EUMEDION
CORPORATE GOVERNANCE FORUM

<u>Submitted electronically</u>

To: International Accounting Standards Board
30 Cannon street
London EC4M 6XH
United Kingdom

The Hague, 4 August 2017

Ref: B17.20

Subject: Eumedion's response to IASB's exposure draft ED/2017/2 'Improvements to IFRS 8 Operating Segments'

Dear Members of the International Accounting Standards Board,

Eumedion appreciates the opportunity to respond to your Exposure Draft 'Improvements to IFRS 8 Operating Segments' ('ED'). Eumedion represents the interests of 65 institutional investors, all of whom are committed to a long term investment horizon. Eumedion aims to promote good corporate governance and sustainability in the companies our participants invest in. We regard accounting standards as a critical part of a global financial infrastructure, especially since investors are dependent on the quality of accounting standards for allocating their own and entrusted capital and act as engaged providers of capital. Together our participants invest over € 4 trillion of capital in equity and corporate non-equity instruments. Our views therefore represent a perspective of users of financial statements.

The relevance of meaningful segment reporting cannot be underestimated. Investors not only need to understand the economic characteristics of the entity as a whole, but also the characteristics of the key parts an entity consists of. Meaningful segment reporting therefore is of utmost importance to investors. IFRS 8 Operating Segments currently does not fulfill the needs of investors. We generally consider the suggested changes in the ED as improvements.

However, we need to express our disappointment that the ED foregoes on more fundamentally addressing the cause of lack of granularity in defining operating segments.

The segmentation criterion introduced by IFRS 8 in 2006 was and remains a major concern for investors as it is based on a 'through the eyes of management' approach for segmentations. The preceding standard, IAS 14 Segment reporting, relied on a more objective segmentation approach that was based on grouping activities with similar risks and rewards. Eumedion was one[1] amongst many[2] that has warned against the consequences of adopting the 'through the eyes of management' approach. In our response to the 2012 post implementation review of IFRS 8 ('PIR') we shared evidence of how IFRS 8 reduced the quality of segment reporting at companies[3]. Even the PIR feedback statement of the Board fails to identify a meaningful improvement in the quality of segment reporting in the years following the introduction of IFRS 8. We can only conclude that IFRS 8, for ten years and counting, has failed to better serve investors.

The current ED suggests a number of changes, many of which we do consider to be significant improvements and, with some modifications, may also improve specifically the problem of segmentation. However, we are convinced that the 'through eyes of management' approach is inferior to segmentations based on similar risk and return characteristics (IAS 14), as the latter is much more in line with the perspective of investors and is a more objective criterion.

If risk and return characteristics are significantly different between two activities, investors tend to prefer a separate operating segment for each activity even though through the eyes of management they may be managed as one. And reversely, if risk and return characteristics are not significantly different between two activities, we would tend to prefer the activities to be aggregated into a single segment, even though through the eyes of management they may be dissimilar. We believe that the risk and return assessment for segment definition in the preceding standard is more likely to also result in a more stable segment definition than the current 'through the eyes of management' perspective in IFRS 8. If there is no significant change in the risk and return characteristics of the segments, we would generally prefer a company to keep the segmentations unchanged, even if there is a change in how management views its business segments. The quality of segment reporting under IFRS 8 even after the proposed improvements will continue to rely on a rather obscure definition of a Chief Operating Decision Maker ('CODM') for which there is a fundamentally better alternative. ESMA also highlighted divergent practices[4] that may still prove difficult to resolve with the proposed improvements.

Still, some of the suggested improvements in the ED may indeed help direct managements' views more towards higher relevance and granularity. Dropping the 'through the eyes of management' approach may prove to be a bridge too far for this post implementation review. We alternatively request the Board to commit to a continued evaluation of the quality of the segment reporting under the hopefully soon to be improved standard. If the relevance and granularity in segment reporting does not significantly improve, the Board should reconsider abandoning the 'through the eyes of

[1] https://www.eumedion.nl/nl/public/kennisbank/consultaties/2007-06-ec-ifrs-8.pdf
[2] http://bruegel.org/wp-content/uploads/imported/publications/pc_sept2007_ifrs.pdf
[3] https://www.eumedion.nl/en/public/knowledgenetwork/consultations/2012-11_response_to_rfi_pir_ifrs_8.pdf
[4] https://www.esma.europa.eu/sites/default/files/library/2015/11/2011_372.pdf

management' approach, in favour of more objective and better auditable criterions like segmentations based on similar risks and rewards.

Please find below our detailed response to the individual questions in the consultation.

If you would like to discuss our views in further detail, please do not hesitate to contact us. Our contact person is Martijn Bos (martijn.bos@eumedion.nl, +31 70 2040 304).

Yours sincerely,

Rients Abma

Executive Director

Eumedion

Zuid Hollandlaan 7

2596 AL THE HAGUE

THE NETHERLANDS

Answers to the questions of the ED

Question 1

The Board proposes to amend the description of the chief operating decision maker with amendments in paragraphs 7, 7A and 7B of IFRS 8 to clarify that:

(a) the chief operating decision maker is the function that makes operating decisions and decisions about allocating resources to, and assessing the performance of, the operating segments of an entity;

(b) the function of the chief operating decision maker may be carried out by an individual or a group—this will depend on how the entity is managed and may be influenced by corporate governance requirements; and

(c) a group can be identified as a chief operating decision maker even if it includes members who do not participate in all decisions made by the group (see paragraphs BC4–BC12 of the Basis for Conclusions on the proposed amendments to IFRS 8).

