STAFF PAPER

16 October 2014

Prepared for Capital Markets Advisory Committee Meeting

Project	**Post Implementation review of IFRS 8 *Operating Segments***		
Paper topic	Discussion of potential amendments to the Standard		
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Questions to the CMAC

Background

In 2013 the IASB published its Report and Feedback Statement "Post-implementation Review: IFRS 8 *Operating Segments"*. In that report, the IASB identified some specific areas for further investigation and potential amendments to the Standard.

Discussions for CMAC

Detailed below are the messages that we received from participants in the post-implementation review and our follow-up outreach. This investigative process also identified possible solutions to the issues raised by participants. We discuss below some potential amendments to IFRS 8, based on a discussion of those proposed solutions.

In this meeting, the staff would like to hear the CMAC's views on how effective any proposed amendments would be and what importance investors would attach to each proposal.

1. Aggregation of operating segments into reportable segments

<table>
<tr><th colspan="2">Summary of the problem and the results of our investigations</th></tr>
<tr><td colspan="2"> IFRS requires that individual operating segments are identified based on the level at which management view the business when taking decisions, such as allocating resources or assessing performance. This is known as the ‘management perspective’ and is the basis of reporting segments in IFRS.
Operating segments are reported separately if revenue, profit or loss, or assets are more than 10% of the whole. Operating segments can be aggregated together if they show ‘similar economic characteristics’.

Many investors think that too much aggregation of operating segments has taken place since the application of IFRS 8.
Investors have also indicated that segments are aggregated in a way that does not assist them in their use of valuation models. Instead, many investors would like the reported segments to be at a level that corresponds with an independent business.

We note, however, that the empirical evidence identified in the academic review shows that the number of reported segments has increased, and the number of single-segment entities decreased, since IFRS 8 was applied. Other findings include:

Many preparers and auditors think that determining when operating segments should be aggregated is difficult in practice because similar economic characteristics are not defined in the Standard.
Aggregation is an area that is subject to frequent regulatory challenges in some jurisdictions.

Some have suggested that these concerns could be addressed by providing more guidance on what is meant by ‘similar economic characteristics’. The Standard talks about this in terms of GM%, but many observe this is an arithmetic output, rather than necessarily demonstrating similar economic characteristics. </td></tr>
<tr><th colspan="2">Possible solutions to the problem -potential amendments to IFRS 8</th></tr>
<tr><td colspan="2">We could propose amending the Standard to include guidance on what is meant by ‘similar economic characteristics’. Some respondents suggested revenue growth, currency, inflation, industry KPIs, or markets as similar economic characteristics that could be used as aggregation criteria.</td></tr>
<tr><td>Benefits</td><td>Disadvantages</td></tr>
<tr><td>Should prevent inappropriate aggregation</td><td>Difficult to give examples of ‘similar economic characteristics’ without them becoming a list of requirements.</td></tr>
<tr><th colspan="2">Question for CMAC members</th></tr>
<tr><td colspan="2">
Do you agree with the above concerns regarding aggregation of operating segments?
If so, do you think the possible solution suggested above would help resolve the problem?
</td></tr>
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2. Preservation of trend data on reorganisation

Summary of the problem and results of our investigations	
Trend analysis is an important tool for investors. We received many examples from participants of entities that have undergone frequent internal reorganisation. Because the identification of operating segments is based on management's perspective of how the business is managed, each internal reorganisation results in a change to the reported segments. Frequent changes to the reported segments could prevent investors from carrying out trend analyses as part of their decision-making process. IFRS requires that comparative information is restated whenever there is a restructuring. Because information about trends by segment is particularly useful to investors, however, some participants suggested that the number of comparative periods required for this information should be increased to 3 or 5 years. However, the IASB acknowledge that this might place an unreasonable burden on preparers. Since we began investigating this issue, we've heard varied messages about whether information about operating segments should be required for additional comparative periods. Investors think that this would be very useful information. Operating segment information is important to them and trends within that information are especially useful. Some investors think that the operating segment disclosures are the most important single source of data about the entity. Preparers, in general, think that it could be onerous to prepare restated information and are also concerned that additional one-off external costs would be incurred in auditing the restated information. They also think that, in some cases, the information might not be available if the required analysis had not been collected in the earlier accounting periods. Others think that the information is likely to be available as restated information would have been used when management made their decision to reorganise the management perspective. They argue that sophisticated reporting systems that consist of a large number of sub-entities can easily be reorganised when the management structure changes.	
Possible solution to the problem- potential amendments to IFRS 8	
We could propose including a requirement that, on a reorganisation of the management perspective, operating segment information is provided for [3] or [5] comparative periods, unless it is not practicable to do so. Some also think that quarterly information for the previous 4 quarters should be presented when the new structure is first used for financial reporting.	
Benefits	*Disadvantages*
Important to investors A significant improvement to financial reporting	Onerous for preparers Additional, one-off audit expense on every reorganisation Some think 5 years is longer than underlying trends last
Question for CMAC members:	
Do you require more than one year's restated analysis when looking at an internal reorganisation? How many years do you use in trend analysis? How important is the quarterly analysis to you?	

