

Project	Annual Improvements—2010-2012 cycle
Topic	IFRS 8 <i>Operating Segments</i>—aggregation of operating segments and identification of the chief operating decision maker

Purpose of this paper

1. In April 2011 the Board received a request to make some minor improvements to IFRS 8 *Operating Segments*, with regard to the application of the aggregation criteria and the identification of the chief operating decision maker (CODM). The Board has asked the IFRS Interpretations Committee (the Committee) to review this submission and give the Board its recommendation on the issues raised in the submission.
2. More specifically, the submitter asks the Board to:
 - (a) include an additional disclosure in paragraph 22 of IFRS 8 requiring a brief description of both the operating segments that have been aggregated and the economic indicators that have been assessed to conclude that operating segments have ‘similar economic characteristics’ in accordance with paragraph 12 of IFRS 8; and
 - (b) emphasise in paragraphs 1 and 7 of IFRS 8 the ‘operating nature’ of the function of the ‘chief operating decision maker’ and clarify that there is a presumption that management reviews the information that is reported to it.
3. The submitter notes that these proposed minor improvements to IFRS 8 would:

This paper has been prepared by the technical staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IFRS Interpretations Committee or the IASB. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination.

Decisions made by the IFRS Interpretations Committee are reported in *IFRIC Update*.

Interpretations are published only after the IFRS Interpretations Committee and the Board have each completed their full due process, including appropriate public consultation and formal voting procedures. The approval of an Interpretation by the Board is reported in *IASB Update*.

IASB Staff paper

- (a) enable securities regulators to challenge issuers more effectively on the adequacy of their segmental reporting;
 - (b) result in an improvement to financial information; and
 - (c) reduce diversity in practice.
4. The submitter suggests that the proposed clarifications should be included as part of the annual improvements project (AIP), because the post-implementation review of IFRS 8 will take place in the long term. The submission is reproduced in full in Appendix B to this paper.
5. This paper:
- (a) provides an explanation of the main issues and provides a staff analysis on each of the issues;
 - (b) includes the staff recommendation to include an additional disclosure in paragraph 22 of IFRS 8 as part of the annual improvements project. The staff is not recommending any modification to paragraphs 1 and 7 of IFRS 8 (as proposed by the submitter); and
 - (c) asks the Committee whether they agree with the staff recommendation.

Structure of this paper

6. This agenda paper is organised as follows:
- **Issue 1:** discusses the proposal to include an additional disclosure to paragraph 22 in IFRS 8 to clarify the meaning of ‘similar economic characteristics’ in paragraph 12.
 - **Issue 2:** discusses:
 - (a) the operational vs. the strategic roles of the CODM in paragraph 7 of IFRS 8; and
 - (b) a modification to the ‘core principle’ in paragraph 1 of IFRS 8.

IASB Staff paper

Issue 1: Disclosure requirements to clarify the meaning of ‘similar economic characteristics’***Description of the issue***

7. IFRS 8 provides guidance for aggregating two or more operating segments into a single operating segment. In accordance with paragraph 12, segments can be aggregated when the segments have **similar economic characteristics**

(emphasis added):

- 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 IFRS, **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.

8. The submitter raises the following concerns on the meaning of ‘similar economic characteristics’ in paragraph 12:
- (a) paragraph 12 mentions only one indicator (ie ‘long term average gross margins’) to assess whether operating segments have ‘similar economic characteristics’; in the submitter’s view other indicators should also be mentioned such as: sales growth, margins, or a combination of various indicators.
 - (b) it is difficult to draw a line to distinguish between what is ‘similar’ and ‘not similar’.

IASB Staff paper

(c) the application of the aggregation criteria requires the use of judgement, and so deciding whether two segments are economically similar is difficult and subjective and leads to diversity in practice.

