EFRAG
European Financial Reporting Advisory Group

Improvements to IFRS 8 *Operating Segments*
(*Proposed amendments to* IFRS 8 *and* IAS 34)
Comment Letter

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

3 August 2017

Dear Mr Hoogervorst,

Re: Exposure Draft ED/2017/2 Improvements to IFRS 8 *Operating Segments* – *Proposed amendments to IFRS 8 and IAS 34*

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Exposure Draft ED/2017/2 Improvements to IFRS 8 *Operating Segments – Proposed amendments to IFRS 8 and IAS 34,* issued by the IASB on 29 March 2017 (the 'ED').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS in the European Union and European Economic Area.

EFRAG welcomes the IASB's efforts to improve IFRS 8 and address issues identified in the Post-implementation Review (PIR) of that Standard. EFRAG also supports most of the amendments proposed in the ED, as they provide useful clarifications of the existing requirements in IFRS 8 and should therefore improve the quality of disclosure of operating segment information.

However, EFRAG disagrees 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 of the financial statements. EFRAG is also concerned that the proposed definition of an entity's 'annual reporting package' may prove difficult to apply in practice, and therefore disagrees with this proposal.

Our detailed comments and responses to the questions in the ED, including some suggestions for further clarification and drafting suggestions, are set out in the Appendix.

If you would like to discuss our comments further, please do not hesitate to contact Isabel Batista, Ioana Kiss or me.

Yours sincerely,

Jean-Paul Gauzès
President of the EFRAG Board

APPENDIX – EFRAG's responses to the questions in the ED

Question 1

The IASB 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?

EFRAG's response

EFRAG generally agrees that the proposed amendments to clarify the description and the role of the chief operating decision maker (CODM) would be helpful to address practice issues in some jurisdictions. However, we think that further guidance is needed on how to identify the CODM in some cases.

EFRAG also agrees with the proposal to require an entity to disclose the title and description of the role of the CODM.

1 EFRAG welcomes the IASB's efforts to provide clarity on the description and role of the CODM. EFRAG understands that, for entities with more complex management structures and different levels of hierarchy, identifying the group or individual responsible for the operating and resource allocation decisions of the entity (the CODM) can be challenging. Given that the identification of the CODM is central to the application of IFRS 8, it is important that an entity is able to identify the CODM appropriately.

2 EFRAG agrees that under IFRS 8 the CODM is a function, rather than a title, and therefore that the CODM can be either an individual or a group as clarified in paragraph 7A of the ED. We also agree with the clarification in paragraph 7B of the ED that when the CODM is a group, it can include members that do not participate in all decision-making for which the CODM is responsible.

3 EFRAG acknowledges that judgement is required to identify the CODM, as the function will vary from entity to entity depending on facts and circumstances and may also be affected by jurisdictional practices and legal and governance requirements. However, EFRAG also understands that the reference to 'allocation of resources' within the description of the CODM has created some ambiguity in identifying the CODM. This is because some commentators consider that, in some cases, the allocation of resources to operating segments is a strategic function rather than an operating decision (and is often the responsibility of the board of directors or a committee rather than a particular individual).

4 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.

5 EFRAG also agrees with the proposed addition of paragraph 22(c) to IFRS 8 to require an entity to disclose the title and description of the role of the individual or the group identified as the chief operating decision maker as this will help users to understand how the CODM was identified.

Question 2

In respect of identifying reportable segments, the IASB 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?

EFRAG's response

While acknowledging the opposite views expressed by investors and regulators, EFRAG disagrees with the IASB's proposal to require an entity to explain why the reportable segments identified in an entity's financial statements are different to the segments reported outside of the entity's 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.

EFRAG agrees with the proposed amendment to paragraph 12 of IFRS 8 and proposed addition of paragraph 12A to IFRS 8 to emphasise the criteria that must be satisfied before two or more operating segments may be aggregated.

Consistency

6 EFRAG appreciates the IASB's efforts to address concerns around inconsistent identification of operating segments between an entity's financial statements and other parts of its reporting, which we understand is a concern for users of financial statements and regulators. EFRAG observes that information provided by IFRS 8 reflects a management perspective, and notes that this approach can be expected to lead to greater consistency with segment information provided outside of the financial statements. Nonetheless, we understand that segments are sometimes identified differently.

