

Regulation Impact Statement

Accounting Standard *AASB 8 Operating Segments*

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Australian Government

**Australian Accounting
Standards Board**

Regulation Impact Statement

AASB 8 OPERATING SEGMENTS

Background

The Australian Accounting Standards Board (AASB) is implementing the Financial Reporting Council's (FRC) strategic directives to:

- adopt International Financial Reporting Standards [the Standards and Interpretations of the International Accounting Standards Board (IASB)] for application to reporting periods beginning on or after 1 January 2005; and
- to harmonise the requirements applicable to general purpose financial reports of public sector entities and those applicable to Government Finance Statistics.

To put the first of the FRC directives into effect the AASB is issuing Australian equivalents to IASB Standards and has undertaken a separate series of projects in respect of harmonising financial reporting requirements and Government Finance Statistics.

Implementation of the FRC's Year 2005 strategic directive does not, of itself, cause a change in the underlying economic circumstances of an entity but at times results in events and transactions being portrayed differently so as to achieve improvements in the transparency and quality of Australian financial reports.

The AASB has decided to continue to issue one series of sector-neutral Standards, that is, Standards applicable to both for-profit and not-for-profit entities, including public sector entities. The AASB has regard to the Standards of the International Public Sector Accounting Standards Board of the International Federation of Accountants (IPSASB) in respect of issues affecting not-for-profit entities. The IPSASB is using the IASB's Standards, to the extent feasible, as the basis for International Public Sector Accounting Standards (IPSASs). Accordingly, adopting IASB Standards simultaneously helps convergence with existing and future IPSASs.

Except for Standards that are specific to the not-for-profit or public sectors or that are purely of a domestic nature, the AASB is using the IASB Standards as the "foundation" Standards to which it adds material detailing the scope and applicability of a Standard in the Australian environment. Additions are made, where necessary, broadening the content to cover sectors not addressed by an IASB Standard and domestic, regulatory or other issues.

AASB 8 *Operating Segments* is part of the set of Australian equivalents to IASB Standards, and is the Australian equivalent of the IASB's IFRS 8 *Operating Segments*.

Under section 227(1) of the *Australian Securities and Investments Commission Act 2001* (ASIC Act), the functions of the AASB are to:

- develop a conceptual framework, not having the force of an accounting standard, for the purpose of evaluating proposed accounting standards and international standards;
- make accounting standards under section 334 of the *Corporations Act* for the purposes of the corporations legislation;
- formulate accounting standards for other purposes; and
- participate in and contribute to the development of a single set of accounting standards for world-wide use having regard to the interests of Australian corporations that raise or propose to raise capital in major international financial centres.

Functions of the FRC include determining the AASB's broad strategic direction, monitoring the development of international standards and the accounting standards that apply in major international financial centres, to further the development of a single set of standards for world-wide use with appropriate regard to international developments and to promote the adoption of international best practice in the Australian accounting standard-setting process.

Both the AASB and the FRC are required to advance the main objects of Part 12 of the ASIC Act, Section 224, to:

- facilitate the development of accounting standards that require the provision of financial information that allows users to make and evaluate decisions about allocating scarce resources, assists directors to discharge their obligations in relation to financial reporting, is relevant to assessing performance, financial position, financing and investment, is relevant and reliable, facilitates comparability and is readily understandable;
- facilitate the Australian economy by reducing the cost of capital, enabling Australian entities to compete effectively overseas and having accounting standards that are clearly stated and easy to understand; and
- maintain investor confidence in the Australian economy (including its capital markets).

It is in this context that the FRC has decided to direct the AASB to adopt IASB Standards with effect from 1 January 2005.

1. Problem

Accounting Standard AASB 114 *Segment Reporting* is the Australian equivalent to the International Accounting Standard IAS 14 *Segment Reporting*.

However, in implementing its Convergence Project with the United States Financial Accounting Standards Board (FASB) the IASB has issued IFRS 8 *Operating Segments* which supersedes IAS 14 with effect for annual reporting periods beginning on or after 1 January 2009. IFRS 8 replicates the requirements of Statement of Financial Accounting Standards SFAS 131 *Disclosures about Segments of an Enterprise and Related Information* issued by the FASB.

