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**International  
Accounting Standards  
Board**

*This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.*

*These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.*

## **INFORMATION FOR OBSERVERS**

**Board Meeting:** 20 July 2006, London

**Project:** Segment Reporting

**Subject:** Analysis of comment letters to ED 8 (Agenda Paper 5)

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### **Introduction**

1. The IASB issued its Exposure Draft ED 8 *Operating Segments* for public comments on 19 January. The comment period ended on 19 May 2006 and the IASB received 182 comment letters.
2. The purpose of this paper is to discuss the following issues:
  - (a) Adoption of the management approach in SFAS 131
  - (b) Scope of the standard
    - Entities that hold assets in a fiduciary capacity for a broad group of outsiders
    - Exemption for separate financial statements
    - Competitive-harm exemption
3. Attached in Appendix A to this Agenda Paper are minor points raised by respondents on the scope. The staff does not intend to discuss these issues at the Board meeting unless otherwise directed by Board members.

4. Subject to the Board's decision on the management approach, the staff will bring the remaining issues arising from the comments on the ED to the Board meeting in September. They include:
- (a) possible departures from the management approach in SFAS 131, including:
    - (i) additional or different disclosures to those in SFAS 131 and
    - (ii) specific measurement requirements for some items
  - (b) the level of reconciliations between segment information and GAAP information
  - (c) the disclosure of geographical information, including issues raised by the Publish What You Pay Campaign and
  - (d) consequential amendments to IAS 34 *Interim Financial Reporting*.

#### **Staff recommendation**

5. The staff recommends that:
- (a) the Board should proceed with the management approach adopted in SFAS 131.
  - (b) the scope of the IFRS should not be extended to cover entities that hold assets in a fiduciary capacity.
  - (c) the draft IFRS should not include the scope exemption for separate financial statements in paragraph 6 of IAS 14.
  - (d) the draft IFRS should not have a competitive harm exemption for public entities.

#### **Staff analysis**

##### **Issue 1: adoption of the management approach**

6. Some respondents disagree with the proposals in ED 8, because they think that

convergence to SFAS 131 is not the best approach, and convergence should instead be made by the FASB to IAS 14. In their view IAS 14 is superior because it provides comparability of information across entities by requiring segment information to be reported on the same basis as the financial statements are reported, using IFRSs, and defining measurement of segment revenue, segment expense, segment result segment assets and segment liabilities.

7. The respondents who disagree with the management approach argue the following:

- The most useful segment information for investors is that based upon economically similar or related product/service lines or geographic factors. That is, they prefer the current requirements in IAS 14 paragraphs 9-15. (CL99)
- Basing segment reporting on management information will further dissociate the reported segment data from other reported IFRS financial statement information. (CL139)
- The segments based on the structure of an entity's internal reporting may not be comparable between entities that engage in similar activities (as opposed to the possible increased comparability within an entity across time). (CL89)
- If ED 8 gives more discretion to entities in the definition of segments, the comparability of information across companies (and related aggregation difficulties) will be lost. Comparability is one of the principles set out in the IASB Framework. (CL121)
- They do not believe that convergence alone is justification for the proposed changes. Segmental reporting is solely a disclosure requirement, and so does not affect reconciliations between IFRS and US GAAP. The convergence project should focus on items reported in the primary financial statements. (CL56)
- The existing approach in IAS 14 is, generally, more suitable as it defines amounts such as segment profit and segment assets, and requires financial information to be prepared consistently with that in the financial statements. Those requirements result in higher quality disclosures and enhance comparability between similar entities. That is, their strong preference is that IAS 14 is not amended at this time. (CL56)

8. Some respondents agree with the management approach for the identification of segments, but do not agree with the management approach for the measurement of the various segment disclosures. They are supportive of the alternative view expressed in the draft IFRS. They doubt in particular whether the publication of internal reporting figures will generate significant benefit for investors if those numbers differ from IFRS figures.
9. The respondents who agree with the management approach just for the identification of segments argue the following:
  - The proposal not to specify a defined measure of profit and loss and so allow the use of non-IFRS compliant data if this is used within the entity by the chief decision-maker would lead to a loss of comparability and consistency of presentation between companies. (CL124)
  - Permitting non-GAAP measures for segment items may not provide reliable and comparable information and might be difficult to understand. They agree with the 'Alternative view of the Board members' (ED 8.AV5). The measures used may therefore mislead the users of the financial statements. (CL161)
  - They strongly disagree with the requirement to use management's internal measures of segment profit or loss and of segment assets. This reduces the comparability of the financial statements of different entities. (CL61)
  - There is the risk that if there are differences in the segment reporting compared with the other components of the financial statements, investors may misinterpret the figures and thus reach incorrect decisions regarding the company assessed, with corresponding consequences. (CL58)
  - It will be difficult for users to understand and interpret information when significant differences exist between internal and external reporting data even if this present draft provides for disclosures in order to explain the basis of measurement and the elements of reconciliation. (CL96)
  - Segment reporting should present numbers for each segment stated on an IFRS basis, with reconciliation to the consolidated financial statements. Without this requirement, users of financial statements may be confused by the use of different sets of data. In addition, as noted in the dissenting opinion, comparison between entities would be extremely difficult. (CL180)

