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Der Standardisierungsrat

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Sir David Tweedie
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Berlin, 18. Mai 2006

Dear Sir David

Re: Exposure Draft of IFRS 8 – *Operating Segments*

We appreciate the opportunity to comment on the Exposure Draft ED 8 *Operating Segments*. We certainly approve of the IASB's objective to bring about convergence between International Financial Reporting Standards and US generally accepted accounting principles, and we fully agree to the Board's decision to adopt the management approach as established under FAS 131.

In particular, we support the FAS 131 approach because it requires entities to provide information that reflects the structure of the entity's internal organisation and is actually used by management for purposes of allocating resources to segments and assessing their performance. We think that providing this information will help users better understand the perspective of an entity's management, and will consequently enhance their ability to predict actions or reactions of management that could significantly affect the entity's prospects for future cash flows. Furthermore, information reported under the management approach is likely to be more specific, and may be provided at less cost to the preparers.

We are aware that the proposed approach to segment reporting might result in segment disclosures being less comparable across entities than they currently are under IAS 14. Considering that comparability is an important characteristic of financial reporting, we perceive this to be a major disadvantage of the new approach.

On the other hand, we acknowledge that increasing comparability by requiring entities to report segment results that reflect IFRS accounting principles will inevitably lead to segment disclosures that, by way of the IFRS adjustments required, do no longer correspond to the segment measure of profit or loss reported to management and used for decision-making purposes.

Since therefore a principled decision has to be made as to whether requiring management information or information that is comparable across entities, we would, on balance, be willing to trade a degree of comparability for information we consider relevant because it reflects the perspective of an entity's management.

In taking this decision, we noted that ED 8 secures some minimum comparability by requiring an entity to provide a reconciliation of the total of segments' results to group profit or loss, and a separate identification and description of material reconciling items. We also considered that the comparability achieved by requiring application of IFRS in determining segments' results would be of limited usefulness given that IFRS segment allocation guidance (including IAS 14 guidance) is not sufficient to ensure a high level of comparability. In our view, far more detailed prescriptions of segment accounting principles, such as specifications of the basis of accounting for inter-segment transfers and methods of allocating costs common to two or more segments, would be required for inter-entity comparisons to be really meaningful.

Additional specifications, however, might encumber the standard and reduce its understandability. The complexity they would add would make it more difficult for preparers to adopt the standard. In contrast, ED 8 in its current shape sets forth a definite principle and provides clear, unequivocal guidance.

Furthermore, we think that cost considerations as well as corporate governance issues covering both internal and external reporting are likely to encourage entities to use a single set of information for all purposes. To the extent that entities are required to use IFRS in their external reporting, we expect most of them to tend towards adopting IFRS accounting principles for internal reporting purposes as well. For this reason, we anticipate that, as a rule, adopting the management approach as proposed will not result in segment information that will materially differ from segment information prepared using IFRS.

As a final remark, we would like to alert the Board to two issues not specifically addressed in the Invitation to Comment.

First, current IAS 14 provides a scope exemption to the effect that if a single financial report contains both the consolidated financial statements of an entity and the separate financial statements of the parent (or of one or more subsidiaries, equity method associates or joint ventures), segment information needs to be presented only on the basis of the consolidated financial statements (IAS 14.6 et seq.). Absent this exemption, segment information would also have to be disclosed for the single financial statements in such a case. We consider this exemption to be helpful and justified on the ground that disclosing segment information twice in the case discussed would be cumbersome for preparers, without providing decision-useful information for users. We would therefore strongly recommend retaining the scope exemption currently provided in IAS 14.6 et seq.

Second, we would like to ask the Board to reconsider its proposition made in ED 8.BC14 to the effect that "'*long-lived assets', as that phrase is used in paragraph 38 of SFAS 131, implies hard assets that cannot be readily removed, which would appear to exclude intangibles*." We think there is reason to conclude that, in principle, intangibles should be within the scope of SFAS 131, and that the potential difference between SFAS 131 and the proposed IFRS referred to in ED 8.BC14 et seq. may not relate to intangibles in general. For a discussion of this issue, and for our specific answers to the questions outlined in the ED, please refer to the appendix.

Comments to the Questions of ED IFRS X – Operating Segments

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?

As explained in our cover letter, we consider the management approach set out in SFAS 131 with its focus on the management's perspective to be an appropriate approach to segment reporting.

However, we would recommend amending the proposed disclosure requirements as far as information on segment assets is concerned. ED 8.22 requires an entity to report a measure of profit or loss and total assets for each reportable segment irrespective of whether total segment assets are regularly provided to the chief operating decision maker. We believe this requirement to be inconsistent with the management approach to the extent that an entity might have to disclose information on segment items even though this information is not used by management for purposes of allocating resources to segments and assessing their performance.

We acknowledge that most entities use information on segment assets for internal reporting purposes (and should therefore be required to disclose segment assets in the notes to their financial statements). However, in some industries such as the information technology industry or other services industries, management may not review assets by segments. In these cases, we do not believe that requiring an entity to disclose information on segment assets will provide any additional benefit to users of the financial statements.

