Hong Kong Institute of
Certified Public Accountants
香港會計師公會

Our Ref.: C/FRSC

Sent electronically through the IASB Website (www.ifrs.org)

16 November 2012

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sirs,

IASB Request for Information of *Post-implementation Review: IFRS 8 Operating Segments*

The Hong Kong Institute of Certified Public Accountants (HKICPA) is the only body authorised by law to promulgate financial reporting, auditing and ethical standards for professional accountants in Hong Kong. We welcome the opportunity to provide you with our comments on this Request for Information. Our responses to the questions raised in your Request for Information are set out in the Appendix for your consideration.

We appreciate the effort of the IASB in carrying out the post-implementation review in response to the requirement introduced by the Trustees of the IFRS Foundation to conduct a post-implementation review of each new standard or major amendment of a standard two years after the effective date. We welcome this new process and support that the Business Combination Standards being the next review project. However, we consider that apart from new standards, the IASB should also look to perform in the near future a post-implementation review of certain major current standards such as IAS 36 *Impairment of Assets*.

In accordance with our due process, the Institute had issued our local invitation to comment on this IASB Request for Information. We also held an IASB Outreach roundtable meeting on 27 September 2012 in Hong Kong with attendees from accounting firms, business, academia and the investing public. Mr. Michael Stewart attended that meeting on behalf of the IASB. We note that we received only a limited number of comment letters from our constituents. It appeared that preparers in particular in Hong Kong did not have a great concern on the implementation of IFRS 8. We believe the possible reason for this is that the implementation of IFRS 8 resulted in a fairly similar level of segment information disclosed compared to its predecessor IAS 14 and most constituents generally did not note any significant improvements or changes in the way they use financial reports as a result of applying IFRS 8.

In addition, the Institute and other regulators in Hong Kong are continuously reviewing published financial statements, predominantly of listed companies, to identify any potential issues relating to the application of financial reporting standards. A summary of key observations would be published in their reports. Our post-implementation review also included a study of the findings in those public reports and we have included their findings in our detailed responses attached in the Appendix. The reports referred to are as follows:

- Quality Assurance Annual Report 2011 published by HKICPA[1] and
- Financial Statements Review Programme Report 2011 published by the Hong Kong Stock Exchange (HKEx)[2]

If you have any questions regarding the matters raised in our submission, please contact Winnie Chan, our Manager of Standard Setting at winniechan@hkicpa.org.hk.

Yours faithfully,

Simon Riley
Director, Standard Setting

SR/WC

Encl.

[1] HKICPA Quality Assurance Annual Report 2011 (http://www.hkicpa.org.hk/file/media/section6_standards/quality_assurance/practice-review/qa-annual-report-2011.pdf)

[2] HKEx Financial Statements Review Programme Report 2011 (http://www.hkex.com.hk/eng/rulesreg/listrules/listguid/Documents/frm-11.pdf)

Hong Kong Institute of CPAs

Comments on the IASB Request for Information of *Post-implementation Review: IFRS 8 Operating Segments*

Question 1

Are you comparing IFRS 8 with IAS 14 or with a different, earlier segment-reporting Standard that is specific to your jurisdiction?

In providing this information, please tell us:

(a) what your current job title is;
(b) what your principal jurisdiction is; and
(c) whether your jurisdiction or company is a recent adopter of IFRSs.

HKICPA is the only body authorised by law to promulgate financial reporting standards for professional accountants in Hong Kong. Hong Kong has fully adopted IFRS since 2005 (word for word) including HKFRS 8 (equivalent to IFRS 8) which became effective for accounting periods beginning on or after 1 January 2009 and superseded HKAS 14 *Segment Reporting* (equivalent to IAS 14).

Question 2

What is your experience of the effect of the IASB's decision to identify and report segments using the management perspective?

Investors: please focus on whether our initial assessment—that the management perspective would allow you to better understand the business—was correct. What effect has IFRS 8 had on your ability to understand the business and to predict results?

Preparers: please include information about whether your reporting of operating segments changed when you applied IFRS 8. If it did, what effect did that change have on the efficiency of your reporting processes and your ability to communicate with investors?

According to the review report of HKEx, among 100 reports of issuers covering the annual, interim and quarterly reports released between October 2009 and April 2011, it is found that 83 issuers disclosed segment information for more than one segment and the remaining 17 issuers reported one single segment.

A majority of the issuers determined operating segments by business lines and disclosed the types of products and services from which each reportable segment derived its revenue.

At the roundtable meeting, we understood from investors that, though they agree that basing segment information on the manner in which the business is structured by management for allocating resources and assessing performance should generate useful information for external users, it is questionable whether the aim of using the management perspective has worked in practice. It was the understanding that the reportable segments identified under IFRS 8 is similar to those identified under IAS 14 and the segment profit measures are also broadly consistent with those reported under IFRSs. Some preparers mentioned that they had previously modeled their internal reporting processes on IAS 14 to prevent a duplication of effort, and consequently did not change their basis of reporting operating segments when applying IFRS 8.

