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CL 162

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ED 8 Operating segments

The IMA is the trade body representing the UK asset management industry. IMA Members include independent fund managers, the asset management arms of retail banks, life insurers and investment banks, and occupational pension scheme managers. They are responsible for the management of approximately £2 trillion of funds (based in the UK, Europe and elsewhere), including institutional funds (for example, pensions and life funds), private client accounts and a wide range of pooled investment vehicles. In particular, our Members manage 99% of UK-authorized investment funds.

In connection with the proposals contained within ED 8, our comments are set out below from two perspectives:

- our Members as major investors in companies whose securities are traded on regulated markets; and
- reports of authorised funds.

From the perspective of the users of accounts and the preparers of the accounts of funds, the IMA supports the convergence of accounting standards in the interests of ensuring the consistency and transparency of accounts internationally and reducing the differences between IFRS and United States Generally Accepted Accounting Principles. However, we have certain observations to make in relation to the proposals in ED 8 on segmental reporting which are summarised below and set out in the attached.

As major investors in companies

From the perspective of the users of accounts, in principle we welcome the IASB replacing IAS 14, Segment Reporting, with the US SFAS 131, Disclosures about Segments of an Enterprise and Related Information. This standard is based on the way management view the entity, and we support it as it undoubtedly has advantages in that it:

- enables users to see the entity through the eyes of management;
- ensures consistency with other parts of the accounts, particularly the management commentary;
- ensures consistency with internal management reports; and
- facilitates the timely production of accounts and interim reports in that the information is readily available and is less costly to produce for preparers.

That said, we have a number of reservations as summarised below.

- *The chief operating decision maker is not defined.* The segments to be reported are on the basis of "internal reports that are regularly reviewed by the entity's chief operating decision maker in order to allocate resources to the segment and assess its performance" (IN11).

However, there is no guidance as to who the chief operating decision maker is - is it the board, executive management or a member of senior management? The amount of detail in the analysis will differ according to the seniority of the chief operating decision maker in the organisation and we believe it would be helpful if there was guidance to help ensure that a sufficiently detailed and meaningful segmental analysis is produced. An analysis according to the reports reviewed by the chief operating officer may not necessarily result in useful information being provided.

- *Different accounting policies for segment information.* The accounting policies management use for segment information may differ from those used in the entity's financial statements in that internal management reports tend to be prepared in accordance with national GAAP. Even though an overall reconciliation is required (paragraph 27) different reportable segments will not necessarily be comparable and to address this we consider that they should be reconciled at the level of individual segments.
- *There is no requirement to analyse liabilities by segment.* It would appear that information is required to be given only on gross assets as significant costs do not have to be analysed. This will result in insufficient information to determine returns on capital for each segment.

We believe that, provided it can be done on a reasonable basis, costs should be analysed, and an analysis of operating profit or earnings before interest and tax given.

- *Insufficient information to allow an analysis of cash flows.* Cash flows are important in analysing accounts but we consider that the standard does not provide for an analysis of these. We consider this is something that needs to be addressed.

In conclusion, we consider that improvements could be made both to IAS 14, Segment Reporting, and to SFAS 131, and that there should be a joint project with the FASB that seeks to harmonise and improve on these two standards before changes are made to the requirements to report segmental information.

Reports of authorised funds

We have considered the possible application of IFRS to authorised funds and the information that would be useful to the users of funds' reports. In this capacity, we also represent the UK authorised funds sector on European and International forums considering IFRS in relation authorised funds.

Whilst the IMA supports the global convergence of accounting standards, we note that SFAS 131 specifically excludes mutual funds from its scope and that ED 8 proposes to bring them within its scope. The fact that SFAS 131 excludes mutual funds supports our contention that its requirements are not appropriate to this sector. We object to the proposal to bring authorised funds within the scope of ED 8, as we do not believe that the proposed standard would result in investors receiving additional information that is useful to them. Instead it would add costs and result in the reporting of voluminous, irrelevant data. Although the proposed standard requires the disclosure of some relevant information, the regulations of authorised funds already require this to be reported. Our concerns are explained below.

- *The segments in which a fund can invest are specified by its constitution and investment policy and are key factors in investors choosing a particular fund.* An authorised fund's constitution and investment policy already specifies the type of securities it can invest in and their geographical spread, which can be restricted to certain countries or regions, or be global. Investors choosing to invest in an authorised fund make a choice to expose themselves to the risks and rewards of these categories of securities and geographical regions.
- *Regulatory requirements already require sufficient disclosures.* Authorised funds are regulated and have extensive reporting requirements which require additional disclosures to those in the accounts or financial reports, including:
 - investment performance; and
 - a review of the investment activities during the period and any other information which would enable investors to make an informed judgement.

