European Securities and Markets Authority

The Chair

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ESMA32-61-179

Mr Jean-Paul Gauzès
President
European Financial Reporting
Advisory Group (EFRAG)
35 Square de Meeûs
1000 Brussels
Belgium

Ref: IASB's Exposure Draft *Improvements to IFRS 8 Operating Segments*

~~Dear Mr Gauzès,~~ Dear Jean-Paul,

The European Securities and Markets Authority (ESMA) thanks you for the opportunity to contribute to the IASB's due process regarding the Exposure Draft (ED) *Improvements to IFRS 8 Operating Segments*. We are pleased to provide you with the following comments with the aim of improving the transparency and enforceability of financial statements.

Like EFRAG, ESMA is supportive of these proposed amendments as they will help increasing consistency in the application of IFRS 8 and will address some of the issues ESMA already raised in its response to the IASB's Post Implementation Review (PIR) of IFRS 8.

In particular, ESMA welcomes the IASB's proposal to emphasise the operating nature of the role of the Chief Operating Decision Maker (CODM). However, ESMA would suggest that the IASB clarifies how to address situations in which the CODM may differ from the decision maker in charge of the allocation of resources.

Unlike EFRAG, ESMA also supports the proposed requirement to disclose when an entity's reportable segments identified in the financial statements differ from segments identified in other parts of the '*annual reporting package*'. This requirement will complement ESMA's 2016 European Common Enforcement Priorities (ECEP) which encourage consistency between Alternative Performance Measures (APMs) presented outside an issuer's financial statements, including APMs by segment, and those presented inside the financial statements. However, ESMA recommends the IASB to refrain from providing a definition of '*annual reporting package*' and instead we suggest to refer to the terminology already adopted in paragraph B88(a) of IFRS 15 *Revenue from Contracts with Customers*.

Finally, unlike EFRAG, ESMA is also concerned about the proposed wording of the new paragraph 20A allowing the disclosure of information not reviewed by or regularly provided to the CODM, which may create opportunities for disclosure arbitrage of APMs in the notes to the financial statements and therefore we suggest the IASB reconsiders this wording.

Our detailed comments on the ED are set out in Appendix I to this letter. Please do not hesitate to contact us should you wish to discuss all or any of the issues we have raised.

Yours sincerely,

Steven Maijoor

Appendix I – ESMA's detailed answers to the questions in the ED

Question 1

The Board proposes to amend the description of the chief operating decision maker with amendments in paragraphs 7, 7A and 7B of IFRS 8 to clarify that:

(a) the chief operating decision maker is the function that makes operating decisions and decisions about allocating resources to, and assessing the performance of, the operating segments of an entity;

(b) the function of the chief operating decision maker may be carried out by an individual or a group—this will depend on how the entity is managed and may be influenced by corporate governance requirements; and

(c) a group can be identified as a chief operating decision maker even if it includes members who do not participate in all decisions made by the group (see paragraphs BC4–BC12 of the Basis for Conclusions on the proposed amendments to IFRS 8).

The Board also proposes in paragraph 22(c) of IFRS 8 that an entity shall disclose the title and description of the role of the individual or the group identified as the chief operating decision maker (see paragraphs BC25–BC26 of the Basis for Conclusions on the proposed amendments to IFRS 8).

Do you agree with the proposed amendments? Why or why not? If not, what do you propose and why?

1. ESMA generally agrees with the proposed amendments to paragraphs 7, 7A and 7B.Particularly, the new emphasis on the operating role of the CODM is in line with ESMA's response to the PIR to IFRS 8[1], in which ESMA recommended that: "To reduce the potential for confusion or too much leeway in defining the CODM, [...] the operating nature of the function should be emphasised in the CODM definition". ESMA also agrees with these amendments as they are consistent with the management approach which underlies both IFRS 8 and the US GAAP ASC 820 and therefore will help maintaining convergence between IFRS and US GAAP in the area of segment reporting.

2. However, ESMA would suggest the IASB to consider the possibility that the decision maker for operating matters may differ from the chief decision maker in charge of strategic decision including the decision on the allocation of resources. Similarly, the CODM may differ from the person or group that is responsible for assessing performance. If this is the case, there might be an inconsistent application of the CODM concept and therefore ESMA would suggest the IASB to clarify how to address any of these situations and whether, for

[1] ESMA's Report on IFRS 8 can be found here: https://www.esma.europa.eu/sites/default/files/library/2015/11/2011_372.pdf

example, the 'operating' role of the CODM should have prevalence over the strategic decision maker or performance assessor.

