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EFRAG's proactive research agenda

Issues Paper- Operating segments

Objective

1 The objective of this session is to obtain the views of EFRAG FR TEG on the possible scope of a project proposing possible enhancements to IFRS 8 *Operating Segments* requirements while retaining the management approach. The views of EFRAG FR TEG are sought after members have taken account of:

(a) the user panel feedback (that will be orally provided); and

(b) the scope and decisions of the US FASB in its project on targeted improvements to the requirements for segment reporting under US GAAP- ASC 280 *Segment Reporting*. The analysis of the enhancement of US GAAP is made because ASC 280 and IFRS 8 currently have converged requirements.

2 The rest of the paper is structured as follows:

(a) Background;

(b) IASB staff views after Third Agenda consultation;

(c) Past IASB work on segment reporting;

(d) EFRAG comments on segment reporting;

(e) Overview of US GAAP developments;

(f) EFRAG Secretariat preliminary view; and

(g) Appendix- Details of US GAAP project on segment reporting

Background

3 On 1 June 2022, after considering both constituents' feedback to the EFRAG joint consultation document and the IASB decisions on its 2022-2026 workplan[1], the EFRAG Financial Reporting Board (FRB) approved the addition of two new projects (connectivity between financial and sustainability reporting, and cash flow reporting) to the EFRAG proactive research agenda and a reserve list of pollutant pricing mechanisms and operating segment reporting with an initial priority ranking of the pollutant pricing mechanisms project. While the segment reporting project has been ranked highly by users, other stakeholders did not consider this project to be of the highest priority. EFRAG FR TEG similarly held reservations on this project during

[1] The IASB added the project on climate-related risks to its maintenance and consistent application workplan and the projects on intangible assets and statement of cash flows and related matters to its research pipeline and included operating segments and pollutant-pricing mechanisms on a reserve list of its research pipeline.

the discussion on possible additions to the EFRAG proactive research agenda held in May 2022.

4 EFRAG FRB recommended that before the commencement of any of the research projects, EFRAG should ensure its work will be complementary to and synergistic with any potential project by the IASB.

5 Accordingly, before deciding on if and how to conduct either a project on segment reporting or pollutant pricing mechanisms, it is necessary for EFRAG to conduct further research into the causes of users' concerns regarding segment reporting information and to assess what changes in identifying segments would be possible while retaining the management approach. Similarly, at a future date, the views of EFRAG FR TEG on the scope of a possible project on pollutant pricing mechanisms will also be sought.

6 In this regard, on 7 July 2022 (i.e., after the upload of this issues paper), EFRAG Secretariat will be seeking the user panel's perspective on the possible suitable scope of a segment reporting project.

7 In addition, EFRAG Secretariat has reviewed the scope and decisions made by the US FASB while developing targeted improvements to US GAAP segment reporting requirements. The FASB project progress is summarised in the Appendix.

IASB staff views after Agenda Consultation

8 The 2021 IASB Third Agenda consultation Request for Information (RFI) noted that investors with concerns on segment reporting had proposed

(a) a potential project should consider improvements to the criteria for aggregating operating segments into reportable segments. The investors suggested that the reliance on management judgement results in insufficient disaggregation;

(b) repeated changes to the composition of reportable segments affect comparability between periods for a reporting company;

(c) the Board should require disclosure of additional line items by segment. These lines could include revenue, assets, equity, capital expenditures, business combinations, non-current assets held for sale and discontinued operations. These additional disclosures should be required regardless of whether the information is regularly provided to the chief operating decision-maker;

(d) the Board should develop requirements for disclosure of a minimum set of key performance indicators by segment to allow basic analysis— for example, margins, turnovers and returns.

9 As part of the decisions on the 2022-2026 IASB workplan, the IASB staff recommended that an operating segment project should aim to research improvements without reconsidering the use of the management approach to determine an entity's operating segments.

10 According to the IASB staff, a project that reconsiders the use of the management approach would not likely be feasible because:

(a) users have mixed views on the benefits of the management approach;

(b) a change from the management approach would represent a fundamental change to IFRS 8 and could result in significant costs to preparers, which may outweigh the benefits of such a change, given the mixed views of users; and

(c) a change from the management approach would result in divergence from US GAAP.