In addition, some preparers found it difficult to identify the chief operating decision maker (CODM). IFRS 8 requires entities to disclose segmental information in a manner consistent with the way components are reported to the CODM. The standard defines the CODM as a function to allocate resources to and assess the performance of the operating segments of an entity. However, in practice, we understand that reporting entities have many different management structures and therefore the function of the CODM could be performed by more than one person (e.g. a board of directors, an executive committee and/or a management committee). As such, some entities have difficulty in identifying a single CODM and in many cases; the Board of Directors is identified as the CODM. This indicates that there might be some confusion caused with the definition of CODM in the standard. In addition, the fact that the identity of the CODM is not required to be disclosed in the financial statements might prevent readers of financial statements from understanding who is reviewing the information which is presented in the segment disclosures.

According to the review reports of the HKICPA and HKEx, it was noted that the segment disclosures in some financial statements were not consistent with management commentary such as directors' reports and the management discussion and analysis ("MD&A"), for example, three segments were disclosed in the segment information note while the business overview in the MD&A included five business operations. We understand that inconsistencies might occur as the information is prepared on different bases. However, we observed that there was a general expectation of users that IFRS 8 would provide a better link between the financial statements and the information reported in the management commentary.

During the roundtable, one of the investors suggested that a two-dimensional segment information presentation in terms of both the business lines and geographical locations for organizations that operate using such a matrix structure would provide easy to understand information to users of financial statements. Therefore it is suggested that the matrix presentation should be required for those organizations for which it is relevant, rather than being a free choice. A copy of this two-dimensional segment presentation has been sent separately to Mr. Stewart.

Question 3

How has the use of non-IFRS measurements affected the reporting of operating segments?

Investors: please comment on the effect that the use of non-IFRS measurements has had on your ability to understand the operating risks involved in managing a specific business and the operating performance of that business. It would be particularly helpful if you can provide examples from published financial statements to illustrate your observations and enable us to understand the effects that you describe.

Preparers: it would be helpful if you could provide information about whether you changed your measurement basis for operating segment information on the application of IFRS 8 and, if so, what effect this has had on your ability to communicate information about operating risks and performance with investors and other users of your financial statements.

We believe that the use of non-IFRS measurements has not affected the reporting of operating segments in a significant manner. A majority of the entities in Hong Kong report segment information using measurement bases that are consistent with IFRSs.

From our roundtable meeting, we understand that some preparers commented that it is difficult to identify the primary information provided to the CODM within a lengthy reporting package. In many of cases, the variety of information available to the CODM via an entity's management reporting system is considered too detailed to disclose in an external financial report.

Some auditors expressed concerns that the time used and costs incurred for auditing non-IFRS measurements has been unduly high and difficulties have been encountered to verify the basis applied. Also, there is a concern that the disclosure of non-IFRS measurements would lead to unintended consequences, for instance, revenue is reported net in the financial statements whereas revenue in the segment report might be shown on a gross basis, which may mislead users.

An investor commented that the use of non-IFRS measurements is not helpful in understanding the operating risks involved in managing a specific business, rather, the sensitivity analysis on credit risk and foreign currency risk etc required under other IFRSs provide more useful information about operating risks.

Question 4

How has the requirement to use internally-reported line items affected financial reporting?

Investors: please focus on how the reported line items that you use have changed. Please also comment on which line items are/would be most useful to you, and why, and whether you are receiving these.

Preparers: please provide information about any changes in reported line items that resulted from the application of IFRS 8.

The requirement to use internally-reported line items has not affected financial reporting. Our understanding is that a majority are using measurement bases that are consistent with IFRSs in their internal reports.

At the roundtable, investors also mentioned a desire for information relating to the marketing budget and research expenditure of each business line to be disclosed, as this would indicate the future direction of the business. However, it is generally understood that preparers are concerned about the commercial sensitivity of this information, particularly in the context of Hong Kong where most of the corporations are family-controlled and have less incentive to provide more information to investors.

<u>**Question 5**</u>

How have the disclosures required by IFRS 8 affected you in your role?

Investors: please provide examples from published operating segment information to illustrate your assessment of the disclosures relating to operating segments. Do you now receive better information that helps you to understand the company's business? Please also comment on the specific disclosure requirements of IFRS 8—for example, those relating to the identification and aggregation of operating segments; the types of goods and services attributed to reportable segments; and the reconciliations that are required. It would also be useful to indicate whether you regularly request other types of segment disclosures.

Preparers: please consider whether operating segment disclosures are more or less burdensome when based on information prepared in accordance with your own internal reporting requirements. If any requirements are burdensome, please provide details of those disclosures and explain why they are costly or time-consuming to prepare. Do you think that the information you present now about operating segments conveys better information to investors and shareholders? It would be useful to indicate whether you regularly report any segment information in addition to that required by IFRS 8.

Our constituents generally did not note any significant improvements or changes in the way they use financial reports as a result of applying IFRS 8.

