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EPSAS issue paper on segment reporting

Paper by Ernst & Young on behalf of Eurostat
- for discussion

Segment reporting under the future European Public Sector Reporting Standards (EPSAS)

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1. Objectives of the Issues Paper

The objective of this issues paper is to develop a proposal for Member States' discussion on segment reporting for EPSAS. To achieve this goal the issues paper takes into account reflections or analyses on this issue made

- (a) in at least three Member States and
- (b) under the existing international financial reporting frameworks (IPSAS, IFRS, GFS/ESA, EC rules).

The issues paper addresses the following questions:

What are the advantages and disadvantages of different possible approaches to segment reporting, or alternatively of excluding completely segment reporting, from the scope of EPSAS?

Which ways of reducing the perceived high burden of segment reporting, and hence of any future segment reporting requirements for EPSAS, do exist and what are the consequences of that?

How could segment reporting under the future EPSAS standard potentially support ESA needs?

2. Background

International private sector as well as public sector accounting standards require certain entities to present information based on segments in their financial statements. According to IPSAS 18 for example this is useful information because: “In most cases, the activities of the entity are so broad, and encompass so wide a range of different geographical regions, or regions with different socio-economic characteristics, that it is necessary to report disaggregated financial and non-financial information about particular segments of the entity to provide relevant information for accountability and decision-making purposes.”¹ In this context the question arises on the purpose and on the need to report financial information based on segments.

The Commission Staff Working document² and the Eurostat study on the impact assessment of EPSAS implementation³ both classify IPSAS 18 under the category of standards that potentially need adaptation and/or implementation guidance. One of the reasons for this classification stated in the Commission Staff Working document is that segment reporting is one of the areas where conceptual differences between IPSAS and GFS can be found.⁴ In fact, both frameworks differ in objectives, information presented and terms used.

Other reasons for this classification stated in the Commission Staff Working document and the Eurostat study on the impact assessment of an EPSAS implementation were:

- Geographical segment reporting could be challenging when implementing IPSAS 18.⁵
- The allocation of assets and liabilities to various segments is seen as being too complicated.
- Segment reporting is not based on market/non-market activities.
- The extensive disclosure requirements of IPSAS were identified by the Member States as requiring the most significant efforts.⁶
- Some Member States considered the information required by IPSAS 18 as not useful. Also difficulties with the identification of segments were reported.⁷

The aim of this issues paper is to analyse and discuss segment reporting under EPSAS in more detail. The questions raised in Chapter 1 have been used as guidelines for the development of this paper.

¹ See IPSAS 18.11.

² See Commission Staff Working Document, annex 7.1.

³ See PwC, Collection of information related to the potential impact, including costs of implementing accrual accounting in the public sector and technical analysis of the suitability of individual IPSAS standards, 2013/S 107-182396, 1 August 2014, p. 134.

⁴ See Commission Staff Working Document, chapter 4.4.

⁵ See Commission Staff Working Document, Annex 6.1, p. 113.

⁶ See PwC, Collection of..., 2013/S 107-182396, 1 August 2014, p. 97.

⁷ See PwC, Collection of..., 2013/S 107-182396, 1 August 2014, p. 124.

3. Description of accounting guidance available in international accounting frameworks and in statistical rules

The following paragraphs provide an overview of the existing accounting guidance with respect to segment reporting.

3.1 International Public Sector Accounting Standards (IPSAS)

3.1.1 Objectives and general requirements of IPSAS 18

IPSAS 18 “Segment reporting” establishes the principles for disclosing financial information by segments in the notes. The objectives of reporting segment information in accordance with IPSAS 18 is twofold:⁸

- 1) To help users of the financial statements to better understand the entity’s past performance, and to identify the resources allocated to support the major activities of the entity; and
- 2) To enhance the transparency of financial reporting and enable the entity to better discharge its accountability obligations.

In this context, IPSAS 18.14 argues that “the governing board and senior manager will require information about segments to enable them (a) to discharge their managerial responsibilities and to evaluate the performance of the entity in achieving its objectives in the past, and (b) to make decisions about the allocation of resources by the entity in the future.”

IPSAS 18 is drawn primarily from IAS 14 “Segment Reporting”. It has to be noted that in the meantime IAS 14 was superseded by IFRS 8 “Operating Segments”.⁹ An update of IPSAS 18 on segment reporting is currently not on the IPSASB’s work programme.

IPSAS 18 requires an entity to disclose segment information both in its separate as well as consolidated financial statements. Relief is granted only where both the consolidated financial statements of a government or other economic entity and the separate financial statements of the parent entity are presented together.¹⁰ In this case, it is sufficient to present segment information on the basis of the consolidated financial statements only.

3.1.2 Identification of segments

IPSAS 18 requires segments to be identified based on the following definition:¹¹

“A segment is a distinguishable activity or group of activities of an entity for which it is appropriate to separately report financial information for the purposes of (a) evaluating the entity’s past performance in achieving its objectives, and (b) making decisions about the future allocation of resources.”

⁸ See IPSAS 18, Section „Objective“.

⁹ The effective date for IFRS 8 is 1 January 2009.

¹⁰ See IPSAS 18.6.

¹¹ See IPSAS 18.9.

In most cases, the major classifications of activities identified in budget documentation will reflect the segments for which information is reported to the governing body and the most senior manager of the entity.¹² Despite the fact that there is a close relationship between the segment and budgeting structures, neither IPSAS 18 nor IPSAS 24 “Presentation of Budget Information in Financial Statements” requires to present budget information based on segments in financial statements. Therefore, some argue that the discharge of the accountability obligations by an entity – being one of the main objectives of IPSAS 18 – is limited.

According to IPSAS 18.14 the information on segments shall enable the governing board and the senior manager (a) to discharge their managerial responsibilities and to evaluate the performance of the entity in achieving its objectives in the past, and (b) to make decisions about the allocation of resources by the entity in the future. Determining the activities that should be grouped as separate segments requires judgment and matters as listed below should be considered¹³:

- ▶ The objective of reporting financial information by segment;
- ▶ The expectation of members of the community regarding the key activities of the entity;
- ▶ The qualitative characteristics of financial reporting; and
- ▶ Whether a particular segment structure reflects the basis on which the governing body and senior manager require financial information to enable them to assess the past performance of the entity in achieving its objectives, and to make decisions about the allocation of resources to achieve future objectives.

