts. AcSB members and CICA staff attended FASB meetings, and FASB members and staff attended AcSB meetings in late 1996 and in 1997 to discuss the issues raised by respondents. Both boards reached agreement on all of the substantive issues to achieve virtually identical standards for segment reporting in the United States and Canada. Members of the Segment Disclosures Advisory Group (formerly the Disaggregated Disclosures Advisory Group) discussed a draft of the standards section in March 1997.

55. The International Accounting Standards Committee (IASC) issued an Exposure Draft of a proposed International Accounting Standard that would replace International Accounting Standard IAS 14, *Reporting Financial Information by Segment*, in December 1995. Although many of its provisions are similar to those of the FASB and AcSB Exposure Drafts, the IASC's proposal is based on different objectives and is different from those Exposure Drafts. A member of the IASC Segments Steering Committee participated in FASB meetings during the redeliberations of the Exposure Draft, and members of the FASB participated in meetings of the IASC Segments Steering Committee. Many of the respondents to the Exposure Drafts encouraged the FASB and the AcSB to work closely with the IASC to achieve similar standards for segment reporting. The IASC expects to issue a standard on segment reporting later in 1997. Although there likely will be differences between the IASC's requirements for segment reporting and those of this Statement, the boards expect that it will be possible to prepare one set of segment information that complies with both the IASC requirements and those of this Statement.

56. This Statement addresses the following key issues:

    (a) What is the appropriate basis for defining segments?

    (b) What accounting principles and allocations should be used?

    (c) What specific items of information should be reported?

    (d) Should segment information be reported in condensed financial statements for interim periods?

[1] Associates are individuals and organizations with a particular interest in financial reporting issues that have volunteered to provide an outside reaction to AcSB positions at an early stage in the AcSB's deliberations.

Defining Operating Segments of an Enterprise

57. The Board concluded that the *industry approach* to segment disclosures in Statement 14 was not providing the information required by financial statement users and that disclosure of disaggregated information should be based on operating segments. This Statement defines an operating segment as a component of an enterprise (a) that engages in business activities from which it may earn revenues and incur expenses, (b) whose operating results are regularly reviewed by the enterprise's chief operating decision maker to make decisions about resources to be allocated to the segment and to assess its performance, and (c) for which discrete financial information is available.

58. The AIMR's 1993 position paper and the report of the AICPA Special Committee criticized Statement 14's industry segment approach to reporting segment information. The AIMR's position paper included the following:

> FAS 14 requires disclosure of line-of-business information classified by "industry segment." Its definition of segment is necessarily imprecise, recognizing that there are numerous practical problems in applying that definition to different business entities operating under disparate circumstances. That weakness in FAS 14 has been exploited by many enterprises to suit their own financial reporting purposes. As a result, we have seen one of the ten largest firms in the country report all of its operations as being in a single, very broadly defined industry segment. [page 60]

The report of the Special Committee said that "[financial statement users] believe that many companies define industry segments too broadly for business reporting and thus report on too few industry segments" (page 69).

59. The report of the AICPA Special Committee also said that "…the primary means to improving industry segment reporting should be to align business reporting with internal reporting" (page 69), and the AIMR's 1993 position paper recommended that:

> ... priority should be given to the production and dissemination of financial data that reflects and reports sensibly the operations of specific enterprises. If we could obtain reports showing the details of how an individual business firm is organized and managed, we would assume more responsibility for making meaningful comparisons of those data to the unlike data of other firms that conduct their business differently. [pages 60 and 61]

Almost all of the users and many other constituents who responded to the Exposure Draft or who met with Board and staff members agreed that defining segments based on the structure of an enterprise's internal organization would result in improved information. They said that not only would enterprises be likely to report more detailed information but knowledge of the structure of an enterprise's internal organization is valuable in itself because it highlights the risks and opportunities that management believes are important.

60. Segments based on the structure of an enterprise's internal organization have at least three other significant advantages. First, an ability to see an enterprise "through the eyes of management" enhances a user's ability to predict actions or reactions of management that can significantly affect the enterprise's prospects for future cash flows. Second, because information about those segments is generated for management's use, the incremental cost of providing information for external reporting should be relatively low. Third, practice has demonstrated that the term *industry* is subjective. Segments based on an existing internal structure should be less subjective.

61. The AIMR and other users have commented that segment information is more useful if it is consistent with explanatory information provided elsewhere in the annual report. They note that the business review section and the chairman's letter in an annual report frequently discuss the enterprise's operations on a basis different from that of

the segment information in the notes to the financial statements and the management's discussion and analysis section, which is required by SEC rules to correspond to the segment information provided to comply with Statement 14. That appears to occur if the enterprise is not managed in a way that corresponds to the way it defines segments under the requirements of Statement 14. Segmentation based on the structure of an enterprise's internal organization should facilitate consistent discussion of segment financial results throughout an enterprise's annual report.

62. Some respondents to the Exposure Draft opposed the Board's approach for several reasons. Segments based on the structure of an enterprise's internal organization may not be comparable between enterprises that engage in similar activities and may not be comparable from year to year for an individual enterprise. In addition, an enterprise may not be organized based on products and services or geographic areas, and thus the enterprise's segments may not be susceptible to analysis using macroeconomic models. Finally, some asserted that because enterprises are organized strategically, the information that would be reported may be competitively harmful to the reporting enterprise.

63. The Board acknowledges that comparability of accounting information is important. The summary of principal conclusions in FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information*, says: "Comparability between enterprises and consistency in the application of methods over time increases the informational value of comparisons of relative economic opportunities or performance. The significance of information, especially quantitative information, depends to a great extent on the user's ability to relate it to some benchmark." However, Concepts Statement 2 also notes a danger:

> Improving comparability may destroy or weaken relevance or reliability if, to secure comparability between two measures, one of them has to be obtained by a method yielding less relevant or less reliable information. Historically, extreme examples of this have been provided in some European countries in which the use of standardized charts of accounts has been made mandatory in the interest of interfirm comparability but at the expense of relevance and often reliability as well. That kind of uniformity may even adversely affect comparability of information if it conceals real differences between enterprises. [paragraph 116]

64. The Board was concerned that segments defined using the approach in Statement 14 may appear to be more comparable between enterprises than they actually are. Statement 14 included the following:

> Information prepared in conformity with [Statement 14] may be of limited usefulness for comparing an industry segment of one enterprise with a similar industry segment of another enterprise (i.e., for interenterprise comparison). Interenterprise comparison of industry segments would require a fairly detailed prescription of the basis or bases of disaggregation to be followed by all enterprises, as well as specification of the basis of accounting for intersegment transfers and methods of allocating costs common to two or more segments. [paragraph 76]

65. Statement 14 explained why the Board chose not to develop a detailed prescription of the bases of disaggregation:

> ... differences among enterprises in the nature of their operations and in the extent to which components of the enterprise share common facilities, equipment, materials and supplies, or labor force make unworkable the prescription of highly detailed rules and procedures that must be followed by all enterprises. Moreover, ... differences in the accounting systems of business enterprises are a practical constraint on the degree of specificity with which standards of financial accounting and reporting for disaggregated information can be established. [paragraph 74]

Those same considerations persuaded the Board not to adopt more specific requirements in this Statement. Both relevance and comparability will not be achievable in all cases, and relevance should be the overriding concern.

