

This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG TEG-CFSS. The paper forms part of an early stage of the development of a potential EFRAG position. Consequently, the paper does not represent the official views of EFRAG or any individual member of the EFRAG Board or EFRAG TEG-CFSS. The paper is made available to enable the public to follow the discussions in the meeting. Tentative decisions are made in public and reported in the EFRAG Update. EFRAG positions, as approved by the EFRAG Board, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

## **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 and EFRAG TEG members' views on the following in preparation for the ASAF meeting in December 2017:
  - (a) feedback received to the IASB 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
  - (b) IASB Staff proposals on areas in the ED they envisage require further analysis.
- 2 At its meeting on 14 November 2017, the IASB will discuss the feedback received on the ED and IASB Staff proposals on areas they believe require further work. This paper has been developed based on the agenda papers that will be discussed at this meeting. The EFRAG Secretariat will provide a verbal update of the IASB discussion and any decisions taken.

### **Agenda papers**

- 3 In addition to this paper, agenda paper 13-02 (EFRAG Final Comment letter on the ED) is provided as background information.
- 4 The EFRAG Secretariat expect the ASAF papers on IFRS 8 to be available after 14 November 2017, which is after the deadline for publication of this paper. We will upload the ASAF papers as background information as soon as they are available. Our understanding is that they will be broadly similar to the IASB November meeting papers on IFRS 8.

### **Background**

- 5 The IASB completed its post-implementation review of IFRS 8 (PIR of IFRS 8) in July 2013, and concluded that there were some areas in IFRS 8 that needed further investigation, while staying converged with the equivalent US GAAP requirements.
- 6 The findings of the PIR of IFRS 8 reported that several users expressed dissatisfaction with the information being reported under IFRS 8, which they regard to be one of the most important pieces of information provided in the financial statements for users. The feedback also highlighted that a source of concern stemmed from the mistrust some investors have in management's intentions and sometimes find that operating segments are reported in such a way as to obscure rather than to inform.
- 7 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. 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.

- 8 In March 2017, the IASB published the ED and requested comments by 31 July 2017. EFRAG published its comment letter on the ED on 3 August 2017 (see agenda paper 13-02 provided as background information).
- 9 The ED included nine proposals summarised as follows:
  - (a) Proposal 1 - 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) Proposal 2 - Explain that the CODM may be an individual or a group (for example an executive committee);
  - (c) Proposal 3 - Explain the role of any non-executive members in the CODM;
  - (d) Proposal 4 - 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) Proposal 5 - 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) Proposal 6 - 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) Proposal 7 - Clarify that an entity may disclose segment information in addition to that regularly reviewed by the CODM;
  - (h) Proposal 8 - Clarify that reconciling items shall be given with sufficient detail in order to enable users of financial statements to understand their nature; and
  - (i) Proposal 9 - 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.

### **Summary of comments received**

- 10 The IASB received 76 comment letters on the ED. Nearly all respondents supported the IASB's intention to improve segment reporting. Furthermore, respondents generally supported/or did not object to the following proposals, subject to clarifications of some areas of the proposals:
  - (a) CODM's identity must be disclosed (Proposal 4);
  - (b) Clarify that additional segment disclosures can be made (Proposal 7);
  - (c) Explain reconciling items in sufficient detail (Proposal 8); and
  - (d) Changes in segmentation (Proposal 9).
- 11 Despite supporting the intention of the ED, respondents generally had mixed views on a number of proposals:
  - (a) Preparers, national standard-setters, accounting firms and accounting associations expressed mixed views in a sense that they agreed with some proposals whilst expressing a number of concerns on the proposals regarding the CODM, (Proposals 1-3), linking IFRS 8 segments with other parts of the

annual reporting package (Proposal 5) and guidance on the aggregation criteria (Proposal 6);

- (b) Overall, investors generally thought the proposals were not sufficient and encouraged the IASB to make changes that are more significant. They noted that they would like entities to provide more detailed segment information in their financial statements;
- (c) Regulators noted that the amendments will help in enforcing IFRS 8 requirements, but asked for more guidance on some of the proposed amendments including clarifications to help identify the CODM (Proposals 1 and 2) and linking IFRS 8 segments with other parts of the annual reporting package (Proposal 5).

