Date

12 May 2006

Le Président

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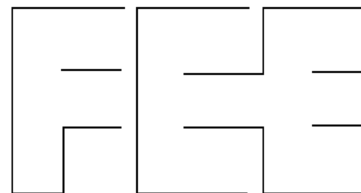


Mr. Stig Enevoldsen
Chairman
Technical Expert Group
EFRAG
Avenue des Arts 13-14
1000 BRUXELLES

Dear Mr. Enevoldsen,

Re: Draft EFRAG comment letter on IASB ED 8 *Operating Segments*

1. FEE (Fédération des Experts Comptables Européens, European Federation of Accountants) is pleased to submit its comments on EFRAG's preliminary views. EFRAG's draft comment letter on the Exposure draft on Operating Segments has been very helpful to us in our discussion of the document. We in particular focus on those issues where we are in disagreement with EFRAG or where we have additional views to present.

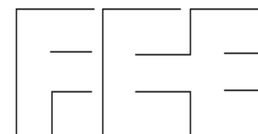
2. We share the concerns of EFRAG regarding some proposals in the exposure draft. We support the use of management approach to identify the operating segments because it enables users to see an entity through the eyes of management. However like EFRAG, we oppose the use of internal accounting policies to measure the segment information, where those policies are different from IFRS accounting policies used in the entity's financial statements.

3. We are not convinced by the reason for changing the standard on segment reporting. The subject is part of the short-term convergence topics in the Memorandum of Understanding between IFRS and US GAAP (27 February 2006). However, we are not aware that segment reporting impacts the reconciliations requirement for US registrants. Achieving convergence on this issue is not a priority for us. The Basis for Conclusions has not proved why IAS 14 is in need of significant changes. We agree with the alternative view in AV6.

4. As stated in our Position Paper "Financial Reporting: convergence, equivalence and mutual recognition", FEE recognises the need for robust, high quality global financial reporting standards and supports the objective of creating a single set of global standards which, however, must ultimately be subordinate to the objective of preserving and improving the quality of principle-based IFRS financial reporting. High quality financial reporting is the overarching objective of standard setting. Long term convergence of standards is desirable but convergence must involve an approach of seeking the best solutions for accounting issues. We believe that the best solution for segment reporting is to identify the segments on the basis of internal reports used by management and to report the information of those segments based on IFRS measures. Therefore, if there is to be a change, we suggest that both IAS 14 and SFAS 131 be amended in this way to converge towards the best solution.

5. Furthermore, we fear that adopting SFAS 131 in IFRS standards may not be sufficient to achieve convergence as this FASB statement is supplemented by detailed guidance to implement it under US GAAP (for example EITF, Staff positions, Action alerts)

6. We have the following comments on the answers to the questions raised in the Exposure Draft included in the appendix of EFRAG's letter.



Question 1 – Adoption of the management approach in SFAS 131

The draft IFRS adopts the management approach to segment reporting set out in SFAS 131 *Disclosures about Segments of an Enterprise and Related Information* issued by the US Financial Accounting Standards Board.

Is this approach to segment reporting appropriate? If not, why not? What, if any, alternative approach would you propose?

EFRAG draft response:
We agree that the management approach is the most appropriate way to determine reportable segments. Such an approach enables users to view the entity's internal organisation and structures from the same perspective as management, which is presumably the perspective that management believes is the most useful to provide users with the most relevant insight in the entity's operations. We also agree that the adoption of such an approach in the external financial statements ought to result in improved segment information, as it is likely that more detailed information about the different components of an entity will be reported if the reportable segments are those the management itself uses to manage the business. For those reasons we believe that the users of the financial statements will benefit from this revised approach to segmentation, because it will enhance their ability to understand and assess better the management actions and estimate better the future cash flows.

However, the proposal to require the use of management's own internal reporting data, even if they are non IFRS compliant ('non IFRS compliant internal reporting data') to report on those identified segments seems to us to be less straight-forward.

- Judging by the explanations in the exposure draft, it would appear that FASB decided that under its old segment reporting standard (SFAS 14) insufficient segmental information was being disclosed, particularly in the interim financial report, and that, to encourage an increase in the amount of segmental information provided, entities needed to be allowed to use the management approach both to segment identification and to measuring the financial performance and financial position of those segments. That may well have been the right decision in those circumstances at that time, but we think the position under IFRS is somewhat different and, as a result, it cannot simply be assumed that adopting the US approach in IFRS will necessarily improve the segmental information provided under IFRS.