66. The AICPA Special Committee, some respondents to the Exposure Draft, and other constituents recommended that the Board require that an enterprise use an alternative method of segmentation for external reporting if its internal organization is not based on differences in products and services or geography. Some specifically recommended adoption of the proposal in the IASC Exposure Draft that was commonly referred to as a “safety net.” The IASC Exposure Draft approach to identifying primary and secondary operating segments calls for review of management’s organization of segments, but both primary and secondary segments are required to be defined either on the basis of related products and services or on the basis of geography. That is, regardless of management’s organization, segments must be grouped either by related products and services or by geographic areas, and one set must be presented as primary segments and the other as secondary segments.

67. The Board recognizes that an enterprise may not be divided into components with similar products and services or geographic areas for internal purposes and that some users of financial statements have expressed a desire for information organized on those bases. However, instead of an alternative method of segmentation, which would call for multiple sets of segment information in many circumstances, the Board chose to require disclosure of additional information about products and services and about geographic areas of operations for the enterprise as a whole if the basic segment disclosures do not provide it.

68. One reason for not prescribing segmentation along bases of only related products and services or geography is that it is difficult to define clearly the circumstances in which an alternative method that differs from the management approach would be applied consistently. An enterprise with a relatively narrow product line may not consider two products to be similar, while an enterprise with a broad product line may consider those same two products to be similar. For example, a highly diversified enterprise may consider all consumer products to be similar if it has other businesses such as financial services and road construction. However, an enterprise that sells only consumer products might consider razor blades to be different from toasters.

69. A second reason for rejecting that approach is that an alternative method of segmentation would increase the cost to some enterprises to prepare the information. A management approach to defining segments allows enterprises to present the information that they use internally and facilitates consistent descriptions of the components of an enterprise from one part of the annual report to another. An enterprise could be organized by its products and services, geography, a mixture of both products and services and geography, or other bases, such as customer type, and the segment information required by this Statement would be consistent with that method of organization. Furthermore, the enterprise-wide disclosures about products and services will provide information about the total revenues from related products and services, and the enterprise-wide disclosures about geography will provide information about the revenues and assets of an enterprise both inside and outside its home country. If material, individual foreign country information also is required.

70. The Board recognizes that some enterprises organize their segments on more than one basis. Other enterprises may produce reports in which their activities are presented in a variety of ways. In those situations, reportable segments are to be determined based on a review of other factors to identify the enterprise’s operating segments, including the nature of the activities of each component, the existence of managers responsible for them, and the information provided to the board of directors. In many enterprises, only one set of data is provided to the board of directors. That set of data generally is indicative of how management views the enterprise’s activities.

Reportable Segments

71. The Board included a notion of reportable segments, a subset of operating segments,

in this Statement by defining aggregation criteria and quantitative thresholds for determining which operating segments should be reported separately in the financial statements.

72. A so-called pure management approach to segment reporting might require that an enterprise report all of the information that is reviewed by the chief operating decision maker to make decisions about resource allocations and to assess the performance of the enterprise. However, that level of detail may not be useful to readers of external financial statements, and it also may be cumbersome for an enterprise to present. Therefore, this Statement uses a modified management approach that includes both aggregation criteria and quantitative thresholds for determining reportable operating segments. However, an enterprise need not aggregate similar segments, and it may present segments that fall below the quantitative thresholds.

Aggregation of Similar Operating Segments

73. The Board believes that separate reporting of segment information will not add significantly to an investor's understanding of an enterprise if its operating segments have characteristics so similar that they can be expected to have essentially the same future prospects. The Board concluded that although information about each segment may be available, in those circumstances the benefit would be insufficient to justify its disclosure. For example, a retail chain may have 10 stores that individually meet the definition of an operating segment, but each store may be essentially the same as the others.

74. Most respondents commented on the aggregation criteria in the Exposure Draft. Many said that the criteria were unreasonably strict, to the extent that nearly identical segments might not qualify for aggregation. Some respondents linked their concerns about competitive harm and too many segments directly to the aggregation criteria, indicating that a relaxation of the criteria would significantly reduce those concerns. To better convey its intent, the Board revised the wording of the aggregation criteria and the introduction to them. However, the Board rejected recommendations that the criteria be indicators rather than tests and that the guidance require only the expectation of similar long-term performance of segments to justify aggregation because those changes might result in a level of aggregation that would cause a loss of potentially valuable information. For the same reason, the Board also rejected suggestions that segments need be similar in only a majority of the characteristics in paragraph 17 to justify aggregation. The Board recognizes that determining when two segments are sufficiently similar to justify aggregating them is difficult and subjective. However, the Board notes that one of the reasons that the information provided under Statement 14 did not satisfy financial statement users' needs is that segments with different characteristics in important areas were at times aggregated.

Quantitative Thresholds

75. In developing the Exposure Draft, the Board had concluded that quantitative criteria might interfere with the determination of operating segments and, if anything, might unnecessarily reduce the number of segments disclosed. Respondents to the Exposure Draft and others urged the Board to include quantitative criteria for determining which segments to report because they said that some enterprises would be required to report too many segments unless specific quantitative guidelines allowed them to omit small segments. Some respondents said that the Exposure Draft would have required disclosure of as many as 25 operating segments, which was not a result anticipated by the Board in its deliberations preceding the Exposure Draft. Others said that enterprises would report information that was too highly aggregated unless quantitative guidelines prevented it. The Board decided that the addition of quantitative thresholds would be a practical way to address respondents' concerns about competitive harm and proliferation of segments without fundamentally changing the management approach to segment definition.

76. Similar to the requirements in Statement 14, the Board decided to require that any operating segment that constitutes 10 percent or more of reported revenues, assets, or profit or loss be reported separately and that reportable segments account for at least 75 percent of an enterprise's external revenues. The Board decided to retain that guidance for the quantitative thresholds because it can be objectively applied and because preparers and users of financial statements already understand it.

