

STAFF PAPER

February 2013

IASB Meeting

Project	Annual Improvements to IFRSs 2010–2012 Cycle (ED/2012/1) comment letter analysis		
Paper topic	IFRS 8 <i>Operating Segments</i> —aggregation of operating segments		
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This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IASB and does not represent the views of the IASB or any individual member of the IASB. Comments on the application of IFRSs do not purport to set out acceptable or unacceptable application of IFRSs. Technical decisions are made in public and reported in IASB *Update*.

Introduction

1. The Exposure Draft (ED) *Annual Improvements to IFRSs 2010–2012 Cycle* (ED/2012/1) published in May 2012 includes the IASB’s proposal to amend paragraph 22 of IFRS 8 *Operating Segments*.
2. This amendment proposes the inclusion of an additional disclosure that would require a description of the judgements that are made by management in aggregating operating segments, including the economic indicators that management has assessed to conclude that operating segments have ‘similar economic characteristics’ in accordance with paragraph 12 of IFRS 8.

Purpose of this paper

3. The objective of this paper is:
 - (a) to present to the IASB the IFRS Interpretations Committee’s (the Interpretations Committee) recommendations on the proposal to amend paragraph 22 of IFRS 8 including:
 - (i) a summary of changes that the Interpretations Committee recommends for finalisation in response to the comments received;
 - (ii) the proposed wording for the final amendments as set out in Appendix A of this Agenda Paper; and

- (b) to get a decision from the IASB on these issues to allow them to be included in the final *Improvements to IFRSs* Standard that is planned to be published in 2013.

Summary of the proposed amendment and the comments received

- 4. A summary of the proposed amendment and the comments received is described in the paragraphs that follow.
- 5. For a detailed description of the comments received and the source of those comments, the IASB should refer to [Agenda Paper 10A](#), which was presented to the Interpretations Committee at the November 2012 meeting.¹

Proposed amendment

- 6. In April 2011 the IASB received a request from the European Securities and Markets Authority (ESMA) to address an issue in IFRS 8, with regard to the application of the aggregation criteria.²
- 7. ESMA noted that the meaning of the term ‘similar economic characteristics’ in paragraph 12 is unclear because:
 - (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 distinguish between what is ‘similar’ and what is ‘not similar’; and
 - (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.

¹ For ease of reference, IASB members will receive a copy of this paper.

² The submitter also requested the IASB to clarify the guidance on the identification of the chief operating decision maker (CODM). The IASB discussed both requests but decided that no further clarification of the requirements in IFRS 8 relating to the identification of the CODM was needed. This decision was reflected in the [IASB Update of November 2011](#).

8. During its deliberations³ the IASB made the following observations about IFRS 8:
- (a) Paragraph 12 does not elaborate upon the meaning of ‘similar economic characteristics’ except to say that operating segments that share similar economic characteristics would be expected to exhibit a similar long-term financial performance. In addition, determining whether operating segments have ‘similar economic characteristics’ requires the use of judgement.
 - (b) Paragraph 22(a) currently contains a requirement to disclose the factors that were used to identify the entity’s reportable segments, including the basis of organisation, and suggests, as an example, disclosing whether operating segments have been aggregated. However, there is no explicit requirement in paragraph 22(a) to disclose the aggregation of operating segments.
9. The IASB proposed to include a disclosure in paragraph 22 by adding paragraph 22(aa). This paragraph is reproduced below (emphasis added):

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

(aa) where operating segments have been aggregated, the judgements made by management in applying the aggregation criteria in paragraph 12. In particular, a brief description of the operating segments that have been aggregated and the economic indicators that have been assessed in determining that they share similar economic

³ The Interpretations Committee discussed this issue at the July 2011 meeting (refer to [Agenda Paper 11](#)). The IASB deliberated this issue at the September 2011 meeting (refer to [Agenda Paper 7K](#)) and at the November 2011 meeting (refer to [Agenda Paper 2A](#)).

characteristics (for example, profit margin spreads, sales growth rates etc); and

(b) ...

10. The IASB observed that including a disclosure in paragraph 22 would provide users with an understanding of how (and the reasons why) operating segments have been aggregated.

