EFRAG

European Financial Reporting Advisory Group

EUMEDION

CORPORATE GOVERNANCE FORUM

EUMEDION Audit Committee

Joint Feedback Statement

Amsterdam - 14 September 2012

Introduction and outline

EFRAG Outreach events

EFRAG holds outreach events in partnership with National Standard Setters and user groups across Europe on a regular basis on topics of general interest to constituents.

For more details of the Autumn 2012 series of events, please see the EFRAG website.

EUMEDION

Eumedion was founded in 2006 and represents institutional investors' interests in the field of corporate governance and sustainability, especially in the Netherlands. 70 participants represent and manage more than €1,000bn in assets.

EUMEDION Audit Committee

The EUMEDION Audit Committee keeps up-to-date on financial and non-financial reporting and advises on the roles and responsibilities of company audit committees and the external auditor.

Françoise Flores, EFRAG Chairman, Saskia Slomp, Director at EFRAG and members of EFRAG and IASB staff, together with representatives of ESMA and The Netherlands Authority for the Financial Markets, attended the part of a meeting of the EUMEDION Audit Committee that was dedicated to the Post-implementation Review of IFRS 8.

EUMEDION Audit Committee members were informed of the latest EFRAG activities and gave evidence as part of the post-implementation review of IFRS 8 *Operating Segments*.

Purpose and use of this feedback statement

This feedback statement has been prepared to summarise the messages received from EUMEDION Audit Committee members.

Evidence on experiences with IFRS 8 *Operating Segments* has been used in the preparation of EFRAG's response to the IASB's *Request for Information.*

This feedback statement has been prepared by the EFRAG secretariat for the convenience of constituents. The content of the report has not been subject to review or discussion by the EFRAG Technical Expert Group.

Summary of contents

EUMEDION CORPORATE GOVERNANCE FORUM

EFRAG European Financial Reporting Advisory Group

IFRS 8 post-implementation review

Information to be considered together with this document

This document should be considered together with the IASB's *Request for Information*, issued as part of the post-implementation review. This, and other information on the project, are available on the EFRAG website.

Background to the post-implementation review

IASB Investor Liaison Hilary Eastman briefly described the post-implementation review process, and noted that the number of responses to the request for information was currently limited. She also mentioned the more common issues that were raised around the standard:

- Identification of the Chief Operating Decision Maker – could it be more than one individual or group; and
- How and when to aggregate and disaggregate segments for reporting purposes.

There had been an expectation that IFRS 8 would result in an increase in the number of segments reported, and this was partially the case. In some jurisdictions, the change was limited but this could potentially be explained by the fact that entities had aligned their internal reporting to the external segment reporting.

Post-implementation reviews are a new part of the IASB's due process, and apply to new standards or major amendments that have taken effect since 2009. The post-implementation review of IFRS 8 is the first to be carried out. IFRS 8 was adopted in 2006, replacing IAS 14, and increased convergence between IFRS and US GAAP.

The outcome of the post-implementation review will be considered when the IASB decides on its future agenda, and options could include:

- Further monitoring should the post-implementation review be inconclusive;
- Retaining IFRS 8 as issued; or
- Revising IFRS 8 to remedy any problems identified.

Areas being investigated

The themes for investigation as part of the post-implementation review are the key decisions taken when adopting IFRS 8 as well as implementation experiences. These key decisions, and how they differ to those underlying IAS 14, are set out on the next page.

A review of existing academic literature and publically available material from accounting firms, regulators and investors has also taken place.

Changes from IAS 14 to IFRS 8

Management basis of identifying operating segments

IAS 14 required segments to be identified either on the basis of businesses or on the geographical environments where the business operated. IFRS 8 requires segments to be defined 'through the eyes of management', so segments are those used internally and reported to the chief operating decision maker (CODM).

Management determined measurement basis

IAS 14 required the amounts disclosed for each line item and segment to be on a measurement basis consistent with the rest of the financial statements (i.e. IFRS measurement basis). IFRS 8 requires the amounts to be on the same basis as the one used by the CODM when allocating resources.

Internally reported line items

IAS 14 required a company to disclose specific line items for each reported segment. IFRS 8 requires disclosure only if those line items are regularly reported to the CODM.