If IFRS 8 is not adopted in Australia, Australian requirements will be different than international standards and the FRC directive would not be met.

2. Objectives

The AASB's objectives in addressing the problem are to improve the quality and usefulness of financial reporting in Australia in respect of for-profit entities in the private and public sectors and to implement the FRC's directives.

3. Options

Option 1

Adopt IFRS 8.

- enables compliance with the FRC directive.

Option 2

Not adopt IFRS 8 and retain AASB 114.

- would mean that there would not be an Australian Standard equivalent to IFRS 8. This would be inconsistent with the FRC's strategic directive relating to adoption of IASB Standards.

Option 3

Adopt IFRS 8 and change the scope to be the same as that of AASB 114.

- enables compliance with the FRC strategic directive and would mean that AASB 8 would apply a broader range of entities than the IASB has specified for IFRS 8.

4. Impact Analysis

- 4.1 In the process of setting accounting standards, AASB issues Exposure Drafts and Invitations to Comment to consult with stakeholders. Comments received from constituents are taken into account in setting the standards.

When issuing Exposure Drafts of Australian equivalents of IASB Standards, the AASB specifically seeks comment from constituents on whether the proposals are in the best interests of the Australian economy and on whether there are regulatory or other issues that may affect the implementation of the proposals.

- 4.2 The AASB assesses from a public interest perspective whether the costs of providing certain financial information exceed the benefits to be derived from its provision. There is no universally accepted methodology for quantitatively measuring costs and benefits of information presented in financial reports. The costs of providing financial information are incurred, in the main, by reporting entities, but extend in various direct and indirect ways to the users of general purpose financial reports. There is no guarantee that the costs are borne ultimately by those who derive the benefits. The AASB considers the benefits and costs for individual Standards in the context of the Year 2005 strategic directive as a whole.

- 4.3 Adopting IFRS 8 will have an impact on current Australian practice. IFRS 8 applies to the parent and group financial statements of an entity whose debt or equity instruments are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets) or that files, or is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market. AASB 8 would apply to a narrower range of entities than are presently required to comply with AASB 114. The AASB considered that adopting the scope of IFRS 8, which is narrower than the scope of AASB 114, would provide some relief from regulatory requirements and

potential cost savings to reporting entities that are for-profit entities and don't have publicly traded debt or equity instruments.

- 4.4 AASB 8 will simplify segment reporting for those Australian for-profit reporting entities that currently report different information for internal and external purposes and potentially for those who are US registrants as these entities may no longer need to maintain differential sets of segment information data. There may also be some savings in audit costs for these entities. However, given the reliance on internal reporting some entities may need to upgrade internal systems and controls to ensure that the information reported is sufficiently robust to satisfy external audit requirements.
- 4.5 For many entities the management-based information and the reduced level of disclosure in respect of operating segments is likely to result in cost savings in information collection, processing, analysis and audit once transition to the new requirements occurs. For example, entities are likely to incur one-off costs in the transition to implement any systems changes and their review for external audit purposes.
- 4.6 The narrower scope of AASB 8 will also mean that a significant number of reporting entities (such as those who have not issued debt or equity instruments that are traded on a public market) are no longer required to provide segment information externally. This is likely to result in lower costs in respect of external audit and in the collection and processing of information to the extent that this information is not needed for management purposes.