11 Therefore, the IASB staff recommended that the objective of a project on operating segments should be to conduct research into:

(a) the underlying causes of users' concerns about the granularity of segment information that entities provide; and

(b) the feasibility (including costs to preparers) of potential solutions that could be implemented without reconsidering the use of the management approach to determine an entity's operating segments.

Past IASB work on segment reporting

12 The IASB issued the feedback statement of the Post-implementation Review (PIR) of IFRS 8 in 2013 here. Respondents to the PIR identified the following areas for potential improvement:

(a) The concept of an identifiable chief operating decision maker (CODM) is confusing and outdated. Identification of the CODM is difficult in practice;

(b) Uncertainty on how the reconciliation should be presented and how reconciling amounts should be disclosed. The items included in the reconciliations are difficult to understand;

(c) Any change in the basis of segmentation from one year to the next results in the loss for investors of valuable trend information;

(d) Many entities present different definitions of 'operating result' or 'operating cash flow', making comparison difficult between entities. Important line items needed to derive these sub-totals are often not separately reported;

(e) Many investors think that operating segments are aggregated inappropriately, reducing the value of the information presented. Some preparers find the aggregation guidance difficult to apply in practice; and

(f) Some investors cannot understand how reconciling amounts relates to an individual segment.

13 In March 2017, the IASB published the ED *Improvements to IFRS 8 Operating Segments* here. After considering the feedback received, the IASB decided not to proceed with the amendments proposed in the ED. They noted that some of its proposals could be dealt with by existing requirements and other proposals would not be effective in addressing the findings from the PIR of IFRS 8. The remaining proposals would not result in sufficient improvements in information to investors to justify the additional costs stakeholders would incur. The project summary is included here.

Feedback received and EFRAG comments on segment reporting

Comment letter to EFRAG joint consultation on agenda

14 Respondents who considered segment reporting to be a high priority conveyed that a review of IFRS 8 was needed considering that (1) a breakdown should be more specific and (2) the interaction between IFRS 8 and both the Management Commentary project and the primary financial statements (PFS) projects should be considered.

15 Other suggestions provided include:

(a) requiring a reconciliation at segment level between non-GAAP management measures and IFRS information;

(b) improving disclosures on the reconciliation between segment and consolidated profit or loss;

(c) requiring a precise description of segments; and

(d) improving the disclosures on changes in segment information.

Past user panel feedback

16 Members of the user panel highlighted the need of improving information about segment reporting and provided the following comments:

(a) IFRS 8 will likely be affected by the PFS project. Thus, it may make sense to wait until the PFS standard is issued;

(b) Granularity should be addressed in IFRS 8; and

(c) Under the current approach (management approach) entities can easily modify their disclosures by referring to internal changes in the information received by the CODM.

EFRAG comments on segment reporting interaction in Primary Financial Statements comment letter

17 EFRAG noted in the comment letter issued in response to the IASB's ED/2019/7 General Presentation and Disclosures that the IASB should consider improvements to the interaction between the proposal in the PFS ED and IFRS 8, by, for example, including minor or auxiliary business activities (i.e., not main business activities) as a different segment. Also, entities with multiple business activities should be allowed or even required to analyse and identify unusual income and expenses on a segment level.

18 In addition, the IASB should consider the link between the concept 'main business activities' in the ED and IFRS 8, in particular how the notion of operating profit will interact with information presented under IFRS 8 (e.g., whether there is a need to present the operating profit by segments and reconciled with IFRS 8 information).

19 Finally, EFRAG requested the IASB to consider how the proposals on operating expenses (breakdown of operating expenses by business lines) would relate to the requirements of IFRS 8.

20 Interactions with IFRS 8 Operating Segments and with the proposals on management performance measures should be further considered as well.

EFRAG comments on segments in Business Combinations Discussion Paper comment letter

21 In its comment letter on the IASB's DP/2020/1 *Business Combinations - Disclosures, Goodwill and Impairment*, EFRAG noted that opportunistic reporting of goodwill impairments losses can be done by means of adopting a certain approach when allocating goodwill to CGUs, either by allocating goodwill to a higher level (where managerial monitoring is possible at a lower level) and/or by reallocating goodwill (for example, by means of changing segment reporting).