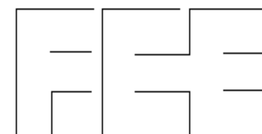
- It is generally accepted that, if financial information is to be of use to users, it needs to be supported by detailed analyses and by explanations of the methodologies used; the internal consistency of the information is also important, as is the comparability of the information with that of other entities'. The proposal is that explanations of the methodologies used will be provided, that the aggregate of the segment information shall be reconciled to the primary financial statements, and that the nature of the reconciling items involved shall be disclosed. Such a disclosure provides users with some information but, unless they understand how much of the difference is attributed to which type of reconciling item and which segment is affected by what, it seems questionable how useful the reconciliation will actually be.

- The exposure draft argues that an advantage of using internal reporting data is that it would enhance the consistency with the MD&A and with other annual report disclosures. We agree that it would be preferable if all the information in the annual report was prepared on the same basis; however, if more than one basis is used it is not clear to us why it is better that the segment information should be consistent with the MD&A than with the primary financial statements. Moreover, most regulators require that non GAAP measures used in the MD&A be reconciled to the financial statements.

- We note that in paragraph BC10 of the Basis for Conclusions the IASB argues that it is increasingly unlikely that there will be substantial differences between IFRS accounts and internal reporting data. If that were true, it would not really matter in the vast majority of cases whether the standard requires internal reporting data or IFRS measures to be used.

- We recognise that the exposure draft is offering almost full convergence between IFRS and US GAAP on segmental reporting and that, if we favour an approach that is different from that proposed in the exposure draft, we are in effect saying that we believe it is more important to adopt our favoured approach to measuring reportable segments than it is to achieve convergence on this issue. Recommending an approach that will not achieve convergence when a convergence opportunity exists is not something that anyone should do lightly.

Having considered all these arguments carefully, we have concluded that we do not support the use of internal reporting data. That is because we believe the segment information will be more useful to users were IFRS accounts to be used instead, and that we do not believe that a deterioration in the quality of the information provided is a cost worth paying for convergence on this issue at this time. We would recommend that the IASB and FASB explore other means of achieving



convergence on this issue. In reaching this conclusion, we were particularly influenced by three points:

- At the moment companies are still struggling with the practical consequences of transitioning in their external financial reports to IFRS and, as a result, currently there may be in many cases substantial differences between IFRS accounts and internal reporting data.
- We have not been persuaded that users would prefer internal reporting data to be used in preparing segment information but not when preparing the primary financial statements themselves. Using two bases will, we believe, cause confusion and will impair the usefulness of the information package as a whole.
- In using IFRS accounts to produce segment information, there seems to be no requirement to allocate amounts that cannot be easily allocated to segments. Such amounts should however be identified and explained.

FEE response:
We support EFRAG's draft response. As mentioned in our general remarks, we believe adoption of the management approach to determine the reportable segments will improve financial information provided to users. However, we do not support the use of management internal reporting data for segment reporting in IFRS accounts.

We support the alternative view expressed in AV5: proper external reporting of segment information should not permit the use of non-GAAP measures because they might mislead users. Using two bases for reporting will confuse users and will impair the usefulness of the information. Furthermore, such approach is contrary to the Framework characteristic of comparability. We suggest EFRAG to insist firmly on this argument. Reconciliations would not be more useful than appropriate information. Furthermore, it is contradictory when the Board itself brings forward the argument that segment information based on internal reporting data instead of IFRS figures is more decision useful, when the objective of IFRS financial statements (including segment information) is to provide information that is useful in making economic decisions according to the Framework.

The paragraph BC 10 is not a convincing argument for the management approach. If it is unlikely that there would be significant differences between IFRS accounts and internal reporting data, the use of IFRS compliant data would not be burdensome.

We acknowledge that information on the assessment by management of their financial position and performance is useful for the readers of financial report in order to better assess the entity's prospects and the resulting future cash flows. However, this information is better placed in a Management Commentary or Director's Report than in the IFRS financial statements.

EFRAG, in its response to question 1, stated that "we have not been persuaded that users would prefer internal reporting data." Does this viewpoint follow consultation with users? In such case it might be useful to expand the observation to indicate why users have such opinions and eventually which users EFRAG has been able to tap.

Question 2 – Divergence from SFAS 131

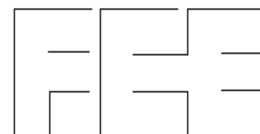
Do you think that the draft IFRS should depart from the management approach in SFAS 131 by setting requirements for

(a) the measurement of specified items or

(b) the disclosure of specified amounts that might otherwise not be given?