IPSAS 18 differs between two types of segments that are reported to the governing body and senior manager of an entity:

	Service segments	Geographical segments
Definition ¹⁴	A distinguishable component of an entity that is engaged in providing related outputs or achieving particular operating objectives consistent with the <u>overall mission of each entity</u> .	A distinguishable component of an entity that is engaged in providing outputs or achieving particular operating objectives within a <u>particular geographical area</u> .
Use ¹⁵	Government departments and agencies are usually managed along service lines, because this reflects the way in which (a) major outputs are identified, (b) their achievements monitored, and (c) their resource needs identified and budgeted.	An entity may be organized and report internally to the governing body and the senior manager on a regional basis – whether within or across national, state, local or other jurisdictional boundaries. Where this occurs, the internal reporting system reflects a geographical segment structure.
Factors that will be considered in	▶ The primary operating objectives of the entity and the goods, services and activities that relate to the	▶ Similarity of economic, social and political conditions in different regions;

¹² See IPSAS 18.4.

¹³ See IPSAS 18.15.

¹⁴ See IPSAS 18.17.

¹⁵ See IPSAS 18.18 and 18.20.

<p>determining whether outputs are related and should be grouped as segments¹⁶</p>	<p>achievement of each of those objectives and whether resources are allocated and budgeted on the basis of groups of goods and services;</p> <ul style="list-style-type: none"> ▶ The nature of the goods or services provided or activities undertaken; ▶ The nature of the production process and/or service delivery and distribution process or mechanism; ▶ The type of customer or consumer for the goods or services; ▶ The way in which the entity is managed and financial information is reported to senior management and the governing board; and ▶ If applicable, the nature of the regulatory environment or sectors of government. 	<ul style="list-style-type: none"> ▶ Relationships between the primary objectives of the entity and the different regions; ▶ Whether service delivery characteristics and operating conditions differ in different regions; ▶ Whether this reflects the way in which the entity is managed and financial information is reported to senior management and the governing board; and ▶ Special needs, skills or risks associated with operations in a particular area.
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Table 1: Service segments versus geographical segments as defined by IPSAS 18

Multiple segmentation is allowed for entities which report segment revenue, segment expenses, segment assets and segment liabilities to the governing body and senior manager on the basis of more than one segment structure, for example by combining both service and geographical segments.¹⁷ In such cases, the segments can be reported separately or as a matrix. In addition, adopting a primary and secondary segment reporting structure with only limited disclosures made about secondary segments is also possible.

The problem with the identification of segments in practice is that government entities are not structured along activities as required by IPSAS 18.9, but along institutions, functions or programs. Taking the public health sector as an example, one might be able to identify institutions located at different levels of government or administration (e.g. Ministry of Health, university medical centres, public hospitals, etc.). In order to generate relevant information for accountability and decision making purposes, most governments group institutions based on those levels of government or administration (e.g. university medical centres in one group, public hospitals in another etc.) rather than based on activities. From the perspective of IPSAS 18, the focus is on the different activities performed for instance by university medical centres (such as research, health services, teaching, administration etc.). Hence, IPSAS 18 would require to form the segments according to these activities, i.e. research, health services, teaching and probably administration. In practice however, governments are often unable or unwilling to produce such information because in their view it is not relevant for accountability or decision making.

A further point of criticism of defining segments based on activities is that governments might be forced into large numbers of very small segments. The reason is that governments often provide a wide range of services, each of which might be further subdivided in a number of activities (see the health example above).

¹⁶ See IPSAS 18.19 and 18.22.

¹⁷ See IPSAS 18.23.

3.1.3 Disclosure requirements

IPSAS 18 sets out the following main requirements for disclosing segment information:¹⁸

- ▶ Segment revenue and segment expense are to be disclosed for each segment. Segment revenue from budget appropriation or similar allocation, segment revenue from other external sources, and segment revenue from transactions with other segments should be reported separately;
- ▶ The total carrying amount of segment assets and segment liabilities for each segment has to be disclosed;
- ▶ The total cost incurred during the period to acquire segment assets that are expected to be used during more than one period for each segment are to be disclosed;
- ▶ An entity shall disclose for each segment the aggregate of the entity's share of the net surplus (deficit) of associates, joint ventures, or other investments accounted for under the equity method, if substantially all of those associates' operations are within that single segment;
- ▶ If an entity's aggregate share of the net surplus (deficit) of associates, joint venture, or other investments accounted for under the equity method is disclosed by segment, the aggregate investments in those associates and joint ventures shall also be disclosed by segment; and
- ▶ An entity shall present a reconciliation between the information disclosed for segments and the aggregated information in the consolidated or entity financial statements.

Once the segments are identified, revenue, expense, assets and liabilities can be allocated to them. IPSAS 18 sets out the following definitions:¹⁹

¹⁸ See IPSAS 18 para. 51-55, 61, 63-64.

¹⁹ See IPSAS 18.27.

Segment assets	Those operating assets that are employed by a segment in its operating activities, and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis ²⁰ .	Segment liabilities	Those operating liabilities that result from the operating activities of a segment, and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis.
Segment revenue	Revenue reported in the entity's statement of financial performance that is directly attributable to a segment, and the relevant portion of entity revenue that can be allocated on a reasonable basis to a segment, whether from budget appropriations or similar, grants, transfers, fines, fees, or sales to external customers or from transactions with other segments of the same entity.	Segment expenses	An expense resulting from the operating activities of a segment that is directly attributable to the segment, and the relevant portion of an expense that can be allocated on a reasonable basis to the segment, including expenses relating to the provision of goods and services to external parties and expense relating to transactions with other segments of the same entity.