9. The submitter does not suggest amending paragraph 12 but instead proposes adding a new disclosure requirement to paragraph 22 (ie adding a new subparagraph (c)) that would require the disclosure of management's judgements made in determining the operating segments shared economic characteristics. This paragraph would read as follows (proposed new text is underlined):

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
- (c) where operating segments have been aggregated, the judgements made by management in the application of the aggregation criteria in paragraph 12. In particular, a brief description of both the operating segments that have been aggregated and the economic indicators assessed, including the measurement range considered to be similar (for example: profit margin spreads, sales growth rates etc.), in determining that they share similar economic characteristics.

10. In the submitter's view explaining the basis for such aggregation would help users to:

- (a) understand how operating segments have been aggregated; and
- (b) determine whether an entity has made an appropriate assessment of the aggregation criteria referred to in paragraph 12 of IFRS 8.

Staff analysis of Issue 1

11. We observe that paragraph 12 in IFRS 8 does not elaborate upon the meaning of 'similar economic characteristics' except to say that operating segments having

IASB Staff paper

similar economic characteristics would be expected to exhibit similar long-term financial performance; for example similar long-term average gross margins.

12. We think, though, that the description in paragraph 12 is intended to include other significant long-term financial performance indicators (which would be expected to be similar for two segments that are considered to have ‘similar economic characteristics’), such as, long-term sales trends¹. Nevertheless, we do not believe that paragraph 12 should include more examples of other ‘long-term financial performance’ indicators to elaborate upon the meaning of ‘similar economic characteristics’, because in our view the term *performance* is an abstract term that means different things to different people and this term has not been defined in IFRSs.
13. Instead, we agree with the submitter’s proposal for supplementing the current disclosure requirements in paragraph 22 regarding the application of the aggregation criteria. Currently, paragraph 22 (a) (refer to paragraph 9 above) contains a requirement to disclose the factors used to identify the entity’s reportable segments, including the basis of organisation and suggests as an example, the disclosure of whether operating segments have been aggregated. In our view this requirement is not explicit enough in this paragraph.
14. One could argue though, that if an entity follows the content of paragraph 17(c) in IAS 1 *Presentation of Financial Statements* regarding fair presentation, an entity would provide the basis for the aggregation of operating segments. This paragraph states that fair presentation requires an entity:
 - (c) To provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the

¹ In Appendix A of the IASB Agenda paper 9 (June 2005) the staff makes a reference to *EIC-115: Segment Disclosures – Application of the Aggregation Criteria in CICA 1701* (December 21, 2000). This document states that (emphasis added): ‘operating segments would be considered to exhibit similar long-term financial performance if **long-term sales trends** are similar and **other key financial measurements** (eg, return on assets, levels of capital investments, operating cash flows) used by the chief operating decision maker do not present contrary evidence’.

IASB Staff paper

impact of particular transactions, other events and conditions on the entity's financial position and financial performance

15. However we agree with the submitter that the basis for such aggregation is not necessarily apparent in paragraph 22 and we do not think that it would necessarily be triggered by the application of paragraph 17(c) of IAS 1.
16. Consequently, we agree on including a more specific requirement in IFRS 8 to disclose the basis for aggregating operating segments in the way proposed by the submitter (refer to paragraph 9, above). In our view this additional disclosure is not a new disclosure in paragraph 22 of IFRS 8; instead, it is specifying the type of information that should be included where operating segments have been aggregated, as part of the information already required by paragraph 22(a).

Issue 2: Identification of the CODM

Description of Issue 2a: strategic vs operational roles of the CODM

17. Paragraph 7 of IFRS 8 provides a description of the CODM as follows (emphasis added):
 - 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.
18. The submitter raises a concern on the description of the CODM in accordance with paragraph 7 (above), because in practice the CODM's functions (ie allocating resources and assessing performance) are not always carried out by the same person for example:
 - (a) the CODM is often a Management Board, which focuses on strategic decisions (ie a 'resource allocation' function); whereas
 - (b) a segment manager focuses on operational decisions (ie an 'assessing performance' function) .
19. The submitter thinks that the CODM's function in paragraph 7 regarding 'resource allocation' suggests that this is more a strategic role, whereas the

IASB Staff paper

‘assessing performance’ function implies a more operational role. In the submitter’s view, the focus of the CODM’s functions should be more operational than strategic. Consequently the submitter suggests amending the definition of the CODM in paragraph 7 to:

- (a) emphasise its functions of making decisions of an operating nature and assessing the performance of an operating segment; and
- (b) delete the reference to the CODM’s function of allocating resources to the operating segments.

