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Item 5 of the Agenda

Draft EPSAS Screening Report
IPSAS 18 – Segment Reporting

Paper by PwC in cooperation with Eurostat

- for discussion -

This document was commissioned by Eurostat. It analyses the consistency of the named IPSAS standard with the draft EPSAS framework, with a view to informing future EPSAS standard setting. This version was prepared taking into account comments received from the participants of the Cell on Principles related to EPSAS Standards.

EPSAS screening report

IPSAS 18 - Segment reporting

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Background

Objectives

Reference is made to the general introduction to the EPSAS screening reports that covers the following elements:

- Key objectives of EPSAS.
- Standard setting process in the public sector.
- Purpose and scope of the screening reports.
- Approach of the screening reports.
- European public good.
- Common elements considered when preparing the reports.

General introduction to IPSAS 18

IPSAS 18 is drawn primarily from International Accounting Standard (IAS) 14 (Revised 1997) 'Segment reporting', published by the International Accounting Board (IASB). In developing IPSAS 18, the International Public Sector Accounting Standards Board (IPSASB) applied its 'Process for Reviewing and Modifying IASB Documents' that identifies public sector modifications where appropriate. This approach enables the IPSASB to build on best practices in private sector financial reporting, while ensuring that the unique features of the public sector are addressed.

Governments and their agencies control significant public resources and operate to provide a wide variety of goods and services to their constituents in differing geographical regions and in regions with differing socioeconomic characteristics. In most cases, the activities of the entity are so broad, 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.

The objective of IPSAS 18 is to establish principles for reporting financial information by segments. The disclosure of this information will:

(a) 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

(b) enhance the transparency of financial reporting and enable the entity to better discharge its accountability obligations (IPSAS 18 para 1).

IPSAS 18 requires entities within its scope to segment their activities in accordance with the criteria laid down in the standard, and then to disclose certain information about those segments using IPSAS accounting policies. IPSAS 18 requires

segments to be identified based on the following definition: “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.” (IPSAS 18 para 9)

Scope of the report

The International Public Sector Accounting Standards Board (IPSASB) issued IPSAS 18 ‘Segment Reporting’ in June 2002.

Segment reporting has been identified by the IPSASB as a potential project to put on its work plan for the period 2019-2023. There are two aspects to this potential project. Firstly, IPSAS 18 is based on IAS 14 ‘Segment reporting’ and this has been superseded by IFRS 8 ‘Operating segments’. Secondly, the need for this project has been raised by constituents who have identified concerns with the quality and usefulness of IPSAS 18. These constituents urged the IPSASB to consider convergence with IFRS 8 and its applicability to public sector entities, as well as the potential to increase the usefulness of information for GFS. In its ‘Strategy and work plan 2019-2023’ document, the IPSASB therefore highlights the two same issues that have been proposed for discussion in the PwC study from 2014 and in the EY issue paper of March 2017.

During its meeting held in March 2021, the IPSASB received an educational session on a proposed limited-scope project to develop an IPSAS aligned with IFRS 8 ‘Operating segments’. The session provided an overview of the requirements of IPSAS 18 ‘Segment reporting’, IFRS 8 and public sector specific issues identified by stakeholders. The IPSASB decided to undertake more research and specifically gather further information related to the challenges in applying IPSAS 18 in practice before it decides whether to add the project to the IPSASB work program.

This report does not anticipate the conclusions of the discussions that will be taking place in the context of reporting segments in the public sector in the future and that might have an impact on the requirements of this standard. Any IPSASB developments in that area will need to be monitored as part of the EPSAS standard setting.

Reference to EFRAG assessment

No specific individual technical assessment of IAS 14, the IFRS equivalent of IPSAS 18, was carried out by the EFRAG, and therefore no specific individual endorsement report was produced.

The EFRAG however provided on 19 June 2002 a positive assessment of all IAS standards existing at 1 March 2002, including IAS 14, as part of the overall introduction of IAS within the EU.