An entity should start from its internal financial reporting system to identify those items that can be directly attributed, or reasonably allocated, to segments.²¹ However, it should be considered that – even though being very well understood by the entity's own management – the internal allocation to segments but could be deemed subjective, arbitrary or difficult to understand by external users of financial statements.²² Such an allocation would not be considered to be a reasonable basis according to the definitions provided by IPSAS 18.

A practical problem in that context is that governments often cannot – at all or often only with huge efforts – allocate assets and liabilities to segments. Also the allocation of revenues (e.g. tax revenues) can be problematic as generally by definition they might be “general purpose”. In the public sector, governments are also often pooling some assets and the allocation of them to segments might be cumbersome. Even more problematic in practice is the allocation of liabilities to specific activities. Furthermore, it has to be mentioned that the Classification of functions of government (COFOG) does not require to allocate assets and liabilities to functions. As the COFOG classification is only used to present expenditures, the classification does not allocate revenues to functions. To sum up, it can be argued that the performance-oriented approach of IPSAS 18 in which not only expenditures but also revenues, assets and liabilities need to be allocated to segments causes additional efforts compared to what is required by ESA.

3.2 International Financial Reporting Standards (IFRS)

End of 2006 the IASB issued IFRS 8 “Operating Segments”. IFRS 8 replaced IAS 14 for reporting periods beginning on or after 1 January 2009. IFRS 8 differs from IAS 14 because it applies a

²⁰ IPSAS 18 does not directly define what is meant by “a reasonable basis”. However, IPSAS 18.31 specifies that a basis for allocating segments that is understood by entity management, but that could be deemed subjective, arbitrary, or difficult to understand by external users of financial statements, cannot be considered as a reasonable basis.

²¹ See IPSAS 18.29.

²² See IPSAS 18.30.

management reporting approach to identifying and measuring the results of reportable operating segments.²³ The IASB is of the view that management reporting approach improves to the quality of the financial reporting allowing users of the financial statements to examine an entity's operations through the eyes of management. The Post Implementation Review (PIR) of IFRS 8 conducted by the IASB has shown that the use of the management perspective made communication from management to investors easier and also that incremental costs of implementing IFRS 8 were low.²⁴ The PIR of IFRS 8 also reported that, overall, preparers generally think that the standard works well in the private sector context. Moreover, auditors, accounting firms, standard-setters and regulators generally support IFRS 8. The IASB's conclusion of the PIR is that "the benefits of applying the Standard were largely as expected and that overall the Standard achieved its objectives and has improved financial reporting"²⁵.

IFRS requires an entity to report financial and descriptive information about its reportable segments. Reportable segments are operating segments or aggregations of operating segments that meet specified criteria. Operating segments are components of an entity about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. Generally, financial information of the segments is required to be reported on the same basis as is used internally for evaluating operating segment performance and deciding how to allocate resources to operating segments. IFRS 8 is therefore characterized by the requirement to disclose information that is actually being used internally by management.

As the basis for measuring segment results (i.e. the surplus or deficit for each segment) reported may differ from the one prescribed by financial reporting standards, reconciliations are required where information which is presented to management by using internal accounting policies differs from IFRS-based information in the primary financial statements.

Past assessments on the implementation of IFRS already pointed out the diversity in the way entities reported their segments based on IAS 14.²⁶ Given the fact that IFRS 8 does not require segment information based on financial reporting standards, disclosures on segment information may be even less comparable than under IAS 14.

IFRS 8 applies to (a) the separate (or individual) financial statements of an entity and (b) to the consolidated financial statements of a group with a parent. For both separate and consolidated financial statements the entity's/parent's debt or equity instruments are traded in a public market or it files, or is in the process of filing, its (consolidated) financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market.²⁷ However, when both separate and consolidated financial statements for the parent are presented in a single financial report, segment information need to be presented only on the basis of the consolidated financial statements.²⁸

²³ See Ernst & Young, IFRS 8 Operating segments, Implementation guidance, 2009, p. 2.

²⁴ See IASB, Post-implementation Review: IFRS 8 Operating Segments, Report and Feedback Statement, July 2013, p. 5.

²⁵ IASB, Post-implementation Review: ..., p. 6.

²⁶ See Ernst & Young, IFRS: Observations on the Implementation of IFRS, September 2006, S. 109 f. and S. 147 f. This study can be accessed under the following link:
https://www.feicanada.org/files/IFRS_Obs_on_the_Implementation.pdf.

²⁷ See IFRS 8.

²⁸ See IFRS 8.4.

With regards to the identification of segments IFRS 8 adopts the management reporting approach to identifying operating segments. An entity is first required to identify all operating segments that meet the definition in IFRS 8. Once all operating segments have been identified, the entity must determine which of these operating segments are reportable. If a segment is reportable, then it must be separately disclosed. This approach is the same as that required by IAS 14 except that it does not require the entity to determine a 'primary' and a 'secondary' basis of segment reporting. As IFRS 8 (similarly to IAS 14) defines reporting segments as the organisational units for which information is reported to key management personnel for the purpose of performance assessment and future resource allocation the structure of operating segments will be the same under IFRS 8 as under IAS 14.²⁹ When an entity's internal structure and management reporting system are not based either on product lines or on geography, IAS 14 required the entity to choose one as its primary segment reporting format. IFRS 8, however, does not impose this requirement to report segment information on a product or geographical basis and in some cases this may result in different segments being reported under IFRS 8 compared with IAS 14.

Regarding the measurement of segment information IFRS 8 requires that the amount of each segment item disclosed in the financial statements matches the corresponding amount reported to the chief operating decision maker (CODM) in the internal management reports. This rule applies regardless of whether or not internal management were prepared in accordance with the IFRS accounting policies of the entity. As a consequence this can result in differences between the amounts reported in segment information and those reported in the entity's primary financial statements. In contrast, IAS 14 required the segment information to be prepared in accordance with the entity's IFRS accounting policies. Finally, certain definitions of IAS 14, such as 'segment revenue', 'segment profit or loss', 'segment assets', and 'segment liabilities', are no longer provided under IFRS 8.