77. Inclusion of quantitative thresholds similar to those in Statement 14 necessitates guidance on how to report operating segments that do not meet the thresholds. The Board concluded that enterprises should be permitted to aggregate information about operating segments that do not meet the thresholds with information about other operating segments that do not meet the thresholds if a majority of the aggregation criteria in paragraph 17 are met. That is a more liberal aggregation provision than that for individually material operating segments, but it prohibits aggregation of segments that are dissimilar.

78. Paragraph 125 of Concepts Statement 2 states that "... magnitude by itself, without regard to the nature of the item and the circumstances in which the judgment has to be made, will not generally be a sufficient basis for a materiality judgment." That guidance applies to segment information. An understanding of the material segments of an enterprise is important for understanding the enterprise as a whole, and individual items of segment information are important for understanding the segments. Thus, an item of segment information that, if omitted, would change a user's decision about that segment so significantly that it would change the user's decision about the enterprise as a whole is material even though an item of a similar magnitude might not be considered material if it were omitted from the consolidated financial statements. Therefore, enterprises are encouraged to report information about segments that do not meet the quantitative thresholds if management believes that it is material. Those who are familiar with the particular circumstances of each enterprise must decide what constitutes *material*.

Vertically Integrated Enterprises

79. The Board concluded that the definition of an operating segment should include components of an enterprise that sell primarily or exclusively to other operating segments of the enterprise if the enterprise is managed that way. Information about the components engaged in each stage of production is particularly important for understanding vertically integrated enterprises in certain businesses, for example, oil and gas enterprises. Different activities within the enterprise may have significantly different prospects for future cash flows, and users of financial statements have asserted that they need to know results of each operation.

80. Some respondents to the Exposure Draft opposed the requirement to report vertically integrated segments separately. They said that the segment results may not be comparable between enterprises and that transfer prices are not sufficiently reliable for external reporting purposes. The Board considered an approach that would have required separate reporting of vertically integrated segments only if transfer prices were based on quoted market prices and if there was no basis for combining the selling segment and the buying segment. However, that would have been a significant departure from the management approach to defining segments. The Board also was concerned that the criteria would be unworkable. Therefore, the Board decided to retain the Exposure Draft's provisions for vertically integrated segments.

Accounting Principles and Allocations

81. The Board decided that the information to be reported about each segment should be measured on the same basis as the information used by the chief operating decision maker for purposes of allocating resources to segments and assessing segments' performance. That is a management approach to measuring segment information as proposed in the Exposure Draft. The Board does not think that a separate measure of

segment profit or loss or assets should have to be developed solely for the purpose of disclosing segment information. For example, an enterprise that accounts for inventory using a specialized valuation method for internal purposes should not be required to restate inventory amounts for each segment, and an enterprise that accounts for pension expense only on a consolidated basis should not be required to allocate pension expense to each operating segment.

82. The report of the AICPA Special Committee said that the Board "should allow companies to report a statistic on the same basis it is reported for internal purposes, if the statistic is reported internally. The usefulness of information prepared only for [external] reporting is questionable. Users want to understand management's perspective on the company and the implications of key statistics." It also said that "key statistics to be reported [should] be limited to statistics a company has available..." (page 72).

83. Respondents to the Exposure Draft had mixed reactions to its measurement guidance. Very few suggested that the Board require allocations solely for external reporting purposes. Most agreed that allocations are inherently arbitrary and may not be meaningful if they are not used for management purposes. No respondents suggested that intersegment transfers should be reported on any basis other than that used internally. However, some respondents recommended that information about each segment be provided based on the accounting principles used in the enterprise's general-purpose financial statements. Some observed that unadjusted information from internal sources would not necessarily comply with generally accepted accounting principles and, for that reason, might be difficult for users to understand. Other respondents argued that comparability between enterprises would be improved if the segment information were provided on the basis of generally accepted accounting principles. Finally, a few questioned the verifiability of the information.

84. The Board decided not to require that segment information be provided in accordance with the same generally accepted accounting principles used to prepare the consolidated financial statements for several reasons. Preparing segment information in accordance with the generally accepted accounting principles used at the consolidated level would be difficult because some generally accepted accounting principles are not intended to apply at a segment level. Examples include allocation of the cost of an acquisition to individual assets and liabilities of a subsidiary using the purchase method of accounting, accounting for the cost of enterprise-wide employee benefit plans, accounting for income taxes in an enterprise that files a consolidated income tax return, and accounting for inventory on a last-in, first-out basis if the pools include items in more than one segment. In addition, there are no generally accepted accounting principles for allocating joint costs, jointly used assets, or jointly incurred liabilities to segments or for pricing intersegment transfers. As a consequence, it generally is not feasible to present segment profitability in accordance with generally accepted accounting principles.

85. The Board recognizes that segment information is subject to certain limitations and that some of that information may not be susceptible to the same degree of verifiability as some other financial information. However, verifiability is not the only important qualitative characteristic of accounting information. Verifiability is a component of reliability, which is one of two characteristics that contribute to the usefulness of accounting information. The other is relevance, which is equally important. Concepts Statement 2 states:

> Although financial information must be both relevant and reliable to be useful, information may possess both characteristics to varying degrees. It may be possible to trade relevance for reliability or vice versa, though not to the point of dispensing with one of them altogether. ... trade-offs between characteristics may be necessary or beneficial.
>
> In a particular situation, the importance attached to relevance in relation to the importance of other decision specific qualities of accounting information (for example,

> reliability) will be different for different information users, and their willingness to trade one quality for another will also differ. [paragraphs 42 and 45]

86. It is apparent that users are willing to trade a degree of reliability in segment information for more relevant information. The AIMR's 1993 position paper states:

> Analysts need financial statements structured so as to be consistent with how the business is organized and managed. That means that two different companies in the same industry may have to report segment data differently because they are structured differently themselves. [page 20]

But, as previously noted, the position paper says that, under those circumstances, analysts "would assume more responsibility for making meaningful comparisons of those data to the unlike data of other firms that conduct their business differently" (page 61).