10. Other respondents supported the management approach adopted in the draft IFRS. They consider the management approach appropriate and superior to the approach of IAS 14, because the management approach for segment reporting allows users to review the operations from the same angle as the management of an entity. They argue that increasing comparability by requiring entities to report segment information that reflects IFRSs will inevitably lead to segment disclosures that, by way of the IFRS adjustments required, will no longer correspond to the segment information reported to management and used for decision-making purposes. They are, on balance, willing to trade a degree of comparability for relevant information that reflects the perspective of an entity's management.
11. The respondents who support the management approach argue the following:
- The management approach set out in SFAS 131 with its focus on the management's perspective is an appropriate approach to segment reporting. They would, on balance, be willing to trade a degree of comparability for information they consider relevant because it reflects the perspective of an entity's management. (CL79)
  - They support global harmonization so that entities do not have to prepare more than one set of information for different regulators. (CL8)
  - The analytical value of segment information is greater if it is consistent with the actual organization and management of the entity. (CL102)
  - Presenting segment information 'through the eyes of management' will be useful to investors, creditors and other users of financial statements, as it will highlight the risks, opportunities and measures that management believe are important and are used by them to make key decisions. This approach will provide a better linkage between the financial statements and information reported in the operating and financial review or equivalent statement of management commentary. (CL137)
  - Under the management approach the reporting entities disclose financial information that already has to be made available on a timely basis to management. Consequently segment disclosures following the management approach in annual and interim reports do not result in significant extra efforts, time and cost. They follow the cost-benefit adequacy that the IASB framework is asking for. (CL5)

- This is a good example where convergence, as the paramount goal of both the FASB and the IASB, can be easily achieved by converging towards one existing standard. In our view it would be inappropriate to develop a completely new standard, especially if one takes into account that SFAS 131 is applicable in the USA for almost ten years now and therefore well known, understood and tested by users, preparers and the markets alike. (CL9)
- Achieving comparability of segment information among entities in the same industry is not the most important aspect of a standard on segment reporting. The current risk and reward approach of IAS 14 does not achieve comparability. The management approach by contrast provides users of financial statements with additional insight into the company and facilitates retracing management's decision how resources have been allocated. (CL72)

12. Provided below is a table that shows the classification of comments from constituents on the management approach.<sup>1</sup>

|                                    | <b>Support for the management approach</b> | <b>Support for the management approach to the identification of segments only</b> | <b>Oppose the management approach</b> | <b>No comment</b> | <b>Total (*)</b> |
|------------------------------------|--|---|---------------------------------------|-------------------|------------------|
| <b>Users</b>                       | 3  | 1   | 3                                     | 0                 | 7                |
| <b>Accounting standard setters</b> | 9  | 2   | 1                                     | 0                 | 12               |
| <b>Institutes and regulators</b>   | 14   | 7   | 6                                     | 2                 | 29               |
| <b>Accounting firms</b>            | 3  | 2   | 2                                     | 0                 | 7                |
| <b>Preparers</b>                   | 22   | 6   | 6                                     | 11                | 45               |
| <b>Academics</b>                   | 1  | 1   | 0                                     | 0                 | 2                |
|                                    |  |   |                                       |                   |                  |
| <b>Total</b>                       | 52   | 19  | 18                                    | 13                | 102              |
| <b>Per cent</b>                    | 51%  | 19%   | 18%                                   | 12%               | 100%             |

<sup>1</sup> A table that gives reference numbers of comment letters falling into each category is provided in Appendix B.

- (\*) The table does not include 80 comment letters from Publish What You Pay and other organisations which support the campaign organised by Publish What You Pay, because their comments are not related to the management approach. The campaign organised by Publish What You Pay is to promote greater transparency in the management of payments paid by the oil, gas and mining industries to governments in developing or transitional countries that are resource-rich. The issues raised by the Publish What You Pay campaign will be brought to the September Board meeting.