*EFRAG's comment letter*

- 12 In its comment letter, EFRAG supported most of the proposed amendments, as they provide useful clarifications of the existing requirements in IFRS 8 and should therefore improve the quality of disclosure of operating segment information. EFRAG made some suggestions for further clarification and drafting suggestions on some of the proposals.
- 13 However, EFRAG disagreed with the proposal to require an entity to explain in the notes why the reportable segments identified in an entity's financial statements are different to the segments reported outside the financial statements. EFRAG also disagreed with the proposal to define an entity's 'annual reporting package', as the proposed definition may prove difficult to apply in practice.

**Proposals with significant comments and IASB Staff analysis**

- 14 Based on the comments received from respondents and the concerns raised, the IASB Staff have identified the following areas as requiring further analysis.
  - (a) Clarifications to help identify the CODM (Proposals 1-3);
  - (b) Linking IFRS 8 segments with other parts of the annual reporting package (Proposal 5); and
  - (c) Clarify criteria for aggregation of segments (Proposal 6).
- 15 The EFRAG Secretariat note that these areas are generally in line with the areas of concern/requiring clarification reported by EFRAG in its comment letter (see paragraph 12 and 13 above).

*Clarifications to help identify the CODM (Proposals 1-3)*

- 16 Many respondents asked for guidance or clarification on the following:
  - (a) what constitutes an operating decision; for example whether a decision about allocation of resources is a strategic or an operating decision;
  - (b) who the CODM is when the decision maker who makes operating decisions differs from the decision maker in charge of the allocation of resources; and
  - (c) whether, and when, a board of directors can be a CODM.
- 17 In addition, some respondents asked what 'amounts reviewed by or regularly provided to the CODM' means in practice in situations when management can access various reports; these situations become increasingly common as technology in general evolves.
- 18 In its comment letter, EFRAG asked for similar clarifications on the identification of the CODM. Specifically, EFRAG noted that:

*EFRAG therefore recommends that the final amendments to paragraph 7 of IFRS 8 address more specifically how the identification of the CODM is affected when operating and strategic decision-making is separated. We understand that, depending on an entity's decision-making hierarchy, a decision maker for operating matters might be a different individual/group to the decision maker responsible for strategic decisions like resource allocation, and in other cases it might not. To address this uncertainty, paragraph 7 of IFRS 8 could 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. The guidance could also explain that being responsible for the allocation of resources and/or for some other strategic decisions does not preclude a particular individual or group being identified as the CODM but is not the primary function.*

IASB Staff proposal to address respondents' concerns/questions

- 19 To address the questions raised, the IASB Staff propose to investigate:
- (a) whether a distinction can be drawn between operating and strategic decisions and whether they can be separately defined;
  - (b) situations when operating decisions are made at more than one level within an organisation;
  - (c) whether the lowest level in an entity that has a responsibility for managing the entire entity can be considered a CODM and how to define this 'lowest level'; and
  - (d) whether a board of directors with a majority of non-executive directors can be a CODM.
- 20 The IASB Staff note that given that different management structures exist in different jurisdictions, it might be difficult to provide specific guidance, beyond that currently in IFRS 8, on how to identify the CODM. One of the possible alternative solutions might be to identify and define the underlying concept without becoming overly prescriptive as to the specific tasks typically performed by the CODM.

*Linking IFRS 8 segments with other parts of the annual reporting package (Proposal 5)*

- 21 The ED proposed requiring an explanation in the notes to the financial statements when segments identified by an entity differ between the financial statements and other parts of its annual reporting package.
- 22 This proposal was welcomed by the regulator ESMA that emphasised that consistency between segment information presented inside and outside the financial statements is key. Also, most respondents agreed that the issue of inconsistency of segment information in an entity's different reports exists in practice.
- 23 However, similar to EFRAG's position in its comment letter, several respondents did not agree with the requirement to link IFRS 8 segments with other parts of the annual reporting package and with the definition of 'the annual reporting package'. To summarise, EFRAG noted that:

*While we support the goal of promoting greater consistency in segment information as reported in an entity's financial statements and other parts of its 'annual reporting package', we do not think that IFRS 8 is the appropriate place for addressing the problem of different segment information provided outside of the financial statements and might lead to confusion about the identification of the reportable segments in IFRS 8.*

