la SOCIÉTÉ FRANÇAISE
des ANALYSTES FINANCIERS

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Mr. Hans Hoogervost
Chairman
International Accounting Standard Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Exposure Draft "Improvements to IFRS 8 Operating Segments (Amendments to IFRS 8 and IAS 34)".

Comments by the French Society of Financial Analysts (SFAF)
Financial Analysis and Accounting Commission

Dear Sir,

The French Society of Financial Analysts, SFAF (Société Française des Analystes Financiers), is very pleased to submit its contribution as part of the consultation undertaken by the IASB on the Exposure Draft "*Improvements to IFRS 8 Operating Segments (Amendments to IFRS 8 and IAS 34)"*.

SFAF represents more than 1,500 members in France and is itself a member of the European Federation of Financial Analysts Societies (EFFAS) which comprises 26 member organizations representing more than 15,000 investments professionals. Its Accounting and Financial Analysis Commission intends to represent analysts and fund managers in the debate on accounting standards. Financial analysts are among the principal users of corporate financial statements and therefore wish to express their opinion on the implementation of new or revised accountings standards.

First, we would like to stress that the operating segment information is among the most used information by financial statement users, and, for that reason, segment information is of utmost importance for investment professionals. Understanding segment performance allows a better analysis of revenue generation margins, cash flow and capital utilization. When this information is presented in a single set of financial statements, it can hardly be identified and without specific segment information, it can be very misleading.

Additionally, and even more importantly, segment information allows users to compare information in the financial statements with outside data such as official statistics related to the various business activities and similar information provided by other groups involved in similar activities. This information allows users to understand the underlying economics of the various components of a group and for this reason we believe that segment information is at the very centre of how analysts and other users rely on information provided by issuers. We would like also to stress that segment information is most useful when used in comparison with other groups. **In a nutshell, such information along with investors' sector knowledge is a <u>key</u> tool to help investors allocating capital in the most efficient manner**. We are therefore expecting that an improvement to IFRS 8 will reinforce the efficiency of this process instead of investing in companies on the basis of suboptimal financial reporting and taking risks that are not fully understood.

This is why SFAF already made comments to the original Exposure Draft in 2006 and to the Post-implementation Review in 2012. SFAF also sponsored some research on segment reporting practices both in France and Europe. Lastly, SFAF also took part to the public consultation on the proposed IFRS 8 standard organized by the European Commission and and EFRAG in June 2007[1].

We therefore believe that improving IFRS 8 is obviously very much linked to the Better Communication program and are therefore keen to provide hereafter our comments on the IASB proposal.

DESCRIPTION OF THE CODM (QUESTION 1)

We fully support the proposed improvement regarding the better identification of the Chief Operating Decision Maker and related disclosures, as we believe that the original definition was a little too vague. In our comment letter for the Post-implementation Review of IFRS 8, dated November 30th 2012, we already stressed that the current practice may lead to poor practices and disclosures. In addition, you can note that ESMA made similar comments.

We also believe that the enhanced clarification may help auditors in doing their job in an appropriate manner.

CONSISTENCY AND AGREGATION OF REPORTABLE SEGMENTS (QUESTION 2)

We believe that identification and aggregation of reportable segments is a major source of frustration for users of financial information.

In our discussions with other users, they very often stress their need for consistency of the presentation of segment performance over time and between the various documents provided by the issuers to communicate their performance with outside stakeholders. Investors and analysts are also not satisfied with aggregation of segments when they are not similar or irrelevant since they cannot deliver proper analysis.

We actually encounter cases where the segment reporting used in the financial statements is inconsistent with the one used in the MD&A or the slides used for the analysts meetings. For

[1] All these contributions are available at http://www.sfaf.com/think-tank/base-documentaire/ in the category Accounting and Financial Analysis Commission.

instance, one major telecom operator during the annual analysts meeting is longly discussing its performance for the mobile market and the fixed-line market. The management is not discussing the performance of the reported segments used under IFRS 8 (Residential customers and Corporate customers) during the meeting, and figures for the segments under IFRS 8 are only included in the Appendix of the slides.

We thus fully support the new requirement that management should explain how this inconsistency is possible. We nevertheless believe that the requirement of explaining this inconsistency might end with boilerplate comments, and finally, might not be able to prevent companies to report irrelevant segments.

