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AFRAC

AUSTRIAN FINANCIAL REPORTING AND AUDITING COMMITTEE

Answers to the European Commission's

Questionnaire on the Endorsement of IFRS 8 – Operating Segments

The Austrian Financial Reporting and Auditing Committee (AFRAC) is the privately organised standard-setting body for financial reporting and auditing standards in Austria, and is supported by the competent Austrian authorities. The members of the Austrian Financial Reporting and Auditing Association, AFRAC's parent organisation, are several Austrian Federal Ministries and a number of public institutions. The members of AFRAC represent preparers of financial statements, certified accountants, academics, investors, analysts, and oversight bodies of capital markets and regulated industries.

The AFRAC International Financial Reporting Standards Working Group prepares comment letters on recent IASB publications and on publications of other standardsetting bodies pertaining to IFRS for final approval by AFRAC. Principal authors of this comment letter were David Grünberger, Peter Geyer and Helmut Kerschbaumer. More information about the Working Group and AFRAC is available under www.afrac.at.

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Outline

1. General comments

The Austrian Financial Reporting and Auditing Committee (AFRAC) welcomes the opportunity to comment on the endorsement of IFRS 8 – Operating Segments issued by the IASB in November 2006. AFRAC was mandated to answer the questionnaire by the Austrian Ministry of Justice.

With the above answers to the Commission's questionnaire, AFRAC hopes to make a contribution to the endorsement of IFRS 8 in Europe. AFRAC is happy to further discuss any of the issues and the answers submitted to the Commission. Please find more information about the Working Group and the AFRAC itself including any contact details on www.afrac.at or contact AFRAC by email at office@afrac.at.

2. Specific comments

Q1. *Please indicate whether you submitted comments to IASB and/or EFRAG during their consultations.*

AFRAC submitted a comment letter on the IASB's Exposure Draft 8 – Operating Segments in April 2006. The comment letter was sent to EFRAG and the IASB.

Q2a. *Do you think information prepared under the management approach on which IFRS 8 is based is more relevant, reliable, comparable, understandable and useful than information prepared under IAS 14?*

The management approach increases transparency by presenting information relevant to management in its decision making process. This contributes to a better understanding and evaluation of strategic and operative management decisions by external users of financial statements and increases the informational value of financial statements. Admittedly, the management approach relies on soft rules which can be misused to present biased information. Nevertheless, information prepared under the management approach has to be **reconciled with the**

corresponding figures presented in the balance sheet and the income statement (IFRS 8.28). Therefore, segment information cannot be biased in general as this would result in inexplicable reconciling items apparent to the uses of the financial statements.

In addition, a significant part of the segment information now required by IAS 14 (geographic information and information on products and services) **will still have to be presented** – but within a different caption named "Entity-wide disclosures" (IFRS 8.32 and .33). These disclosures have to be measured according to general IFRS-valuation rules. Concerns that the management approach might lead to less reliable information are partly based on a misconception that the management approach fully replaces information now required by IAS 14.

Q2b. *Do you think that information prepared under the management approach improves the true and fair representation of business activities?*

Under the management approach, the readers of the financial statements will gain insight into the most relevant internal data and evaluations which are actually used by management. This is essential to understanding strategic and operational decisions made by management as well as any measures management might propose to shareholders. Readers will thus be enabled to judge business processes from a management perspective – in addition to the accounting perspective which is still contained in the financial statements.

Q2c. *Are you of the opinion that segment information based on the management approach provides greater accuracy for measuring individual segments and ultimately results in greater forecast precision than segment information based on IAS 14?*

Management will be judged on information it has presented in prior segment reports. It will be expected to demonstrate that it relies on sound and discernable internal information. This also creates peer pressure to present comparable, high-level

segment information and will promote industry-specific standards to measure segment performance.

We note that the use of management information may reduce comparability of financial information across firms and particularly across firms in different countries. In contrast to the FASB, the IASB aims at developing global standards and needs to consider national differences more than a national standard setter such as FASB. Although worldwide application may reduce comparability between countries to a greater extent than could be inferred from the use in the U.S., we believe that the benefits of the management approach still outweigh the disadvantages on average.

Q3a. *Do you assess that cost for preparation of information is lower under IFRS 8 than under IAS 14?*

Many entities can benefit from synergies when using the management approach: As most segment information can be extracted directly from data readily available in the companies' management accounting systems, costs to compile data for accounting purposes are likely to decrease.

Q3b. *Do you think that the cost/benefit balance of replacing IAS 14 by IFRS 8 is positive (e.g. lower cost outweighing the potentially lower quality of information provided or potentially higher quality of information provided outweighing higher cost)?*

The balance can be considered positive. This is especially true when the detriments of any further European "carve outs" and the substantial risks to the convergence process between Europe and the US are considered. The convergence process as a whole is vital to reduce cost of financial reporting for entities listed in European and third country stock exchanges.

Q4. *Do you consider that the principles on which IFRS 8 is based, in particular the fact that information for segment reports should be prepared through the eyes of the "chief operating decision maker", would pose problems on established EU practices, e.g. in the area of corporate governance?*

As these principles are limited to segment information and much of the information now required by IAS 14 is still presented within the "Entity-wide disclosures" (IFRS 8.32 and .33), we see no problems with established EU practices.

Subjective judgement has always been an integral element of financial accounting (see IAS 1.116) and not specific to IFRS 8.

Q5. *Do you agree with the argument that IFRS 8 requires smaller listed companies to report a segment by segment analysis of their business including commercial sensitive information with the effect that competitiveness of smaller listed companies in the EU will be harmed? Please provide reasons for your view and indicate how far that constitutes a change compared to the requirements of IAS 14.*

We do not agree with this argument because such information is also required by IAS 14. The same quantitative thresholds to identify reportable segments contained in IAS 14.34 to .38 are now used in IFRS 8.13 to .15. Therefore, smaller listed companies would generally not report additional segments

Q6a. *Do you believe that the lack of mandatory requirements for full segment information on a geographical basis in IFRS 8 gives sufficient reason for a non-endorsement decision?*

Much of this information will still be required to be presented by IFRS 8.33. Therefore, this is no argument against endorsement of IFRS 8.

Q6b. *Do you believe that other mandatory requirements for segment information are missing in IFRS 8 (compared to IAS 14)? If yes, which ones?*

We are not aware of significant requirements which are missing in IFRS 8.

Q7. *Can you provide any information that has been generated by field studies, research work, internal analysis carried out in your organisation, jurisdiction?*

No.

Q8. *If you have any further comments on this consultation please provide them to us.*

We want to remind the Commission of its great responsibility for the international convergence of accounting standards. Such convergence is crucial to promote efficient financial markets and to lower the cost of financial reporting in multinational groups.

In light of the costs of financial reporting, we recommend prompt endorsement of IFRS 8. In Austria, many entities are required to adopt IFRS for the first time in periods ending on 31 December 2007. These entities should have the possibility to adopt IFRS 8 already in their first financial statements. Endorsement after 2007 would cause additional cost of adoption.