EFRAG
European Financial Reporting Advisory Group

29 November 2012

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

Dear Sir/Madam,

Re: IFRS 8 *Operating Segments* Post-implementation Review

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing in response to the *Request for Information,* issued by the IASB in July 2012 (the 'RFI') as part of its Post-implementation Review of IFRS 8 *Operating Segments*.

This letter reflects the evidence gathered from European constituents during EFRAG's outreach activities, conducted in partnership with European National Standard Setters and user organisations and with involvement of the IASB. The appendix below summarises the evidence gathered at the various outreach events held throughout Europe, responses to questionnaires to constituents and EFRAG staff reviews of operating segment disclosures in financial statements.

We highlight that, similarly to the IASB's own efforts, it has been difficult to successfully engage a wide range of constituents in this evidence gathering exercise. Therefore the summary of evidence gathered presented below should be read in this context.

EFRAG believes that these difficulties in gathering evidence should be considered when further Post-implementation Reviews are carried out. In particular, the feedback EFRAG received was that Post-implementation Reviews should focus on the effects and usability of the current standard, rather than on a comparison to its predecessor.

The summary of our findings are set out in Appendix 1 following the questions in the RFI. The key areas of IFRS 8 with which constituents (including users, preparers, auditors and regulators) had particular comments and concerns were the level of aggregation of operating segments, the identification of the Chief Operating Decision Maker, reconciliations of line items between the total for reportable segments and the values reported in the primary statements and the preparation of entity-wide information. The results of our review corroborate ESMA's findings as published in its 2011 report on the implementation of IFRS 8. The difficulties encountered and comments provided differed given the background of the constituents. In general preparers considered IFRS 8 to work reasonably well. Users and ESMA indicated that they are able to work with it, but identified several specific areas for improvement.

However in some instances it is not clear whether the difficulties were caused by the standard, and could therefore be resolved through a change in or interpretation of the standard, or by how IFRS 8's requirements have been implemented and applied in practice. Before any further standard-setting effort is undertaken following the results of the *Request for Information* of this Post-implementation Review, the evidence we found demonstrates the need for the IASB to examine in more detail with regulators, such as ESMA, and auditors the application of the standard in practice to identify implementation issues; and possibly the need for guidance to improve the clarity of the standard and the usefulness of the information it results in.

If you would like to discuss our comments further, please do not hesitate to contact Michel Sibille, Benjamin Reilly or me.

Yours sincerely,

Françoise Flores

EFRAG Chairman

Appendix 1 – Detailed Responses to questions in the *Request for Information*

Question 1

Are you comparing IFRS 8 with IAS 14 or with a different, earlier segment-reporting Standard that is specific to your jurisdiction?

In providing this information, please tell us:

(a) what your current job title is;

(b) what your principal jurisdiction is; and

(c) whether your jurisdiction or company is a recent adopter of IFRSs.

If you work in a non-IFRS environment your input is still useful to us—but we would like to know about your current reporting of operating segments so that we can assess your information in that context.

EFRAG's Response

1 EFRAG's response is a summary of evidence gathered from constituents during the course of Post-implementation Review. This has included formal questionnaires to constituents, outreach events[1] hosted in partnership with National Standard Setters and user organisations and EFRAG staff reviews of operating segment disclosures in financial statements that were identified by constituents as particularly noteworthy. Members of the IASB staff also attended outreach events and received questionnaire responses.

2 The response rate to the formal questionnaires was low and EFRAG has found it particularly difficult to engage users in this process. Therefore evidence contained within this summary should be read in this context. However evidence received from those constituents who did engage was generally consistent within each category (users, preparers, auditors, regulators). The evidence provided by users was corroborated by ESMA's 2011 report on enforcement of the standard across Europe[2].

3 The IAS Regulation (No 1606/2002) requires the consolidated financial statements of EU listed companies to be prepared under IFRS as endorsed by the European Union. This took effect for annual periods beginning 1 January 2005. Therefore listed companies in the EU have reported under both IFRS 8 and IAS 14 *Operating Segments*. Neither users nor preparers expressed significant interest in a comparison between IFRS 8 and IAS 14, but instead focused on how IFRS 8 was implemented in practice and the usefulness of the information it resulted in.

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[1] See Appendix 2 for details of the outreach events

[2] ESMA report *Review of European enforcers on the implementation of IFRS 8 – Operating Segments* published November 2011.

Question 2

What is your experience of the effect of the IASB's decision to identify and report segments using the management perspective?

The use of the management perspective to identify operating segments

4 IAS 14 identified reportable segments on the basis of the goods and services provided to customers, or by geographical region. IFRS 8 identifies reportable segments on the basis of the internal reporting to the Chief Operating Decision Maker ('CODM') in allocating the company's resources. This allows investors and analysts to see the company from management's perspective.