Reports also typically contain an analysis of the portfolio by asset type and geographical region, as appropriate, and details of large holdings.

- *The information investors want is already disclosed.* The main investors in authorised funds tend to be retail investors who do not have the time, expertise, inclination or wealth to manage their own diversified investment portfolios, and who are primarily interested in their fund's performance, the geographical spread of its holdings, and the costs of running the fund. This information is already required to be disclosed.
- *The information envisaged in the ED is not necessarily available.* An authorised fund's main objective is to deliver investment performance and it is inevitable that in a competitive environment this will be monitored by its management by asset type and geographical region, if relevant. However, in considering this, in our experience managers do not allocate general expenditure to asset categories or geographical regions other than buying and selling costs which are reflected in acquisition and sale prices, respectively.
- *The disclosures envisaged will be of little interest to investors.* For example, when an investor invests in a global fund, he is looking for an investment return from global investments, whether they are equities, bonds or mixed, and has chosen to expose himself to the risks and rewards of such investments. He is likely to need information to enable him to decide whether to buy more, sell or hold his investment. Information on the fund's net income, yield and capital growth, together with the prospects of the global markets and a comparison to other global funds are useful to this decision. In our experience, an analysis that allocates income and expenditure to particular segments is of no interest to most investors in these funds and could be costly to produce.

Please contact us if you would like clarification on any of the points in this letter or the attached, or if you would like to discuss any issues further.

Yours sincerely

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cc. European Fund and Asset Management Association
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ANNEX

IMA RESPONSE TO IASB EXPOSURE DRAFT – ED8 OPERATING SEGMENTS

The IMA's answers to the specific questions raised are as set out below.

Question 1 – Adoption of the management approach in SFAS 131

Is this approach to segment reporting appropriate? If not, why not? What, if any, alternative approach would you propose?

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. From the perspective of the users of accounts, in principle the IMA supports this approach in that it:

- enables users to see the entity through the eyes of management;
- ensures consistency with other parts of the accounts, particularly the management commentary;
- ensures consistency with internal management reports; and
- facilitates the timely production of accounts and interim reports in that the information is readily available and is less costly to produce for preparers.

That said, the segments to be reported are to be determined on the basis of internal reports reviewed by the entity's chief operating decision, but there is no guidance as to who the chief operating decision maker is - is it the board, executive management or a member of senior management? The amount of detail in the analysis will differ according to the seniority of the chief operating decision maker in the organisation and we believe it would be helpful if there was guidance that will ensure that a detailed and meaningful segmental analysis is produced. An analysis according to the reports reviewed by the chief operating offices may not otherwise always provide information that is useful to investors.

Question 2 – Divergence from SFAS 131

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 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. In this respect, it would appear that information is required to be given only on gross assets in that significant costs do not have to be analysed. This means that there is insufficient information to determine returns on capital for each segment. We believe that, provided it can be done on a reasonable basis, costs should be analysed, and an analysis of operating profit or earnings before interest and tax given.

Furthermore, cash flows are important in analysing accounts but we consider that the ED does not require sufficient information on these to be disclosed. We consider that this is something that needs to be addressed.

Question 3 – Scope of the standard

Do you agree with the scope of the draft IFRS? If not, why not?

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 entities that hold assets in a fiduciary capacity for a broad group of outsiders.

From the perspective of the users of accounts, we support the scope of the standard. However, from the perspective of preparers of the accounts of authorised funds and the information that investors in those funds would find useful, we do not believe that funds should be included within the scope of the standard. We consider that to do so would add costs and result in the reporting of voluminous, irrelevant data. Information that is of interest to investors in funds is already required to be disclosed by regulations. Our concerns in summary are:

- segments are specified by an authorised fund's constitution and investment policy and is a key factor when investors select a particular fund;
- regulatory requirements already require sufficient disclosures;
- the information the main investors want is already disclosed;
- the information envisaged in the ED is not necessarily available; and
- the disclosures envisaged will be of little interest to investors.

Question 4 – Level of reconciliations

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.

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.

In this respect, the accounting policies management use for segment information may be different from those used in the entity's financial statements in that internal management reports tend to be based on information prepared in accordance with national GAAP. Even though an overall reconciliation is required (paragraph 27), the reportable segments will not necessarily be comparable and we consider that these should be reconciled at the level of individual segments.

Question 5 – Geographical information about 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?

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.

The IMA does not have any particular views on this requirement.

Question 6 – Consequential amendments to IAS 34 *Interim Financial Reporting*

Do you agree with the consequential amendments made to IAS 34? If not, why not?

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. From the perspective of the users of accounts, the IMA strongly supports this and it is one of the factors that makes the management approach welcome.