87. The Board believes that the information required by this Statement meets the objective of reliability of which both representational faithfulness and verifiability are components. An auditor can determine whether the information reported in the notes to the financial statements came from the required source by reviewing management reports or minutes from meetings of the board of directors. The information is not required to be provided on a specified basis, but the enterprise is required to explain the basis on which it is provided and to reconcile the segment information to consolidated enterprise totals. Adequate explanation and an appropriate reconciliation will enable a user to understand the information and its limitations in the context of the enterprise's financial statements. The auditor can test both the explanation of segment amounts and the reconciliations to consolidated totals. Furthermore, because management uses that information in its decision-making processes, that information is likely to be highly reliable. The information provided to comply with Statement 14 was more difficult to verify in many situations and was less reliable. Because it was prepared solely for external reporting purposes, it required allocations that may have been arbitrary, and it was based on accounting principles that may have been difficult to apply at the segment level.

88. Paragraph 29 requires amounts allocated to a segment to be allocated on a reasonable basis. However, the Board believes that the potential increased reliability that might have been achieved by requiring allocation of consolidated amounts is illusory because expenses incurred at the consolidated level could be allocated to segments in a variety of ways that could be considered "reasonable." For example, an enterprise could use either the number of employees in each segment or the segment's total salary expense in relation to the consolidated amounts as a basis for allocating pension expense to segments. Those two approaches to allocation could result in significantly different measures of segment profit or loss. However, both the number of employees and the total salary expense might be reasonable bases on which to allocate total pension expense. In contrast, it would not seem reasonable for an enterprise to allocate pension expense to a segment that had no employees eligible for the pension plan. Because of the potential for misleading information that may result from such allocations, the Board decided that it is appropriate for this Statement to require that amounts allocated to a segment be allocated on a reasonable basis.

89. The Board also considered explicitly requiring that revenues and expenses directly incurred by or directly attributable to an operating segment be reported by that segment. However, it decided that, in some cases, whether an item of revenue or expense is attributable to an operating segment is a matter of judgment. Further, such an explicit requirement would be an additional modification of the management approach to measurement. While the Board decided not to include an explicit requirement, it believes that many items of revenue or expense clearly relate to a particular segment and that it would be unlikely that the information used by management would omit those items.

90. To assist users of financial statements in understanding segment disclosures, this Statement requires that enterprises provide sufficient explanation of the basis on which the information was prepared. That disclosure must include any differences in the basis of measurement between the consolidated amounts and the segment amounts. It also must indicate whether allocations of items were made symmetrically. An enterprise may allocate an expense to a segment without allocating the related asset; however, disclosure of that fact is required. Enterprises also are required to reconcile to the consolidated totals in the enterprise's financial statements the totals of reportable segment assets, segment revenues, segment profit or loss, and any other significant segment information that is disclosed.

91. In addition, the advantages of reporting unadjusted management information are significant. That practice is consistent with defining segments based on the structure of the enterprise's internal organization. It imposes little incremental cost on the enterprise and requires little incremental time to prepare. Thus, the enterprise can more easily report segment information in condensed financial statements for interim periods and can report more information about each segment in annual financial statements. Information used by management also highlights for a user of financial statements the risks and opportunities that management considers important.

Information to Be Disclosed about Segments

92. The items of information about each reportable operating segment that must be disclosed as described in paragraphs 25-31 represent a balance between the needs of users of financial statements who may want a complete set of financial statements for each segment and the costs to preparers who may prefer not to disclose any segment information. Statement 14 required disclosure of internal and external revenues; profit or loss; depreciation, depletion, and amortization expense; and unusual items as defined in APB Opinion No. 30, *Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*, for each segment. Statement 14 also required disclosure of total assets, equity in the net income of investees accounted for by the equity method, the amount of investment in equity method investees, and total expenditures for additions to long-lived assets. Some respondents to the Exposure Draft objected to disclosing any information that was not required by Statement 14, while others recommended disclosure of additional items that are not required by this Statement. This Statement calls for the following additional disclosures only if the items are included in the measure of segment profit or loss that is reviewed by the chief operating decision maker: significant noncash items, interest revenue, interest expense, and income tax expense.

93. Some respondents to the Exposure Draft expressed concern that the proposals would increase the sheer volume of information compared to what was required to be reported under Statement 14. The Board considers that concern to be overstated for several reasons. Although this Statement requires disclosure of more information about an individual operating segment than Statement 14 required for an industry segment, this Statement requires disclosure of information about only one type of segment–reportable operating segments–while Statement 14 required information about two types of segments–industry segments and geographic segments. Moreover, Statement 14 required that many enterprises create information solely for external reporting, while almost all of the segment information that this Statement requires is already available in management reports. The Board recognizes, however, that some enterprises may find it necessary to create the enterprise-wide information about products and services, geographic areas, and major customers required by paragraphs 36-39.

94. The Board decided to require disclosure of significant noncash items included in the measure of segment profit or loss and information about total expenditures for additions to long-lived segment assets (other than financial instruments, long-term customer relationships of a financial institution, mortgage and other servicing rights,

deferred policy acquisition costs, and deferred tax assets) if that information is reported internally because it improves financial statement users' abilities to estimate cash-generating potential and cash requirements of operating segments. As an alternative, the Board considered requiring disclosure of operating cash flow for each operating segment. However, many respondents said that disclosing operating cash flow in accordance with FASB Statement No. 95, *Statement of Cash Flows*, would require that they gather and process information solely for external reporting purposes. They said that management often evaluates cash generated or required by segments in ways other than by calculating operating cash flow in accordance with Statement 95. For that reason, the Board decided not to require disclosure of cash flow by segment.

95. Disclosure of interest revenue and interest expense included in reported segment profit or loss is intended to provide information about the financing activities of a segment. The Exposure Draft proposed that an enterprise disclose gross interest revenue and gross interest expense for all segments in which reported profit or loss includes those items. Some respondents said that financial services segments generally are managed based on net interest revenue, or the "spread," and that management looks only to that data in its decision-making process. Therefore those segments should be required to disclose only the net amount and not both gross interest revenue and expense. Those respondents noted that requiring disclosure of both gross amounts would be analogous to requiring nonfinancial services segments to disclose both sales and cost of sales. The Board decided that segments that derive a majority of revenue from interest should be permitted to disclose net interest revenue instead of gross interest revenue and gross interest expense if management finds that amount to be more relevant in managing the segment. Information about interest is most important if a single segment comprises a mix of financial and nonfinancial operations. If a segment is primarily a financial operation, interest revenue probably constitutes most of segment revenues and interest expense will constitute most of the difference between reported segment revenues and reported segment profit or loss. If the segment has no financial operations or only immaterial financial operations, no information about interest is required.

