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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 September 2006, London

**Project:** Segment Reporting

**Subject:** Continuation of comment letters analysis to ED 8  
(Agenda Paper 3)

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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. At its July Board meeting, the Board tentatively concluded that:
  - (a) The management approach should be adopted as set out in the ED.
  - (b) The standard should not apply to entities that hold assets in a fiduciary capacity. However, the Board took the view that publicly accountable entities should be within the scope of the standard. Accordingly, a future amendment of the scope of the standard is likely to be proposed to include publicly accountable entities, once a definition of such entities has been developed in the project on SMEs.
  - (c) The scope exemption similar to that in paragraph 6 of IAS 14 (for parent entity separate financial statements when presented in the same report as its consolidated financial statements) should be included in the standard.

- (d) A competitive harm exemption should not be included in the standard.
  - (e) If an entity that is not required to apply the standard chooses to disclose segment information that does not fully comply with the standard, it should disclose that the segment information does not comply with the standard.
  - (f) There is no need to include in the standard a reference to not-for-profit entities.
  - (g) The wording of the scope paragraphs of the segment reporting standard and IAS 33 *Earning per Share* be changed to clarify that the entity referred to in the scope paragraph is the parent preparing consolidated financial statements, and that the standard applies to entities that are presently required to file their financial statements with regulators.
3. This paper is a continuation of the comment letter analysis of Agenda Paper 5 of the July 2006 Board meeting. The issues to be discussed in this paper are:
- (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*.
4. Attached in Agenda Paper 3A are minor points raised by commentators on various issues arising from the ED. The staff does not intend to discuss these issues at the Board meeting unless otherwise directed by Board members.

#### **Staff recommendation**

5. The staff recommends that:

- (a) The draft IFRS should not define the measures of segment revenues, segment expenses, segment results, segment assets and segment liabilities that are required to be disclosed.
- (b) Paragraph 22 should be amended so that measures of segment profit or loss and total assets need be disclosed only if they are regularly provided to the CODM.
- (c) Information about segment liabilities should be disclosed on the same basis as information about segment assets.
- (d) Reconciliation at the individual segment level should not be required.
- (e) Segment information by individual country should not be required.
- (f) The Board should proceed with the consequential amendments to IAS 34 *Interim Financial Reporting*.
- (g) The consequential amendments to paragraph 16(g) of IAS 34 should be amended to clarify that the additional interim information on profit and loss items should be disclosed only if the specified amounts are included in the measure of segment profit or loss reviewed by the chief operating decision maker.

## **Staff analysis**

### **Issue 1: Divergence from SFAS 131**

#### **Issue 1-1 Specific measurement requirements for some items**

- 6. Some respondents support the approach of IAS 14 which requires certain items to be disclosed and specifies how those items should be measured. They argue that it is essential to define the key terms of segment revenues, segment expenses, segment result, segment assets and segment liabilities. They comment that the major benefits of doing so is enhanced comparability between reporting entities. Other benefits include significantly reduced potential for reporting entities to mislead users or undermine IFRS-compliant information.
- 7. One respondent disagrees with asymmetrical allocations. An example of such an allocation is the allocation of depreciation expense to a segment without allocating the related depreciable assets to that segment. This

commentator is concerned that asymmetrical allocations to reportable segments will diminish the clarity and comparability of segment reporting. It maintains that the draft IFRS should require consistent attribution of revenues, expenses and assets to segments.

8. Other respondents disagree with any departure from SFAS 131. They highlight that a departure from the management approach with regards to the measurement of specified items would eliminate the major benefits of the management approach. Any entity that does not use an IFRS measure and IFRS accounting principles in its internal reporting would be required to adjust its internal measure of segment profit or loss to IFRSs for the purposes of reporting in its financial statements. Further, they note that the asserted usefulness of IFRS segment information to investors is questionable because the numbers produced are (at least from the perspective of management) not needed to evaluate the performance of the segments.
9. [Paragraph omitted from observers notes]
10. [Paragraph omitted from observers notes]

## **Issue 1-2 Additional or different disclosures to those of in SFAS 131**

### **A measure of segment assets – paragraph 22**

11. Paragraph 22 of the ED requires an entity to report a measure of profit or loss and total assets for each reportable segment. Some respondents argue that the measure of segment assets need only be disclosed if used internally – i.e. if provided to the chief operating decision maker. They argue that, whilst it can be expected that a measure of segment profit is available in every entity's internal reporting, this is not the case for a measure of segment assets. In the particular case of service industries or other industries with low utilisation of physical assets, management may not review assets by segments. If a measure of segment assets is not used internally by management, it is highly unlikely that such a measure would provide useful information for investors that would justify the additional resources needed to track assets by segment for external reporting purposes only.
12. [Paragraph omitted from observers notes]

13. To ensure clarity of the requirements in the proposed IFRS, the staff recommends changing the wording of paragraph 22 as follows:

An entity shall report a measure of profit or loss and total assets for each reportable segment if those amounts are regularly provided to the chief operating decision maker.