5 EFRAG's evidence gathering identified that both users and preparers in general believe that the identification of the CODM is key to the level at which financial information is aggregated. Evidence from users was also that the operating segment results are used primarily in the development of valuation models based on cash flows. This information was not particularly used for stewardship, or for assessing an entity's risks.

	Evidence from users	**Evidence from preparers/auditors/others**
Identifying the CODM	It was sometimes not clear how companies identified the CODM. For companies who identified the CODM as the Board of Directors, some users were unclear how this linked with good corporate governance given the inclusion of non-executive directors. It was also noted that there appeared to be an inconsistency in the standard: the role was identified as the CODM, but the examples given of allocating resources and assessing performance could be strategic functions.	Preparers had not seen significant challenges in identifying the CODM. Some preparers based their identification of operating segments not only on how they reported internally, but also on how they communicated with the market.
Aggregation and definitions of operating segments based on reporting to the CODM	A number of companies aggregated business operations into operating segments in a way that did not assist the use of information in valuation models. Examples of these provided by users included: • A company involved in extractive activities which has two segments. One of these segments includes both retail operations and processing activities. These have very different profit margins and growth/risk characteristics. • A vertically integrated clothing and branded goods company with multiple sorts of retail operations	Multiple levels of aggregation were used for different purposes. The level chosen by the entity for disclosure was a choice. Frequently, when multiple activities were aggregated together into a single reporting segment, this reflected the entity's management structure. Regulatory authorities have highlighted that the requirement to identify an operating segment based on what is reported to an entity's CODM could result in entities including an 'artificial' aggregation level in their corporate structure or reporting. This would allow an

	(e.g. clothing, homeware). The two reported segments were production and retail, without any information that allowed users to analyse profit margins by type of product. As users are using operating segment information to produce cash flow forecasts, this level of aggregation is not helpful. Multiple users stated that they would like the operating segment information to be provided at a level corresponding to a business that could be valued independently. They said this was not possible whenever such a business was spread across two or more defined operating segments.	entity to define these aggregated businesses as a single operating segment, despite detailed operational reporting and the corporate structure reflecting a different level of disaggregation below what is reported to the CODM. This is especially the case where an entity has identified that their overall board is the CODM. Some entities reported to the CODM in multiple ways, but could only choose one as the basis for defining operating segments. The set of numbers chosen was usually the one with the most complete information available. For example, if a company broke down its operations in three different ways for profit and loss analysis, but only one of these had comparable balance sheet information, operating segments were defined on the basis of the breakdown that also included a balance sheet.
Communication with investors	When IFRS 8 was first applied, information in management discussion and analysis was not always consistent with the information presented in operating segments disclosures. For most companies these are now consistent, but management discussion and analysis sometimes contains detail on a different level of aggregation. However it is not always clear what operations are contained within a particular operating segment, especially when it is described by name only.	Companies and auditors usually check that communication is consistent with operating segment disclosures. In some cases, users requested other breakdowns which were also supplied.

Question 3
How has the use of non-IFRS measurements affected the reporting of operating segments?

6 A significant number of preparers expressed their strong support for the use of non-IFRS measurements in the preparation of operating segment information, highlighting that IAS 14 required the inclusion of values that were not included anywhere else in the financial statements. There was limited use of measurement bases that differed significantly from IFRS, as companies did not wish to implement multiple reporting mechanisms.

7 Evidence from users was that the lack of comparability meant it was not possible to directly compare the performance between entities on a detailed level, but this was not a major concern as operating segment information is used to generate cash flows to estimate the entity value.

	Evidence from users	**Evidence from preparers/auditors/others**
The measurement basis	This was not an area of concern unless the difference to IFRS, as identified by the reconciliation, was material. However, when it was material and a company used multiple measurement bases in its operating segments information, it was very difficult to understand the impact of this on the results of any individual operating segment.	Preparers felt that IFRS 8 was significantly better than IAS 14, as it did not require them to report numbers that were not reported elsewhere in the financial statements or used internally. The majority used a measurement basis close to IFRS to reduce complexity. Some preparers also said that they would continue to use a measurement basis close to IFRS only as long as IFRS continued to reflect the economics of the underlying transactions (for example, the current accounting for operating leases as a lessor under IAS 17, compared to those proposed in the *Leases* project).
Reliability of information	Users did not express any concerns about the reliability of the segmental information.	The numbers were as thoroughly audited as any other numbers in the financial statements. However, in some organisations without comprehensive accounting policies of their own it was not always possible for auditors to challenge the measurement basis: if those were the numbers used by the CODM, then those were the numbers that were required to be reported.

Question 4
How has the requirement to use internally-reported line items affected financial reporting?

8 The concept of a single reporting package for the use of the CODM was not consistent with modern practice, especially given electronic reporting. This was especially true for those CODMs who chose to 'drill-down' into summarised information presented to them. The outcome of this was that CODMs may look at lots of different information other than the information required to be disclosed by IFRS 8. The information CODMs use may also change over time.