IAS 14, issued in August 1997, was applicable to annual periods beginning on or after 1 July 1998 and was superseded by IFRS 8 'Operating segments' with effect from annual periods beginning on or after 1 January 2009.

EFRAG has carried out an evaluation of IFRS 8. EFRAG supported IFRS 8 and has concluded that it meets the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards that:

- it is not contrary to the 'true and fair principle' set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and
- it meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

For the reasons given above, EFRAG concluded that it is in the European interest to adopt IFRS 8 and, accordingly, EFRAG recommended its adoption as it is conducive to the European public good.

Reference to EPSAS issue papers[1]

The PwC study of 2014[2] analysed the suitability of the IPSAS standards as a basis for developing EPSAS. This included the analysis of IPSAS 18 'Segment reporting'; some of the comments received mentioned that the information required by the standard is not useful and that it is difficult to identify segments. As a possible solution to address the comments, the appropriateness of a (partial) alignment of the IPSAS standard on segment reporting and IFRS 8 could be explored. IFRS 8 capitalises on information already available and the entity's existing internal reporting structure. IPSAS 18 was classified under category 2 'Standards that (may) need (some) amendments or for which implementation guidance is (maybe) needed', as general concerns have been raised on the usefulness of the detailed IPSAS disclosure requirements and the workload associated with its implementation.

In the course of developing the technical proposal on EPSAS, Eurostat commissioned a series of twenty technical issues papers (IPs), which analyse in particular key public sector specific accounting issues. The papers were discussed at the EPSAS Working Group meetings during 2016-2018. The papers are all publicly available on Eurostat's website. Each of the IPs seek to identify conclusions and key issues for further discussion. Taking into consideration the analyses provided in the IPs and the initial views exchanged with Member States' public sector accounting experts during the Working Group meetings, Eurostat drew tentative conclusions that

[1] EPSAS Issues papers are available on https://ec.europa.eu/eurostat/web/epsas/key-documents/technical-developments

[2] 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 (Ref. 2013/S 107-182395)

may serve, together with the IPs themselves, as considerations for future standard setting.

One EPSAS IP developed in March 2017 addresses the area of segment reporting. The main concerns expressed by the Member States are summarised below:

- Geographical segment reporting could be challenging when implementing IPSAS 18.
- 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.
- Some Member States considered the information required by IPSAS 18 as not useful. Also, difficulties with the identification of segments were reported.

A number of issues included in the EPSAS IP were linked to the relevance of the segment information provided by IPSAS 18 and to the fact that there are high burdens, costs and impracticalities involved with applying IPSAS 18. Therefore, the EPSAS Working Group would need to discuss whether IPSAS 18 or a modified approach is able to fulfil the EPSAS needs. The approach of using IFRS 8 instead of IPSAS 18 for EPSAS did not seem fully appropriate given that the IFRS 8 approach might be not able to ensure comparability. The usefulness of segment reporting could be improved if linkages to budgeting would be made in an EPSAS environment. The functional classification provided by COFOG[3] 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, the alignment between budgeting, statistics and financial reporting could be achieved.

Eurostat tentatively concluded:

- from a cost/benefit point of view, and despite its usefulness for COFOG purposes, segment reporting should not be considered as a priority for further EPSAS work, unless on the grounds of decision making and accountability purposes specific to certain governments or reporting entities;
- nevertheless, Eurostat stressed its potential importance for consolidation purposes and the need to review the role of segment reporting in the context of consolidation.

[3] Classification of the Functions of Government.

Screening of IPSAS 18 ’Segment reporting’ against criteria set in the draft EPSAS framework

Introduction

The EPSAS criteria listed in the draft EPSAS framework have been used to perform an assessment of IPSAS 18 ‘Segment reporting’, published in 2002 by the IPSASB.

In order to develop recommendations, one should first considered whether IPSAS 18 would meet the qualitative characteristics of the draft EPSAS CF, i.e. whether it would provide relevant, reliable, complete, prudent, neutral, verifiable, economically substantive, understandable, timely and comparable information and would not be contrary to the true and fair view principle.