Given the fact that IFRS 8 does not define segments as either business or geographical segments and does not require measurement of segment amounts based on an entity's IFRS accounting policies, an entity must disclose an explanation of how it determined its reportable operating segments, and the basis on which the disclosed amounts have been measured. These disclosures include reconciliations of the totals of key segment amounts to the corresponding entity amounts reported in the IFRS financial statements.

IFRS 8 requires that a measure of profit or loss and assets for each segment must be disclosed. Additional line items, such as interest revenue and interest expense, are required to be disclosed if they are provided to the CODM (or included in the measure of segment profit or loss reviewed by the CODM). By contrast, IAS 14 specifies the items that must be disclosed for each reportable segment.

When an entity receives more than 10% of its revenue from a single customer further disclosures are required. In this instance, the entity must disclose this fact, the total amount of revenue earned from each such customer, and the name of the operating segment that reports the revenue without identifying the individual customer. IAS 14 does not contain such a requirement.

3.3 ESA 2010

ESA 2010 provides an integrated picture of government accounts with the following measures of government activity: revenue, expenditures, deficit/surplus, financing, other economic flows and balance sheet levels.³⁰ Unlike private sector accounting, ESA does not require to provide information

²⁹ See Ernst & Young, IFRS 8 Operating segments, Implementation guidance, 2009, p. 4.

³⁰ See ESA 2010, para. 20.01.

based on predefined segments. Segment information on a balance sheet level that is comparable to IPSAS 18 does not have to be provided.

In the ESA system, revenue is classified by nature. For expenses, classifications by both nature and function are foreseen (see below). However, ESA 2010 does not require revenues and expenses to be structured by segments in the sense of IPSAS 18.

3.3.1 Revenue

Government revenue is classified in ESA 2010 according to the nature/type of the revenue stream. The different revenue categories recorded are:³¹

- ▶ Taxes;
- ▶ Social contributions;
- ▶ Sales of goods and services;
- ▶ Other current revenue; and
- ▶ Capital transfer revenue.

3.3.2 Expenditure

ESA 2010 provides two different classifications of government expenditure, one by nature and one by function (COFOG).

3.3.2.1 Classification of government expenditures by nature

The different expenditure categories recorded under the first classification are:

- ▶ Intermediate consumption;
- ▶ Compensation of employees;
- ▶ Interest;
- ▶ Social benefits other than social transfers in kind;
- ▶ Social transfers in kind via market producers;
- ▶ Subsidies;
- ▶ Other current expenditure;
- ▶ Capital expenditure.

3.3.2.2 Classification of government expenditures by function

The “Classification of functions of government (COFOG)” provides a classification of expenditures by function. The COFOG classification describes government expenditure according to 10 major functions set out below, and according to two additional levels of increased detailed breakdown not presented here. For example, the second level is necessary to provide information on research and development expenditure, as well as to provide information on government expenditure dedicated to the risks and social needs of social protection.

The ten functions of government according to the COFOG classification are:

- | |
|--|
| <ol style="list-style-type: none">1. General public services;2. Defense;3. Public order and safety;4. Economic affairs; |
|--|

³¹ See ESA 2010, para. 20.72.

- | |
|---|
| <ol style="list-style-type: none">5. Environmental protection;6. Housing and community amenities;7. Health;8. Recreation, culture and religion;9. Education;10. Social protection. |
|---|

Table 1: Functions of government according to the COFOG classification

Source: ESA 2010, table 20.1

A classification of expenditures using the classification of functions of government (COFOG) is an integral part of the government finance presentation. It is considered to be “a major analytical instrument of government expenditure, especially useful for international comparisons”.³² The aim of the COFOG classification is to show the purpose for which expenditure transactions are undertaken. Such purposes may differ from the administrative arrangement of governments. ESA 2010 provides the following example: An administrative unit responsible for health services can undertake activities with an educational purpose, such as training of medical professionals.³³ A cross presentation of government transactions by economic nature (the usual ESA classification) and according to functions is requested.

3.3.3 Classification by subsector of government

According to ESA 2010, the general government sector (S.13) is divided into four subsectors:

- (1) central government (excluding social security funds) (S.1311);
- (2) state government (excluding social security funds) (S.1312);
- (3) local government (excluding social security funds) (S.1313); and
- (4) social security funds (S.1314).

For reporting purposes ESA 2010 distinguishes between these four subsectors of government.³⁴ It prepares financial information both at subsector level (S.1311 – S.1314) and at sector level (S.13).

3.4 EU Accounting Rules

The EU Accounting Rules (EAR) do not have a separate standard on segment reporting. Requirements on segment reporting are incorporated in EAR 1. Segment information shall be presented in the notes to the financial statements, on the basis of the figures of the statement of financial performance.³⁵ Segment information shall be presented for the EU institutions (including the European Commission), agencies and bodies on a consolidated level and also for the European Commission in their separate financial statements.

The current objective of the segment report at consolidated level is, as a minimum, to provide the user of the financial statements with financial information pertaining to individual EU activities. As the EU activities are split in terms of budgetary programming into headings of the Multi Annual Financial Framework (MFF), it has been decided to reflect the structure in the segment report accordingly. EAR 1 argues that assets and liabilities are not always directly attributable to activities, and that therefore segment reporting of balance sheet items would not provide relevant

³² See ESA 2010, para. 20.109.

³³ See ESA 2010, para. 20.109.

³⁴ ESA 2010, para. 7.02 requires for example that a balance sheet is drawn up for subsectors.

³⁵ See EAR 1, para. 12.

information to the user.³⁶ For the reasons mentioned above not all of the requirements have been incorporated in EAR 1.

The segment report therefore only provides information on revenues (exchange and non-exchange) and expenses. In terms of presentation, the segments can be grouped in the following MFF categories:

- 1) Smart and inclusive growth;
- 2) Sustainable growth;
- 3) Security and citizenship;
- 4) Global Europe;
- 5) Administration; and
- 6) Not assigned to MFF heading.