20. The submitter’s proposed amendment to paragraph 7 is shown below (proposed new text is underlined and proposed deleted text is struck through):

- 7 The term 'chief operating decision maker' identifies a function, not necessarily a manager with a specific title. That function is to be involved in making operating decisions within an operating segment and ~~allocate resources to and~~ assessing 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 who may individually or collectively assess the performance of an operating segment and be involved in the making of operating decisions.

Description of Issue 2b: modification to the ‘core principle’ in IFRS 8.1

21. In addition, the submitter raises another concern on the use of judgement in identifying operating segments, because the submitter thinks that the use of judgement could sometimes ‘circumvent’ the ‘core principle’ in paragraph 1 of IFRS 8 (of providing users with useful information to evaluate an entity). The submitter suggests that this could happen, for example, when an entity applies its judgement in such a way as to reduce the number of operating segments by focusing on the level at which members of the CODM collectively monitor performance, rather than the level at which those same members individually monitor performance. To address this concern, the submitter suggests a modification to the ‘core principle’ in paragraph 1 to emphasise that there is a presumption that management reviews the information reported to it and that information disclosed by an entity under IFRS 8 is the information that is used by an entity to assess performance.

IASB Staff paper

22. The submitter's proposed amendment to paragraph 1 is shown below (proposed new text is underlined):

- 1 An entity shall disclose information used to assess performance to enable users of its financial statements to evaluate the nature and financial effects of the different business activities in which it engages and the different economic environments in which it operates.

Staff analysis of Issue 2

Issue 2a – strategic vs operational roles of the CODM

23. Paragraph 5 in IFRS 8 gives account of the CODM's role in identifying operating segments as follows (emphasis added):

- 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.

24. From our understanding of paragraph 5 we can determine that the CODM:

- (a) is a decision-maker;
- (b) is actively involved in reviewing information of an operating nature; and
- (c) fulfils two distinct but related functions (ie performance assessment and resource allocation).

25. In addition, paragraph 9 of IFRS 8 notes that the CODM generally discusses operating activities, financial results or other plans for the segment with the 'segment manager' or even the CODM might also fulfil the role of segment manager. The content of this paragraph is shown below (emphasis added):

- 9 Generally, **an operating segment has a segment manager who is directly accountable to and maintains regular contact with the chief operating**

IASB Staff paper

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.

26. We think that the CODM’s functions are clearly stated in paragraphs 5 and 7 (ie assessing performance and allocating resources), being that the former function is more operating in nature and the latter function more strategic in nature. We think that it is IFRS 8’s objective to distinguish between two different types of functions (ie performance assessment and resource allocation) and bring them together to describe the roles that the CODM performs. Consequently, we disagree with the submitter’s proposals to:
- (a) emphasise the CODM’s involvement in making operating decisions in paragraph 7; and
 - (b) delete the CODM’s function of ‘allocating resources to the operating segments’.
27. In addition, we think that the application of paragraph 7 in IFRS 8 for identifying the CODM (ie the fact that ‘CODM’ depicts more ‘a function than a manager with a specific title’) takes for granted the fact that the CODM could vary across entities (for example, while one entity might consider one individual to be its CODM, another entity might consider a full board of executives to be its CODM) and that this identification will depend on specific facts and circumstances applying to each entity.
28. In such cases where two different individuals or groups within an entity perform separately the ‘operating function’ and the ‘strategic function’ (for example a CODM taking on a strategic function and a segment manager taking on an operating role) we think that in this case, the identification of the operating segment as a component of an entity should take into account the views from both the CODM and the segment manager to ensure that this identification is

