



MONASH University
Business and Economics
Department of Accounting and Finance

14 March 2005

The Chairman
Australian Accounting Standard Board
PO Box 204
Collins Street West
Victoria 8007

Submission on ED 145 Operating Segments

A copy of my submission to the IASB on IASB ED 8 is attached. It is doubtful if replacing one badly flawed standard with another badly flawed standard will advance the quality of the financial reporting framework. As to the scope of any replacement standard, the test must be whether the entity or consolidated entity is a reporting entity. As a matter of general principle, sector neutrality requires that any new standard should apply to all reporting entities be they in the public sector or private sector, or for profit or not for profit. However, there may be compelling reason why segment reporting should not be extended to all reporting entities; without a detailed discussion in the ED of these issues, in particular with input from constituents in the not-for-profit sector and the public sector, I am unable to make an informed assessment on this matter.

If technical staff of the Board wish to discussion any matter raised in the submission I can be contacted either by email:

ian.langfield-smith@buseco.monash.edu.au

or by telephone on + 61 3 9905 2701.

Yours truly,

Ian Langfield-Smith
Lecturer in Accounting

Attachment: Submission to IASB

**Department of Accounting and Finance
Building 11E
Monash University
Clayton 3800 Australia**

**Email: ian.langfield-smith@buseco.monash.edu
Telephone: +61 3 9905 2701
Fax: +61 3 9905 5475**



MONASH University
Business and Economics
Department of Accounting and Finance

14 March 2005

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

Submission on ED 8 Operating Segments

It is timely that the Board address the problems of segment reporting given the numerous problems with IAS 14; however the proposals in ED 8 are unlikely to increase the quality of financial reporting – without fundamental change they are likely to significantly reduce the quality of financial reporting. The underlying rationale of the ED seems to be a desire to pander to the wishes of preparers and to the unrepresentative group of users loosely described as financial analysts. In mandating disclosure in general purpose financial reports, it is the information needs of users in general that are to be addressed, not those of an small, unrepresentative group of users whose special needs can be best addressed outsider the regulation of the contend to general purpose financial reports.

While the ED is not as poorly drafted as most of the Boards previous efforts, the drafting cannot be reasonably described as being anywhere near matching words-best-practice for drafting of financial reporting standards. The absence of definitions is of considerable concern. It escapes me how a document that is

Department of Accounting and Finance
Building 11
Monash University
Clayton 3800 Australia

Email: ian.langfield-smith@buseco.monash.edu.au
Telephone: +61 3 9905 2701
Fax: +61 3 9905 5475

devoid of definitions (even cross-references to definitions in other standards) can properly be described as imposing a standard of conduct; to call such a document a standard is both misleading and deceptive. While the drafting style does not blatantly discriminate against those with reading disabilities, it appears that the Board has not seen fit to do anything to address my previously expressed concerns about the unnecessary difficulty imposed on those with reading disabilities by the Board's failure to use an appropriate drafting style. I do not see how anyone of integrity could consider the drafting style adopted by the Board an appropriate way of ensuring that the Board's standards do not breach laws designed to ensure accessibility of documents to those with reading disabilities. The Board's failure to address those issues shows contempt for those with reading disabilities and by its wilful nature indicates a lack of commitment by the Board to the accepted standards of professional behaviour.

My detailed comments on the proposals in ED 8 are attached.

If technical staff of the Board wish to discussion any matter raised in the submission I can be contacted either by email:

ian.langfield-smith@buseco.monash.edu.au

or by telephone on + 61 3 9905 2701.

Yours truly,

Ian Langfield-Smith
Lecturer in Accounting

CC Australian Accounting Standards Board

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?