If so, identify the requirements you would add and indicate what you see as the relative costs and benefits of any such requirements.

EFRAG draft response:
The IASB is in effect faced with a choice: either converge or adopt one of the various non-converged approaches available. As explained in our answer to question 1, we think it important that IFRS measures are used to prepare



segment information; in our view this is more important than simply achieving convergence.

FEE response:
We agree with EFRAG and believe it is more beneficial to use IFRS measures for segment information than to converge with US GAAP on this point. We think the draft IFRS should depart from SFAS 131 for the measurement of items reported.

Question 3 – Scope of the standard

The existing standard IAS 14 requires entities whose equity or debt securities are publicly traded and entities that are in the process of issuing equity or debt securities in public securities markets to disclose segment information. The draft IFRS extends the scope to include also entities that hold assets in a fiduciary capacity for a broad group of outsiders.

Do you agree with the scope of the draft IFRS? If not, why not?
EFRAG draft response:
The Basis for Conclusions reports that the Board considered extending the scope of the proposed standard to all entities defined in the SME project as publicly accountable, but eventually decided to extend it only to some unlisted publicly accountable entities (in particular those that hold assets in a fiduciary capacity). However, it does not explain:

- why the extension proposed is considered appropriate. This makes it difficult to comment on the appropriateness of the proposal. Presumably the view has been taken that, say, customers depositing money at an unlisted bank are interested in exactly the same information about that bank that its shareholders would be interested in were the bank listed. We wonder whether that is really the case; in other words, we wonder whether segment information is really what the 'public' wants in at least some of these cases.

- how the standard would apply in at least some of the cases. For example, assume that the reporting entity is an unlisted conglomerate with a small banking subsidiary. It would appear that the group would be required to prepare segment information even though only one small part of the group acts as a fiduciary and even if the banking activity is shown as a single segment. We question whether this is really what is intended.

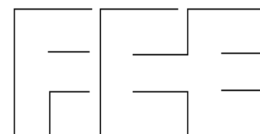
  Similarly, we think it might be worth considering exactly what the standard would require, say, a mutual fund to provide in the form of segment information. It is not controversial that such entities should provide some sort of analysis of their investment portfolio, but it is less clear that the draft standard, if strictly applied, would actually require such disclosures.

We think it would also be useful if the standard could explain exactly what is meant by 'fiduciary'. This may be a well-understood notion in some countries, but would appear to be a less understood term in some other countries.

The draft standard proposes that, if an entity that prepares its financial statements in accordance with IFRS is not required to provide segment information by this standard nevertheless chooses to provide segment information, it cannot state that the financial statements have been prepared in accordance with IFRS unless the segment information provided complies with the detailed requirements of this standard. We support this latter proposal.

FEE response:
We agree with EFRAG that the extension of the scope is not clearly justified in the Basis for Conclusions. It is not clear why holders of fiduciary assets would be interested in segment reporting. We believe they are usually more interested in information on the value of their assets and the fluctuation. We have the impression that in EFRAG's analysis, fiduciary is understood to include "on-balance positions". We would be really concerned if assets under management of banks and insurance entities would need to give rise to separate segment reporting requirements and encompass such assets in positions. We would prefer the scope of the standard to remain as it is in IAS 14.

Regarding paragraph 3 of the scope, we question whether financial information on segregation of the activities disclosed in the notes, which is not labelled 'segment information', must be in compliance with the IFRS on segment reporting.



Question 4 – Level of reconciliations

The draft IFRS requires an entity to provide, for specified items, reconciliations of total reportable segment amounts to amounts recognised by the entity in accordance with IFRSs. It does not require such reconciliations for individual reportable segments.

Do you agree with the level of reconciliations required in the draft IFRS? If not, indicate what you see as the relative costs and benefits of any other level of reconciliation.

EFRAG draft response:
The draft IFRS specifies the line items that should be dealt with in the reconciliations. We agree with the line items proposed.

FEE response:
We agree with the level of reconciliation. If individual segments are prepared under IFRS measures, it is not necessary to require reconciliation for individual reportable segments. However, if the proposals in ED 8 are kept in the final standard, reconciliation for individual reportable segments should be required.

Question 5 – Geographical information about assets

The draft IFRS requires an entity to disclose geographical information about non-current assets excluding specified items. It does not require disclosure of geographical information about total assets.

Do you agree with the requirement to disclose geographical information about non-current assets excluding specified items? If not, for which assets would you require geographical information to be given?

EFRAG draft response:
We understand that the main reason why the proposed disclosure focuses on non-current assets rather than all assets is because the location of many current assets is easy to change quickly and therefore is often not important. Furthermore, if there are restrictions on, for example, repatriation, other disclosure requirements will apply.