It is foreseen by EAR 1 that individual EU institutions, agencies and bodies may present a segment report in their financial statements, if appropriate. This information should be disclosed taking into account the materiality of each segment and the specificities of the activities. The definitions of a segment, segment revenues and segment expenses are similar to IPSAS 18.

At consolidated level, the segment revenues and expenses to be disclosed are those directly attributable to a segment.

³⁶ See EAR 1, section 12.

4. Country analysis on segment reporting by Member States

4.1 Selection of countries

The following sections provide an overview on how segment reporting is treated in a selection of Member States or other administrative entities with high accounting maturity. The selection was based on the following considerations:

- ▶ Austria: Austria adopted the accrual basis IPSASs on 1 January 2013 at the federal level and has scored over 70% in the accounting maturity assessment of the PwC study.
- ▶ City State of Hamburg, Germany: Hamburg applies accrual accounting based on national accounting standards. However, Hamburg decided not to apply segment reporting for their consolidated financial statements. The City of Hamburg was considered to be of interest in order to get an understanding why this decision was made.
- ▶ France: France applies accrual accounting since 2006 and there are similarities between the IPSAS accounting framework and the French Central Government Accounting Standards. These standards require entities to report segment information.
- ▶ Portugal: Since Portugal is currently reforming its public sector accounting framework based on IPSAS, it is of interest what is envisaged by the standard setter with regards to segment reporting.

The focus of this analysis is to identify how the selected Member States and entities report segment information.

4.2 Methodology

To get an overview of Member States' current approaches to segment reporting, EY conducted semi-structured interviews based on a questionnaire. Respondents to the questionnaire were government representatives from the respective entities. The following questions were asked in the questionnaire:

1. Does your government/entity report financial information based on segments?
2. Is there a requirement to report segment information, or does the government/entity provide the information voluntarily?
3. If your government/entity does provide segment information:
 - a. What accounting framework is used for reporting of segments (IPSAS, national GAAP, IFRS etc.)?
 - b. What are the reasons/benefits seen for reporting segment information?
 - c. What are obstacles of providing segment information?
 - d. How are the segments structured (e.g. based on services, organizational/"geographical" aspects (e.g. by ministry))?
 - e. In what frequency is segment information provided?
4. Who are the recipients or main user groups of segment reporting?
5. If your government/entity does not report segment information, what were the reasons for the decision not to report segment information?

4.3 Austria

The Austrian Federal government does report financial information based on segments. Through reference to IPSAS as the relevant accounting framework for the Austrian Federal Government there is a requirement to report segment information. Therefore, IPSAS 18 is used for the reporting of segments. The segments are structured based on organizational aspects, i.e. by ministries. Segment information is provided on an annual basis.

The following users were considered as main recipients or main user groups of segment reporting:

- ▶ Parliament
- ▶ Executives in administration

The reasons/benefits seen for reporting segment information were:

- ▶ Compliance with IPSAS
- ▶ To provide detailed information regarding ministries for evaluation purposes (separate financial statements are prepared for each Ministry). Budget and actuals can be compared on a ministry-by-ministry basis
- ▶ Information of parliament

The fact that segment information has to be prepared annually at the same time as the financial statements preparation is considered to be an obstacle for segment reporting. Financial statements for the segments have to be prepared on a ministry level and this means some additional effort.

4.4 France

The Central Government of France reports financial information based on segments. Standard 16 of the Central Government Accounting Standards (CGAS) requires entities to report segment information. Standard 16 is based on IPSAS 18 Segment Reporting and IFRS 8 Operating Segments. For the definition of segments CGAS 16 recommend to use missions, which correspond to major public policies.³⁷ This reflects also the budget presentation. Segments made up of groups of missions must have a stable composition and be limited in number, so as to ensure the comparability over time and understandability of the segment information reported. It is also mentioned that international standards recommend limiting the number of segments to about ten.³⁸ Segment information is provided on an annual basis.

The same users as for the financial accounts are considered as the main recipients or main user groups of segment reporting. According to the Conceptual Framework for Central Government Accounting the financial accounts are primarily directed to citizens and their representatives.³⁹ However, accounting information must also meet the needs of those responsible for conducting and managing the Central Government's tasks and activities. Finally, international public institutions,

³⁷ In 2011, when the missions were introduced, the general budget was divided into 32 missions. Missions are further sub-divided into specific budget authorisations by programme. See Note Presenting Opinion No. 2011-06 of the 8th July 2011 Relating to Segment Reporting for Central Government.

³⁸ IFRS 8 limits the number of segments to about ten. A larger number of segments shall only be provided if management believes that information about the segment would be useful to users of the financial statements (see IFRS 8.13). IPSAS 18 does not provide a recommendation about the number of segments.

³⁹ See Central Government Accounting Standards. January 2016, p. 10.

capital markets and investors in debt securities are also considered as recipients of financial information.

The main reasons/benefits seen for reporting segment information are to mirror budget presentation and to provide information on missions, which is the way the French Central Government communicates on its activities.

A major obstacle for providing segment information is the fact that some segments (i.e. missions) regroup several ministries into one segment. As a consequence it is difficult to appropriately show who (i.e. which ministry) controls what (i.e. which assets) within a specific segment.

4.5 Hamburg

The „Free und Hanseatic City of Hamburg“ (short: FHH) has structured its budget based on „Einzelplänen“ (single plans or “sections”), i.e. based on the structure of the authorities within the FHH. The structure of the budget therefore reflects the political responsibilities of the respective Senators (Ministers). The respective “Einzelpläne” (plans) are structured based on product groups and products which are allocated to product groups. Within the “Einzelpläne” these product groups are aggregated to “Aufgabenbereichen” (task areas). In addition to that, the accounting supports the “integrierte Produktrahmen” (integrated product framework). The “integrierte Produktrahmen” is a standardized framework defined at federal level. The information on the described segmentation is only provided for the “Ergebnisrechnung” (statement of financial performance), but not for the balance sheet items. Balance sheet information based on segments is not provided.