*Furthermore, EFRAG considers 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 IFRS financial*

*statements, which as explained above, is contrary to the objective of IFRS Standards which focus on requirements for financial statements.*

*EFRAG disagrees with the proposal to define an entity's annual reporting package in IFRS 8 as it may prove difficult to apply in practice.*

*IASB Staff proposal to address respondents' concerns*

- 24 Given the concerns raised, the IASB Staff will ask the IASB whether they wish to proceed with the proposal, and if so, whether it should develop implementation guidance on 'the annual reporting package'. The IASB Staff suggestions include:
- (a) restricting the requirement so that it refers only to the annual report, not to the whole annual reporting package; or
  - (b) redefining 'the annual reporting package' to exclude, for example, preliminary announcements in order to ensure consistency with International Standard on Auditing 720 (Revised) *The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements* (ISA 720).

*Clarify criteria for aggregation of segments (Proposal 6)*

- 25 To assist preparers in exercising judgement about aggregation of operating segments in IFRS 8, the IASB proposed adding further examples of similar economic characteristics to the aggregation criteria.
- 26 Although most preparers, national standard-setters, accounting firms and accounting associations agreed with this proposal, they asked for guidance on the following matters:
- (a) How to assess similar economic characteristics. More specifically, how should entities weight similar economic characteristics? Or should management exercise judgement based on its understanding of the most relevant measures (for example, those that the CODM uses in reviewing the performance of, and allocating resources to, individual segments)?
  - (b) Further explain what the term 'long-term financial performance' means. For example, should the performance be similar on a long-term annual basis or is it sufficient that the long-term average is similar?
- 27 The respondents that disagreed with the proposal noted that the amendment might result in too much disaggregation of segments by entities.
- 28 In its comment letter, EFRAG agreed with the proposal on the basis that it would help address user concerns about over-aggregation of segments.

*IASB Staff proposal to address respondents' concerns*

- 29 The IASB Staff will ask the IASB whether it would like to consider alternative ways to address the concerns identified in the PIR of IFRS 8. Alternatively, if the IASB want to proceed with the proposed amendment, whether it should develop more guidance to address the questions raised by respondents.
- 30 Furthermore, the IASB Staff note that the FASB is currently considering the following two new approaches to the aggregation criteria:
- (a) move the quantitative thresholds for determining a reportable segment as a number one step in the aggregation criteria, ie develop a bright line threshold for aggregation; and
  - (b) remove the aggregation criteria altogether, but retain the practicable limit guidance (for example, a practical upper limit of 10 reportable segments).
- 31 The IASB Staff inform that in the past the FASB considered an approach similar to the one that the IASB has proposed (ie clarifying the meaning of similar economic characteristics), but decided not to proceed with this approach.

**Other proposals**

- 32 The IASB Staff believe that the remaining proposals can be finalised, subject to evaluation of matters raised in the comment letters. In summary, the IASB Staff note that:
- (a) Proposal 4: CODM's identity must be disclosed - the IASB Staff do not anticipate difficult finalising this proposal given that entities in some jurisdictions already disclose the identity of CODM.
  - (b) Proposal 7: clarify that additional information about segments can be provided - the IASB Staff will need to confirm that this proposal is consistent with the projects Principles of Disclosure and Primary Financial Statements, especially in the area of entities disclosing non-GAAP measures.
  - (c) Proposal 8: explain reconciling items in sufficient detail - the IASB Staff envisage that it will not be problematic to finalise this amendment, unless the IASB wants to consider the tentative thinking by the FASB about the format of reconciliations.
  - (d) Proposal 9: changes in segmentation – provide restated interim information earlier – the IASB Staff do not anticipate difficulties to finalise this proposal.
- 33 The EFRAG Secretariat note that in its comment letter EFRAG generally supported the above proposals, subject to some clarifications.

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

- 34 Do EFRAG CFSS and EFRAG TEG members have any questions or comments on the feedback received on the proposals in the ED and the suggestions put forward by the IASB Staff for further analysis as outlined in:
- (a) paragraphs 19 and 20 (Proposal 1-3);
  - (b) paragraph 24 (Proposal 5); and
  - (c) paragraph 29-31 (Proposal 6)?
- 35 At this stage, do EFRAG CFSS and EFRAG TEG members have any other comments on the proposals in the ED?