We agree with the approach proposed.

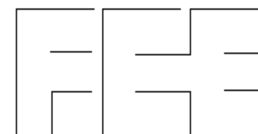
FEE response:
We agree with EFRAG and the approach proposed. We welcome the inclusion of intangible assets in the requirement for disclosure of geographical information about assets, through the use of the term "non-current assets" in ED 8 instead of the term "long-lived assets" in SFAS 131 as explained in BC15. Furthermore, we note that the exposure draft does not provide any basis for requiring disclosure on non-current assets and not all assets. Since it is a change compared to IAS 14, it should be explained in the Basis for Conclusions. EFRAG has itself presumed the argument for this approach but we suggest asking IASB to include it in the Basis for Conclusions.

Question 6 – Consequential amendments to IAS 34 *Interim Financial Reporting*

The draft IFRS requires an entity to disclose more segment information in interim financial reports than is currently required, including a reconciliation of the total of the reportable segments' measures of profit or loss to the entity's profit or loss.

Do you agree with the consequential amendments made to IAS 34? If not, why not?

EFRAG draft response:
We agree with the proposed amendment to IAS 34; such information should be provided in interim financial reporting even if internal reporting data are not to be used to prepare the segment information in order to help users understand the nature and impact of items – or part of items – of revenue and expense not being allocated to individual segments.



FEE response:
We agree with EFRAG and with the proposed amendment to IAS 34.

Other comments

EFRAG draft response:
Finally, we express a concern about the quantitative thresholds as described in paragraphs 12-18 of the draft IFRS. Although we understand that setting such thresholds can help ensure that sufficient segments are shown, we think the inclusion of quantitative thresholds of this kind is not consistent with a principle based standard. We are also concerned that, by mentioning explicitly a 10 per cent threshold, the effect might be to set some sort of precedent for determining materiality in other areas.
Including quantitative thresholds should not be understood as overriding basic and sound presentation principles defined in IAS 1 requirements. If, in addition to these basic requirements, quantitative thresholds are deemed helpful we believe they should only work on the basis of rebuttable presumptions, in order to avoid the well known "bright line" undesirable impacts.

FEE response:
We do not share EFRAG's concern about the quantitative thresholds. This guidance was already part of existing IAS 14 (paragraphs 35-38) and we do not believe it represents a threat to principle-based standard or a risk of abuse. The thresholds have been used by existing preparers of segment information.

We suggest that information on geographical areas be described by the term "economic area" instead of "country of domicile". To require disclosure of revenues and assets for the home country and for all foreign countries appears to be very US oriented. In the EU, an entity could have very low revenues from its country of domicile, but the economic area, i.e. the EU, would be an important part of its revenues. We believe it would be more relevant in an international standard to make this geographic distinction by economic areas instead of countries.

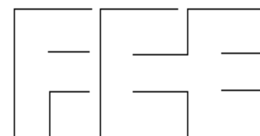
We suggest to IASB to clarify whether the currency used to present segment information should be the functional currency of each individual segment or the presentation currency of the group.

The example in the implementation guidance could be improved. We point out for example the table on page 6 cannot be easily linked to the reconciliations on page 7. The total revenues and the total profit and loss for the reportable segments on page 7, IG 4, cannot be found directly in the table on page 6, IG 3.

***Additional question**:*

EFRAG draft response:
From a purely practical point of view, using the internal reporting data for segment reporting will impose the lightest burden on preparers. It is noted in particular that it can be burdensome and arbitrary to allocate some IFRS measures to reportable segments, and that there are risks in requiring the disclosure of information for external reporting purposes that is not used internally. For these reasons it is likely that the use of internal reporting data is likely to result overall in more segment information being provided more quickly than any other approach. If the approach as proposed in the exposure draft is retained, the reconciliation requirements should be amended so that, where there is a difference between an internal measure and an IFRS measure, the difference is highlighted and fully explained at the segment level. Entities should be required to reconcile their segment information on a segment by segment level to IFRS-based segment information.

FEE response:
We do not agree with this alternative view in EFRAG's draft response. As mentioned in our general comments and in Question 1, we do not support the use of management internal measures for segment reporting. Furthermore, we are not convinced that the full reconciliation at the segment level would be less burdensome to preparers than to allocate IFRS measures to reportable segments, especially in cases where different internal measures or different currencies are used in different segments.



We would be pleased to discuss any aspect of this letter with you.

Yours sincerely,

David Devlin
President