#### **Information about segment liabilities**

14. Some respondents proposed adding a requirement for each entity to disclose information about segment liabilities. They believe that the disclosure of gross segment assets may be irrelevant since gross assets at a given moment in time can be highly volatile and may not reflect the true level of activity, risk or scale of an entity. They highlight that one of the more useful ratios in financial statement analysis is return of net operating assets (RNOA). Accordingly, they would prefer to see disclosure of operating net assets and separately any net debt or other non-operational assets or liabilities which have been allocated to the segment. As a result the sum of segmental net assets should be equal to the overall net assets of the group or a reconciliation be provided to this number.
15. Other respondents propose adding a requirement for an entity to disclose the information about segment liabilities if, and only if, they are included in the measure of segment performance reviewed by, or otherwise regularly provided to, the chief operating decision maker. They believe that information about segment liabilities might be helpful to users if segment liabilities are considered by management when assessing a segment's performance.
16. As stated in BC 96 of ED 8, FASB decided not to require the disclosure of segment liabilities under SFAS 131 because it believed that liabilities are incurred centrally and that entities often do not allocate those amounts to segments.
17. [Paragraph omitted from observers notes]
18. [Sentence omitted from observers notes]. On balance, therefore the staff recommends changing the wording of paragraph 22 as follows:

An entity shall report a measure of profit or loss and measures of total assets and liabilities for each reportable segment if those amounts are regularly provided to the chief operating decision maker.

#### **No need for interest to be disclosed**

19. Some commentators noted that paragraph 22 of the ED requires entities to report, for each reportable segment, interest revenue and interest expense. In their view such a requirement contravenes the principle of the management approach, where in the particular case of the financial services industry, it is common practice that the method of accounting for interest income is the net balance between interest income and interest expense. One commentator, however, did not support the offset of interest revenue and interest expense on the grounds that it would be inconsistent with the requirements of IAS 1.
20. [Paragraph omitted from observers notes]

#### **Sub-total for tangible non-current assets**

21. One respondent commented that in the interest of harmonisation, differences between SFAS 131 and the draft IFRS should be minimised. They noted the change from 'long-lived assets' excluding intangible assets in SFAS 131 to 'non-current assets' including intangible assets in the ED. As stated in BC 15, the change reflects the fact that the Board did not agree with the FASB *Guidance on Applying Statement 131* which excludes intangible assets from those to be disclosed. Whilst CL 8 agrees that the position the IASB has taken results in more meaningful information, they suggest that the IFRS should require disclosure of sub-total of tangible non-current assets that accords with the requirements of SFAS 131.
22. [Paragraph omitted from observers notes]

#### **Issue 2: Level of reconciliations**

23. Some respondents disagree with the level of reconciliations proposed in the draft IFRS. They argue that if the draft IFRS allows segment information to be measured based on 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 argue that reconciling only total segment amounts to amounts presented in the financial statements does not give useful information. As a result they suggest that the following two-tier reconciliations should be required to enable users to analyse financial statements properly:

- (a) a reconciliation and explanation of the differences between the segment non-IFRS management information and the segment IFRS measures; and
  - (b) a reconciliation and explanation of the differences between the total segment IFRS measures and the amounts in the financial statements
24. Other respondents support the level of reconciliations in the draft IFRS. They note that a reconciliation for each individual reportable segment would effectively force entities to prepare a segment reporting in accordance with IFRSs for external reporting purposes only, which they argue would be onerous and outweigh the potential benefits. Furthermore, they argue more detailed reconciliations would not be more understandable to users than the reconciliations in ED 8 since two figures for each segment might be confusing. They do not think that the additional costs to the reporting entities are justified.
25. [Paragraph omitted from observers notes]

### **Issue 3: Geographical information about assets**

#### **Issue 3-1 Disclosure of information on a country-by-country basis**

26. ED 8 proposed the following geographical disclosures, as required by SFAS 131:
- (a) revenues from external customer (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.
27. Eighty respondents from the Publish What You Pay campaign requested that the scope of the draft IFRS be extended to require additional disclosure on a country-by-country basis of:
- (a) Turnover in total
  - (b) Third party turnover
  - (c) Third party costs excluding those of employment
  - (d) Interest paid
  - (e) Profit before tax
  - (f) Tax charge on profit split between current and deferred tax
  - (g) Other taxes or equivalent charges due to the government of the territory in respect of local operations
  - (h) The actual payments made to the government of the country and its agencies for tax and equivalent charges in the period
  - (i) The liabilities owing locally for tax and equivalent charges at the beginning and end of each period as shown on the balance sheet at each such date
  - (j) Deferred taxation liabilities for the country at the start and close of the period
  - (k) Gross and net assets employed
  - (l) The number of employees engaged, their gross remuneration and related costs
  - (m) The name of all subsidiaries working within the territory
  - (n) Comparative data where appropriate in each case