	Evidence from users	**Evidence from preparers/auditors/others**
Consistency of profit measures	Profit measures were generally not comparable across companies. In some situations users felt this was deliberate. A study conducted by one user organisation identified that of four construction companies on a particular market, three used a measurement basis that excluded adjustments required by IFRIC 15 *Agreements for the Construction of Real Estate*. Each of these three companies chose a different way of measuring performance.	Most significant line items not included were 'extraordinary' items that do not relate to recurring cash flows or that are linked to accounting requirements not looked at for internal purposes (e.g. amortisation). Some preparers also excluded financing costs, as these did not reflect the results of a segment. Preparers felt that the definition of profit reflected the activities of the entity, and depended upon this. In some cases, this resulted in measures comparable with those of other entities. Auditors had generally not considered whether the information was comparable, but looked at whether the measures of profit were consistent with management accounting.
Differences between reporting packages and IFRS 8 disclosures	Disclosed line items sometimes summarised multiple different items. Breakdowns of this summarised information were sometimes made available to analysts on request.	Disclosed line items sometimes summarised multiple different items. The basis for disclosing line items in IFRS 8 is the information that is regularly provided to the CODM. Modern reporting methods mean that the CODM may review information that is not part of a regular reporting pack. However, whether this was done (such as drilling down into reporting packs) depended on the nature of and the choices made by the CODM.

Question 5

How have the disclosures required by IFRS 8 affected you in your role?

9 The reconciliations between the total of reported segments and the values for the entity were not easily understood by users, and were sometimes included within 'all other segments'. Reconciliations were used to identify whether some adjustments to operating segment information needed to be made before inclusion in valuation models.

10 Geographic information could be difficult to prepare, especially for companies who are not organised on that basis. It was also not clear what country was required to be disclosed when a single transaction could take place across multiple borders. In some cases, geographic information was not disclosed.

	Evidence from users	**Evidence from preparers/auditors/others**
Information about geographic areas	Information on geographic areas was not always included.	In some entities, particularly financial services, it could be difficult to identify which country the revenue related to. This was particularly true within the European single market. For example, a company incorporated in the Netherlands may have a branch in Luxembourg that services a client in Germany. It was felt IFRS 8 was not clear on which country should be disclosed. Some specifically stated the notion of 'country of domicile' was outdated. A global consumer goods company noted that additional data-collection processes had to be put in place to identify the country of revenue.
Information about products and services	Information on products and services was not always included.	Preparers did not understand why the information was on a different measurement basis to the other requirements in IFRS 8 and felt that it would be easier if it were the same.
Reconciliations between measurement basis and IFRS basis numbers in financial statements	Some companies included measurement basis and consolidation adjustments within 'all other segments' and did not present a separate reconciliation. When reconciliations were prepared, the key use was in identifying if there were material differences between IFRS and the measurement bases used by the entity. If the value of the reconciling items was not material in	When deciding on the level of disclosures, a similar level of materiality was used as for the rest of the financial statements. Preparers recognised that reconciliations that they provided were not always easy to understand for users.

	total, it was not considered further. When there were material reconciling items, it could be very difficult to understand what they were and how they arose.	

Question 6 **How were you affected by the implementation of IFRS 8?**

Implementation experiences

11 Users specifically stated that due to the long period of time since implementation of the standard, they were not able to give detailed evidence on how the transition had affected them. EFRAG believes that this should be considered during future Post-implementation Reviews.

	Evidence from users	**Evidence from preparers/auditors/others**
Implementation experiences	Users have found it difficult to analyse financial statements and derive robust valuations from them. It was not possible to give detailed information on what changes had been made to valuation models due to the long period of time since the standard was adopted.	Implementation was generally simple, but the entity-wide disclosures were more difficult than expected. In some cases additional costs were incurred due to putting in place additional controls.

Appendix 2: List of Outreach Events and evidence gathering sessions

EFRAG hosts outreach events across Europe in partnership with National Standard Setters and user organisations. The outreach events are an opportunity for constituents to directly contribute to EFRAG's input to the IASB and express their views on topics of interest. During the autumn 2012 series of outreach events, the following included a session on the IFRS 8 Post-implementation Review and contributed to this summary of evidence. Feedback statements will be published on the autumn 2012 outreach events page on the EFRAG website. Input was also obtained from EFRAG User Panel members at its September meeting.

Date	Location	Event
14 September 2012	Amsterdam	EUMEDION Audit Committee
28 September 2012	Brussels	EFFAS Financial Accounting Committee
11 October 2012	Brussels	European Outreach Event
29 October 2012	Copenhagen	Joint Outreach Event with the Confederation of Danish Industry and FSR – Danish Auditors.
8 November 2012	Warsaw	Joint Outreach Event with the Polish Accounting Standards Committee and Ministry of Finance
13 November 2012	Frankfurt	Joint Outreach Event with the German Accounting Standards Committee