Table of costs and benefits

	Option 1	Option 2	Option 3	Comments
Details	<p>Adopt IFRS 8.</p> <p>Complies with FRC directive.</p>	<p>Not adopt IFRS and retain AASB 114.</p> <p>Does not comply with FRC directive.</p>	<p>Adopt IFRS 8 but expand the scope to be the same as that of AASB 114.</p> <p>Complies with FRC directive (but extends the scope of IFRS 8).</p>	<p>While Option 1 has a much narrower scope, it is only likely to apply to entities for which the incremental costs of complying are relatively lower than for other businesses.</p> <p>Ref 4.2 to 4.6 above.</p> <p>Option 2 is not a feasible option given the FRC directive.</p>
Benefits	<p>Consistent with international practice.</p> <p>Internationally consistent financial information facilitates lower cost of capital. (ASIC Act s224 – see background section for details)</p>	<p>Inconsistent with international practice.</p> <p>Benefits of lower cost of capital are unlikely to be achieved.</p>	<p>Similar benefits as option 1.</p>	<p>As the Australian economy is a small part of the world economy the benefits of international consistency and comparability are likely to be eroded if IFRSs are not adopted.</p>

	Option 1	Option 2	Option 3	Comments
Costs				
Mainly accounting and auditing (businesses are currently comply with basic requirements). However, AASB 8 may require more robust information requiring additional costs.	As the entities that apply AASB 8 are likely to be larger businesses which already will have the systems in place the incremental costs are likely to be relatively lower than for smaller entities.	Small businesses are likely to have relatively larger incremental costs.		
Estimate of number of businesses affected	2,000 (all of which have issued, or are in the process of issuing, equity or debt securities in a public market).	22,000	22,000	
Incremental cost of implementing standard per business*	\$2,000	\$2,000	\$2,000	
Total incremental costs	\$4,000,000	\$44,000,000	\$44,000,000	

*These are estimated average costs are based on limited research. Amounts in individual cases may be much higher or lower than this estimated average.

5. Consultation

The AASB issued Exposure Draft ED 145 *Operating Segments*, the Australian equivalent to the IASB ED 8 *Operating Segments*, in January

2006. ED 145 proposed the adoption of the IASB proposals in Australia and sought comment on the appropriateness of extending the proposed approach to apply to not-for-profit reporting entities in the private sector and the public sector.

Ten submissions were received in respect of the proposals in the ED and although there was substantial support for adopting an Australian equivalent to IFRS 8 in respect of for-profit reporting entities there was little support for applying the basis of the approach to not-for-profit entities in both the private and public sectors. There was limited support for requiring those entities presently included in the scope of AASB 114 to comply with the new standard.

6. Conclusion and Recommendation

Compared to Option 1 -

Option 2 has lower benefits and higher costs.

Option 3 has the same amount of benefit but a higher cost.

In complying with the FRC directive in relation to IASB Standards the AASB decided to follow Option 1 and adopt IFRS 8 by making an Australian equivalent to IFRS 8 and issuing it as AASB 8 *Operating Segments*. The AASB decided that AASB 8 should have the same scope of IFRS 8 and, accordingly, it applies to for-profit reporting entities that have debt or equity instruments issued in a public market or are in the process of issuing such instruments.

The approach to AASB 8 is unique in terms of Australian Accounting Standards in that Australian Accounting Standards normally apply to entities that are required to prepare financial reports in accordance with Part 2M.3 of the Corporations Act and that is a reporting entity; general purpose financial reports of each other reporting entity, and financial reports that are, or are held out to be, general purpose financial reports.

In forming this conclusion, the AASB considered that the benefits of facilitating the Australian economy by reducing the cost of capital, enabling entities to compete effectively overseas and the provision of information that is relevant, reliable and facilitates comparability outweighed the costs to individual entities of adopting Australian equivalents to IASB Standards. The Board also noted that the basis of the approach required by AASB 8 in respect of identifying operating segments and the nature of the information required to be reported means that there is likely to be a much closer relationship between the information collected and reported to management

and that required to be reported in the financial statements which is expected to reduce the costs of compliance.

7. Implementation and Review

AASB 8 will be subject to review and revision taking account of international developments, particularly the processes for review and revision undertaken by the IASB, and of the experience of constituents in implementing the Standard. In this respect the IASB has foreshadowed its intention to propose extending the scope of IFRS 8 to include all entities that hold assets in a fiduciary capacity for a broad group of outsiders once the outcome of its project dealing with accounting by small and medium-sized enterprises is known.