28. 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 Publish What You Pay campaign advocates that a country-by-country requirement be incorporated into IFRSs so that information on payments to individual governments is available in entities' financial statements, especially in extractive industries. In their view, the publication of information on payments by extractive industries operators and other companies to governments on a country-by-country basis is in the interest of all users of financial statements including employees and local government agencies.
29. The supporters of the campaign presume that country-by-country information is available. They argue that entities structure their operations on a country-by-country basis to comply with the local laws and to limit group risk. Such structures assist management in measuring local performance through significant internal reporting lines.
30. Supporters of the campaign acknowledged that the extended disclosure requirements could be provided in other ways. For instance, they cited that Corporate Social Responsibility (CSR) reports could include this data or that listing agreements could be amended to require its disclosure. However, they argue that because the CSR model relies on voluntary disclosure, it is believed that few entities would provide the additional information. In their view a compulsory regime within an IFRS platform is necessary. They concluded by adding that the suggested disclosure could be produced at relative little cost as this information is already generated at subsidiary level.
31. [Paragraph omitted from observers notes]
32. [Paragraph omitted from observers notes]
33. [Paragraph omitted from observers notes]

### **Issue 3-2 Other geographical disclosures suggested**

34. Some respondents commented that the reasons for providing geographical disclosures were inadequately explained in the ED. Suggestions for other

geographical disclosures were:

- (a) disclosures by geographical areas, not individual countries
  - (b) disclosure of profit or loss as well as non-current assets
  - (c) disclosure of net assets instead of non-current assets
  - (d) disclosure of total assets instead of non-current assets
  - (e) disclosure of current assets as well as non-current assets
  - (f) disclosure of financial assets as well as non-current assets
  - (g) disclosure of deferred tax assets
35. Other respondents argued that the geographical disclosure of non-current assets should not be required if those amounts are not reviewed by the CODM. Yet other respondents argued that the non-current assets excluded from the disclosure in the ED (i.e. financial instruments, deferred tax assets, post-employment benefit assets, and rights arising under insurance contracts) should be included if they are reviewed by the CODM. Finally some respondents argued that there should be no exemption for disclosure on the grounds of excessive cost.
36. [Paragraph omitted from observers notes]
37. Paragraph 104 of the Basis for Conclusion of SFAS 131 provides the rationale for the disclosure of both revenues and assets relating to geographical segments. According to that paragraph, analysts indicated that information about revenues from customers in different geographic areas would assist them in understanding concentrations of risk due to negative economic changes in economic conditions and prospects for growth due to positive economic changes. They also suggested that information about assets located in different areas would assist them in understanding concentrations of risks.
38. [Paragraph omitted from observers notes]

### **Issue 3-3 Country of domicile (Paragraph 32)**

39. Some respondents are of the opinion that the wording of paragraph 32 about

geographical information is inappropriate for many entities. They argue that the information about country of domicile would be relevant when a large proportion of an entity's business is carried out in its country of domicile. However, there are many circumstances where the country of domicile represents a small proportion of the entity's business and in these cases the information required would not be very relevant. In addition, SFAS 131 has been designed for entities in the US. Their "country of domicile" is in itself a significant geographical area. These respondents suggest that the information should instead be given about the country of principal activities.

40. [Paragraph omitted from observers notes]

#### **Issue 4: Consequential amendments to IAS 34 *Interim Financial Reporting***

##### **Issue 4-1 Consequential amendments**

41. Some respondents disagree with the consequential amendments to IAS 34 on the grounds that the requirements for additional segment information could be excessively erroneous. These respondents argue that the draft mandates certain disclosures at the interim level that may not be regularly produced, or even particularly significant in the context of the entity's business. For example, a split of revenue between internal and external customers. They are also concerned that the cost and time involved in the provision of such segmental analysis for interim reporting will be higher than suggested by the ED.

42. Others suggest that IAS 34 should be left alone until such a time as the IASB decides to commence work on its comprehensive revision. They note that the IFRIC Draft D18 *Interim Financial Reporting and Impairment* has shown that there are fundamental issues associated with the nature and purpose of interim financial reporting which need to be resolved.

43. Other respondents agree with the consequential amendments to IAS 34, specifically the requirement to include more comprehensive segment reporting in the interim financial statements.

44. [Paragraph omitted from observers notes]

45. [Paragraph omitted from observers notes]

**Issue 4-2 Condition for disclosure of interim segment information**

46. One respondent suggests that the proposed changes to IAS 34 should be amended to clarify that the additional interim information on profit or loss items is required to be disclosed only 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 him.

47. [Paragraph omitted from observers notes]

48. [Paragraph omitted from observers notes]