96. The Board decided not to require the disclosure of segment liabilities. The Exposure Draft proposed that an enterprise disclose segment liabilities because the Board believed that liabilities are an important disclosure for understanding the financing activities of a segment. The Board also noted that the requirement in FASB Statement No. 94, *Consolidation of All Majority-Owned Subsidiaries*, to disclose assets, liabilities, and profit or loss about previously unconsolidated subsidiaries was continued from APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, pending completion of the project on disaggregated disclosures. However, in commenting on the disclosures that should be required by this Statement, many respondents said that liabilities are incurred centrally and that enterprises often do not allocate those amounts to segments. The Board concluded that the value of information about segment liabilities in assessing the performance of the segments of an enterprise was limited.

97. The Board decided not to require disclosure of research and development expense included in the measure of segment profit or loss. The Exposure Draft would have required that disclosure to provide financial statement users with information about the operating segments in which an enterprise is focusing its product development efforts. Disclosure of research and development expense was requested by a number of financial statement users and was specifically requested in both the report of the AICPA's Special Committee and the AIMR's 1993 position paper. However, respondents said that disclosing research and development expense by segment may result in competitive harm by providing competitors with early insight into the strategic plans of an enterprise. Other respondents observed that research and development is only one of a number of items that indicate where an enterprise is focusing its efforts and that it is much more significant in some enterprises than in others. For example, costs of employee training and advertising were cited as items that often are more important to some enterprises than research and development, calling into question

the relevance of disclosing only research and development expense. Additionally, many respondents said that research and development expense often is incurred centrally and not allocated to segments. The Board therefore decided not to require the disclosure of research and development expense by segment.

Interim Period Information

98. This Statement requires disclosure of limited segment information in condensed financial statements that are included in quarterly reports to shareholders, as was proposed in the Exposure Draft. Statement 14 did not apply to those condensed financial statements because of the expense and the time required for producing segment information under Statement 14. A few respondents to the Exposure Draft said that reporting segment information in interim financial statements would be unnecessarily burdensome. However, users contended that, to be timely, segment information is needed more often than annually and that the difficulties of preparing it on an interim basis could be overcome by an approach like the one in this Statement. Managers of many enterprises agree and have voluntarily provided segment information for interim periods.

99. The Board decided that the condensed financial statements in interim reports issued to shareholders should include disclosure of segment revenues from external customers, intersegment revenues, a measure of segment profit or loss, material changes in segment assets, differences in the basis of segmentation or the way segment profit or loss was measured in the previous annual period, and a reconciliation to the enterprise's total profit or loss. That decision is a compromise between the needs of users who want the same segment information for interim periods as that required in annual financial statements and the costs to preparers who must report the information. Users will have some key information on a timely basis. Enterprises should not incur significant incremental costs to provide the information because it is based on information that is used internally and therefore already available.

Restatement of Previously Reported Information

100. The Board decided to require restatement of previously reported segment information following a change in the composition of an enterprise's segments unless it is impracticable to do so. Changes in the composition of segments interrupt trends, and trend analysis is important to users of financial statements. Some financial statement issuers have said that their policy is to restate one or more prior years for internal trend analysis. Many reorganizations result in discrete profit centers' being reassigned from one segment to another and lead to relatively simple restatements. However, if an enterprise undergoes a fundamental reorganization, restatement may be very difficult and expensive. The Board concluded that in those situations restatement may be impracticable and, therefore, should not be required. However, if an enterprise does not restate its segment information, the enterprise is required to provide current-period segment information on both the old and new bases of segmentation in the year in which the change occurs unless it is impracticable to do so.

Enterprise-Wide Disclosures

101. Paragraphs 36-39 require disclosure of information about an enterprise's products and services, geographic areas, and major customers, regardless of the enterprise's organization. The required disclosures need be provided only if they are not included as part of the disclosures about segments. The Exposure Draft proposed requiring additional disclosures about products and services and geographic areas *by segment*. Many respondents said that that proposal would have resulted in disclosure of excessive amounts of information. Some enterprises providing a variety of products and services throughout many countries, for example, would have been required to

present a large quantity of information that would have been time-consuming to prepare and of questionable benefit to most financial statement users. The Board decided that additional disclosures provided on an enterprise-wide basis rather than on a segment basis would be appropriate and not unduly burdensome. The Board also agreed that those enterprise-wide disclosures are appropriate for all enterprises including those that have a single operating segment if the enterprise offers a range of products and services, derives revenues from customers in more than one country, or both.

102. Based on reviews of published information about public enterprises, discussions with constituents, and a field test of the Exposure Draft, the Board believes that most enterprises are organized by products and services or by geography and will report one or both of those types of information in their reportable operating segment disclosures. However, some enterprises will be required by paragraphs 36-39 to report additional information because the enterprise-wide disclosures are required for all enterprises, even those that have a single reportable segment.

Information about Products and Services

103. This Statement requires that enterprises report revenues from external customers for each product and service or each group of similar products and services for the enterprise as a whole. Analysts said that an analysis of trends in revenues from products and services is important in assessing both past performance and prospects for future growth. Those trends can be compared to benchmarks such as industry statistics or information reported by competitors. Information about the assets that are used to produce specific products and deliver specific services also might be useful. However, in many enterprises, assets are not dedicated to specific products and services and reporting assets by products and services would require arbitrary allocations.

Information about Geographic Areas

104. This Statement requires disclosure of information about both revenues and assets by geographic area. Analysts said that information about revenues from customers in different geographic areas assists them in understanding concentrations of risks due to negative changes in economic conditions and prospects for growth due to positive economic changes. They said that information about assets located in different areas assists them in understanding concentrations of risks (for example, political risks such as expropriation).

105. Statement 14 requires disclosure of geographic information by geographic region, whereas this Statement requires disclosure of individually material countries as well as information for the enterprise's country of domicile and all foreign countries in the aggregate. This Statement's approach has two significant benefits. First, it will reduce the burden on preparers of financial statements because most enterprises are likely to have material operations in only a few countries or perhaps only in their country of domicile. Second, and more important, it will provide information that is more useful in assessing the impact of concentrations of risk. Information disclosed by country is more useful because it is easier to interpret. Countries in contiguous areas often experience different rates of growth and other differences in economic conditions. Under the requirements of Statement 14, enterprises often reported information about broad geographic areas that included groupings such as Europe, Africa, and the Middle East. Analysts and others have questioned the usefulness of that type of broad disclosure.

106. Respondents to the Exposure Draft questioned how revenues should be allocated to individual countries. For example, guidance was requested for situations in which products are shipped to one location but the customer resides in another location. The Board decided to provide flexibility concerning the basis on which enterprises attribute revenues to individual countries rather than requiring that revenues be attributed to

countries according to the location of customers. The Board also decided to require that enterprises disclose the basis they have adopted for attributing revenues to countries to permit financial statement users to understand the geographic information provided.