Question 2

In respect of identifying reportable segments, the Board proposes the following amendments:

(a) adding a requirement in paragraph 22(d) to disclose an explanation of why segments identified in the financial statements differ from segments identified in other parts of the entity's annual reporting package (see paragraphs BC13–BC19 of the Basis for Conclusions on the proposed amendments to IFRS 8); and

(b) adding further examples to the aggregation criteria in paragraph 12A of IFRS 8 to help with assessing whether two segments exhibit similar long-term financial performance across a range of measures (see paragraphs BC20–BC24 of the Basis for Conclusions on the proposed amendments to IFRS 8).

Do you agree with the proposed amendments? Why or why not? If not, what do you propose and why?

3. ESMA strongly agrees with the proposed amendment to paragraph 22(d), which goes into the direction expressed in our response to the PIR on IFRS 8 that consistency between segment information presented inside and outside the financial statements is key.

4. As per our enforcement experience in Europe[2], when operating segments identified in the management report differed from those in the financial statements, IFRS 8 had been applied incorrectly.

5. The requirement to add an explanation would in fact have at least three benefits:

   - it introduces an element of discipline in preparing segment information, so as to ensure that the management view of segments is not presented in arbitrarily different ways just because segment information are presented in different statements;

   - it removes any potential barriers to the users' proper understanding of segment information presented in the financial statements; and

   - it eliminates any possibility of 'arbitrage' between the two documents of statements and another one.

[2] Please see the Decision EECS/0211-04 in the 11th Extract from the EECS Database

6. ESMA highlights the importance of the statement in the proposed paragraph 19A: "*Identification of segments is based on how an entity's operations are reported to the chief operating decision maker.*" ESMA suggests that IASB provides further explanation on this statement, either in the Basis for Conclusions or in the Standard, to indicate that there is a presumption that information that is *reported* to the CODM is also *reviewed* by the CODM. As already suggested in ESMA's response to the PIR of IFRS 8, this will also reduce diversity in practice, ensuring better compliance with the core principle and enhance the enforceability of IFRS 8.

7. Consistency between the reportable segments presented inside and outside the financial statements is key as highlighted by the statement included in the ESMA 2016 European Common Enforcement Priorities[3]: *"ESMA expects that the elements presented in the segment information in the financial statements and those included in the press releases, management reports or analysts' presentations are consistent in terms of segments presented and measures disclosed."*

8. ESMA suggests that the same consistency is required also for segments reported inside the interim financial statements and outside those statements. ESMA would see no reason why the rationale applicable to the required consistency for annual financial statements, should not apply also to interim statements.

9. The definition of '*annual reporting package*' may overlap with jurisdiction-specific definitions provided for by local applicable laws. For example, the IASB's definition of annual reporting package, although similar to the European definition of 'annual financial reports'[4], is broader as it comprises also different forms of communication to users, including investors presentation.

10. Nevertheless, ESMA would recommend the IASB to refrain from providing a definition of '*annual reporting package*' and use instead to the terminology already adopted in paragraph B88(a) of IFRS 15 *Revenue from Contracts with Customers* which refers to: '*disclosures presented outside the financial statements (for example, in earnings releases, annual reports or investor presentations)*'.

11. Finally, ESMA suggests that the concept behind the 'annual reporting package' would be best addressed as part of the Principles of Disclosures project.

12. ESMA generally agrees with the inclusion of further examples to the aggregation criteria in paragraph 12A as this would improve the enforceability. However, in ESMA's view this improvements would be limited unless the term 'often' in that paragraph is replaced with

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[3] ESMA's 2016 ECEP can be found here: https://www.esma.europa.eu/sites/default/files/library/esma-2016-1528_european_common_enforcement_priorities_for_2016.pdf

[4] For example, Article 4 of the Transparency Directive (Directive 2004/109/EC)[4], defines the *annual financial reports* as comprising of the following documents: (a) the audited financial statements; (b) the management report; and (c) statements made by the persons responsible within the issuer that the financial statements are prepared in accordance with the applicable set of accounting standards and give a true and fair view.

