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## **Amendments to IFRS 8 *Operating Segments* and IAS 34 *Interim Financial Reporting* Issues Paper**

### **Objective**

- 1 The objective of this session is to obtain EFRAG CFSS members' views on some proposed amendments in the Exposure Draft ED/2017/2 *Improvements to IFRS 8 Operating Segments – Proposed amendments to IFRS 8 and IAS 34 Interim Financial Reporting* (the 'ED') and on the initial assessment made by EFRAG in its draft comment letter, in preparation for the ASAF meeting in July 2017.

### **Agenda papers**

- 2 In addition to this paper, the following agenda papers are provided for the session for background only:
  - (a) Agenda paper 11-02 ASAF Paper 05 on IFRS 8 ED; and
  - (b) Agenda paper 11-03 EFRAG Draft Comment Letter on Improvements to IFRS 8 *Operating Segments*.

### **Background**

- 3 The IASB completed its post-implementation review of IFRS 8 (PIR of IFRS 8) in July 2013. The IASB concluded that there were some areas in IFRS 8 that needed further investigation, while staying converged with the equivalent US GAAP requirements. In March 2017, the IASB published the ED that addresses these issues and requests comments by 31 July 2017. EFRAG published its draft comment letter on the ED on 26 April 2017 and requests comments by 17 July 2017. A copy of the draft comment letter is included as agenda paper 11-03 as background information.
- 4 IFRS 8 is substantially converged with the US GAAP equivalent literature Statement of Financial Accounting Standards (SFAS) 131 Disclosures about Segments of an Enterprise and Related Information (Accounting Standards Codification Topic 280 Segment Reporting), which was subject to a post-implementation review by the Financial Accounting Foundation (FAF) in 2012.
- 5 Both the IASB and the FAF concluded that the management perspective in IFRS 8 is the correct basis on which to identify and provide information about operating segments.
- 6 This paper summarises the proposed amendments to IFRS 8, the view expressed by EFRAG in its draft comment letter and the feedback received from the EFRAG User Panel on those amendments.

- 7 The ED proposes to:
- (a) **Clarify the role and function of the CODM as the one that makes operating decisions and decisions about allocating resources to, and assessing the performance of, the operating segments of an entity.**
  - (b) Explain that the CODM may be an individual or a group (for example an executive committee).
  - (c) Explain the role of any non-executive members in the CODM.
  - (d) Require an entity to disclose the title and description of the role of the individual or the group that is identified as the chief operating decision maker which may also include non-executive members.
  - (e) **Add a requirement to disclose an explanation of why segments identified in the financial statements differ from segments identified in other parts of an entity's annual reporting package.**
  - (f) **Add further examples of similar economic characteristics to the aggregation criteria in order to help with the assessment of whether two segments exhibit similar long-term financial performance.**
  - (g) Clarify that an entity may disclose segment information in addition to that regularly reviewed by the CODM.
  - (h) Clarify that reconciling items shall be given with sufficient detail in order to enable users of financial statements to understand their nature.
  - (i) **Require an entity to restate segment information for all interim periods presented earlier (both of the current financial year and of prior financial years) in the first interim report following a change in the composition of an entity's reportable segments.**
- 8 EFRAG CFSS and EFRAG TEG members are asked to comment on the proposals highlighted in bold which are seen as having a greater impact on the information used by the users of financial statements and will be discussed at the ASAF meeting. These are discussed in more detail in the paragraphs below.

### **Function of the Chief Operating Decision Maker**

#### *Proposal in the ED*

- 9 The proposed amendment emphasises that the function of the CODM is the one that makes operating decisions and decisions about allocating resources to, and assessing the performance of, the operating segments of an entity. The amendment clarifies that the CODM is not necessarily a manager with a specific title but rather a function.

#### *EFRAG's view in its draft comment letter*

- 10 EFRAG agrees with the proposal to clarify the role of the CODM, given that the identification of the CODM is central to the application of IFRS 8.
- 11 EFRAG acknowledges that judgement is required to identify the CODM, as the function will vary from entity to entity depending on facts and circumstances as well as jurisdictional legal and governance requirements. However, EFRAG has learned that the reference to 'allocation of resources' has created some ambiguity in identifying the CODM, as some consider that the allocation of resources to operating segments is a strategic function rather than an operating decision.
- 12 EFRAG is therefore of the view that the amendment should also explain that the **primary function** of the CODM is to assess the performance of an entity's operating segments and make operating decisions about them. Additionally, the CODM can also be responsible for the allocation of resources and/or some other strategic

decisions; however, these additional functions do not preclude a particular individual or group of being identified as the CODM.

*EFRAG User Panel feedback*

- 13 The EFRAG User Panel generally welcomed the clarification of the function of the CODM. However, some EFRAG User Panel members expressed concerns that the level of identification of the CODM was too high and it focused on the top management layer which in some circumstances resulted in too little granularity/disaggregation and too few operating segments being reported by entities.

**Question for EFRAG CFSS and EFRAG TEG members**

- 14 Do you agree that the proposed clarification to the function of the CODM will help with identifying the CODM?

**Consistency of reportable segments**

*Proposal in the ED*

- 15 Despite the management perspective in IFRS 8, it appears that entities report different segments outside the financial statements from those identified in the financial statements.
- 16 The proposed amendments to IFRS 8 would require an entity to explain in the financial statements why the reportable segments identified in the financial statements differ from those identified in other parts of the 'annual reporting package'.
- 17 IFRS 8 amendments also introduce a proposed definition for 'annual reporting package' being a set of one or more documents that are published at approximately the same time as the entity's annual financial statements, communicate the entity's annual results and are publicly available.