107. As a result of its decision to require geographic information on an enterprise-wide basis, the Board decided not to require disclosure of capital expenditures on certain long-lived assets by geographic area. Such information on an enterprise-wide basis is not necessarily helpful in forecasting future cash flows of operating segments.

Information about Major Customers

108. The Board decided to retain the requirement in Statement 14, as amended by FASB Statement No. 30, *Disclosure of Information about Major Customers*, to report information about major customers because major customers of an enterprise represent a significant concentration of risk. The 10 percent threshold is arbitrary; however, it has been accepted practice since Statement 14 was issued, and few have suggested changing it.

Competitive Harm

109. A number of respondents to the Exposure Draft noted the potential for competitive harm as a result of disclosing segment information in accordance with this Statement. The Board considered adopting special provisions to reduce the potential for competitive harm from certain segment information but decided against it. In the Invitation to Comment, the Tentative Conclusions, and the Exposure Draft, the Board asked constituents for specific illustrations of competitive harm that has resulted from disclosing segment information. Some respondents said that public enterprises may be at a disadvantage to nonpublic enterprises or foreign competitors that do not have to disclose segment information. Other respondents suggested that information about narrowly defined segments may put an enterprise at a disadvantage in price negotiations with customers or in competitive bid situations.

110. Some respondents said that if a competitive disadvantage exists, it is a consequence of an obligation that enterprises have accepted to gain greater access to capital markets, which gives them certain advantages over nonpublic enterprises and many foreign enterprises. Other respondents said that enterprises are not likely to suffer competitive harm because most competitors have other sources of more detailed information about an enterprise than that disclosed in the financial statements. In addition, the information that is required to be disclosed about an operating segment is no more detailed or specific than the information typically provided by a smaller enterprise with a single operation.

111. The Board was sympathetic to specific concerns raised by certain constituents; however, it decided that a competitive-harm exemption was inappropriate because it would provide a means for broad noncompliance with this Statement. Some form of relief for single-product or single-service segments was explored; however, there are many enterprises that produce a single product or a single service that are required to issue general-purpose financial statements. Those statements would include the same information that would be reported by single-product or single-service segments of an enterprise. The Board concluded that it was not necessary to provide an exemption for single-product or single-service segments because enterprises that produce a single product or service that are required to issue general-purpose financial statements have that same exposure to competitive harm. The Board noted that concerns about competitive harm were addressed to the extent feasible by four changes made during redeliberations: (a) modifying the aggregation criteria, (b) adding quantitative materiality thresholds for identifying reportable segments, (c) eliminating the requirements to disclose research and development expense and liabilities by segment, and (d) changing the second-level disclosure requirements about products and services and geography from a segment basis to an

enterprise-wide basis.

Cost-Benefit Considerations

112. One of the precepts of the Board's mission is to promulgate standards only if the expected benefits of the resulting information exceed the perceived costs. The Board strives to determine that a proposed standard will fill a significant need and that the costs incurred to satisfy that need, as compared with other alternatives, are justified in relation to the overall benefits of the resulting information. The Board concluded that the benefits that will result from this Statement will exceed the related costs.

113. The Board believes that the primary benefits of this Statement are that enterprises will report segment information in interim financial reports, some enterprises will report a greater number of segments, most enterprises will report more items of information about each segment, enterprises will report segments that correspond to internal management reports, and enterprises will report segment information that will be more consistent with other parts of their annual reports.

114. This Statement will reduce the cost of providing disaggregated information for many enterprises. Statement 14 required that enterprises define segments by both industry and by geographical area, ways that often did not match the way that information was used internally. Even if the reported segments aligned with the internal organisation, the information required was often created solely for external reporting because Statement 14 required certain allocations of costs, prohibited other cost allocations, and required allocations of assets to segments. This Statement requires that information about operating segments be provided on the same basis that it is used internally. The Board believes that most of the enterprise-wide disclosures in this Statement about products and services, geography, and major customers typically are provided in current financial statements or can be prepared with minimal incremental cost.

Applicability to Nonpublic Enterprises and Not-for-Profit Organizations

115. The Board decided to continue to exempt nonpublic enterprises from the requirement to report segment information. Few users of nonpublic enterprises' financial statements have requested that the Board require that those enterprises provide segment information.

116. At the time the Board began considering improvements to disclosures about segment information, FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations*, had not been issued and there were no effective standards for consolidated financial statements of not-for-profit organizations. Most not-for-profit organizations provided financial information for each of their funds, which is a form of disaggregated information. The situation in Canada was similar. Thus, when the two boards agreed to pursue a joint project, they decided to limit the scope to public business enterprises.

117. The Board provided a limited form of disaggregated information in paragraph 26 of Statement 117, which requires disclosure of expense by functional classification. However, the Board acknowledges that the application of that Statement may increase the need for disaggregated information about not-for-profit organizations. A final Statement expected to result from the FASB Exposure Draft, *Consolidated Financial Statements: Policy and Procedures*, also may increase that need by requiring aggregation of information about more entities in the financial statements of not-for-profit organizations.

118. The general approach of providing information based on the structure of an enterprise's internal organization may be appropriate for not-for-profit organizations. However, the Board decided not to add not-for-profit organizations to the scope of this

Statement. Users of financial statements of not-for-profit organizations have not urged the Board to include those organizations, perhaps because they have not yet seen the effects of Statement 117 and the Exposure Draft on consolidations. Furthermore, the term *not-for-profit organizations* applies to a wide variety of entities, some of which are similar to business enterprises and some of which are very different. There are likely to be unique characteristics of some of those entities or special user needs that require special provisions, which the Board has not studied. In addition, the AcSB has recently adopted standards for reporting by not-for-profit organizations that are different from Statement 117. In the interest of completing this joint project in a timely manner, the Board decided not to undertake the research and deliberations that would be necessary to adapt the requirements of this Statement to not-for-profit organizations at this time. Few respondents to the Exposure Draft disagreed with the Board's position.

Effective Date and Transition

119. The Board concluded that this Statement should be effective for financial statements issued for fiscal years beginning after December 15, 1997. In developing the Exposure Draft, the Board had decided on an effective date of December 15, 1996. The Board believed that that time frame was reasonable because almost all of the information that this Statement requires is generated by systems already in place within an enterprise and a final Statement was expected to be issued before the end of 1996. However, respondents said that some enterprises may need more time to comply with the requirements of this Statement than would have been provided under the Exposure Draft.