Summary of the comments received

11. The IASB received 84 comment letters on the ED in total. Only 65 respondents expressed their views on the proposed amendment to paragraph 22 of IFRS 8.
12. **Almost two-thirds** of the respondents (a mix of preparers, users and standard-setters) **agreed** with the proposal to add paragraph 22(aa) to supplement the guidance in paragraph 22 of IFRS 8.
13. **Fewer than a third** of respondents expressed **disagreement** with the IASB's proposal. Their main concerns are as follows:
- (a) the examples of economic indicators are not reasonable;
 - (b) the proposed disclosure is addressing an enforcement concern;
 - (c) the proposed change would create divergence with US GAAP;
 - (d) the proposed changes to IFRS 8 are premature; and
 - (e) the proposed disclosure is not needed because it is covered elsewhere in IFRS.
- (a) Examples of economic indicators in par 22(aa) are not reasonable*
14. Respondents note that the economic indicators included in paragraph 22(aa) (ie profit margin spreads, sales growth rates etc) are not reasonable as aggregation criteria and would not help users to understand how operating segments are aggregated. Moreover, they think that the aggregation basis should be decided by management and judged by auditors.
15. Some are also of the view that including examples would prevent management from using other economic indicators to evaluate whether segments have similar economic features.

16. Members of the Interpretations Committee disagreed with the concern raised by respondents because they observed that the examples of economic indicators in the proposed paragraph are examples of *long-term financial performance indicators* and are not meant to be exhaustive.
17. The Interpretations Committee confirmed that the application of the aggregation criteria in paragraph 12 of IFRS 8 still requires a significant amount of judgement and it is management who should specify the economic indicators that have been evaluated (whether qualitative or quantitative) in aggregating the operating segments.
18. Nevertheless to avoid any confusion, the Interpretations Committee further recommended to the IASB that it should not include examples of economic indicators in the proposed new paragraph.

(b) The proposed disclosure is addressing an enforcement concern

19. To some respondents, the objective of the proposed additional disclosure appears to be written from an enforcer's perspective. They also think that the proposed additional disclosure stems from an implementation issue rather than from an actual deficiency in the guidance in IFRS 8.
20. The Interpretations Committee observed that the proposed amendment meets the objective of clarifying the nature of the disclosures that are required when operating segments have been aggregated and to ensure that the identification and aggregation of operating segments is transparent enough to provide investors with useful information.

(c) The proposed change would create divergence with US GAAP

21. Some respondents thought that the proposed amendment would create an unnecessary divergence with US GAAP.
22. The Interpretations Committee disagreed with this concern because, as noted above, by proposing the amendment to paragraph 22, the IASB has identified an area of improvement in IFRS 8 to ensure that the identification and aggregation of operating segments is transparent enough to provide investors with useful information.

(d) Changes to IFRS 8 are premature

23. A few respondents think that changes to IFRS 8 are premature and should not be made until a full Post-implementation Review of IFRS 8 has been completed.⁴
24. Members of the Interpretations Committee disagreed with this view. The proposed disclosure is to clarify 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). Consequently, this will provide increased clarity where diversity currently exists, yet not suggest whether or not aggregation of segments should be permitted and on what basis.

(e) The proposed disclosure is covered elsewhere in IFRS

25. Some of the respondents argue that the proposed amendment is not needed because paragraph 122 of IAS 1 *Presentation of Financial Statements* already requires entities to disclose judgements in applying an entity's accounting policies. Other respondents argue that the guidance in paragraphs 12 and 22(a) of IFRS 8 already requires the disclosure of the basis for aggregation of operating segments.
26. The Interpretations Committee observed that:
- (a) the guidance in paragraph 122 of IAS 1 is quite general and lacks specific detail about how this guidance would be applied when aggregating operating segments; and
 - (b) paragraph 22 only requires a disclosure on “whether operating segments have been aggregated” (emphasis added) but not necessarily the basis for such aggregation (ie “why operating segments were aggregated”).
27. Consequently, the Interpretations Committee thinks that the IASB should introduce a more specific requirement to IFRS 8 to disclose the basis for aggregating operating segments.

⁴ We noted a similar comment on the proposed amendment to paragraph 28(c) of IFRS 8 which is discussed in Agenda Paper 8C of February 2013.

Transition and effective date

28. A majority of respondents **agree** with the transition and effective date of the proposed amendment to paragraph 22 of IFRS 8. It would be applied in annual periods beginning on or after 1 January 2014 with earlier application permitted.

Interpretations Committee recommendation

29. On the basis of the analysis in the previous section, the Interpretations Committee recommends the IASB to:
- (a) proceed with the proposed amendment to paragraph 22 of IFRS 8 which proposes adding paragraph 22(aa); and
 - (b) include minor edits to paragraph 22(aa) to further clarify the focus of the proposed disclosure.
30. The recommended changes are included as appendices:
- (a) **Appendix A** shows the proposed amendment, highlighting differences from the currently effective Standard; and
 - (b) **Appendix B** shows revisions to the wording in the previously published Exposure Draft, following the recommendations in this paper.

Question to the IASB

1. Does the IASB agree with the Interpretations Committee's recommendations on finalising the amendment to IFRS 8 on the aggregation of operating segments, including the proposed wording changes, as described in Appendix A and Appendix B?