‘only’ so to reproduce the wording used in the last part of BC23 In fact, the reference to the fact that only **<u>‘often’</u>** operating segments may be viewed as having similar economic characteristics if they are similar across a range of measures of long-term financial performance, would limit the enforceability of this part of the proposed amendments.

Question 3

The Board proposes a clarifying amendment in paragraph 20A of IFRS 8 to say that an entity may disclose segment information in addition to that reviewed by, or regularly provided to, the chief operating decision maker if that helps the entity to meet the core principle in paragraphs 1 and 20 of IFRS 8 (see paragraphs BC27–BC31 of the Basis for Conclusions on the proposed amendments to IFRS 8).

Do you agree with the proposed amendment? Why or why not? If not, what do you propose and why?

13. The rationale of the new paragraph 20A is to allow an entity to disclose additional information to comply with the disclosure objective in par. 20 of IFRS8. However, ESMA notes that according to paragraph 5(b) of IFRS 8, operating segments are those whose operating results are regularly reviewed by the entity's chief decisions maker. ESMA is concerned that the proposed wording would have some unintended consequences.

14. ESMA disagrees that disclosure of additional information that is not reviewed by or reported to the CODM would improve the quality of the IFRS 8 disclosures. In ESMA's view, it is important that the information provided by entities to comply with IFRS 8 have a clearly defined scope, which is currently provided for by the definition of an operating segment in paragraph 5 of IFRS 8. ESMA believes that the disclosures on IFRS 8 should not go beyond this scope because this would be inconsistent with the management approach that underlies the standard.

15. From an enforcement perspective, the introduction of this requirement could open up possibilities for disclosure arbitrage. For example, entities might decide to provide segment-specific (or entity-wide) Alternative Performance Measures (APMs) inside the financial statements on the grounds that they are consistent with the principle in paragraph 20 of IFRS 8, although they are not regularly reviewed to the CODM and not prepared in accordance with IFRS, with the sole objective of avoiding compliance with the requirements in ESMA's APM Guidelines.

16. Furthermore, ESMA believes that the IASB should refrain from introducing new requirements relating to general issues such as those relating to the approach to the disclosure of additional information. In ESMA's view, such general issues should be addressed more systematically and effectively as part of the Disclosure Initiative project.

Question 4

The Board proposes a clarifying amendment in paragraph 28A of IFRS 8 to say that explanations are required to describe the reconciling items in sufficient detail to enable users of the financial statements to understand the nature of these reconciling items (see paragraphs BC32–BC37 of the Basis for Conclusions on the proposed amendments to IFRS 8).

Do you agree with the proposed amendment? Why or why not? If not, what do you propose and why?

17. ESMA agrees with the proposed amendments in paragraph 28A. However, we note that paragraph 16 of IFRS 8 requires information about other business activities and operating segments that are not reportable to be combined and disclosed in a generic "all other segments" category that is presented separately from other reconciling items in the reconciliations prescribed in paragraph 28.

18. As indicated in its answer to the PIR of IFRS 8, ESMA noted that "*43% of the sample combined the information from "all other segments" and other reconciling items (inter-segments eliminations, unallocated assets or liabilities)*".

19. In order to improve the implementation of the requirements in paragraph 28, ESMA suggests including a reference in paragraph 28A(c) to "corporate headquarters" and "some functional departments", in line with paragraph 6 of IFRS 8. In addition, ESMA recommends to clarify, for instance in the basis for conclusions, that corporate headquarters or some functional departments that engage in business activities from which an entity may not earn revenues, would neither qualify as operating segments, nor as other business activities and therefore they cannot be disclosed as part of "all other segments", but they shall be disclosed as part of the reconciliation items.

Question 5

The Board proposes to amend IAS 34 to require that after a change in the composition of an entity's reportable segments, in the first interim report the entity shall present restated segment information for all interim periods both of the current financial year and of prior financial years, unless the information is not available and the cost to develop it would be excessive (see paragraphs BC2–BC10 of the Basis for Conclusions on the proposed amendments to IAS 34).

Do you agree with the proposed amendment? Why or why not? If not, what do you propose and why?

20. ESMA agrees with the proposed amendments to IAS 34. In addition, ESMA suggests including in IAS 34 the requirement in paragraph 30 of IFRS 8 to disclose "*in the year in*

which the change occurs segment information for the current period on both the old basis and the new basis of segmentation", when segment information for previous periods is not restated. This requirement would apply, unless the necessary information is not available and the cost to develop it would be excessive.