3. Improvements to the understandability of the reconciliation

Summary of the problem identified and the results of our investigations
Segment information prepared in accordance with the management perspective will not necessarily agree with the financial statements. This is because some parts of the entity, such as corporate HQs, may not meet the definition of an operating segment. In addition, the information disclosed may not agree as to amount if the management perspective uses a different measurement basis or definition of operating result, eg EBITDA. Consequently, the Standard requires that amounts reported in the operating segment note must be reconciled with the amounts in the financial statements. Most preparers think that the requirements for reconciliations are clear and easy to comply with. However, a few preparers think that the reconciliations are complex and that the requirements are not clear. Some were confused about how to show the different elements of the reconciliation separately. Some regulators complain that reconciliations may be poorly prepared and do not comply with the Standard when reconciliations of some specified financial statement line items are omitted. Regulators comment that preparers may omit some reconciliations or fail to disclose information about 'other segments' separately from reporting segments. Many investors find the reconciliations difficult to understand because explanations of reconciling items are often insufficient to allow investors to understand the nature of the adjustment.

Possible solutions to the problem -potential amendments to IFRS 8
1. We could propose amending the Standard to provide additional examples of how the reconciliation should be prepared. 2. We could clarify that reconciling items that arise from use of non-IFRS measurement bases should be shown separately from reconciling items that arise due to non-reported segments of the entity. 3. The information value could also be improved by providing a fuller description of each reconciling item.

Benefits	*Disadvantages*
Reinforces existing requirements, facilitating enforcement Clarifies the requirements for preparers Results in more understandable information for investors	Additional examples could result in a 'boilerplate' format of reconciliation which doesn't provide useful information

Question for CMAC members:
Are you concerned about the quality of information contained in the reconciliations? How do you think that the IASB should change the requirements to improve the quality of presented reconciliations?

4. Allocation of reconciling items to individual segments

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<tr><td colspan="2">Summary of the problem identified and results of our investigations</td></tr>
<tr><td colspan="2">Investors think that the reconciliations do not provide enough information to understand how the amount relates to each segment. Many investors have requested that reconciliations should be prepared on a segment-by-segment basis. Preparers and others have cautioned against a segment-by-segment reconciliation because they think that would result in a need to allocate reconciling items to segments when there is no systematic basis on which to do so. In accordance with that view, non-systematic allocations would reduce the value of the segment information produced.</td></tr>
<tr><td colspan="2">Possible solutions to the problem-potential amendments to IFRS 8</td></tr>
<tr><td colspan="2">1. We could propose amending the Standard to require that items in the reconciliation are allocated segment-by-segment.</td></tr>
<tr><td>Benefits</td><td>Disadvantages</td></tr>
<tr><td>Provides more useful information to investors, which allows them to assess the effect of significant adjustments, such as goodwill amortisation or remeasurement, on individual segments.</td><td>Goes against the ‘management perspective ‘ view

Value of reported information may be reduced by arbitrary or non-systematic allocations, providing less meaningful or relevant information.

Onerous for preparers

May represent a competitive disadvantage to the entity because it could highlight confidential information</td></tr>
<tr><td colspan="2">2. We could propose including context about the usefulness of this information in IFRS 8 and requiring that fuller descriptions of separate reconciling items are made.</td></tr>
<tr><td>Benefits</td><td>Disadvantages</td></tr>
<tr><td>Provides more useful information to investors</td><td></td></tr>
<tr><td colspan="2">Question for CMAC members</td></tr>
<tr><td colspan="2">Do you think that reconciling items should be allocated to individual segments? If so, how would you use that further information? Would narrative explanations of the adjustments be sufficient for you to perform your own allocations?</td></tr>
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5. Increasing the number of reported line items

<table>
<tr><td colspan="2">Summary of the problem and results of our investigation</td></tr>
<tr><td colspan="2">Apart from a requirement to present a measure of profit or loss, the Standard does not generally prescribe which line items should be reported by segment. As part of the management perspective approach the entity reports those line items reported internally and used by management when assessing performance or allocating resources.

Some investors think that the use of internally reported line items does not always provide them with the information they need to make comparisons across entities. Investors report that some line items have a special relevance to their decision-making:

• non-cash expenses such as depreciation and amortisation;
• investing activities such as capital expenditures, marketing, and research and development because this helps indicate the future direction of the business;
• impairment of goodwill in order to understand poor performance by some sectors and the outcome of acquisitions;
• non-recurring items; and
• other line items that affect future cash flows.

Most investors that we spoke to would like us to mandate particular line items for segment disclosures. A few investors noted, however, that the importance of different line items varies by industry/sector (eg research and development is very important for pharmaceutical entities, but not for the construction industry). These investors think that we should not specify individual line-items in order to avoid creating non-relevant, boilerplate disclosures.</td></tr>
<tr><td colspan="2">Possible solutions to the problem - potential amendments to IFRS 8</td></tr>
<tr><td colspan="2">IFRS 8 paragraph 23 requires nine specific types of line items, including revenue, are reported ‘if included in the measure of segment P&L reviewed by the chief operating decision maker (the ‘CODM’) or otherwise regularly provided to the CODM’.</td></tr>
<tr><td colspan="2">1. We could propose replacing that condition with ‘unless it impracticable to do so’.

2. We could propose extending the disclosure requirements to include lines such as capital expenditure, R&D, marketing, goodwill impairment. However, it could be very difficult to agree what those lines would be as they vary by sector.

3 Propose including general guidance about investors’ needs, what types of line items are important and why.</td></tr>
<tr><td>Benefits</td><td>Disadvantages</td></tr>
<tr><td>Provides more useful information to investors because it would enable them to better model data</td><td>Conflicts with the ‘management perspective’ principle

Onerous for preparers

May put IFRS preparers at a competitive disadvantage</td></tr>
<tr><td colspan="2">Question for CMAC members</td></tr>
<tr><td colspan="2">How would you define the line items that should be reported by segment? How would you word that requirement to ensure you receive the information that you need, rather than boilerplate disclosures?</td></tr>
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