Some preparers considered that the requirement of disclosing geographic areas of operation under IFRS 8 is less flexible when compared with that under IAS 14. Specifically, entity-wide disclosures are not determined by the management approach which is used to identify and measure operating segment information. Additional burden would be imposed on preparers if that geographic information is not reviewed by the management.

Some investors commented that the requirement of allocating revenue from external customers to geographic areas is not robust enough. Currently, an entity may allocate the revenue from external customers to geographic areas as it deems most appropriate. It is noted that the areas presented would generally include the selling location and customer location. Since the customer location for some multi-nationals would only represent its head office location and the products might be transported to other locations, the usefulness of disclosing customer location could be questioned. It is believed that the disclosure of the geographic areas that reflect the underlying business risks of the company is more important.

Question 6

How were you affected by the implementation of IFRS 8?

Preparers: in answering this question please focus on whether you incurred significant unexpected costs, either as a one-time expense when implementing the Standard or as a recurring cost at each reporting cycle. If you did incur unexpected costs, please explain what these were and in what way they were required to comply with IFRS 8.

In addition, we would like to know what practical difficulties you encountered, if any, when applying IFRS 8. Did you find that IFRS 8 is clear about all aspects of the requirements, such as the identification of operating segments, aggregation of segments and the nature of the CODM? If IFRS 8 is not clear, please provide details of your experience.

Investors: please focus on whether the way in which you use financial reports has changed as a result of applying IFRS 8. Please explain to us what that effect was and the consequences of any changes to how you analyse data or predict results.

We understand that practitioners do not consider IFRS 8 to be a particularly difficult standard to apply, other than the potential difficulty in identifying the CODM. Since a majority of the entities in Hong Kong typically prepare their internal reports on the same measurement bases with IFRSs, we do not believe that significant costs either as a one-time expense when implementing the Standard or as a recurring cost at each reporting cycle have been incurred.

However, as mentioned in Q5, we understand that some preparers considered that the requirement of disclosing geographic areas of operation under IFRS 8 imposed additional burden under the situation where the information is collected for pure disclosure purpose but is not provided to the management.

The information required by IFRS 8 may on certain cases be highly judgmental and we note from the publicly available reports prepared by regulators in Hong Kong that common issues identified are as follows:

- Inadequate disclosure of factors used to identify reportable segments and reasons for aggregation of segments;
- Inadequate entity-wide disclosures;
- Inadequate disclosure of material reconciling items; and
- Differences in how segments are described between the financial statements and management commentary.

Other comments

A number of clarifications to IFRS 8 are suggested below for the consideration of the IASB:

1. Paragraph 13 of IFRS 8 sets out three quantitative thresholds in determining whether to report information about an operating segment:

   (a) revenue
   (b) profit or loss
   (c) assets

   The general understanding is that the above 3 thresholds are referring to segment figures i.e. segment revenue, segment profit or loss and segment assets.

   Paragraph 23 of IFRS 8 has been amended and information about segment assets is required to be reported if such an amount is regularly provided to the chief operating decision maker.

   If an entity is not required to report segment assets because such an amount is not regularly provided to its CODM, we consider that the entity is also not required to check the asset threshold in determining whether an operating segment is a reportable segment. However, the wording in paragraph 13 of IFRS 8 does not contain such exclusion. It is not clearly stated in the standard whether the entity is required to check the asset threshold in determining whether an operating segment is a reportable segment if an assets amount is not regularly provided to its CODM. This may create a practical problem because a segment assets total amount does not exist in this case and the entity will need to allocate the assets amount to a segment in order to evaluate the asset threshold.

   It is suggested that paragraph 13 of IFRS 8 should be amended to make it clear that the requirement of checking an asset threshold does not apply if the assets amount is not regularly provided to the CODM.

2. Paragraph 23 of IFRS 8 states that "An entity shall report a measure of total assets and liabilities for each reportable segment if such amounts are regularly provided to the chief operating decision maker." This sentence can be interpreted as requiring segment assets and liabilities amounts to be reported only when <u>both</u> amounts are regularly provided to the CODM. Disclosure is not required if only either an assets or and liabilities amount is regularly provided to the CODM. We understand that this is not the intention of IFRS 8.

   It is suggested that paragraph 23 of IFRS 8 should be amended to state clearly that an amount for assets and an amount for liabilities is required to be reported when such an amount is regularly provided to the CODM.

3. In setting out the three quantitative thresholds in determining whether to report information about an operating segment under paragraph 13 (a) to (c) of IFRS 8, the 10% threshold is used. The 10% threshold is also used in paragraph 34 of IFRS 8 in determining whether a customer is a major customer.

However, under paragraph 33(a) and (b) of IFRS 8, in determining whether to disclose separately the geographical information about revenue and non-current assets, the threshold stated is whether the amounts are material. This has the potential to create diversity in disclosures by different entities.

We suggest that paragraph 33(a) and (b) of IFRS 8 should be amended to require separate disclosure of geographical information about revenue and non-current assets if the amounts exceed 10% of the total. This is in line with the requirements in paragraphs 13 and 34 of IFRS 8.

~ End ~