7 While acknowledging the concerns expressed by users and regulators, EFRAG disagrees with the IASB's proposal in paragraph 22(d) of the ED to require an entity to explain why reportable segments identified in the financial statements are different to the segments reported outside of the entity's financial statements. 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.

8 EFRAG observes that paragraph 14 of IAS 1 *Presentation of Financial Statements* states that reports and statements outside financial statements are outside the scope of IFRS Standards. EFRAG notes that such reports are primarily the responsibility of other regulatory authorities and that the applicable requirements vary from one jurisdiction to another. Furthermore, EFRAG observes that paragraph BC18 of the Basis for Conclusions in the ED states that IFRS Standards set requirements for financial statements and not for management commentary and other reported information, reinforcing the statement in paragraph 14 of IAS 1. Paragraph BC18 goes on to say that, consequently, the IASB concluded that it was not in a position to mandate consistency in the identification of segments between the financial statements, the management commentary and other reported information.

9 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 also questions whether the proposal may extend the scope of auditors' responsibility for information reported outside the financial statements and therefore increase costs for preparers.

10 EFRAG also disagrees with the proposed definition of an entity's 'annual reporting package' in the proposed requirements of paragraph 22(d) of the ED. In our view, it is likely to prove difficult to apply this definition in practice in view of the variety of reporting requirements that apply at national/jurisdictional level. For example, we note that the European Union (EU) Transparency Directive issued in 2004 and revised in 2013 sets out specific requirements in relation to annual and half yearly financial reports. EFRAG also considers that the proposed wording (in paragraph 19B of the ED) 'is published at approximately the same time' could lead to differences of interpretation. Accordingly, if the IASB decides to proceed with the proposal EFRAG suggests that it would be preferable to use existing terminology and refer to 'annual report'. For example, paragraph B88(a) of IFRS 15 *Revenue from Contracts with Customers* refers to 'disclosures presented outside the financial statements (for example, in earnings releases, annual reports or investor presentations)'. A second example is paragraph 13 of IAS 1 that refers to a 'financial review' prepared by an entity's management that can include a description and explanation of the main features of an entity's financial performance and financial position, including certain information that might not be reported in the financial statements.

11 Finally, EFRAG observes that a similar consistency issue is likely to apply to IAS 34 *Interim Financial Reporting* in terms of identifying the same segments throughout the interim reporting package.

Aggregation criteria

12 EFRAG understands that users have raised concerns that, in their view, operating

segments are sometimes over-aggregated with the effect that reported segment information is at too high a level to provide meaningful insights into the performance of the different components of an entity. EFRAG therefore supports the proposed amendment to clarify that all the criteria in paragraph 12 of IFRS 8 must be satisfied before operating segments may be aggregated. EFRAG considers the proposed amendment to reach an acceptable balance between promoting discipline in the application of the aggregation criteria while retaining a principle-based approach.

13 EFRAG also agrees with the proposal to add new paragraph 12A 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. Currently, IFRS 8 provides an example of a similar characteristic to be a long-term average gross margin. However, some respondents to the PIR asked for additional examples and noted that the focus on gross margins is not always appropriate. EFRAG therefore considers that the proposed clarification will provide a better link with the entity's decision-making and, as a result, provide more relevant information for users. We also consider the additional examples would serve as guidance to help entities apply the segment aggregation principle, without creating a rule of general applicability.

Question 3

The IASB 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?

EFRAG's response

EFRAG does not oppose the proposed clarification in paragraph 20A of the ED on the basis that it does not change the existing requirements in IFRS 8 and may provide useful information to users even if the additional information is not used by the CODM.

14 EFRAG understands that paragraph 20A of the ED is intended to remind entities that they may disclose additional information about their reportable segments if it helps to meet the core principle in IFRS 8. Therefore, EFRAG considers that this proposal does not change the existing requirements in IFRS 8. Accordingly, one could argue it is unnecessary as entities ought to be applying the core principle already when they apply IFRS 8.

15 EFRAG is aware that some users, including members of the EFRAG User Panel, asked for specific line items to be disclosed for reportable segments in addition to those listed in paragraphs 23 and 24 of IFRS 8. However, EFRAG also understands that the specific line items that users are interested in depend on the entities and industries that they analyse. This makes it difficult for the IASB to develop a list that would satisfy all users as the relevance of specific line items depends on an entity's facts and circumstances, and the prescription of specific information may not be consistent with the management approach that underlies IFRS 8.