IASB Staff paper

based on the manner resources are allocated and on how performance is assessed. We think that this conclusion can be drawn from the reading of paragraphs 5 and 7 in IFRS 8; this is, that operating segments are identified by the CODM and are based on the information that the CODM reviews to make strategic decisions about resource allocations to the segments and operational decisions about performance assessment of the segments. However, we would like to ask the Committee if they agree with this view or whether they think we should propose:

- (a) an annual improvement to paragraph 7 or paragraph 5 or both; or
- (b) an interpretation to paragraph 7 of IFRS 8.

Issue 2b –Modification to the ‘core principle’ in IFRS 8.1

29. The submitter suggests that the ‘core principle’ in paragraph 1 should be modified to emphasise that the information that is disclosed by an entity under IFRS 8 is used by an entity to ‘assess performance’. We agree that, on the basis of paragraph 5 of IFRS 8, segment information is closely related to the information that is regularly reviewed by the CODM (in assessing the resources to be allocated to the segment and in assessing its performance). We, disagree, however, with the proposed amendment to paragraph 1, because we think that the emphasis in paragraph 1 of IFRS 8 should remain as it is, by highlighting the generation of information that enables users to make more informed decisions, instead of highlighting the nature of the information reviewed by the CODM.
30. On the basis of our discussion above, we do not recommend any amendment to paragraphs 1 and 7 in IFRS 8 as proposed by the submitter.

Staff recommendation

31. On the basis of our analysis of **Issue 1 (refer to paragraphs 7–16)** we recommend that the Committee should suggest to the Board that it should amend paragraph 22 as follows: (proposed new text is underlined):

IASB Staff paper

32. This paragraph would read as follows (proposed new text is underlined):

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
- (c) where operating segments have been aggregated, the judgements made by management in the application of the aggregation criteria in paragraph 12. In particular, a brief description of both the operating segments that have been aggregated and the economic indicators assessed, including the measurement range considered to be similar (for example: profit margin spreads, sales growth rates etc.), in determining that they share similar economic characteristics

33. On the basis of our analysis of **Issue 2 (refer to paragraphs 18–30)** we do not recommend that the Committee should suggest to the Board any amendments to paragraphs 1 and 7 of IFRS 8.

Assessment against the new annual improvements criteria

34. We have assessed the proposed amendment to paragraph 22 against the enhanced annual improvements criteria, which are reproduced in full below:

In planning whether an issue should be addressed by amending IFRSs within the annual improvements project, the IASB assesses the issue against the following criteria. All criteria (a)–(d) must be met to qualify for inclusion in annual improvements.

- (a) The proposed amendment has one or both of the following characteristics:
 - (i) clarifying—the proposed amendment would improve IFRSs by:
 - clarifying unclear wording in existing IFRSs, or
 - providing guidance where an absence of guidance is causing concern.

A clarifying amendment maintains consistency with the existing principles within the applicable IFRSs. It does not propose a new principle, or a change to an existing principle.

IASB Staff paper

- (ii) correcting—the proposed amendment would improve IFRSs by:
- resolving a conflict between existing requirements of IFRSs and providing a straightforward rationale for which existing requirement should be applied, or.
 - addressing an oversight or relatively minor unintended consequence of the existing requirements of IFRSs.

A correcting amendment does not propose a new principle or a change to an existing principle.

[Staff analysis—this criterion is satisfied. There is a need for clarification of the requirements in paragraph 22 regarding the application of the aggregation criteria. Currently this paragraph requires the disclosure of the factors used to identify the entity’s reportable segments and suggests as an example, the disclosure of whether operating segments have been aggregated. However it does not specifically include a requirement to state the basis for the aggregation of operating segments.]