This report considers the disclosure requirements applicable to segment reporting for each of the qualitative characteristics of the draft EPSAS CF.

Further, this paper includes a high-level comparison between the requirements of IPSAS 18 and other international accounting and financial reporting frameworks applied by the public sector entities in various jurisdictions, such as IFRS, ESA 2010 and EU Accounting Rules, bearing in mind the objective of alignment, reduction of cost of implementation and compliance cost.

Finally, it is assessed whether IPSAS 18 would be conducive to the European public good.

The findings are presented below, and the conclusion is included in the next section of this report.

Conformity with Qualitative Characteristics

Relevance

Financial and non-financial information is relevant if it is capable of making a difference in achieving the objectives of GPFRs. Financial and non-financial information can make a difference when it has confirmatory value, predictive value, or both.

The objective of the IPSAS 18 is to establish principles for reporting financial information by segments so users of financial statements can discern information about an entity's reporting segments and changes in such reporting segments. The core principle of IPSAS 18 is that an entity should disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates.

IPSAS 18 defines two types of segments that are reported to the governing body and senior manager of an entity (IPSAS 18 para 17):

- *Service segments:* A distinguishable component of an entity that is engaged in providing related outputs or achieving particular operating objectives consistent with the overall mission of each entity. 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.
- *Geographical segments:* A distinguishable component of an entity that is engaged in providing outputs or achieving particular operating objectives within a particular geographical area. 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.

Determining the activities that should be grouped as separate segments requires judgment and matters as listed below should be considered:

- 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.

- 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 para 15).

Also, there are several factors to be contemplated in determining whether outputs (goods and services) are related and should be grouped as segments for financial reporting purposes include:

(a) The primary operating objectives of the entity and the goods, services, and activities that relate to the achievement of each of those objectives, and whether resources are allocated and budgeted on the basis of groups of goods and services.

(b) The nature of the goods or services provided, or activities undertaken.

(c) The nature of the production process and/or service delivery and distribution process or mechanism.

(d) The type of customer or consumer for the goods or services.

(e) Whether this reflects the way in which the entity is managed, and financial information is reported to senior management and the governing board.

(f) If applicable, the nature of the regulatory environment, (for example, department or statutory authority) or sector of government (for example finance sector, public utilities, or general government) (IPSAS 18 para 19).

A geographical segment structure may be adopted where the key performance assessments and resource allocation decisions to be made by the governing body and senior manager are determined by reference to regional achievements and regional needs. Factors that should be taken into account in determining whether financial information should be reported on a geographical basis include:

(a) Similarity of economic, social, and political conditions in different regions.

(b) Relationships between the primary objectives of the entity and the different regions.

(c) Whether service delivery characteristics and operating conditions differ in different regions.

(d) Whether this reflects the way in which the entity is managed, and financial information is reported to senior managers and the governing board.

(e) Special needs, skills, or risks associated with operations in a particular area (IPSAS 18 para 22).

The assessment of activities that should be grouped as separate segments and determining whether outputs (goods and services) are related can involve a certain degree of judgment. In cases where the evaluation is subjective, the disclosures about assumptions and judgement used to determine segments would be helpful to explain decisions reached in challenging scenarios and thereby will either enhance relevance of information or limit the loss of relevance that might result from applying inappropriate judgement.

According to the EPSAS IP developed in March 2017 on segment reporting, a practical problem with the identification of segments is that the government entities are not structured along activities as required by IPSAS 18 para 9, but along institutions, functions or programs. In order to generate relevant information for accountability and decision-making purposes, most governments group institutions based on levels of government or administration rather than based on activities. 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.