The Board also proposes in paragraph 22(c) of IFRS 8 that an entity shall disclose the title and description of the role of the individual or the group identified as the chief operating decision maker (see paragraphs BC25–BC26 of the Basis for Conclusions on the proposed amendments to IFRS 8).

Do you agree with the proposed amendments? Why or why not? If not, what do you propose and why?

Response question 1: We agree that the proposed amendments may trigger an improvement in segment reporting, compared to the current IFRS 8 standard. As explained in the introduction of this letter, we do consider these improvements to be second best as we have more faith in a criterion that takes investors' segment information needs as a starting point, instead of the information considered by a CODM as a starting point. The proposed improvements acknowledge that in there can be a group of people that is involved in making operating decisions and decisions about allocating resources to, and assessing the performance of, the entity's operating segments. Broadening the definition of the Chief Operating Decision Maker ('CODM') and requiring the identification of the CODM is beneficial for investors, as it may be helpful in expanding the number of reported segments and help enforce the standard.

Question 2

In respect of identifying reportable segments, the Board proposes the following amendments:

(a) adding a requirement in paragraph 22(d) to disclose an explanation of why segments identified in the financial statements differ from segments identified in other parts of the entity's annual reporting package (see paragraphs BC13–BC19 of the Basis for Conclusions on the proposed amendments to IFRS 8); and

(b) adding further examples to the aggregation criteria in paragraph 12A of IFRS 8 to help with assessing whether two segments exhibit similar long-term financial performance across a range of measures (see paragraphs BC20–BC24 of the Basis for Conclusions on the proposed amendments to IFRS 8).

Do you agree with the proposed amendments? Why or why not? If not, what do you propose and why?

Response question 2: We agree with the amendments and have suggestions for further improvements. Eumedion observes that many financial reports, and even more investor relation presentations, provide more than one break down. Examples of different types of segmentations are: by product, customer, geographic area, technology, input type, revenue type, and very industry specific or even company specific segmentations. The proposed changes to IFRS 8 could be even more explicit that the CODM of an entity is most likely to use not one but several relevant break downs. Eumedion would like see that IFRS 8 more explicitly invites an entity to consider providing more than just one break down and mention some or all of the forementioned types of segmentations as inspiration for preparers. This is in addition to the helpful proposed paragraph 20A which relates to break downs not considered by the CODM.

We would like to highlight that the proposed requirement to explain differences between segmentations in the financial report and other parts of the annual reporting package should only be required in situations where other parts of the reporting package contain additional types breakdowns or a breakdown of a higher granularity than the one(s) presented in the financial accounts. Especially since not all parts of the annual reporting package may contain breakdowns. We see this requirement within the remit of IASB as it affects the financial accounts, i.e. such requirement does not govern other parts of the reporting package.

We expect the requirement in paragraph 22(d) to foremost result in better alignment between financial statements and other parts of the annual reporting package. The explanation may help investors in their engagement with companies on this topic.

Eumedion fully supports the new requirement that operating segments may be viewed as having similar economic characteristics only if they are similar across a range of measures of long-term financial performance.

Question 3

The Board proposes a clarifying amendment in paragraph 20A of IFRS 8 to say that an entity may disclose segment information in addition to that reviewed by, or regularly provided to, the chief operating decision maker if that helps the entity to meet the core principle in paragraphs 1 and 20 of IFRS 8 (see paragraphs BC27–BC31 of the Basis for Conclusions on the proposed amendments to IFRS 8).

Do you agree with the proposed amendment? Why or why not? If not, what do you propose and why?

Response to question 3: We agree with the amendments and have suggestions for further improvements. Eumedion considers this paragraph helpful as it allows for inclusion of segmentations based on the investor perspective insofar these are different from the management perspective. Preparers may find inspiration if the Board were to include some examples of different types of segmentations in the standard, such as segmentations by product, customer, geographic area, technology, input type, revenue type, and industry or company specific segmentations.

Question 4

The Board proposes a clarifying amendment in paragraph 28A of IFRS 8 to say that explanations are required to describe the reconciling items in sufficient detail to enable users of the financial statements to understand the nature of these reconciling items (see paragraphs BC32–BC37 of the Basis for Conclusions on the proposed amendments to IFRS 8).

Do you agree with the proposed amendment? Why or why not? If not, what do you propose and why?

Response to question 4: We agree with the amendments. We expect the proposed amendments to properly resolve the current uncertainty whether the measurement basis of line items of which the totals appear to be in line with the primary financial statements, indeed have the same measurement basis as the primary financial statements throughout each segment. We also are much in favour of the explicit requirements for unallocated amounts and intersegment eliminations. This significantly increases the credibility and also auditability of the amounts presented in operating segment information.

Question 5

The Board proposes to amend IAS 34 to require that after a change in the composition of an entity's reportable segments, in the first interim report the entity shall present restated segment information for all interim periods both of the current financial year and of prior financial years, unless the information is not available and the cost to develop it would be excessive (see paragraphs BC2–BC10 of the Basis for Conclusions on the proposed amendments to IAS 34).

Do you agree with the proposed amendment? Why or why not? If not, what do you propose and why?

Response to question 5: We agree with this amendment. Segment information is of great importance for investors. Changes in reportable segments immediately call for up-to-date comparable historical information. We reluctantly agree to include the escape from this disclosure due to 'excessive costs'. If this provision turns out to be excessively used, this element needs to be revised in the future.