- (b) The proposed amendment is well-defined and sufficiently narrow in scope such that the consequences of the proposed change have been considered.

[Staff analysis—this criterion is satisfied. The issue is sufficiently narrow to ensure that the proposed change has been considered sufficiently and identified.]

- (c) It is probable that the IASB will reach conclusion on the issue on a timely basis. Inability to reach a conclusion on a timely basis may indicate that the cause of the issue is more fundamental than can be resolved within annual improvements.

[Staff analysis—this criterion is satisfied. We think that the Committee will be able to address these issues on a timely basis and think that the Board should also be in a position to reach a conclusion on a timely basis. The issue can be sufficiently tackled by adding a disclosure requirement in paragraph 22(c) that will provide increased clarity where diversity currently exists, while not significantly affecting the primary accounting treatment that exists in practice for this issue. In our view this additional disclosure is not a new disclosure in paragraph 22 of IFRS 8; instead, it is specifying the type of information that should be included where operating segments have been aggregated, as part of the information already required by paragraph 22(a)].

- (d) If the proposed amendment would amend IFRSs that are the subject of a current or planned IASB project, there must be a need to make the amendment sooner than the project would.

[Staff analysis—this criterion is satisfied. There is no current IASB project on IFRS 8 even though a post-implementation review is planned for the near future.]

IASB Staff paper

Staff conclusion

35. On the basis of the assessment under the existing annual improvements criteria, we think that the Committee should recommend to the Board that the change proposed to paragraph 22(a) in IFRS 8 (refer to Appendix A of this paper) should be included in the **2010-2012 annual improvements** cycle

Questions to the Interpretations Committee**Questions—proposed amendments to IFRS 8**

1. Does the Committee agree to recommend to the Board to amend paragraph 22 in IFRS 8, by adding subparagraph 22(c) to require more specifically a disclosure on the application of the aggregation criteria, as shown in Appendix A? **(Issue 1)**

(Issue 2)

2a. Does the Committee agree to recommend that the Board does not to amend paragraph 7 to clarify the identification of the CODM?

2b. If the Committee does not agree with 2a (see above), does the Committee think that it should recommend to the Board that this paragraph should be clarified on what information should be used to identify the operating segments and the information to be disclosed in situations where the two functions performed by the CODM (ie assessing performance and allocation of resources) are performed by two different parties? If the Committee agrees that such clarification is needed, then do you think we should propose:

- a) an annual improvement to paragraph 5 or paragraph 7 or both?; or
- b) an interpretation to paragraph 7?

3. Does the Committee agree to recommend that the Board does not to modify the 'core principle' in paragraph 1 regarding the objective of IFRS 8? **(Issue 2b)**

IASB Staff paper

Appendix A—Proposed changes

A1. The proposed amendment to paragraph 22 is presented below.

Amendment to IFRS 8 *Operating Segments*

Paragraph 22(c) has been added (new text is underlined).

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
 - (c) where operating segments have been aggregated, the judgements made by management in the application of the aggregation criteria in paragraph 12. In particular, a brief description of both the operating segments that have been aggregated and the economic indicators assessed, including the measurement range considered to be similar (for example: profit margin spreads, sales growth rates etc.), in determining that they share similar economic characteristics.

A2. We are proposing adding the following paragraph to the Basis for Conclusions of IFRS 8:

Basis for Conclusions on proposed amendments to IFRS 8 *Operating Segments*

This Basis for Conclusions accompanies, but is not part of, the proposed amendments.

General information

- BC1 The Board received a request to add a disclosure requirement in paragraph 22 of IFRS 8 *Operating Segments* concerning the application of the aggregation criteria. This requirement would further clarify the

IASB Staff paper

basis for such aggregation. The Board agreed with that request and proposes adding paragraph 22(c) to IFRS 8 to achieve this.