The FHH has a requirement to report segment information. The requirement of a segmentation based on „Einzelplänen“ corresponds to the political responsibility of the respective responsible leader of the authority and is expected – also due to historical reasons – by the budget law-making authority (see § 77 Landeshaushaltsordnung (LHO) of the FHH).

A segmentation based on the “Integrierte Produktrahmen” is uniform for all states and the Federal Government in Germany (see §§ 10 Abs. 2 S. 5 und 11 Abs. 3 in conjunction with § 49a Haushaltsgrundsätzegesetz).

The so-called „Landeshaushaltsordnung“ (State Budget Order) is the relevant regulation for the financial reporting of the FHH. It refers to the first and second section, first and second subsection of the third book of the German Commercial Code (“HGB”) and the “Grundsätze ordnungsmäßiger Buchführung” (Generally Accepted German Accounting Principles). Whereas private sector entities that prepare consolidated financial statements under German law have to report segment information within their consolidated financial statements, the consolidated financial statements of the City State of Hamburg do not have a segment report in the notes.

In Hamburg, segment information is provided on a monthly basis for internal reporting purposes. Vis-à-vis the parliament quarterly and annual information is provided.

Recipients or main user groups of segment reporting are the elected politicians (“Bürgerschaft”). The reports are publicly available and the general public has access to them.

According to the interview partner, financial reporting based on segments offers a reporting on financial performance based on costs and revenues as well as product performance indicators corresponding to the political responsibility.

The following obstacles of providing segment information were seen:

- ▶ Providing balance sheet information based on segments is currently not supported by the currently used book-keeping system. No demand for such reporting has been expressed yet.
- ▶ The implementation of a solution for providing balance sheet information based on segments would imply considerable technical and organizational efforts.

An additional segmentation next to the existing financial reporting based on segments only makes sense, if users of the financial statements would express a need for it. This need is currently neither expressed by political parties, nor by capital providers or the public.

4.6 Portugal

According to the current accounting framework in Portugal there is no requirement for segment reporting that is similar to the requirements of IPSAS 18, Segment Reporting. Although, the current public sector accounting framework (POCP – Plano Oficial de Contabilidade Pública), which is based on national standards and will be replaced by an IPSAS-based framework by January 2017, requires public sector entities to include in the notes to the budgetary and financial statements revenues by activities and markets (internal and external) since those activities and markets are substantially different. Next to segment information on assets and liabilities also segment information on expenses need to be provided. The new accounting framework has an accounting standard, Norma de Contabilidade Pública 25, that is based on IPSAS 18, Segment Reporting. Separate and consolidated financial statements must comply with this standard.

Segments will be structured according to the program structure used for budgeting purposes and also based on sub-sectors (as defined under statistical accounting). In line with IPSAS 18 segment information shall be provided on an annual basis.

Given the fact that segment information is currently not provided, the identification of the recipients or main user groups was considered being difficult. Therefore, it is referred to the conceptual framework to identify potential users of segment information. On the basis of the general considerations of the Conceptual Framework, public managers, citizens, resource providers and recipients of services and their representatives are considered being the main users of the segment reports.

In Portugal, segment reporting was considered being useful because of the following reasons:

- ▶ Given that at the consolidated general government level, each level of government will be considered as a segment, segment reporting will show the resource allocation to policies.
- ▶ Furthermore, segment information can be linked to the costs of policies.
- ▶ Also an alignment with performance budgeting could be achieved as performance budgets are based on programs. When segments are also defined based on programs then comparisons between program budgets and segment information based on programs can be made.

Finally, since segments are grouped based on sub-sectors (local government, social security, central government) an alignment with statistical accounting and GFS can be achieved. Segments can also represent legal entities that are included in a broader reporting entity, like in a Ministry or a part of it.

So far no obstacles of providing segment information were identified in Portugal.

4.7 Summary and conclusions from the country analysis

Besides the FHH, all Member States analysed report segment information in accordance with international standards. In all three cases, IPSAS 18 is used as a reference. In France, reference is also made to IFRS 8.

With regards to the segmentation approach, Austria has chosen a segmentation structure based on organizational aspects, i.e. by ministries. In contrast to that, the French central government's segmentation is based on missions, which correspond to major policies. Also in Portugal, it is envisaged to follow the program structure used for budgeting purposes for their segmentation. Next to that, also segments based on sub-sectors shall be presented. The FHH reports segment information only in terms of the statement of financial performance and in accordance to the budget structure.

Parliament is considered being the main recipient or main user group of segment reporting. Next to parliamentarians, citizens and executives in the public administration are viewed being main recipients of segment information. Only France identifies international public institutions, capital markets and investors in debt securities as main user group for segment reporting.

The main benefits identified were:

- ▶ Relevant information provided to parliament
- ▶ To provide detailed information regarding ministries for evaluation purposes and compliance with IPSAS
- ▶ To mirror budget presentation and to provide information on missions (France) or policies (Portugal)

The major obstacles to segment reporting stated by Member States were:

- ▶ Extensive reporting requirements and resulting efforts
- ▶ Segmentation based on missions and limiting the amount of segments to about 10 segments. As a result, several ministries were grouped into one segment. For such segments, there are no clear responsibilities.
- ▶ IT and organizational challenges related to the provision of balance sheet information based on segments.
- ▶ Missing demand by users of the financial statements for segment information in accordance with international standards.

To sum up, the segmentation and the benefits stated by Member States show that Member States see a clear relationship between budgeting and financial reporting for segment reporting purposes. International standards relating to segment and budgeting reporting do not address this relationship so far.

5. Discussion of matters relevant for a European harmonization

5.1 Advantages and disadvantages of different possible approaches to segment reporting?

As outlined already in Chapter 3.1 the usefulness of providing segment information based on IPSAS 18 can be questioned. The following tables provide a summary of the pros and cons of different possible approaches to segment reporting in accordance with IPSAS 18 on a stand-alone basis:

For the purpose of identifying advantages and disadvantages of possible approaches to segment reporting under EPSAS the following three approaches were identified for reporting segment information:

1. Reporting segment information in compliance with IPSAS 18
2. Reporting a reduced set of segment information (i.e. only segment revenue and segment expenses)
3. Excluding segment reporting from the scope of EPSAS

Under approach 1, the usefulness of IPSAS 18 is assessed both at EU level and at national level. In the case of not reporting segment information under EPSAS (approach 3) also the implications for EPSAS were considered.