*Staff analysis*

13. [Paragraph omitted from observer notes]
14. [Paragraph omitted from observer notes]
15. [Paragraph omitted from observer notes]
16. [Paragraph omitted from observer notes]
17. [Paragraph omitted from observer notes]
18. [Paragraph omitted from observer notes]
19. [Paragraph omitted from observer notes]

**Issue 2: Scope of the standard**

**Issue 2-1 Entities that hold assets in a fiduciary capacity for a broad group of outsiders**

20. IAS 14 currently applies only to entities whose equity or debt securities are publicly traded and entities that are in the process of issuing equity or debt in public securities markets. The ED proposed extending the scope to cover also entities that hold assets in a fiduciary capacity for a broad group of outsiders.

21. Some respondents (CL9, 12, 55, 95, 139, etc.) agree with the extension of the scope of the standard. They also support the view that the standard should be extended to all entities that have public accountability, because the need for segment information is not differentiated by whether an entity is public or not. Some of them argue that all IFRSs should apply to all profit-oriented entities as outlined in the preface to IFRSs. However, some of them (CL82, 148, 152, 157, 158, etc.) suggest that the Board should clarify the notion and the boundaries of ‘entities that hold assets in a fiduciary capacity for broad group of outsiders’.
22. For example, one respondent expresses the following concerns:
- The wording can imply that only fiduciary contracts over specific assets are within the scope. The Board should clarify whether ‘fiduciary capacity’ shall be seen as a broad term relating an economic function or whether the term refers to the specific financial service of issuing fiduciary contracts over specific assets. (CL7)
  - The Board might also clarify the relationship between the term ‘fiduciary capacity’ and the subsequent examples of banks, insurance companies etc. Do banks or insurance companies generally act in a fiduciary capacity in the meaning of the draft standard or only those banks or insurance companies that issue fiduciary contracts? (CL7)
  - The Board might also clarify whether the ED only covers an entity whose ‘fiduciary capacity’ constitutes the main business purpose or also an entity to which fiduciary activities are incidental to its main business activities. (CL7)
23. Other respondents (CL56, 91, 125, 128, 137, etc.) argue that the scope of the standard should not be amended until the Board has concluded on the definitions of ‘fiduciary capacity’ and ‘public accountability’ in the SMEs project. Otherwise, the scope of the IFRS might have to be amended twice rather than once. They further argue that the IFRS should define the terms to avoid any misunderstanding.
24. Other respondents (CL6, 69, 122) also believe that the reference to ‘insurance company’ in the scope is too broad. They argue that while a life insurer will generally be acting in a fiduciary capacity on behalf of policyholders and customers, a general insurer is typically not. The assets held by a general



insurer are not in the capacity as a fiduciary. The assets are held to meet obligations to creditors including policyholder liabilities of the general insurer (if no claim is made the general insurer retains the assets) with all other assets forming the equity of the shareholders.

25. [Paragraph omitted from observer notes]

26. [Paragraph omitted from observer notes]

27. [Paragraph omitted from observer notes]

28. [Paragraph omitted from observer notes]

29. [Paragraph omitted from observer notes]

30. [Paragraph omitted from observer notes]

31. [Paragraph omitted from observer notes]

## **Issue 2-2 Exemption from segment reporting for separate financial statements**

32. Some respondents (CL3, 15, 55, 67, 94, 95, 101, 102, 110, 125, 137, 151, 152, 166, 180) recommend including in the IFRS the scope exemption in paragraph 6 of IAS 14. Paragraph 6 gives an exemption from segment reporting in the separate financial statements of the parent where a financial report contains both consolidated financial statements and the parent's separate financial statements.

33. These respondents argue that legal entities within a consolidated group are often set up to comply with particular legal or regulatory requirements, yet the business can often be run on cross-border/cross-entity basis. As a result, business performance is often not considered at a legal entity level, since it is a largely artificial distinction. Collecting segmental information for such entities, where it will typically not be readily available, is likely to be costly and of little benefit to users and because the information provided would not reflect how the business is run i.e. it is not conducted within the context of that single entity.

- 34. [Paragraph omitted from observer notes]
- 35. [Paragraph omitted from observer notes]
- 36. [Paragraph omitted from observer notes]
- 37. [Paragraph omitted from observer notes]

### **Issue 2-3 Competitive-harm exemption**

- 38. Some respondents are opposed to a standard being imposed that, they argue, will potentially destroy shareholder value in some instances. They recommend that entities should be exempt from aspects of the standard if disclosure could cause competitive damage. The entity would be required to explain the reasons on a 'comply or explain' basis. (CL17, 18, 54, 57, 70, 147, 176)
- 39. [Paragraph omitted from observer notes]
- 40. [Paragraph omitted from observer notes]
- 41. [Paragraph omitted from observer notes]