IPSAS 18 is a disclosure standard. In other words, it has no impact on the way income, expenses, assets, liabilities or equity are recognised, measured or presented in financial statements. However, segment information is a highly relevant source for users of financial statements to get a better understanding of the overall performance of an entity's activities. The characteristics of different lines of services or geographical segments can vary significantly, and segment information can help identify the resources allocated to support the major activities and operating objectives of the entity. The provision of relevant segment information has an important predictive value, as it is a helpful basis in understanding performance and in supporting decision making.

Segments should be identified based on the components of the operations that are considered to be important for accountability and decision-making purposes. This should correspond to the internal reporting structure and the major classifications of activities identified in budget documentation and this will then reflect the way information is reported to the governing body and senior management, and the way the discharge is given in terms of management responsibilities.

In practice however, IPSAS 18 information may also be only prepared to achieve compliance with accounting and reporting standards. Preparing IPSAS 18 information may appear quite artificial with little added value for both users and preparers when IPSAS 18 segmental information is different from the one used for internal purposes; it may then result in a formal presentation exercise that would not depict the economic reality of the public sector entity and may lead to unnecessary overload of information.

In conclusion, IPSAS 18 does not fully satisfy the ‘QC’ Relevance. A revised or updated IPSAS standard (based on the requirements of IFRS 8, which is built based on the internal reporting structure of the entity, and/or a COFOG classification, which is also used for ESA reporting purposes) could result in the provision of more relevant information compared to IPSAS 18. However, in the latter case it should also be taken into account whether that would really serve the wider range of future users of EPSAS or primarily EU, national and international institutions.

Faithful representation / Reliability

To be reliable, financial and non-financial information must provide a faithful representation of the substance of economic and other phenomena that it purports to represent. The notion of faithful representation and reliability in the draft EPSAS CF is linked to the qualitative characteristics of completeness, prudence, neutrality, verifiability, substance over form and being free from material error. These characteristics are separately discussed below.

According to IPSAS 18, segment accounting policies are the accounting policies adopted for preparing and presenting the financial statements of the consolidated group or entity as well as those accounting policies that relate specifically to segment reporting (IPSAS 18 para 27). There is a presumption that the accounting policies that the governing body and management of an entity have chosen to use in preparing the consolidated or entity-wide financial statements are those that the governing body and management believe are the most appropriate for external reporting purposes (IPSAS 18 para 44).

IPSAS 18 permits the disclosure of additional segment information that is prepared on a basis other than the accounting policies adopted for the consolidated or entity financial statements provided that:

(a) the information is relevant for performance assessment and decision-making purposes; and

(b) the basis of measurement for this additional information is clearly described. (IPSAS 18 para 46).

Since the purpose of segment information is to help users of financial statements better understand and make more informed judgments about the entity as a whole, IPSAS 18 requires conformity with these adopted accounting policies. This approach helps to provide reliable financial information.

In conclusion, IPSAS 18 satisfies the reliability criterion and results in the provision of reliable and faithfully represented information.

Completeness

The information which fulfils the recognition criteria should be complete within the bounds of materiality and cost-benefit considerations.

IPSAS 18 shall be applied in complete sets of published financial statements that comply with IPSASs (IPSAS 18 para 4). If both consolidated financial statements of a government or other economic entity and the separate financial statements of the parent entity are presented together, segment information needs to be presented only on the basis of the consolidated financial statements.

In some cases an entity's internal reporting to the governing body and the senior manager may be structured to aggregate and report on a basis that distinguishes revenues, expenses, assets, and liabilities related to budget dependent activities from those of trading activities, or which distinguishes budget-dependent entities from commercial public sector entities (IPSAS 18 para 4). Reporting segment information in the financial statements on the basis of only these segments is unlikely to meet the objectives specified for IPSAS 18, because these segments are unlikely to provide information that is relevant to users about, for example, the performance of the entity in achieving its major operating objectives. Also, when internal reporting to the governing body and senior manager is structured to report only compliance information, reporting externally on the same basis as the internal reporting to the governing body and senior manager will not meet the requirement of IPSAS 18 (IPSAS 18 para 24).