Approach 1: Reporting segment information in compliance with IPSAS 18	
<p><u>Advantages</u></p> <ul style="list-style-type: none"> + This approach provides information on the financial position and financial performance on the basis of service or geographical segments. + An alignment of the segment reporting structure with the organizational and/or budgetary structure is possible. + If policy areas are addressed by several levels of government (e.g. a ministry and linked agencies, state-owned entities) segment information can provide cross-sectional information, e.g. what is done by a government overall in certain activity areas (segments). 	<p><u>Disadvantages</u></p> <p><u>A. Relevance of information</u></p> <ul style="list-style-type: none"> - The discharge of the accountability obligations by an entity is limited as neither IPSAS 18 nor IPSAS 24 require to compare actuals to budget information based on segments.⁴⁰ - In cases where the segment reporting structure does not follow the budgeting structure, budget and actual information based on segments cannot be provided. - The identification of segments in practice can be problematic as government entities are rarely structured along activities. - The performance-oriented approach of IPSAS 18 does not really fit in a government context. - Considering its high degree of aggregation and the substantial efforts involved, the usefulness of providing segment information on a consolidated level can be questionable (e.g. at EU or country level)

⁴⁰ To achieve accountability, segment information would have to provide budget and actual information. See for example the concept as envisaged in Portugal. Neither IPSAS 18 nor IPSAS 24 requires to present segment information based on budget and actuals.

	<p><u>B. High burdens/impracticability/cost</u></p> <ul style="list-style-type: none">- Given that segments need to be defined by activities governments might be forced to define a very large number of very small segments.- Reporting segment information imposes a range of reporting challenges to entities that can impose considerable costs to them. E.g. according to IPSAS 18.49 if a segment is identified as a segment for the first time in the current period, prior period segment data that is presented for comparative purposes shall be restated to reflect the newly reported segment as a separate segment (unless it is impracticable to do so). Further challenges are the technical difficulties, i.e. to have the appropriate IT systems and organizational structure in place that are able to account for segment information. A further issue are transactions between entities within a single segment. According to IPSAS 18.41 those intra-economic entity balances and transactions need to be eliminated.- The allocation of assets, liabilities and revenues (e.g. tax revenues or joint assets, see IPSAS 18.47) can be problematic in practice and might be cumbersome.- IPSAS 18 applies to both separate and consolidated financial statements which can cause considerable efforts.
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It needs to be added, that, on an international level, IPSAS 18 is seldomly applied. In New Zealand, for example, public benefit entities do not need to comply with the requirements of IPSAS 18. This is mainly due to the fact that the New Zealand government has its own requirements for segment reporting. The New Zealand Government provides segment reporting information based on institutional components (Core Crown, Crown Entities and State-owned enterprises) and major economic activities.

Approach 2: Reporting a reduced set of segment information	
<p><u>Advantages</u></p> <ul style="list-style-type: none"> + The cost-benefit relationship is probably better than applying an IPSAS 18 approach, e.g. less efforts and difficulties for allocating joint assets or liabilities. + As COFOG already requires that expenses would have to be reported by functions, such a segmentation approach could build on the statistical data already available. 	<p><u>Disadvantages</u></p> <ul style="list-style-type: none"> - Approach is not in compliance with IPSAS. - Approach does only cover the financial performance of segments but not their financial position. - Problem of allocating revenues to segments still persists. - As the statistical data and the EPSAS accounting data might differ in terms of recognition and presentation, the use of ESA data is limited.

Approach 3: Excluding segment reporting from the scope of EPSAS	
<p><u>Advantages</u></p> <ul style="list-style-type: none"> + Less efforts for financial reporting purposes. 	<p><u>Disadvantages</u></p> <ul style="list-style-type: none"> - Not in compliance with IPSAS - Some information, which could potentially be considered useful by stakeholders, could be missing if there is no requirement for segment reporting.

5.2 Option to use IFRS 8 instead of IPSAS 18 for segment reporting

A further possibility could be to use the approach of IFRS 8 for segment reporting under EPSAS. The 2014 PwC report suggested with respect to the IPSAS disclosure requirements that the appropriateness of a (partial) alignment with IFRS 8 should be explored. The report argued that IFRS 8 builds on information already available that fits the entity's reporting/accountability structure.

The following table discusses advantages and disadvantages of the IFRS 8 approach under EPSAS:

Discussion of the IFRS 8 approach for EPSAS	
<p><u>Advantages</u></p> <ul style="list-style-type: none"> + IFRS 8 provides greater flexibility than IAS 14 as IFRS 8 does not require to present segment information based on financial reporting standards. + Given the fact that IFRS 8 requires a management approach, entities could use the information that is already available internally. + The management reporting approach allows users of financial statements to examine an entity's operations through the eyes of 	<p><u>Disadvantages</u></p> <ul style="list-style-type: none"> - In the public sector, it might be difficult to exactly define responsibilities within a "management approach" especially to differ between government and administration. However, a possible approach to solve that issue could be to use the budget structure for segmentation purposes. - Given that each entity would be able to use its own internal management reporting approach, comparability of segment

<p>management.</p>	<p>information is limited. It has to be considered that for internal reporting purposes not necessarily (unadjusted and audited) accrual information is used.</p> <ul style="list-style-type: none"> - As IFRS 8 also follows a performance-oriented approach and requires to allocate revenues to segments this might not be appropriate from a conceptual point of view (e.g. there could be entities that are only financed by transfers and do not generate revenues; so performance in terms of revenues and expenses might not be the appropriate perspective).
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Given that the IFRS 8 approach is not able to ensure comparability, we suggest to not follow this approach under EPSAS.