120. The Board also decided not to require that segment information be reported in financial statements for interim periods in the initial year of application. Some of the information that is required to be reported for interim periods is based on information that would have been reported in the most recent annual financial statements. Without a full set of segment information to use as a comparison and to provide an understanding of the basis on which it is provided, interim information would not be as meaningful.

Appendix B

Amendments to Basis for Conclusions on other IFRSs (included in the Basis for Conclusions on the corresponding HKFRSs)

This appendix contains amendments to the Basis for Conclusions on other IFRSs that are necessary in order to note the replacement of IAS 14 by IFRS 8.

* * *

The amendments contained in this appendix when this Basis for Conclusions was issued have been incorporated into the relevant Basis for Conclusions.

HKFRS 8 IG
Issued March 2007

Guidance on Implementing
Hong Kong Financial Reporting Standard 8

Operating Segments

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

CONTENTS

paragraphs

GUIDANCE ON IMPLEMENTING IFRS 8 *OPERATING SEGMENTS*

INTRODUCTION IG1

DESCRIPTIVE INFORMATION ABOUT AN ENTITY'S REPORTABLE SEGMENTS IG2

Description of the types of products and services from which each reportable segment derives its revenues (paragraph 22(b))

Measurement of operating segment profit or loss, assets and liabilities (paragraph 27)

Factors that management used to identify the entity's reportable segments (paragraph 22(a))

INFORMATION ABOUT REPORTABLE SEGMENT PROFIT OR LOSS, ASSETS AND LIABILITIES IG3

RECONCILIATIONS OF REPORTABLE SEGMENT REVENUES, PROFIT OR LOSS, ASSETS AND LIABILITIES IG4

GEOGRAPHICAL INFORMATION IG5

INFORMATION ABOUT MAJOR CUSTOMERS IG6

DIAGRAM TO ASSIST IN IDENTIFYING REPORTABLE SEGMENTS IG7

APPENDIX

Amendments to guidance on other IFRSs

Guidance on implementing IFRS 8 *Operating Segments*

This guidance accompanies, but is not part of, IFRS 8.

Introduction

IG1 This implementation guidance provides examples that illustrate the disclosures required by IFRS 8 and a diagram to assist in identifying reportable segments. The formats in the illustrations are not requirements. The Board encourages a format that provides the information in the most understandable manner in the specific circumstances. The following illustrations are for a single hypothetical entity referred to as Diversified Company.

Descriptive information about an entity's reportable segments

IG2 The following illustrates the disclosure of descriptive information about an entity's reportable segments (the paragraph references are to the relevant requirements in the IFRS).

Description of the types of products and services from which each reportable segment derives its revenues (paragraph 22(b))

Diversified Company has five reportable segments: car parts, motor vessels, software, electronics and finance. The car parts segment produces replacement parts for sale to car parts retailers. The motor vessels segment produces small motor vessels to serve the offshore oil industry and similar businesses. The software segment produces application software for sale to computer manufacturers and retailers. The electronics segment produces integrated circuits and related products for sale to computer manufacturers. The finance segment is responsible for portions of the company's financial operations including financing customer purchases of products from other segments and property lending operations.

Measurement of operating segment profit or loss, assets and liabilities (paragraph 27)

The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies except that pension expense for each operating segment is recognised and measured on the basis of cash payments to the pension plan. Diversified Company evaluates performance on the basis of profit or loss from operations before tax expense not including non-recurring gains and losses and foreign exchange gains and losses.

Diversified Company accounts for intersegment sales and transfers as if the sales or transfers were to third parties, ie at current market prices.

Factors that management used to identify the entity's reportable segments (paragraph 22(a))

Diversified Company's reportable segments are strategic business units that offer different products and services. They are managed separately because each business requires different technology and marketing strategies. Most of the businesses were acquired as individual units, and the management at the time of the acquisition was retained.

Information about reportable segment profit or loss, assets and liabilities

IG3 The following table illustrates a suggested format for disclosing information about reportable segment profit or loss, assets and liabilities (paragraphs 23 and 24). The same type of information is required for each year for which a statement of comprehensive income is presented. Diversified Company does not allocate tax expense (tax income) or non-recurring gains and losses to reportable segments. In addition, not all reportable segments have material non-cash items other than depreciation and amortisation in profit or loss. The amounts in this illustration, denominated as "currency units (CU)", are assumed to be the amounts in reports used by the chief operating decision maker.

	Car parts	Motor vessels	Software	Electronics	Finance	All other	Totals
	CU	CU	CU	CU	CU	CU	CU
Revenues from external customers	3,000	5,000	9,500	12,000	5,000	1,000[(a)]	35,500
Intersegment revenues	-	-	3,000	1,500	-	-	4,500
Interest revenue	450	800	1,000	1,500	-	-	3,750
Interest expense	350	600	700	1,100	-	-	2,750
Net interest revenue [(b)]	-	-	-	-	1,000	-	1,000
Depreciation and amortisation	200	100	50	1,500	1,100	-	2,950
Reportable segment profit	200	70	900	2,300	500	100	4,070
Other material non-cash items:							
Impairment of assets	-	200	-	-	-	-	200
Reportable segment assets	2,000	5,000	3,000	12,000	57,000	2,000	81,000
Expenditures for reportable segment non-current assets	300	700	500	800	600	-	2,900
Reportable segment liabilities	1,050	3,000	1,800	8,000	30,000	-	43,850

(a) Revenues from segments below the quantitative thresholds are attributable to four operating segments of Diversified Company. Those segments include a small property business, an electronics equipment rental business, a software consulting practice and a warehouse leasing operation. None of those segments has ever met any of the quantitative thresholds for determining reportable segments.

(b) The finance segment derives a majority of its revenue from interest. Management primarily relies on net interest revenue, not the gross revenue and expense amounts, in managing that segment. Therefore, as permitted by paragraph 23, only the net amount is disclosed.

Reconciliations of reportable segment revenues, profit or loss, assets and liabilities

IG4 The following illustrate reconciliations of reportable segment revenues, profit or loss, assets and liabilities to the entity's corresponding amounts (paragraph 28(a)-(d)). Reconciliations also are required to be shown for every other material item of information disclosed (paragraph 28(e)). The entity's financial statements are

assumed not to include discontinued operations. As discussed in paragraph IG2, the entity recognises and measures pension expense of its reportable segments on the basis of cash payments to the pension plan, and it does not allocate certain items to its reportable segments.

