EFFAS THE EUROPEAN FEDERATION OF FINANCIAL ANALYSTS SOCIETIES

IASB – International Accounting Standards Board
IFRS – International Financial Reporting Standard

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Post Implementation Review: IFRS 8 Operating Segments
Comments by the European Federation of Financial Analysts Societies (EFFAS)
Financial Accounting Commission – FAC

Dear Madam, dear Sir,

The European Federation of Financial Analysts Societies is the European umbrella organization of national analysts' societies. It comprises 27 members representing more than 16,000 users' professional in the areas of equity and bond research, asset management as well as investment advice. EFFAS Commission on Financial Accounting represents the views of investment professionals in the field of accounting. ***(Question -1)***

The Financial Accounting Commission is pleased to share with you the views of European users of financial statements regarding implementation of IFRS-8. We believe that segment information is of utmost importance for analyzing financial statements. Knowledge about segment performance allows a better analysis of income origination, margins, cash flow and capital utilization. However, that information presented in a single financial statement can hardly be identified. Without segment information, financial statements can be very misleading.

Additionally, and even more importantly, segment information should allow users to compare information in the financial statements with outside information such as official statistics related to the various business activities and similar information from other groups. This information permits users to understand the underlying economics of the various components of a group and for this reason we believe that segment information is at the very center of how analysts and other users rely on information provided by issuers. Moreover, such information along with investors' sector knowledge facilitates allocating investors' funds in the most efficient manner.

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When the proposal to move from IAS 14 to IFRS 8 was announced, many analysts believed that the real aim was to reach convergence standards with US GAAP. In fact, analysts were reluctant to accept the notion of the management perspective as it was believed to be too flexible and could significantly impair the value of segment reporting. Consistency and comparability was a major concern.

In 2008, the standard became effective and three years into its application, analysts have observed that segment reporting presented with the eyes of the Chief Operating Decision Maker (CODM) has provided diverging interpretations sometimes based on different legal frameworks. A survey of 65 Swedish entities showed that some entities defined the CODM as the Board, others as the CEO or the management group or simply just wrote chief operating decision maker.

In addition, based on both the experience of members of the Financial Accounting Commission and as a result of meetings with users in national societies it can be said that the management approach leaves room for great flexibility in segment identification. We have been presented with cases where users would not recognize the segments identified as relevant and thus not providing useful information regarding the performance of the various components of the groups. We have also reviewed cases of companies that have changed the identified segments for unexplained reason at least not discussed in their management report. In some instances, the segments were changed because some sub-segments had been reallocated to other segments without sufficient disclosure and reconciliation. *(Question- 2)* As an illustration, we have in mind a major European company that opted for early adoption of IFRS 8 and has changed the definition of segment and sub-segment every year preventing users from doing any meaningful time series analysis. In London in February 2012, the Financial Accounting Commission had an opportunity to discuss this and other examples from published financial statements with the IASB Board and staff. ***(Question 4-6)***

Regarding information provided at segment level, we believe that the introduction of the management perspective has significantly impaired comparability between companies. In particular, we base our position on two research papers published by one of the national society member of EFFAS. The first research was based on a sample of the largest 53 companies of one European country[1] for fiscal year 2010 and the second research covered a sample of 50 of the largest European groups[2] for fiscal year 2011.

Key findings of the national report were the following:

- There was a general cohesiveness between the definition of segments in the annual report, the MD&A and the slides used for investor presentations.

- There were about 15 different definitions of "profit" (EBITDA, adjusted EBITDA, EBIT before PPA, operating profit before exceptional items etc.) for the segment, most of which were based on non-IFRS definitions.

[1] SFAF report published November 2011.
http://www.sfaf.com/index.php?option=com_docman&task=cat_view&gid=23&Itemid=465
[2] SFAF report published November 2012.
http://www.sfaf.com/index.php?option=com_docman&task=cat_view&gid=23&Itemid=465

- Around 50% of the group using a non-GAAP measure of profit did not provide any reconciliation of this “profit” with a IFRS GAAP measure of profit.

Key findings of the European report were the following:

- 76% of the sample published non-GAAP measures (sometimes several) of segment profit.

- There are more than ten different definitions of “profit”: EBITDA, adjusted operating income, underlying profit, core profit, business operating profit,… .

- 28% of the sample did not provide any reconciliation at segment level between the non-GAAP measures for segment profit and IFRS operating income.

The two research papers show that moving from IAS 14 to IFRS 8 has created a proliferation of definitions of segment profit and in most cases without reconciliation to an IFRS GAAP. This means that comparability between companies has decreased and segment reporting is not as useful when comparing companies within similar sectors. In fact, we think that this challenges a key argument for IFRS adoption particularly in the European Union namely comparability. The Financial Accounting Commission presented additional examples related to this from published financial statements at a joint meeting with IASB and EFRAG in Brussels in September 2012.

It should be mentioned that we support the publication of non-GAAP information at segment level as it might enhance the understanding of the various business activities. However, we believe that non-GAAP information should be reconciled at each segment level to facilitate comparability with other groups involved in similar activities. This is a key concept to ensure segment information to be useful. ***(Question 3)***

We question the argument heard in many occasions stating that the identified problems created by implementing IFRS 8 are due to the lack of enforcement. We believe that a standard based on the management approach inherently embeds the risk of being less transparent presenting segment information and in return provides less-usable and non-useful information.

Therefore, we are convinced that IFRS 8 should be adjusted and revisited to:

- include *a de minimis* reconciliation, at segment level, between non-GAAP management measures and IFRS measures;
- any difference between segments and group profit should be reconciled and explained in detail, stating in particular why these incomes and expenses are unallocated;
- definition of segments: there should a detailed definition of the segment (just a single name can be misleading);
- any change in segments: there should be a detailed explanation for the changes.

Users will welcome information illustrating reconciliation between segment reporting and financial statements that permits comparability. Management changes in how business are operated rate should also be explained to understand changes in segment reporting.

We believe also that the geographic information not only of sales (previously available under IAS 14), is of great importance for users. As illustrated in some past instances (Russian, Asian, and Euro zone crisis) it can be the most important and the most relevant information for the investor.

If you have any question and/or would like to comment on specific points, the commission will be more than willing to do so.

Best regards,

Javier de Frutos
Chair, EFFAS Commission on
Financial Accounting

EFFAS Financial Accounting Commission

EFFAS was established in 1962 as an association for nationally-based investment professionals in Europe. Headquartered in Frankfurt am Main, EFFAS comprises 27 member organisations representing more than 16,000 investment professionals. The Commission on Financial Accounting is a standing commission of EFFAS aiming at proposing and commenting on financial issues from an analyst standpoint. FAC members are Javier de Frutos (Chairman, Spain), Jacques de Greling (Vice-Chairman, France), Friedrich Spandl (OVFA, Austria), Henning Strom (NFF, Norway), Ivano Mattei (AIAF, Italy), Taras Koval (USFA, Ukraine), Jérôme Vial (SFAA, Switzerland) and Rolf Rundfelt (SFF, Sweden).

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