

Corporate Reporting User Forum  
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International Accounting Standards Board  
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Dear Mr Lee

The Corporate Reporting User Forum welcomes the opportunity to comment on ED8 Operating Segments. Our response is set out below.

#### **About the corporate reporting user forum (CRUF)**

The CRUF came together in 2005 as a discussion forum to help its participants in their approach to the debate on current and future corporate reporting requirements. In particular, participants are keen to have a fuller input into the deliberations of the International Accounting Standards Board. CRUF participants come from across the City of London, including individuals from both buy and sell-side institutions, and from both equity and fixed income markets.

The CRUF is a discussion forum. It does not seek to achieve consensus views, though at times its participants will agree to make joint representations to standard setters or to the media. The chairmanship of the CRUF rotates at each meeting and different individuals take leadership in discussions on different topics and in the initial drafting of representations.

Its participants take part in CRUF discussions and joint representations as individuals, not as representatives of their employer organisations. Notwithstanding this, it would not be correct to assume that those individuals who do not participate in a given initiative disagree with that initiative. The members of the Forum that have specifically endorsed this response are listed below.

#### **General comments and convergence**

As users of financial statements we strongly support progress towards a unified set of global accounting standards, including convergence of IFRS and US GAAP. As part of this process we support a focus on principles based standards supported by clear guidance and sufficient disclosures to enable users to fully understand the performance, cash flow and financial position of reporting entities.

We recognise that as a rapid method of achieving convergence, the selection of the best of IFRS or US standards has some merit. However, we are concerned that where this results in a US

standard being unilaterally adopted this will often result in a move away from a principles based approach to ever greater detailed rules, although arguably not in the particular case of SFAS 131. Also we do not believe that convergence of segmental disclosures is a high priority given that this is not the cause of reconciling items. In our view there are aspects of both IAS 14 and SFAS 131 that could be improved. Therefore, we would ideally like to see a joint IASB/ FASB project to improve on both standards rather than simply adopting SFAS 131 largely unchanged. If the IASB does not wish to do this then we would agree with the adoption of SFAS 131 only if accompanied by the improvements that we outline below.

The purpose of segmental reporting should be to enable users to identify the performance of the components of a business. It should help users build forecasts of entity cash flows and facilitate sum-of-parts type valuations of businesses. All too often companies seek to comply with the letter of a standard rather than consider the ultimate reporting objective, which in the case of segment reporting might involve limited disclosures simply because of, for example, how the company has managed to define the chief operating decision maker. Therefore, we would like to see a clearer statement in ED 8 of the principles of segmental reporting and a requirement that reporting entities disclose whatever is necessary to comply with those principles, even if this necessitates disclosures that are not specifically mandated. Such principles should include a requirement that entities disclose sufficient information to enable users to identify segment performance, cash flow and return on capital. It should also include principles that would mean that further more detailed segments would need to be disclosed in addition to those reported on to the chief operating decision maker where a failure to do so would materially hinder users ability to understand the business.

### **Key concerns with ED8**

We recognise that there are several advantages to adopting a management approach to segment reporting including greater consistency with the management commentary in financial statements, consistency with other communications to users and also the facilitation of more comprehensive interim segmental disclosures. However, we are concerned that without safeguards this approach could lead to entities providing information that fails to meet the overall objective for segment information we outline above. For example, a management approach could involve the aggregation of information for segments that would be reported separately under IAS 14 when viewed more from a risks and rewards perspective. Also the performance and other metrics that are reported could take on a variety of forms with different entities using different non-GAAP measures and with no reconciliation to GAAP measures at the segment level under ED8 / SFAS 131.

Of particular concern to us is that, unlike IAS 14, ED8 does not include a requirement to analyse liabilities by segment. Segment return on capital is frequently used in the analysis of businesses and to only analyse gross assets by segment fails to provide sufficient information to derive meaningful returns. Clearly analysing liabilities by segment is generally restricted to what might be termed 'operating liabilities', but this is exactly what is required to generate segment return on capital given that the performance metric analysed by segment is generally a pre-interest operating income measure. Accordingly we would prefer a requirement to analyse (operating) liabilities by segment to be added to the existing SFAS 131 requirements.