Revenues	CU
Total revenues for reportable segments	39,000
Other revenues	1,000
Elimination of intersegment revenues	(4,500)
Entity's revenues	35,500

Profit or loss	CU
Total profit or loss for reportable segments	3,970
Other profit or loss	100
Elimination of intersegment profits	(500)
Unallocated amounts:	
Litigation settlement received	500
Other corporate expenses	(750)
Adjustment to pension expense in consolidation	(250)
Income before income tax expense	3,070

Assets	CU
Total assets for reportable segments	79,000
Other assets	2,000
Elimination of receivable from corporate headquarters	(1,000)
Other unallocated amounts	1,500
Entity's assets	81,500

Liabilities	CU
Total liabilities for reportable segments	43,850
Unallocated defined benefit pension liabilities	25,000
Entity's liabilities	68,850

Other material items	Reportable segment totals CU	Adjustments CU	Entity totals CU
Interest revenue	3,750	75	3,825
Interest expense	2,750	(50)	2,700
Net interest revenue (finance segment only)	1,000	-	1,000
Expenditures for assets	2,900	1,000	3,900
Depreciation and amortisation	2,950	-	2,950
Impairment of assets	200	-	200

The reconciling item to adjust expenditures for assets is the amount incurred for the corporate headquarters building, which is not included in segment information. None of the other adjustments are material.

Geographical information

IG5 The following illustrates the geographical information required by paragraph 33. (Because Diversified Company's reportable segments are based on differences in products and services, no additional disclosures of revenue information about products and services are required (paragraph 32).)

Geographical information	**Revenues**[(a)]	**Non-current assets**
	CU	CU
United States	19,000	11,000
Canada	4,200	-
China	3,400	6,500
Japan	2,900	3,500
Other countries	6,000	3,000
Total	35,500	24,000

(a) Revenues are attributed to countries on the basis of the customer's location.

Information about major customers

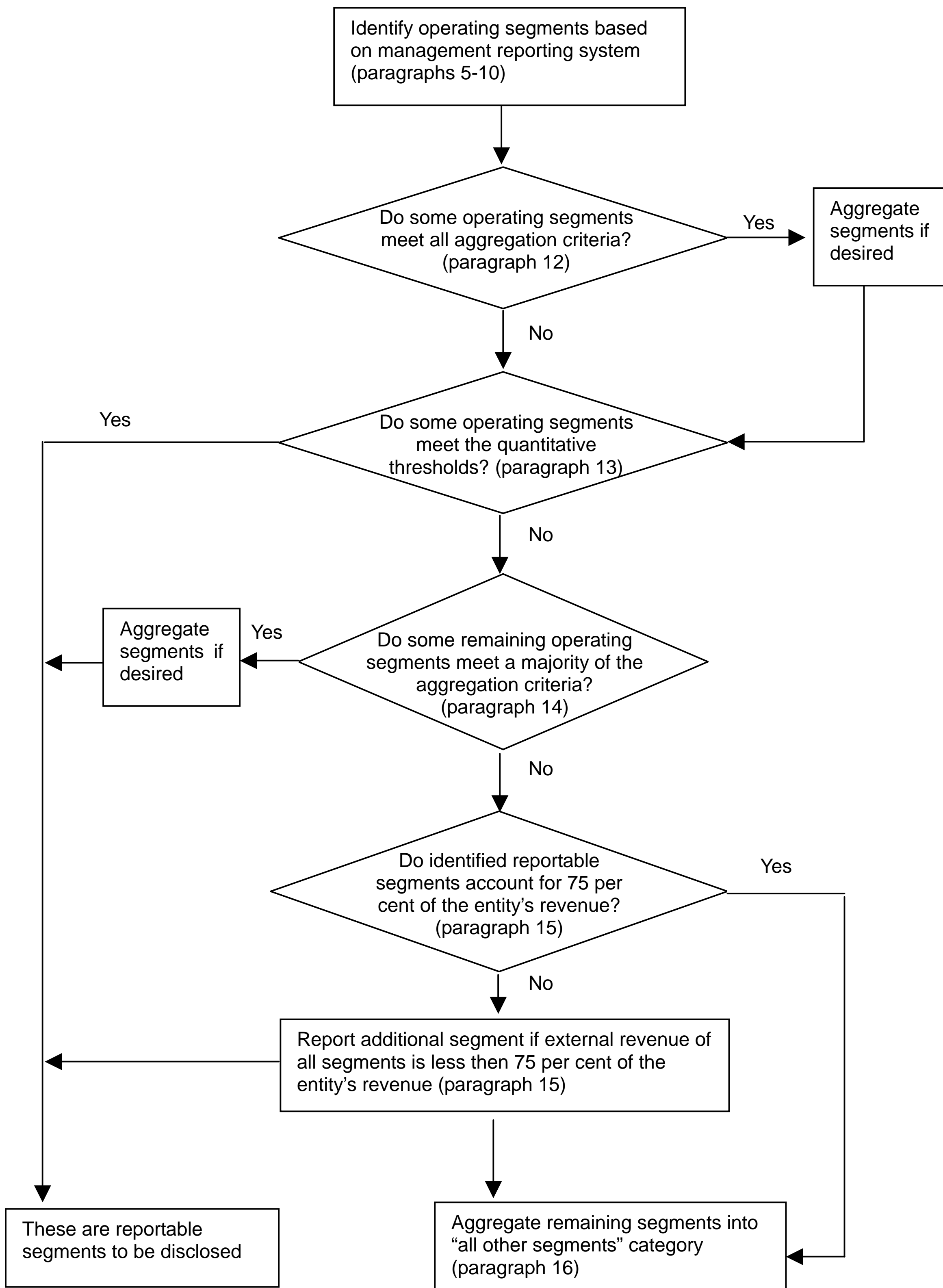
IG6 The following illustrates the information about major customers required by paragraph 34. Neither the identity of the customer nor the amount of revenues for each operating segment is required.

Revenues from one customer of Diversified Company's software and electronics segments represent approximately CU5,000 of the Company's total revenues.

Diagram to assist in identifying reportable segments

IG7 The following diagram illustrates how to apply the main provisions for identifying reportable segments as defined in the IFRS. The diagram is a visual supplement to the IFRS. It should not be interpreted as altering or adding to any requirements of the IFRS nor should it be regarded as a substitute for the requirements.

Diagram for identifying reportable segments



Appendix
Amendments to other Implementation Guidance

This appendix contains amendments to guidance on other IFRSs that are necessary in order to ensure consistency with IFRS 8. In the amended paragraphs, new text is underlined and deleted text is struck through.

* * *

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