22 EFRAG noted that, in some circumstances, operating segments can be defined by entities independent from the structure of cash inflows and as companies can claim that they are not "monitoring" goodwill, this could lead to the situation whereby the allocation of goodwill is not connected to the reasons it was recognised as of the acquisition date. In such circumstances, events that trigger impairment may become more difficult to promptly be identified

Overview of US GAAP developments

23 Currently, IFRS 8 and US GAAP ASC 280 *Segment Reporting* are converged standards. As noted, by the IASB staff while recommending the inclusion of segment reporting to the reserve list of the IASB research pipeline, a change from the management approach would result in divergence from US GAAP.

24 However, it is worth noting that, in September 2017, the FASB decided to add segment reporting to its technical agenda with a focus on improvements to segment aggregation criteria and disclosure requirements (see a summary of FASB Tentative

Decisions as of April 2022). An exposure draft is expected at a future date. Hence, it is unclear the extent the US GAAP-IFRS requirements will remain converged.

25 The EFRAG Secretariat's understanding is that the FASB project has so far primarily focused on enhanced disclosure requirements including through principles-based disclosure requirements. For instance, it includes the **significant expense principle** that would require the disclosure of the significant segment expense categories and amounts that are both regularly provided to the CODM and included in the reported measure of segment profit or loss. Also, improved reconciliation requirements have been under discussion.

26 The Appendix has details of the progress of the FASB project.

EFRAG Secretariat

27 EFRAG Secretariat recommends that the scope of the research should encompass targeted changes based on the retention of the management approach. This is similar to what the US FASB is doing towards Topic 280 whose requirements are converged with IFRS 8. As noted, the focus of FASB is primarily focused on enhanced disclosures including through proposals for principles-based disclosures (e.g., the significant expense principle) and improving reconciliations.

28 The possible EFRAG research scope on operating segments could be to build on and test the applicability of proposed disclosure requirements being considered under US GAAP. In addition, the research question could explore options for aggregation criteria for reported segments.

Questions for EFRAG FR TEG

29 As noted, EFRAG is considering a research project on segment reporting that would be synergistic with a potential future IASB project. Paragraphs 8 to 21 summarise the ideas on the possible way forward including those proposed in the IASB RFI and from EFRAG's past positions. Paragraph 23 to 26 and the Appendix details the approach that has been taken by the US FASB so far.

30 If subject to resources, and after evaluating both pollutant pricing and operating segments, EFRAG was to undertake a research project on targeted improvements to segment reporting (i.e., without changes to management approach),

(a) If any, what aspects of the FASB targeted improvements to Topic 280 could be explored for their applicability to IFRS 8?

(b) Do you agree or disagree with the EFRAG Secretariat preliminary view (in paragraphs 27 and 28) that the scope of such a project should be and to build on and test the applicability of US GAAP proposals for enhanced disclosures and to develop proposals for aggregation criteria?

Appendix Background information on the FASB segment reporting project

1 The background information of FASB Topic 280 (with FASB discussions and decisions from June 2018 to April 2022) is included below because IFRS 8 and Topic 280 requirements are converged.

2016 FASB Agenda Consultation

2 In 2016, FASB issued a proposed Invitation to Comment, *Agenda Consultation*. Segment reporting was included as one of the five possible topics for possible inclusion in the FASB agenda. The below three alternatives were presented

3 Alternative #1: Reconsider aspects of the Topic 280 Disclosure Requirements

(a) Alternative A: Certain pieces of individual segment information that have unique significance to users would be added to the required segment disclosures and would only be reported by segment if those items and amounts are reviewed regularly by CODM (e.g. gross margin, operating cash flows, and working capital). Conforming changes could be made as any income statement changes (e.g., if functional lines are disaggregated into natural components, then segment disclosures could be amended to require disaggregation of segment functional amounts

(b) Alternative B: Alternative A disclosures would be reported in a single, structured table- whereby segment totals would be reconciled to consolidated totals and require a narrative description of the line captions on the financial statements where those consolidated amounts are located. Individual segments would be disclosed in the table only if that information is regularly reviewed by the CODM.

(c) Alternative C: Replace Topic 280 disclosures with a disclosure principle mandating segment reporting along the lines presented in the consolidated financial statements but limited to items regularly reviewed by the CODM.

4 Alternative #2: Reexamine aggregation criteria

(a) Aggregation criteria would be reexamined to introduce greater standardization and additional aggregation tests could be introduced into the criteria.