We have heard the argument that, as the IASB is not in charge of defining information provided outside of the financial statements (i.e. the "annual reporting package"), it cannot link the information provided in segment reporting with the information outside of the financial statements. We believe however that since IFRS 8 is based on the management approach, it already means that there is a link between some non-financial information (non-IFRS) with the financial information as required by IASB.

We fully support also the better definition of the aggregation criteria. Adding "*and only if*" in paragraph 12 is reinforcing the strength that should be given to the list of criteria of paragraph 12. We also support the paragraph 12A that makes clearer what means "*similar economics characteristics*". We would nevertheless suggest that the Board adds in this paragraph 12A a reference to similar capital intensity.

We also encounter a lot of problems with <u>sub-segments</u>, these ones being at levels which are not really covered by the current standard. In particular, we sometimes encounter a lot of changes over time in the identification of sub-segments (sometimes representing as much as 20 or 30% of preparers consolidated revenues or EBITDA), without any substantial change in the segments themselves (the real reason might be that the performance of one of the previously reported sub-segments is under pressure), which makes comparisons over time almost impossible.

INFORMATION TO PUBLISH (QUESTION 3)

We, of course, fully support the possibility to publish additional information with the segment reporting beyond the one that is reviewed by the CODM on a regular basis (paragraph 20A). It might be helpful for users to better understand the situation or the evolution of some segments.

RECONCILIATION (QUESTION 4)

We consider that the new writing on the reconciliation of published segment information is improved.

We nevertheless believe that the proposed requirement fails to meet the real needs of users. Users have always required to have <u>a detailed reconciliation</u> with an IFRS measure, <u>at each segment level</u>. This is key for users in order to make comparisons with other groups with similar segments. Not providing this kind of reconciliation at segment level fails to allow users to understand the situation and the performance of similar activities in a safe manner, and might lead to significant mis-allocation of assets by investors.

A research paper sponsored by SFAF ("'The segment information practices of the biggest European companies" published in June 2013 and also available on SFAF website at the same address as indicated on page 2 of this comment letter) demonstrated that the higher the fraction of 'IFRS operating income'[2] excluded from the segment income called Total Management Approach Income (TMAI), the higher the probability reconciliation will not be provided. Even when the difference is small, the operating income segment allocated to segments may be much smaller than the total income segment. Five companies (10% of the sample) did not allocate more than 25% of TMAI.

The study's main recommendations were the following:

1. The use of Non-GAAP indicators does not prevent disclosure of IFRS operating income by segment. It is thus necessary to reconcile Non-GAAP with IFRS operating income by segment and not just on an overall basis.

2. Company managers must disclose more qualitative and quantitative information on changes in segment identification but also on segment breakdown to avoid temporal discontinuity in performance analysis.

3. Information disclosed to investors should focus on the same indicators and segments as those used in consolidated financial statements.

We believe that this analysis is still valid and that, as outlined in this report, there are a significant number of issuers which don't produce such reconciliation.

Members of various working groups such as Efrag User Panel or IASB CMAC have outlined the same need for a reconciliation. We understand therefore that this position is widely shared among users of financial statements.

INTERIM INFORMATION (QUESTION 5)

We fully support the requirement to publish pro-forma interim information for segment reporting when segments definition is changed. It might help investors to better understand the possible seasonality effects of the newly identified segments.

ADDITIONAL COMMENTS

We thank the IASB for these proposed improvements. However, we strongly believe that they are insufficient to correct the flaws of IFRS 8. We have consistently said that the introduction of the management approach in the segment reporting is incompatible with the goal pursued, i.e. to provide information to users that is comparable and understandable for an external viewer, without being misleading. From a European (and

[2] i.e., in this report, "IFRS Operating income" is operating income as disclosed in the consolidated financial income statement.

international) perspective, the adoption of IFRS is supposed to bring enhanced comparability, not less[3].

In this respect, we consider that the Board, when moving from IAS 14 to IFRS 8, for the sake of convergence with US GAAP, made a major concession to the detriment of the quality of the financial information and investors protection (which was also underlined by other users associations), and users of IFRS information are still bearing the cost.

As segment information is really key for users, we thus believe the Board still has to further improve / change segment reporting much beyond the change proposed in this exposure draft, and this point has to remain a key priority.

We thank you for the opportunity given to us to provide our view on such important aspects of financial reporting for users. We really hope that the views of users will drive the work of the IASB and remain available for any further information.

Yours faithfully,

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[3] As an example, for companies reporting under IFRS, we have seen a case where the performance reporting for the various segments was made under US GAAP !