Analysing cash flows is a key component of investment analysis and we are concerned that the ED 8 proposals do not provide sufficient information to enable cash flow to be analysed at the segment level. IAS 14 is also lacking in this regard. We would like cash flow analysis to be

included as a general principle of segmental analysis and also a measure of segment cash flow to be included in the list of disclosure requirements.

## **Answers to specific questions**

### **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?*

We agree that a management approach is appropriate, both to the determination of reportable segments and to the identification of metrics to be reported for each segment. However, we believe that for this approach to be successful then appropriate safeguards need to be put into place. These must ensure that a sufficiently detailed analysis of the business by segment is done to ensure that meaningful data is provided. This means being very clear what in principle is meant by ‘chief operating decision maker’ and a requirement to further analyse segments reported to the chief operating decision maker where there are material differences in the risk and reward characteristics of the components of a segment. We note that in the US it has been necessary for the SEC to issue additional guidance on SFAS 131 and we question how successful implementation of ED 8 would be without this additional guidance.

We also believe that a pure management approach to determining the metrics to be reported may not always provide useful information. It should not be left purely to the reporting entity to decide what measure of profit or loss to report by segment. This particularly applies to the allocation of costs to segments where IAS 14 creates a stronger imperative than does ED 8. It is also important that the measure of profit or loss reported is consistent with the definition of segment assets and liabilities.

### **Question 2 – Divergence from SFAS 131**

*The wording of the draft IFRS is the same as that of SFAS 131 except for changes necessary to make the terminology consistent with that in other IFRSs.*

*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.*

We are happy with the management approach and the consequence of this which is that metrics reported by different entities may not be entirely consistent. The greater consistency with management discussion and the increased relevance to users in being given metrics actually used

by management in decision making more than compensate for any lack of comparability between entities. However, we believe that safeguards should be in place such that an entity cannot report say gross profit by segment, thereby leaving significant costs unanalysed, when an analysis of operating profit or EBIT would be far more useful. This relates to our comments above that the allocation of costs between segments is important, as long as a reasonable basis for such allocation is available. Consistent with our answer to question 1 above, we believe that a measure of segment operating income that is consistent with the definition of segment capital to generally be the most useful for investors. A reporter should be required justify the disclosure of other metrics.

We believe that ED 8 should be amended to mandate the disclosure of the following items in addition to those included in SAFS 131

- a) Segment liabilities: This should be on a similar basis to that in IAS 14 with the overriding principle that the measure of segment profit or loss and segment net assets be consistent and suitable for use in measuring segment return on capital.
- b) Segment cash flow: Most of the components of segment cash flow are already mandated within ED 8. The only additional analysis would be for the change in working capital items.

### **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?*

We agree.

### **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.*

We do not agree with the level of reconciliation required in ED 8. We believe that the reconciliation to GAAP figures should be done at the level of the individual segments. We think this is important in a management approach such that an element of consistency and comparability is available to investors in addition to the benefits of having metrics actually used by management for decision making. For example, management may chose to evaluate segment performance before taking account of share based remuneration. While it is important to see this metric, we also believe it is vital that those costs that are unallocated in reporting to management are fully allocated (assuming a suitable basis is available) in the reconciliation with segment performance on a GAAP basis.

If it is deemed by an individual company that reconciling to GAAP at a segment level is too costly to be done in interim or quarterly reports, then we would accept that such a reconciliation be only done on an annual basis, for which it is likely most of the information would already be available.

#### **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?*

We have no strong views on the specific measure of assets that is disclosed in geographical information. As with operating segments we would like to see a stronger statement of the principles and objectives of reporting geographical information, particularly the role in identifying risks and currency exposures. An entity should be required to provide more information than merely a geographical analysis of revenue and non-current assets if this is necessary to achieve these principles.

We also question the focus in ED 8 on individual countries. It would be more helpful to users if the analysis were based on economic, political, currency and other risks. It would seem to us that such a basis is consistent with a management approach anyway.

#### **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?*

Yes we strongly support the requirement to give more segment information in interim reports. This is a key factor in persuading us that the management approach is appropriate.

Yours sincerely,

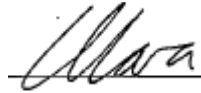


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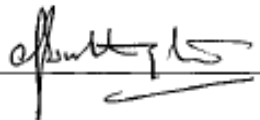
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