Disclosure requirements

As well as requiring reconciliations between the operating segment information required and IFRS numbers for certain line items, IFRS 8 also requires certain information across the entity, including revenue by type and country (where material).

Management basis for identifying operating segments

Summary of evidence received from EUMEDION Audit Committee members on the impact of the management approach to identifying operating segments – page 1.

Area	**Comment**
Identifying the Chief Operating Decision Maker	A large number of companies identify the board as the CODM. This is difficult to understand, especially when the board contains non-executive directors, who for corporate governance reasons should not be taking operating decisions. There is also a lack of clarity in IFRS 8 on whether the CODM is an operating function, or strategic, given they are responsible for allocating resources – which could be strategic level decision making.
	A lot of companies aggregate businesses into reported segments in a way that difficult to understand, difficult to compare, and does not reflect how investors would like to assess the company. This is especially a problem if a company reports a combination of geo and business segments in one overview.
	In many cases companies' segment disclosures are not granular enough: very frequently it appears that the CODM-view somehow results in only two or three operating segments.
	The requirement to define operating segments based on reporting to the CODM is possibly hindering better disclosure, given that the CODM may be very senior and only receive summarised information. A significant disadvantage of the CODM approach is that in many cases comparability over years is hindered by frequent changes in how the CODM views the business, even if the underlying businesses from a risk and return perspective has not changed that much.

Management basis for identifying operating segments

Summary of evidence received from EUMEDION Audit Committee members on the impact of the management approach to identifying operating segments – page 2.

Area	Comment
The use of segmental disclosure	Information on operating segment disclosures is not regularly used to assess the performance of management, but is used in fundamental analysis to model revenue and margin development. The segments also are important for assessing risks.
Defined Segments	Characteristics of operating segment disclosures that were not found helpful were where the segments were very uneven (for example, an entity which disclosed two segments, one of which was 90% of the company) or where a single segment contained multiple different business operations. An example of this was a company that included the processing of raw materials and retail sales in a single segment.

Management determined measurement basis

Summary of evidence received from EUMEDION Audit Committee members on the impact of a management determined measurement basis

Area	Comment
The use of a non-FRS measurement basis	It is frequently not clear what the measurement basis is. The grand total of all segments and intersegment eliminations may be identical to a line item measured according to IFRS, but that does not need to imply that the results per segment are also measured according to IFRS. If through the eyes of management certain charges are allocated from one segment to another (for example ‘corporate’), the net effect is zero and requires no reconciliation to the grand total.
	It is highly important that users are able to identify what part of the presented line items are attributable to the common shareholders of the reporting entity (as opposed to what part is attributable to outside shareholders of any partially owned subsidiaries). This is not only relevant for the primary financial statements, but also for segment reporting.

Internally reported line items

Summary of evidence received from EUMEDION Audit Committee members on the impact of only requiring disclosure of internally reviewed line items

Area	Comment
Disclosure only of those line items reported to the CODM	In terms of the big picture of understanding operating segments, the major problem faced is in the identification of operating segments and not the number of line items.
	The use of line items that have an alternative measurement basis in segment reporting is not considered to be a problem, with an important caveat: instead of a reconciliation of the grand total to IFRS only, the unadjusted IFRS line item should be added to the table. This allows users to compare the differences per segment.
	It would be nice to be able to identify the amount of working capital employed in an operating segment, and also the total capital employed.
	Comparability is important, but if there are material differences in the measures used by different companies they are considered when conducting analysis. Indicators that there may be major differences include large eliminations and large items that reconcile to IFRS.
Helpful operating segment disclosures	An example of operating segment disclosures that was considered helpful was the publishing company *Reed Elsevier* that broke down its operations in three different ways. This allowed the information to be analysed in the way the analyst found most helpful. In general, segment reporting should at least include both a business breakdown and a geographical breakdown.

Entity-wide disclosures

Summary of evidence received from EUMEDION Audit Committee members on the entity-wide disclosure requirements

Area	Comment
Overall impact of IFRS 8	The overall opinion is that IFRS 8 requires a number of amendments to better reflect user needs.