IASB Staff paper

Appendix B – Request for Annual Improvements

B1 The staff received the following request. All information has been copied without modification, except for details that would identify the submitter of the request and details that are subject to confidentiality.

REQUEST FOR ANNUAL IMPROVEMENTS

I. Aggregation of Operating Segments

Description of the issue identified

1. IFRS 8 paragraph 12 states that operating segments may be aggregated if all of the aggregation criteria are met.
2. Neither the standard itself nor the basis for conclusions provide any further guidance on what is meant by the term 'similar economic characteristics' or how it should be applied. The only reference in the standard is to similar long term average gross margins as an indicator of similar economic characteristics. This is probably because the standard is based upon an original standard designed for use in the US which has a single internal market and where there would consequently have been minimal need to think about detailed factors defining what similar economic characteristics mean in a geographical context because the only relevant market was the US one.

Difficulties encountered

3. Practical difficulties are being encountered regarding where to draw the line between "similar" and "not similar". Clearly the Board must have intended that this would differentiate some operating segments from others, but at what level?
4. It is the issuer's primary responsibility to provide an answer to this question. Judgement is needed in defining criteria that will help assess how operating segments should be aggregated. The criteria might relate to the overall rate of growth of the economy in separate economic areas. They could also relate to sales growth, margins, other performance indicators or a combination of various indicators.
5. As enforcers, we have seen financial statements where operating segments have been aggregated into one or several reporting segments but where no explanation has been provided as to which individual operating segments had been aggregated, nor any explanation of whether an assessment had been made of whether the aggregation of the segments was compliant with IFRS 8 paragraph 12.

IASB Staff paper

Proposed solution/recommendation

6. The application of the aggregation criteria requires a significant amount of discretion. For instance, they allow "professional judgment" of whether an aggregation is consistent with the core principle of IFRS 8 in deciding how aggregation can be applied, if at all. Deciding if two segments are sufficiently economically similar to aggregate them can be difficult and subjective in some cases.

7. This level of subjectivity leads to diversity in practice with some companies deciding to aggregate more than others in the process combining segments which probably should be reported separately. Additionally, the level of subjectivity applied by management may not be apparent from the disclosures given under IFRS 8 paragraph 22 either.

8. Therefore, [XXX] believes that emphasis should be put on disclosures that would help users understand the judgements made by management in deciding whether operating segments can be aggregated. As a consequence, we would suggest a limited amendment to paragraph 22 as follows (paragraph (c) below):

“An entity shall disclose the following general information:

a) factors used to identify the entity’s reportable segments [...]

b) types of products and services from which each reportable segment derives its revenues.

c) where operating segments have been aggregated, the judgements made by management in the application of the aggregation criteria in paragraph 12. In particular, a brief description of both the operating segments that have been aggregated and the economic indicators assessed, including the measurement range considered to be similar (For example, profit margin spreads, sales growth rates etc.), in determining that they share similar economic characteristics.”

9. [XXX] believes that the additional disclosure requirements concerning the judgments made will provide users with important information that will enable them to reach their own judgements as to whether the level of aggregation is appropriate. It will also require management, and auditors, to consider more closely whether the divergence in economic indicators disclosed truly represents economic similarity.

IASB Staff paper

II. Identification of Chief Operating Decision Maker**Description of the identified issue**

10. The core principle of IFRS 8 is to enable users of financial statements to evaluate the nature and financial effects of the business activities in which the entity engages and the economic environments in which it operates.

11. The standard requires companies to identify the function of the Chief Operating Decision Maker (“CODM”) and goes on to explain that the CODM is the function that regularly reviews results to make decisions about resources to be allocated to the segment and to assess its performance. It appears in practice that allocating resources and assessing performance may not always be carried out by the same persons or using the same set of information. For example, the argument has been raised with us that information was obtained but not used for allocating resources.