Public sector entities can generally identify (a) the costs of providing certain groups of goods and services or of undertaking certain activities, and (b) the assets that are necessary to facilitate those activities. Some assets, expenses, and liabilities may not be able to be directly attributed, or allocated on a reasonable basis, to individual segments, because they support a wide range of service delivery activities across a number of segments or are directly related to general administration activities that are not identified as a separate segment. The unattributed or unallocated revenue, expense, assets, and liabilities would be reported as an unallocated amount in reconciling the segment disclosures to the aggregate entity revenue as required by IPSAS 18 (IPSAS 18 para 31). Reconciliation of unallocated balances provides users with a complete overview of the transactions relating to segments at each reporting date, the attribution principles meet the QC 'Completeness'.

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

- 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.
- An entity shall present a reconciliation between the information disclosed for segments and the aggregated information in the consolidated or entity financial statements (IPSAS 18 para 52-75).

In presenting the reconciliation, segment revenue should be reconciled to entity revenue from external sources (including disclosure of the amount of entity revenue from external sources not included in any segment's revenue), segment expense shall be reconciled to a comparable measure of entity expense, segment assets shall be reconciled to entity assets and segment liabilities shall be reconciled to entity liabilities. This reconciliation provides users with a complete overview of the revenue, expense, assets and liabilities relating to segments that enhances QC 'Completeness'.

To sum up, IPSAS 18 satisfies the completeness criterion based on its scope and disclosure requirements, however a revised or updated IPSAS standard (based on the principles of IFRS 8 and/or a COFOG classification, which is also used for ESA reporting purposes) could also result in a high-quality financial information, potentially produced at a lower cost, building on internally available data.

Prudence

Prudence is the inclusion of a degree of caution in the exercise of the judgments needed in making the estimates required under conditions of uncertainty, such that assets or revenue are not overstated while liabilities or expenses are not understated.

As already mentioned above, IPSAS 18 is a disclosure standard, therefore it has no impact on the way income, expenses, assets, liabilities or equity are recognised, measured or presented in financial statements. The screening analysis has not identified any issue that could be linked to the QC 'Prudence'.

Neutrality

Information is neutral if it is free from bias. GPFSs are not neutral if the information they contain has been selected or presented in a manner designed to influence the making of a decision or judgment in order to achieve a predetermined result or outcome.

In some cases, determining segments and allocating revenue, expenses, assets and liabilities to those segments could be subjective.

On the other hand, in a principles-based control model, the use of judgement is an inherent factor, and the disadvantage of applying principles instead of rules, is that there might be divergence in practice. As noted earlier in the discussion about relevance and reliability QCs, the level of judgment required by IPSAS 18 is not so exceptional in nature that it would be impracticable to apply the standard in a consistent manner and achieve neutral presentation of the reporting entity.

Verifiability

Verifiability is the quality of information that helps assure users that GPFSs is based on supporting evidence in a way that it faithfully represents the substance of economic and other phenomena that it purports to represent.

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. As a result, the budget documentation may serve as a relevant supporting evidence for properly defining reporting structures for segment reporting purposes.

The screening analysis has not identified any issue that could be linked to the QC 'Verifiability'. The provisions of IPSAS 18 result in the verifiable information compiled from the information available in the accounting systems. Also, a cohesiveness between various disclosure notes required by IPSAS 18 (i.e. consistent accounting policies and reconciliation of items of surplus/deficit and assets/liabilities to the sub-totals presented in the primary statements) provides evidence of verifiable and reliable information that complements other information provided in the financial statements.

Substance over form

QC 'Substance over form' is achieved when the underlying transactions, other events, activities or circumstances are accounted for and presented in accordance with their economic reality, and not merely their legal form.

As IPSAS 18 is a disclosure standard, reflecting the substance of the activities, assets and liabilities that are reported in the measurement of these items is mainly dependent on other standards. The screening analysis has not identified any issue that could be linked to the QC 'Substance over form'.