(b) Quantitative thresholds could be introduced to clarify when individual segments can be aggregated.

5 Alternative # 3: Apply the segment reporting standard from a governance perspective

(a) Rather than being provided from the CODM perspective, segment information could be identified at the level of the governing body, such as the board of directors or trustees and the package of information that is reviewed regularly by that governance group.

FASB decisions

6 In September 2017, the FASB started with targeted improvements to the aggregation criteria and disclosure requirements. In 2021, FASB issued an invitation to comment.

June 2018

7 As detailed in the June 2018 FASB staff presentation to the IASB, in September 2017, the FASB started with targeted improvements to the aggregation criteria and disclosure requirements.

8 For the aggregation criteria, FASB decided to focus on either of the following two alternatives for improvement:

(a) Remove the aggregation criteria, thereby each operating segment would be reported, but retain the practical limit guidance.

(b) Re-order the process for determining reportable segments and move the quantitative thresholds earlier in that process.

9 For the segment disclosure requirements, FASB decided to focus on three areas:

(a) Add individual pieces of segment information to the list of required disclosures

(b) Require the disclosures to be reported in a table

(c) Require a table of regularly reviewed information based on how it relates to the lines in the financial statements.

December 2018

10 FASB was not persuaded that the alternatives (regarding aggregation) provided cost-beneficial solutions.

April 2019

11 FASB discussed options to both expand the list of required disclosures and require those disclosures in a tabular format. FASB staff was instructed to expand the list of required disclosures in Topic 280 to include the cost of revenue, research and development expense, a measure of cash flow, and inventory by reportable segment. Staff was instructed to develop principles-based disclosure requirements in addition to the list of required disclosures and to explain the reasons why items from the list of required disclosures are not reported.

May 2019

12 FASB dismissed an alternative to require a financial statement format for reportable segments. Staff should undertake research into how the segment reconciliation requirements could be improved and additional general segment disclosure requirements could be required.

December 2019

13 FASB directed the staff to perform outreach with investors on certain potential segment disclosure improvements. The Board also directed the staff to accelerate work on one specific issue that would potentially clarify the requirements in Topic 280, to encourage greater reporting of total assets by reportable segment for public entities.

October 2020

14 FASB decided to pursue a principle (the "**significant expense principle**") that would require the disclosure of the significant segment expense categories and amounts that are both:

(a) Regularly provided to the CODM

(b) Included in the reported measure of segment profit or loss

January 2021

15 **Order of Applying the Significance Threshold**. Applying the principle would involve the following steps:

(a) An entity should identify segment expenses from the information that is regularly provided to the CODM.

(b) The entity would then apply the significance threshold to determine which of those expenses should be disclosed.

16 **Significant threshold**- FASB discussed stakeholder feedback that the effect of the significance threshold within the principle may be perceived in different ways. FASB decided to retain the significance threshold and make no further changes.

17 **Applying the Principle when Multiple Segment Profit or Loss Measures Are Reported**- FASB approved Clarifying guidance that if a CODM is regularly provided with multiple sets of segment expenses that are measured under different accounting bases, the expenses to be reported under the principle should be those that are included in the reported measure of segment profit or loss.

18 **Different Fact Patterns in Which Expenses Are Regularly Provided to the CODM:** Stakeholder feedback that segment expenses are regularly provided to a CODM under various fact patterns, including when an amount for total segment expenses is provided or when segment expenses on a variance basis are provided. It was decided that FASB staff should explore the following:

(a) A requirement that the principle would include segment expenses that can be easily derived from information regularly provided to the CODM. For example, segment expenses may be regularly expressed on a ratio basis rather than absolute amounts to the CODM. The principle would include CODM reports in which the amount of the segment expense is easily derivable from the information.

(b) A requirement to disclose other segment expenses amount and a description of its composition.

(c) A requirement to describe the basis for allocating expenses to the segments.

March 2021

19 **Reconciliation Requirement-** Current reconciliation requirements in Topic 280, Segment Reporting, should also apply to the significant expenses disclosed under the principle. FASB decided that each significant expense category disclosed under the principle should be reconciled to its corresponding consolidated amount.