5.3 What are ways of reducing the perceived high burden of segment reporting

The following table provides an overview on the possible ways of reducing the perceived high burden of segment reporting, and hence of any future segment reporting requirements for EPSAS. In addition, the consequences of the identified possible ways will be discussed.

Possible ways of reducing the perceived high burden of segment reporting	Consequences of the identified possible ways
<p>To require to report segment information only in consolidated financial statements only.</p>	<p>Reporting segment information in separate financial statements would not be required. This would lead to a significant reduction in efforts. However, this approach would not be compliant with IPSAS.</p>
<p>To report segment information only based on revenues and expenses (approach 2).</p>	<p>Reporting assets and liabilities based on segments would not be required. This would lead to a significant reduction of efforts. However, this approach would not be in compliance with IPSAS.</p>
<p>To not require the elimination of intra-economic entity balances and transactions for entities within a single segment (IPSAS 18.41)</p>	<p>For consolidated financial statements on higher government levels this would lead to a significant reduction of efforts.</p>
<p>To require that segments should be classified by functions or sub-sectors of government.</p>	<p>More details on this approach are provided in the next section. Such an approach to reporting segment information under EPSAS could facilitate the process of deriving ESA-compatible data from EPSAS financial statements. The classification of segments by functions as well as sub-sectors of government can be in compliance with IPSAS.</p>

5.4 How could segment reporting under the future EPSAS standard potentially support ESA needs?

Under ESA 2010 COFOG requires to classify expenses by nature as well as by function. A possibility how a future EPSAS standard could potentially support ESA needs would be to develop, as a substitute for the IPSAS segment reporting standard, an EPSAS standard which seeks to align the accounting and statistical bases of reporting. For an alignment of both accounting frameworks it needs to be focussed on the definition of the segments as well as on the elements used for segment reporting.

Given that ESA requires a classification of expenses not only by nature but also by function, a future EPSAS standard on segment reporting could allow the preparation of accounting data which is at the same time also compatible with ESA requirements. By defining segments based on the 10 functions of government defined in the COFOG classification (see section 3.3.2.2 above), the segmentation prepared under a new EPSAS standard could be compatible with the ESA requirements. Given the fact that the 10 functions of government can be in line with the service segment structure as required by IPSAS 18, an alignment with IPSAS in the area of identification of segments can be achieved. Given the fact that also government use COFOG for budgeting purposes also an alignment with budgeting could be achieved.

A further approach for classifying segments is based on sub-sectors of general government (i.e. central, state and local government, as well as social security) and public corporations (i.e. public non-financial corporations and public financial corporations). The segmental analysis breakdown used in the UK's Whole of Government Accounts is defined as central government, local government, financial public corporations and non-financial public corporations.⁴¹ The advantage of classifying segments based on sub-sectors of general government would be an alignment with statistical accounting and GFS. Such an approach can help in aggregating information for ESA reporting needs.

However, when it comes to the alignment of the elements required for segment reporting purposes, i.e. segment assets, segment liabilities, segment revenues and segment expenses, then there are a number of differences between ESA and EPSAS.⁴² EPSAS uses revenues, expenses, assets and liabilities as elements whereas ESA uses revenues, expenditures, assets and liabilities as elements. ESA uses different recognition and measurement criteria for the accounting of assets and liabilities and related revenues and expenditures. For example, the categorization of revenues and expenses/expenditures differs between IPSAS and ESA. Also, ESA recognizes tax revenues at a different point in time than IPSAS. Therefore, as long as EPSAS and ESA follow different accounting rules for those elements, no alignment between segmented information under EPSAS (IPSAS) and ESA can be achieved. A future EPSAS standard can therefore only support ESA needs in terms of identifying segments.

⁴¹ See for example HM Treasury, Whole of Government Accounts for the year ended 31 March 2015, source: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/525617/WEB_whole_of_gov_accounts_2015.pdf (accessed on 27 February 2017).

⁴² For an overview on the differences between IPSAS and government finance statistical reporting see the IPSASB Consultation Paper, IPSASs and Government Finance Statistics Reporting Guidelines, September 2012.

6. Conclusions

The analysis has shown that there are a number of issues linked to the relevance of the segment information provided by IPSAS 18 and that there are high burdens, costs and impracticabilities involved with applying IPSAS 18 (see Chapter 5.1). Therefore, the EPSAS Working Group would need to discuss whether IPSAS 18 or a modified approach is able to fulfill the EPSAS needs.

In EY's view, the reporting of a reduced set of segment information (i.e. only segment revenues and expenses and not segment assets and segment liabilities) seems probably better suited from a cost-benefit point of view. However, it has to be considered that such an approach would not comply with IPSAS.

In EY's view, the approach of using IFRS 8 instead of IPSAS 18 for EPSAS seems not appropriate given that the IFRS 8 approach is not able to ensure comparability (see Chapter 5.2).

The usefulness of segment reporting could be improved if linkages to budgeting would be made in an EPSAS environment. The country analysis has shown that Member States providing segment information relate the structure of their segments to the structure of their budgets. By such an approach, the accountability of politicians and executives could be improved. Also the relationship between the planned and actual resource allocation based on segments and the planned and achieved results per segment could be better assessed by a budget orientation of segmentation. The disadvantage of such an approach is that comparability between different jurisdictions cannot be achieved due to the jurisdictional sovereignty in budgeting matters.

The functional classification provided by COFOG would allow to align ESA and a possible future EPSAS in terms of the identification of segments. Given that the budget of governments also follows the COFOG classification, also alignment between budgeting, statistics and financial reporting could be achieved. However, the fact that statistical data and EPSAS accounting data might differ in terms of recognition, measurement and presentation implies that comparability between EPSAS and ESA is limited. This does not mean that COFOG is not suitable for identifying segments. In EY's view, COFOG could be a suitable approach for identifying segments.

In EY's view, it would have to be discussed whether an approach to only report segment revenues and expenses based on the COFOG classification and not segment assets and segment liabilities can be considered as sufficient for EPSAS purposes.

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