Understandability

‘Understandability’ QC is achieved when information is presented in a manner that facilitates expert and non-expert users to comprehend its meaning. Understandability is one of the qualitative characteristics of financial information as per IPSASB conceptual framework, which stipulates that information should be presented in a manner that responds to the needs and knowledge base of users, and to the nature of the information presented.

The notion of understandability requires that the financial information provided be readily understandable by users with a reasonable knowledge of business and economic activity and accounting and the willingness to study the information with reasonable diligence. Although the notion of ‘understandability’ addresses various aspects, most of the aspects are covered by the discussion above about relevance, reliability and comparability.

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. Reporting on the basis of both service segments and geographical segments in the external financial statements often will provide useful information if the achievement of an entity’s objectives is strongly affected both by the different products and services it provides and the different geographical areas to which those goods and services are provided. 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 (IPSAS 18 para 23).

Although the relevance for governments of a matrix presentation is not always obvious, the information that would be presented following such a matrix presentation should not cause major understandability issues.

The definitions of segment revenue, segment expense, segment assets, and segment liabilities include amounts of such items that are directly attributable to a segment and amounts of such items that can be allocated to a segment on a reasonable basis (IPSAS 18 para 28). Once the segments are identified, revenue, expense, assets and liabilities can be allocated to them. An entity should start from its internal financial reporting system to identify those items that can be directly attributed, or reasonably allocated, to segments.

In some cases, a revenue, expense, asset, or liability may have been allocated to segments for internal financial reporting purposes on a basis that is understood by entity management, but that could be deemed subjective, arbitrary, or difficult to understand by external users of financial statements. Such an allocation would not constitute a reasonable basis under the definitions provided by IPSAS 18. Conversely, an entity may choose not to allocate some item of revenue, expense, asset, or liability for internal financial reporting purposes, even though a reasonable

basis for doing so exists. Such an item is allocated pursuant to the definitions of segment revenue, segment expense, segment assets, and segment liabilities in IPSAS 18.

The way in which asset, liability, revenue, and expense items are allocated to segments depends on such factors as the nature of those items, the activities conducted by the segment, and the relative autonomy of that segment. It is not possible or appropriate to specify a single basis of allocation that should be adopted by all entities. Nor is it appropriate to force the allocation of entity asset, liability, revenue, and expense items that relate jointly to two or more segments, if the only basis for making those allocations is arbitrary or difficult to understand. The resulting allocations should be consistent, in case of jointly used assets are allocated to segments if, and only if, their related revenues and expenses are also allocated to those segments (IPSAS 18 para 47).

In the context of governments, the performance-oriented approach of IPSAS 18 can cause a practical problem as allocation of assets and liabilities and “general purpose” tax revenues to segments is difficult. Furthermore, it should be mentioned that the COFOG does not require allocation of assets and liabilities to functions, as the COFOG classification is only used to present expenditures, the classification does not allocate revenues to functions.

The implementation of IPSAS 18 might introduce the use of internal reasoning in determining the applicable allocation basis that may impair understandability by external users according to the EPSAS CF.

Comparability

Comparability is the quality of information that enables users to identify similarities in, and differences between, two sets of phenomena in different reporting entities or in one reporting entity at different points in time. A key objective of EPSAS is to achieve the necessary level of financial transparency and comparability of financial reporting, between and within EU Member States.

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 should be restated to reflect the newly reported segment as a separate segment, unless it is impracticable to do so (IPSAS 18 para 49). This provision of IPSAS 18, in isolation, ensures the provision of comparable information, hence enhances the comparability QC.

IPSAS 18 provides limited guidance on what constitutes a reasonable allocation basis, and around the facts and circumstances that would indicate not allocating revenue, expenses, assets and liabilities to segments. This might raise concerns about the impact of significant judgement on the comparability of information.