12. However, in the basis for conclusions the IASB explains that it concluded that the management approach was the most appropriate basis for the disclosure of segmental information. IFRS 8 paragraph BC4 states that the requirements of SFAS 131 (on which IFRS 8 is based) are based on the way that management regards an entity, focussing on information about the components of the business that management uses to make decisions about operating matters.

13. This definition creates confusion and conflicts with the objective cited by the IASB when issuing IFRS 8 that the individual(s) who decide(s) what resources to allocate to segments review segment performance on an irregular basis² and where they allocate resources based on only information aggregated at a consolidated level.

14. Based on the definition in IFRS 8 paragraph 7, the CODM is often the Management Board. In practice, the Management Board focuses on strategic decisions whereas operational decisions may be made at a level below the CODM by the segment manager who is directly accountable to and maintains regular contact with the CODM.

15. The rather general definition of a CODM means that management’s judgement must be applied to identify operating segments. Such judgements may be directed in such a way as to reduce the number of operating segments, thereby circumventing the core principle of IFRS 8. For example, we have identified situations in which a company apparently assigns one reporting segment to each member of the Board in order to claim that the CODM (the Board)

² IFRS 8.5(b) states that the ‘operating results are regularly reviewed by the entity’s chief operating decision maker’ but this notion is subjective.

IASB Staff paper

monitors the entity's whole activities and not the separate segments. The argument used is that resources are allocated and performance is reviewed at a higher, more aggregated level. The operational structure within the company, however, remains unchanged; all operating segments are organized and performance is assessed as it was prior to the assignment of specific "responsibilities" to the individual Board members.

Difficulties encountered

16. The term Chief Operating Decision Maker suggests that the person so designated should be involved in making operating decisions. Yet the requirement that they make resource allocation decisions suggests that they, in fact, predominately make strategic decisions. Diversity in practice is likely to result given this potential for confusion.

17. This potential for confusion may also allow for possible misuse of the standard. IFRS 8 was designed to provide useful information to financial statement users, allowing them to evaluate the nature and financial effects of the business activities in which a company engages and the economic environments in which it operates. If, for example, management can claim that it simply does not use the information reported to it or can simply add an aggregation layer to the company's organisation in order to reduce the number of operation segments despite the operational structure within the company remaining unchanged, then the core principle of IFRS 8 would not be met.

Proposed solution / recommendation

18. Consideration could be given to amending the definition of the CODM. To reduce the potential for confusion or misuse, we propose that the operating nature of the function should be emphasised in the CODM definition. Examples can also be provided in the standard to promote the use of objective evidence in identifying "operating nature", such as organisational charts, lines of reporting and management bonus schemes. In addition, the standard should clarify that there is a presumption that management reviews the information reported to it. We believe this clarification would reduce potential diversity in practice, ensuring better adherence to the standard's core principle as well as enhancing the enforceability of IFRS 8.

19. To achieve the necessary clarifications detailed above, we suggest the following minimal wording changes to the text of IFRS 8 which could be considered in conjunction with the Annual Improvements Project:

Amendment to the core principle: IFRS 8 paragraph 1

20. An entity shall disclose the information used to assess performance to enable users of its financial

IASB Staff paper

statements to evaluate the nature and financial effects of the different business activities in which it engages and the different economic environments in which it operates.

Proposed amendment to IFRS 8 paragraph 7

21. The term 'chief operating decision maker' identifies a function, not necessarily a manager with a specific title. That function is to be involved in making operating decisions within an operating segment and ~~allocate resources to and~~ assessing 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 who may individually or collectively assess the performance of an operating segment and be involved in the making of operating decisions.

Proposed amendment to the basis for conclusions

22. The information set which should be used for the purpose of reporting information about operating segments should be the one that is used to assess the performance of operating segments. The information set would, therefore, be the one used by the individual or group of individuals, who may not regularly meet, as the basis for making such decisions. There is a rebuttable presumption that the CODM reviews the information set that he receives.

23. Organisational charts, lines of reporting and management bonus schemes may assist in identifying operating segments.