*EFRAG's view in its draft comment letter*

- 18 EFRAG has expressed preliminary reservations about whether it is within the IASB's mandate to require entities to explain in their financial statements why reportable segments outside of the financial statements are different to the segments reported inside the financial statements.
- 19 EFRAG also explains that the proposal risks creating a broader precedent that future amendments to IFRS Standards might require entities to explain other differences between information reported inside and outside the financial statements. Furthermore, the proposed definition of an entity's 'annual reporting package' may prove difficult to apply in practice, in view of the variety of reporting requirements that apply at national/jurisdictional level.
- 20 EFRAG recommends that the IASB should liaise with relevant authorities to examine the consequences of the proposal and determine the most appropriate course of action, in order to ensure that users receive consistent operating segment information.
- 21 In its draft comment letter, EFRAG has included a specific question to constituents on this proposal which is reproduced in the questions to EFRAG CFSS and EFRAG TEG members in paragraphs 24-25 below.

*EFRAG User Panel feedback*

- 22 EFRAG User Panel members did not see a problem with having differently reported operating segments inside and outside the financial statements. In their view, there were different views of how management looked at its business and therefore

different segmentations, which deserved a place in the financial statements, if regarded as useful for users.

- 23 EFRAG User Panel members were concerned that requiring entities to explain why their segmentation differed inside and outside the financial statements might discourage entities identifying different segments and lead to investors losing additional segment information which is currently reported outside the financial statements.

**Questions for EFRAG CFSS and EFRAG TEG members**

- 24 Do you agree with EFRAG's preliminary reservations over the proposal to require an entity to explain in the financial statements how and why the reportable segments identified in the financial statements differ from those identified in other parts of the 'annual reporting package'? If not, why? If you agree with EFRAG's preliminary position, what steps, if any, do you think the IASB could take to address the lack of consistency in identifying operating segments across an entity's communications as to address users' and regulators' concerns?
- 25 What are your views on the proposal to define an 'annual reporting package' and the proposed definition?

**Aggregation of reportable segments**

*Proposal in the ED*

- 26 The feedback from the PIR of IFRS 8 suggested that IFRS 8 is difficult to apply when aggregating operating segments. Additionally, users of financial statements reported that too much aggregation takes place, which did not assist them in their use of valuation models. Some users also noted difficulties with the meaning of 'similar economic characteristics' such as a gross margin percentage which is not always useful guidance.
- 27 To address these concerns, the IASB is proposing to emphasise in IFRS 8 that certain criteria must be satisfied before two or more segments may be aggregated and include additional examples of economic characteristics such as revenue growth and return on assets.

*EFRAG's view in its draft comment letter*

- 28 In its draft comment letter, EFRAG agrees with the proposal and considers it as an acceptable balance between promoting discipline in the application of the aggregation criteria while retaining a principle-based approach, but would caution against any further prescription.
- 29 EFRAG also agrees with the proposal to include additional examples of economic characteristics to IFRS 8 in order to emphasise that operating segments with similar economic characteristics would normally be expected to have a range of measures in common, instead of depending on a single measure of financial performance.

*EFRAG User Panel feedback*

- 30 EFRAG User Panel welcomed the proposed amendment. Additionally, a suggestion was made that if the segmentation started at a sufficiently low level then the entity would work up the reportable segments by aggregating operating segments exhibiting similar economic characteristics as is already required by IFRS 8.

**Question for EFRAG CFSS and EFRAG TEG members**

- 31 Do you agree with EFRAG's preliminary views on this proposal?

## **Restatement of segment information**

### *Proposal in the ED*

- 32 Feedback from the PIR of IFRS 8 confirmed that segment trend analysis is an important tool for users of financial statements. Some users asked for three to five years of comparative segment information after an internal reorganisation. However, other users said that segment information for the previous year was more important than information that is several years old.
- 33 Currently, IFRS 8 requires comparative information for earlier periods to be restated whenever an entity changes the composition of its reportable segments. However, an entity does not need to provide restated information for a comparative interim period until information for that corresponding current interim period is reported.
- 34 To respond to the request from users, the IASB is proposing to add paragraph 45A to IAS 34 to require all interim periods presented earlier (current and prior years) to be restated and presented in the first interim financial report after a change in the composition of reportable segments, unless the information is not available and the cost to develop it would be excessive.
- 35 The determination of whether the information is not available and the cost to develop it would be excessive shall be made for each individual item of disclosure. The entity shall disclose whether it has restated the segment information for earlier periods.

### *EFRAG's view in its draft comment letter*

- 36 EFRAG agrees with the proposal and considers that it would enable users of the financial statements to update their modelling of data and trend information in a timely manner.

### *EFRAG User Panel feedback*

- 37 EFRAG User Panel members welcomed the proposal which would provide restated segment information at the earliest interim report following a change in the composition of an entity's reportable segments.

#### **Questions for EFRAG CFSS and EFRAG TEG members**

- 38 Do you agree with the proposal to restate segmental information in the interim period?
- 39 Have you received feedback from preparers about this proposal?
- 40 Do you have any additional comments/ remarks on the proposed amendments to IFRS 8 which were not discussed in detail in this paper?