Appendix A—Changes for finalising the amendment

A1. The proposed amendment to paragraph 22(a) is presented below.

Amendment to IFRS 8 *Operating Segments*

Paragraph 22 is amended and paragraph 36C is 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
 - (aa) the judgements made by management in accordance with the aggregation criteria in paragraph 12. In particular, a brief description of the operating segments that have been aggregated in this way and the economic indicators that have been assessed in determining that they share similar economic characteristics; and
 - (b) types of products and services from which each reportable segment derives its revenues.

Transition and effective date

...

36C Annual Improvements to IFRSs 2010–2012 Cycle issued in [date] amended paragraphs 22 and 28⁵. An entity shall apply those amendments for annual periods beginning on or after 1 January 2014. Earlier application is permitted. If an entity applies those amendments for an earlier period it shall disclose that fact.

⁵ This corresponds to the proposed amendment to IFRS 8 on the reconciliation of segment assets. This issue is discussed in the IASB Agenda Paper 8C of February 2013.

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

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

A title and paragraphs BC30A and BC30B are added.

Aggregation of operating segments

BC30A The IASB received a request to consider including a disclosure in paragraph 22 that would require a description of the operating segments that have been aggregated and the economic indicators that have been assessed to decide whether operating segments have ‘similar economic characteristics’ in accordance with paragraph 12. The IASB observed that:

- (a) Paragraph 12 does not elaborate upon the meaning of ‘similar economic characteristics’ except to say that operating segments that share similar economic characteristics would be expected to exhibit a similar long-term financial performance. In addition, determining whether operating segments have ‘similar economic characteristics’ requires the use of judgement.
- (b) Paragraph 22(a) currently 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, disclosing whether operating segments have been aggregated. However, there is no explicit, or indeed apparent, requirement in paragraph 22(a) to disclose the aggregation of operating segments.

BC30B The IASB noted that the disclosure is complementary to the information required by paragraph 22(a). The IASB thinks that including a disclosure requirement in paragraph 22 would provide users with an understanding of the judgements made by management on how (and the reasons why) operating segments have been aggregated. The judgements made by management may relate to the application of any of the criteria in paragraph 12 of IFRS 8, which states that, two or more operating segments may be aggregated into a single operating segment if aggregation is consistent with the core principle of IFRS 8, the segments have similar economic characteristics and the segments are similar based on the factors listed in paragraphs 12(a)–(e). Consequently, the IASB added paragraph 22(aa) to complement the disclosure required in paragraph 22(a). The requirements in paragraph 22(b) remain the same and its wording has not been modified.

Appendix B—Changes from the Exposure Draft published in May 2012 following our recommendations in this paper

B1 The amendment to paragraph 22(a) is presented below. New text that is proposed to be added on the basis of the comment letter analysis, which arises from the proposed amendment included in the ED (May 2012), is shown with a double-underline. Text that is proposed to be deleted with respect to the proposed amendment included in the ED (May 2012), is shown with a double-strike-through.

Amendment to IFRS 8 *Operating Segments*

Paragraph 22 is amended and paragraph 36C is added. New text is underlined and deleted text is struck through.

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
 - (aa) where operating segments have been aggregated, the judgements made by management in accordance with the aggregation criteria in paragraph 12. In particular, a brief description of the operating segments that have been aggregated in this way and the economic indicators that have been assessed in determining that they share similar economic characteristics ~~(for example, profit margin spreads, sales growth rates etc);~~ and
 - (b) types of products and services from which each reportable segment derives its revenues.

Transition and effective date

...

36C *Annual Improvements to IFRSs 2010–2012 Cycle* issued in [date] amended paragraphs 22 and 28.⁶ An entity shall apply those amendments for annual periods beginning on or after 1 January 2014. Earlier application is permitted. If an entity applies those amendments for an earlier period it shall disclose that fact.

⁶ This corresponds to the proposed amendment to IFRS 8 on the reconciliation of segment assets. This issue is discussed in the IASB Agenda Paper 8C of February 2013.

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Aggregation of operating segments

BC~~30A~~ The IASB received a request to consider including ~~an additional~~ a disclosure in paragraph 22 that would require a description of the operating segments that have been aggregated and the economic indicators that have been assessed to decide that operating segments have ‘similar economic characteristics’ in accordance with paragraph 12. The IASB observed that:

- (a) paragraph 12 does not elaborate upon the meaning of ‘similar economic characteristics’ except to say that operating segments that share similar economic characteristics would be expected to exhibit a similar long-term financial performance. In addition, determining whether operating segments have ‘similar economic characteristics’ requires the use of judgement.
- (b) paragraph 22(a) currently 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, disclosing whether operating segments have been aggregated. However, there is no explicit, or indeed apparent, requirement in paragraph 22(a) to disclose the aggregation of operating segments.

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