Furthermore, it appears to be acceptable accounting practice under US GAAP for entities in the information technology industry that do not track assets by segments for internal reporting purposes to just state this fact and not provide any disclosures on segment assets at all (see for example the segment reporting of Microsoft or SAP in their 2005 annual SEC filings).

We therefore recommend amending the ED to require disclosure of total assets for each reportable segment only if this information is regularly provided to the chief operation decision maker.

Question 2 – Divergence from SFAS 131

The wording of the draft IFRS is the same as 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.

(a) As already pointed out in our cover letter, we are aware that under the management approach proposed in ED 8, comparisons across entities will be more difficult to make than is the case under IAS 14. This is because under the ED 8 there is no standardised segment measure of profit or loss; and even if two companies use the same measure, the reported segments results might not be comparable because they have been arrived at using different accounting policies. It is true that the draft standard requires a reconciliation of the total of the reportable segments' results to consolidated profit or loss before income tax expense or income and discontinued operations; but still, comparisons across entities will become more difficult than is the case under current IAS 14.

To amend this state of affairs and increase comparability, the new Standard might require using IFRS accounting principles in segment reporting, or prescribe a standardised measure of segment profit or loss, or both. In terms of enhanced comparability and consistency of reporting across entities, there is much to be said for requiring segment information to be provided based on IFRS accounting principles. Furthermore, we consider that requiring allocations to segments to be symmetrical – as current IAS 14 does – is certainly conducive to segment information that is both meaningful and comparable.

On deliberation, however, we would advise, albeit somewhat reluctanty, not to set any such requirements. First and foremost, such requirements might prejudice the management approach. Any entity that does not use an IFRS measure and IFRS accounting principles in its internal reporting would be required to adjust its internal measure of segment profit or loss to IFRS for purposes of reporting segment results in their financial statements. Likewise, any entity that uses non-symmetrical segment allocations internally, would be required to adjust its internal measures for external reporting purposes. As a consequence, with these entities the segment measure reported externally will differ from the internal measure. However, if there is no identity of internal and external measure, the management approach will have been abandoned in substance.

Considering that information used by management for decision-making purposes is likely to be both relevant and reliable, we think that providing such information should be the overriding concern when setting a measure of segment profit or loss, even if this might result in segment information that is less comparable across entities, and possibly non-symmetrical.

In taking this decision, we noted, that cost considerations as well as corporate governance issues covering both internal management and external reporting are likely to encourage entities to use a single set of information for all purposes. To the extent that entities are required to use IFRS in their external reporting, we expect most of them to tend towards adopting IFRS accounting principles for internal reporting purposes as well. Furthermore, we assume that absent a requirement to observe symmetry for allocation purposes, entities will still use symmetrical allocations in their internal reporting, except in rare circumstances (related for instance to allocating the interest element of pension costs). This is because we hold that, as a rule, asymmetrical segment information is unlikely to be decision-useful. However, it is in order to take account of possible exceptions to the rule that we would abstain from setting a general requirement to allocate symmetrically.

Finally, we considered that requiring IFRS to apply on segment level or prescribing a standardised IFRS measure such as IAS 14 currently provides would ensure but an insufficient level of comparability. In our view, the guidance IAS 14 provides to this effect, requiring entities to allocate items of revenue, expense, asset, or liability to segments if a reasonable basis for doing so exists, is not sufficiently precise to ensure a satisfying degree of comparability across entities. This is mainly because there will be various allocation methods that might be considered reasonable. Furthermore, IAS 14 provides entities with some latitude in deciding whether general administrative expenses incurred at the entity level are to be allocated to segments or not. We therefore hold that current IFRS are not sufficiently prescriptive to ensure a satisfactory level of comparability of segments' performance across entities.

As a result, if additional requirements for the measurement of specified items were established, we would oppose them to the extent that they would entail disclosures of segment measures of profit or loss, or of segments' assets or liabilities that differ from the information used for internal reporting purposes.

(b) We propose to add a requirement for an entity to disclose segment liabilities if, and only if, they are included in the measure of segment performance reviewed by, or otherwise regularly provided to, the chief operating decision maker. We believe that information about segment liabilities might be helpful to users if segment liabilities are considered by management when assessing a segment's performance.

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 understand the Board initially considered extending the scope of the proposed IFRS to all entities that have public accountability but noted that it is too early to adopt the proposed definition of public accountability that is being considered in the SME project. Instead, the Board extended the scope to include entities that hold assets in a fiduciary capacity for a broad group of outsiders. We are unaware of the specific reasons which led the Board to scope in these entities (while excluding others). Furthermore, we have not found a conclusive answer as to how financial reporting will be improved by extending the scope as proposed. We therefore would like to ask the Board to be more explicit about the reasons for its decision, and prefer to retain the scope as currently defined in IAS 14 for the time being.