The approach is not appropriate for two main reasons; firstly the underpinnings are fatally flawed. The rationale is one of pandering to the desires of preparers and financial analysts; recent experience in the United States of America indicates that both groups have an unfortunate tendency of being both untrustworthy and unethical. Accordingly, a standard that is directed to pandering to their needs is unacceptable, *unless* it can be irrefutably established that it will meet the needs of users in general, with strict controls on the ability of preparers to inappropriately manipulate the financial information presented in the financial report. Unfortunately, the permissive nature of SFAS 131 means that this cannot be guaranteed. While the managerial approach may be useful in identifying segments, it is completely inappropriate when it comes to determining the nature of the disclosures to be made and the measurement rules to be adopted.

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.

The determining of segments is problematic; while the approach in IAS 14 is not free from difficulties, there are also difficulties in the approach in SFAS 131. In an ideal world, the criteria used to identify segments should be such that there is comparability between segment information presented by different entities. Unfortunately, as far as I am aware no one has been able to develop a

criterion that will result in comparable identification in the context of financial reporting standards applicable on a global scale. Thus, while there are numerous problems with the management approach in SFAS 131 in terms of the identification of segments, it is no worse than the alternatives and has some limited advantages. This does not mean that it is appropriate to accept that the same test should be applied in determining how items are to be measured and which items are to be disclosed. I agree with the dissenting view in the Basis for Conclusions that it is essential to define the key terms, segment revenues, segment expenses, segment assets and segment result and that it is completely inappropriate to include “non-GAAP” measures in segment disclosures (see paragraphs AV3 and AV5). However, I do not agree that the definitions in IAS 14 are necessarily appropriate, in particular the reliance on the concept of ordinary activities in the definition of segment revenue when the definition of segment expense relies on the concept of operating activities, means that the difference between them – segment result – must be of dubious utility. Such an obvious inconsistency undermines the credibility of the standard.

The rationale for allowing so-called “non-GAAP” measures that by doing so the preparation of interim financial reports will be facilitated and it will encourage management to make disclosures is neither sensible nor compelling. While it may be that time constraints for the preparation of interim financial reports may be such that some modification to the recognition and measurement rules may be appropriate, it does not follow that for the annual financial report, where these time constraints do not presumably apply, that it is either appropriate or sensible to make such a compromise. While the use of different rules for interim and annual financial reports is not ideal, it is a situation which already exists for other items, so why not here? It is incumbent on those putting forward such an extraordinary proposition to explain why the situation for interim financial information is any different. Another problem is that when “non-GAAP” measures are adopted, a mere description of those methods (even if contrasted with the description of the GAAP measure) without quantification of the impact of that difference is of little, if any, use to users (such quantification is not proposed; see IN14). If a quantification of the difference is provided, then the rationale for not using the GAAP measure in the first place disappears.

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?

The extension of the scope is supported; however the absence of a clearly articulated rationale is unfortunate. I note that in Australia an appropriate rationale would be found in statements of accounting concepts SAC 1 and SAC 2 which have no counterpart in the IASB Framework.

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.

At this stage I have no specific comment on this issue.

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?

At this stage I have no specific comment on this issue.

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?

At this stage I have no specific comment on this issue.

Comments on ED 8

Throughout ED 8 the term “the entity shall” or “an entity shall” are used without first clearly identifying what these terms are purporting to refer to. It appears what is intended by this term it means the parent entity in the group for which consolidated financial statements are being prepared, rather than the consolidated entity itself. It is also unclear from the words used if segment information is required both in the consolidated financial statements and the individual financial statements of the parent. This oversight probably flows from the fact that in the United States of America most, if not all, jurisdictions only require the preparation of consolidated financial statements. However, the IASB cannot assume that this is always the case.

In various places it is suggested that disclosures need not be made because of cost considerations: for example in paragraph 32 if information is not available and the cost to develop it would be excessive. If information is not to be provided, the test to be applied should be consistent with the IAS 1 paragraph 11 requirement that compliance is impracticable. (A similar test is applied in IAS 8.) One would have thought that the issues addressed in each case are essentially indistinguishable; accordingly it is completely unacceptable that a different test is being proposed. The use of a different test, without explaining why it is necessary to do so, undermines the credibility and integrity of the IASB’s financial reporting standards. It is, unfortunately, another instance of the propensity of the Board to fail to ensure that the requirements of individual standards are consistent; the inattention to detail is most disappointing and suggests a serious weakness in the pre-publication quality control procedures adopted by the board.