16 EFRAG supports the proposed addition of paragraph 20A to IFRS 8, as this reminds preparers of the general principle in IAS 1 that information in addition to that prescribed in IFRS Standards should be provided when compliance with the specific requirements in IFRS Standards is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial

position and financial performances. For this reason, we are not concerned that the proposal could lead to the provision of additional information about segments that includes information that is not reviewed by, or regularly provided to, the chief operating decision maker.

17 Finally, EFRAG agrees with the IASB not to extend the number of specific line items to be disclosed under IFRS 8 as this might not result in more relevant information for investors and could run contrary to the general direction of the IASB's Principles of Disclosure project.

Question 4

The IASB 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?

EFRAG's response

EFRAG agrees with the proposed clarification through the addition of paragraph 28A of the ED.

18 EFRAG notes that the proposal to add paragraph 28A to IFRS 8, which essentially replaces the last section of existing paragraph 28, is intended to emphasise, rather than change, the existing requirement that all material reconciling items must be separately identified and explained in sufficient detail to allow users of financial statements to understand their nature.

19 EFRAG notes that, as explained in paragraphs BC34-37 of the ED's Basis for Conclusions, user respondents to the IASB's PIR of IFRS 8, including the EFRAG User Panel, asked for the reconciliations to be prepared segment-by-segment as they needed a better explanation of the nature of individual reconciling items which some entities include in a column titled 'other'. EFRAG considers that the emphasis created by paragraph 28A of the ED should help address this concern. EFRAG therefore supports this clarification.

Question 5

The IASB 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?

EFRAG's response

EFRAG agrees with the proposal to add paragraph 45A to IAS 34 regarding the restatement of previously reported interim periods when there is a change in the composition of an entity's reportable segments.

20 EFRAG agrees with the proposal to add new paragraph 45A to IAS 34 to require that, when an entity changes the composition of its reportable segments, it should

present restated segment information for each previously reported interim period both of the current and prior financial years, unless the information is not available and the cost to develop it would be excessive. We consider that this proposal will help to provide users with relevant trend information following a reorganisation or other event that results in a change in an entity's reportable segments. We also consider that this is unlikely to have a major impact on costs to preparers as the proposal requires restatement of the interim periods of the comparative year (which under IFRS is generally one year), and therefore would generally not require the collection of new information.

21 Furthermore, EFRAG observes that this proposal is consistent with the existing requirements in paragraph 29 of IFRS 8 that state that if operating segments change, an entity must restate comparatives including interim periods, in line with the new operating segments unless the information is not available and the cost to develop it would be excessive. In EFRAG's view, the proposal requires information to be presented for each previously reported interim period of the prior financial year(s), rather than only information about year(s)-to-date and corresponding prior interim period(s).

22 EFRAG acknowledges that feedback from the PIR on IFRS 8 reported that some users of financial statements asked for an increased number of periods of restated comparative information, ranging from three to five years. However, EFRAG agrees with the IASB's rationale in paragraph BC5 of the ED's Basis for Conclusions on the amendment to IAS 34, that requiring restated information for three to five years prior to the change might place an unreasonable burden on preparers in relation to the benefits for users.

Other matters – Transition and effective date

EFRAG's response

EFRAG supports retrospective application of the proposed amendments to IFRS 8.

EFRAG recommends the IASB to align the proposal in paragraph 58 of the ED with the relevant paragraph in the Basis for Conclusions.

23 EFRAG agrees with retrospective application of the amendments to IFRS 8. This will have the effect that segment information will be presented on the same basis in the current period and the comparative period(s). EFRAG also agrees with the reasoning of the IASB in paragraph BC38 of the ED's Basis for Conclusions that requiring retrospective application should not be onerous on the basis that the amendments deal with mainly clarify existing requirements rather than impose new ones.

24 Regarding the application of the amendments to IAS 34, EFRAG notes that paragraph 58 of the proposed amendments to IAS 34 suggests that the amendments should be applied prospectively, with earlier application permitted. However, paragraph BC11 of the Basis for Conclusions proposes that an entity should apply the amendments retrospectively. EFRAG recommends the IASB to align the proposal in paragraph 58 of the ED with the relevant paragraph in the Basis for Conclusions.