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 agree with the level of reconciliations. It is true that requiring a reconciliation at group level instead of at segment level might weaken comparability because a group level reconciliation does not necessarily provide information about which segments are affected by the reconciling items. Also there is no reconciliation for intersegment transactions as these are eliminated on consolidation and do not enter group profit or loss.

However, we would advise not to require a reconciliation at segment level because of the possible practical difficulties, and the additional costs, involved in providing such reconciliations. A case in point would be an entity that for internal reporting purposes accounts for inventory on a last-in, first-out basis if the inventory pool contains items in more than one segment. A segment level reconciliation would not only require (in conformity with the draft standard proposed) revaluating the pool on a FIFO or average cost basis, but also reallocating the revalued pool to the segments concerned.

Furthermore, considering that a reconciliation on segment level will require the disclosure of two measures of profit or loss for each segment, we fear that such a disclosure might confuse users and raise questions on their part as to which is the 'correct' segment result.

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 consider non-current assets (excluding certain items as specified in ED 8) to be more exposed to risks associated with a particular geographical area than are current assets. We therefore think that restricting disclosures to non-current assets – as required by the draft standard – will provide more meaningful information.

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?

The proposed amendments to IAS 34 require an entity to disclose additional information on particular profit and loss line items in its interim financial statements if IFRS 8 requires that entity to disclose segment information in its annual financial statement. We think that the proposed changes to IAS 34 should be amended to clarify that the additional interim information on profit on loss items is only to be disclosed if the specified amounts are included in the measure of segment profit or loss reviewed by the chief operating decision maker or are otherwise regularly provided to him. We believe this qualification to be more in line with the guiding principle of the ED.

Otherwise, we agree with the consequential amendments made to IAS 34 to the extent the draft standard will be adopted as proposed. If, however, further requirements are added to the standard that would compel an entity to provide various adjustment to its internal measure and consequently affect its ability to provide the additional information in a timely manner, we would object to requiring entities to disclose more segment information in interim financial reports than is currently required.

Other comments – Clarification of disclosure requirement when more than one measure of profit or loss is used

ED 8.25 requires an entity that uses more than one measure of segment profit or loss or of the segment's assets for internal reporting purposes, to report segment measures that it believes are determined in accordance with the measurement principles most consistent with those used in measuring the corresponding amounts in its financial statements. However, ED 8 does not specify whether an entity would be allowed to disclose more than one measure used internally if it wishes to do so. We would therefore recommend amending ED 8 to clarify that more than one segment measure of profit or loss or of the segment's assets may be disclosed in the financial statements provided these measures are reported internally to the chief operating decision maker and the basis of measurement is clearly described.

Other comments – Potential difference between ED 8 and SFAS 131 with respect to intangibles

In its Basis for Conclusions, the Board identifies the inclusion of intangibles into the scope of ED 8 as one potential difference between SFAS 131 and the proposed IFRS. ED 8.BC14 reproduces a passage of the *FASB Staff Guidance on Applying Statement 131* stating that "'*long-lived assets', as that phrase is used in paragraph 38 of SFAS 131, implies hard assets that cannot be readily removed, which would appear to exclude intangibles*."

Citing the FASB staff guidance, ED 8.BC14 et seq. suggests that the disclosure requirements of SFAS 131 on long-lived assets might not apply to intangibles. We are not sure whether this is actually the case. In its guidance, the FASB staff cites two reasons for its conclusion that long-lived assets appear to exclude intangibles: the view that long-lived assets are potentially at greater risk than other assets; and SFAS 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*, which in its scope referred to "*long-lived assets, certain identifi-*

able intangibles, and goodwill,” suggesting that the term long-lived assets relates to tangible assets only. We do not think that the reasons given provide sufficient ground for considering intangibles to be scoped out of SFAS 131.

For one, we do not consider intangibles such as a right to use a particular trade name or technology in a certain area, to be, in general, potentially at less risk than a tangible asset located in the same area.

And furthermore, SFAS 121 has been superseded by SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* whose scope has been amended to encompass long-lived assets, excluding (among others) *“intangible assets not being amortized*”. This scope revision suggests that, in contrast to the conclusion drawn in the FASB Staff Guidance, the term ‘long-lived assets’ does actually include intangible assets. In addition, SFAS 131 itself, when discussing geographic information, requires disclosures of “*long-lived assets other than* […] *long-term customer relationships* […]*, mortgage and other servicing rights* […]” (SFAS 131.38.b), likewise implying that intangibles generally are to be included in the meaning of long-lived assets.

As a result, we think there is reason to conclude that, in principle, intangibles should be within the scope of SFAS 131, and that the potential difference between SFAS 131 and the proposed IFRS referred to in ED 8.BC14 et seq. may not relate to intangibles in general. We would therefore like to ask the Board to reconsider this aspect of its Basis for Conclusions.

Yours sincerely,

Prof. Dr. Harald Wiedmann
President