Paragraph IN14:

The proposal that there merely be an explanation of how various segment items are measured without also identifying the difference (if any) from the GAAP measure, and without providing a quantification of the impact, results in information having little credibility and it will be of extremely limited usefulness.

Paragraph 4:

The requirement in paragraph 4(c) is open to managerial manipulation; I think the correct test is “for which an informed user would reasonably expect discrete information to be available”; the current test is the wrong way around.

Paragraph 19:

The disclosure test in this paragraph is appropriate; however, other provisions of the standard are inconsistent with this test, for example the absence of a requirement to quantify the effect of using non-GAAP measures for items included in determining segment disclosures.

Paragraph 19:

Given the process by which the so-called “segment profit or loss” is determined, it is misleading to suggest that the amount is profit or loss, particularly when non-GAAP measures are used. The usage fails to give an appropriate warning about the nature and significance of the information provided. The term “segment result” used in IAS 14 avoids this potential to mislead and confuse.

Paragraph 22:

Most of the items listed in paragraph 22 are appropriate; however the test for whether they are included is inappropriate – it should not depend on managerial desire but on what users would expect competent and informed managers to reasonably include. Given the theoretical and practical problems associated with tax-effect accounting, I doubt that any useful purpose can be found in meaningless allocation of income tax expense to operating segments.

The last paragraph of paragraph 22 – the setoff of interest revenue and interest expense – is not supported. No compelling rationale is given for doing this; as it is contrary to the fundamental rule that offset is not permitted, the wishy-washy rationale presented is completely inadequate justification. Mere disclosure of the fact of offsetting is of itself of little benefit without note disclosure of the gross amounts. It is doubtful if such setoff would ever be consistent with the requirement in IAS 1 that the information in the financial report must be presented fairly. Also, in those jurisdictions such as Australia where there is also a requirement that the financial report give a true and fair view, setoff without disclosure of the gross amounts would fail the true and fair view test.

Paragraph 26:

The disclosures required by this paragraph are completely inadequate; without disclosure of the quantitative effect of the difference the disclosures are pointless; no informed user of the financial report would be able to make sense of the impact without such disclosure.

Paragraph 32:

In paragraph 32 it is not clear how we are to identify the relevant entity; I suspect it must be the parent entity preparing consolidated financial statements, but this may not be the case. This issue need to be clearly dealt with for the reasons given in my introduction comment. Also, there seems to be an inconsistency between what is said in the IN paragraphs and the basis for conclusions and the disclosure requirements in paragraph 32(a). This may merely be due to the application of the materiality test, but that may not be so given the considerable uncertainties about the application of the materiality test imposed in IAS 1 and the very limited discussion of materiality in the Framework.

Basis for conclusions

Without further discussion, it is unclear what is intended by the desirable characteristic referred to in the last sentence of paragraph BC5 would in fact be capable of realisation. As far as I can see it seems to be based on unsupported assertions by financial analysts; of itself this alone does not establish the correct approach to be taken when developing segment reporting requirements. The position is not advanced by shoddy arguments in paragraph BC6; the claimed benefit is (d) and (e) are as a matter of logic subject to challenge when it come to determining the best approach to segment reporting. The fact that SFAS 131 is perceived as being in some ways better than SFAS 14 does not mean that it should be preferred; many of the relevant benefits could be obtained by revising the requirements of IAS 14. In short, the argument is fatally flawed.

I am in general agreement with the concerns expressed in the alternative view in AV1-AV6; however, I believe that there is a need to revise the definitions of both segment revenue and segment expense, and that the term segment result is preferable to the misleading term segment profit or loss.

Implementation guidance

I have not reviewed the implementation guidance in a detailed manner. However, there are some obvious errors in it. For example, on page 7 in IG4, the in last line it should be “profit or loss before income tax expense” not “income before income tax expense”. Such an obvious draft error is inexcusable.