20 **Interaction with Existing Expense Disclosures by Reportable Segment:** Interaction between the significant expenses disclosed under the principle and the segment expenses currently required to be disclosed under Topic 280, specifically, (1) interest expense, (2) depreciation, depletion, and amortization expense, (3) income tax expense, and (4) significant noncash items other than depreciation, depletion, and amortization expense. FASB approved retaining current expense disclosures in Topic 280 and requirements for public entities to comply with the principle.

21 **Disclosure of Total Expenses and Other Expenses by Reportable Segment:** FASB approved the proposal that a public entity would be required to disclose the following information by reportable segment irrespective of whether the CODM is regularly provided with this information:

(a) An amount for other items that is the difference between segment revenue less the significant expenses disclosed under the principle and the segment profit or loss measure

(b) A description of the composition of other items. Other items may include (1) insignificant expenses and the remaining expenses included in the reported measure of segment profit or loss that are not separately disclosed under the principle and (2) gains and losses that also are included in the measure of segment profit or loss. A public entity would not be required to reconcile the amount for other items to a corresponding consolidated amount.

22 **Description of the Basis for Allocating Expenses to the Segments:** FASB approved the proposal that requires a public entity to describe the basis for allocating expenses to its segments. Amend existing guidance to require a public entity to disclose the nature of any substantial change in expense allocation methods from prior periods that are used to determine the measure of segment profit or loss and the effect, if any, of those changes on the measure of segment profit or loss.

23 **Easily Derivable Notion:** Segment expenses may be regularly provided to the CODM as a percentage of segment revenue rather than as absolute amounts. Staff to perform additional outreach on the drafting and scope for future consideration by the Board.

May 2021

24 **Interim Reporting:** FASB approved the proposal that a public entity would be required to apply the significant expense principle on an interim basis in addition to an annual basis. The Board also decided that an entity would be required to apply on an interim basis, the annual disclosure requirements in paragraphs 280-10-50-22 and 280-10-50-25. FASB decided not to require additional reconciliations for any interim segment disclosures. Rather, the existing reconciliation for segment profit or loss would be retained.

Oct 2021

25 **Easily Computable Concept:** FASB approved the Easily computable concept. That concept would require public entities to disclose significant segment expense categories and amounts that are easily computable from the management reports that are regularly provided to the CODM.

26 **Mapping of Entity-Wide Amounts to the Income Statement Lines:** Each significant segment expense category disclosed should be based on the information that is regularly provided to the CODM and reconciled to its corresponding consolidated expense amount on an annual basis. The consolidated expense amount may not have a one-for-one relationship to an income statement line. FASB considered but decided not to require public entities to map each consolidated expense amount to the income statement lines.

27 **Single Reportable Segment Entities:** Implications of applying the principle and the existing segment disclosure requirements to single reportable segment entities. FASB decided to specify that single reportable segment entities should apply all disclosure requirements in Topic 280 consistent with requirements for multiple reportable segment entities.

Dec 2021

28 **Multiple Segment Profit or Loss Measures:** FASB discussed whether to clarify which of a segment's profit or loss measures the principle applies to when multiple measures are reported. FASB decided that the principle should apply to all reported measures of a segment's profit or loss.

29 **Applying the Significant Expense Principle to Gross Interest Expense for Financial Operations** Segments Topic 280, Segment Reporting, currently allows a public entity to disclose only net interest revenue for a financial operations segment when a majority of the segment's revenues are from interest and the CODM primarily relies upon net interest revenue to assess segment performance. FASB decided that the proposed Update would require a financial operations segment that discloses net interest revenue to also disclose gross interest expense if that information meets the requirements for disclosure under the significant expense principle.

30 **Reconciliation of Significant Segment Expenses to Consolidated Expense Amounts**: FASB decided not to require the total of the reportable segments' amount for each significant expense category disclosed under the principle to be reconciled to its corresponding consolidated amount.

April 2022

31 FASB decided not to require public entities to map each consolidated expense amount to the income statement lines

32 Interest Expense for Financial Operations Segments: Topic 280 currently allows a public entity to disclose only net interest revenue for a financial operations segment when a majority of the segment's revenues are from interest and the CODM primarily relies upon net interest revenue to assess segment performance. FASB decided that the proposed Update would require a financial operations segment that discloses net interest revenue to also disclose gross interest expense if that information meets the requirements for disclosure under the significant expense principle.