Some guidance for cost allocation can be found in other IPSASs. For example, IPSAS 12 'Inventories', provides guidance for attributing and allocating costs to inventories, and IPSAS 11 'Construction Contracts', provides guidance for attributing and allocating costs to contracts (IPSAS 18 para 39). That guidance may be useful in attributing and allocating costs to segments, however acknowledging that allocation might remain a judgemental and complex area that could cause diversity and inconsistent application in practice. Furthermore, it may be difficult to fully compare segments from one entity to another, as government entities can be organised in different ways, especially in terms of their budgetary structure.

As a conclusion, the provisions of IPSAS 18 contain some limitations in respect of the comparability QC, especially concerning the allocation of segment revenue, expenses, assets and liabilities to the segments identified in accordance with IPSAS 18. These are however inherent in the nature of the information to be provided and should be considered in the overall assessment of the suitability of the proposed rules against the EPSAS CF, in conjunction with other QCs such as relevance.

Alignment with other frameworks

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. Unlike financial accounting and reporting, ESA does not require to provide information based on predefined segments. Segment information on a balance sheet level that is comparable to IPSAS 18 does not have to be provided.

Under ESA, 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.

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

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

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

The “Classification of the 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:

1. General public services.
2. Defence.
3. Public order and safety.
4. Economic affairs.
5. Environmental protection.
6. Housing and community amenities.
7. Health.
8. Recreation, culture and religion.
9. Education.
10. Social protection.

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. 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. A cross presentation of government transactions by economic nature (the usual ESA classification) and according to functions is requested.

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.13 13); and
(4) social security funds (S.1314).

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

IFRS[4]

IPSAS 18 is drawn primarily from IAS 14 (revised 1997). The main differences between IPSAS 18 and IAS 14 are as follows:

- IPSAS 18 defines segments differently from IAS 14. IPSAS 18 requires entities to report segments on a basis appropriate for assessing past performance and making decision about the allocation of resources. IAS 14 requires business and geographical segments to be reported.
- IAS 14 requires disclosure of segment result, depreciation, and amortization of segment assets and other significant non-cash expenses. IPSAS 18 does not require the disclosure of segment result. IPSAS 18 encourages, but does not require, the disclosure of significant non-cash revenues that are included in segment revenue, segment depreciation, and other non-cash expenses or segment cash flows as required by IPSAS 2 'Cash Flow Statements'.
- IPSAS 18 does not require the disclosure of information about secondary segments but encourages certain minimum disclosures about both service and geographical segments.
- IPSAS 18 does not specify quantitative thresholds that must be applied in identifying reportable segments.
- IPSAS 18 uses different terminology, in certain instances, from IAS 14.

IAS 14 has been replaced by IFRS 8 'Operating segments'. IFRS 8 is in essence different from IPSAS 18 and the previous IAS 14. It requires entities to provide information about operating segments as viewed 'through the eyes of management' (the so-called 'management approach'). This means that the operating segments for accounting purposes should be the same as those used for internal management purposes, and the performance measures are based on the accounting policies used for internal reporting purposes.

[4] Refer to the IPSAS-IFRS Alignment Dashboard regularly updated by the IPSASB available on https://www.ifac.org/system/files/uploads/IPSASB/Agenda%20Item%201.5%20IPSAS%20IFRS%20Alignment%20Dashboard_June%202019.pdf

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 should be presented in the notes to the financial statements, on the basis of the figures of the statement of financial performance. Segment information should 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 information regarding the EU activities. As the EU activities are split in terms of budgetary programming into headings of the Multiannual 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, segment reporting of balance sheet items would not provide relevant information to the user.

The segment report 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.
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 such segment revenues and expenses should be disclosed that are directly attributable to a segment. It is considered that assets and liabilities are not directly attributable to a segment and should not be reported.

European Public Good

Assessing whether IPSAS 18 is conducive to the European public good

The assessment of whether IPSAS 18 would be conducive to the European public good addresses the following items:

a) Whether the standard will improve financial reporting;
b) The costs and benefits associated with the standard; and
c) Whether the standard could have an adverse effect to the European economy, including financial stability and economic growth.

These assessments will allow the EU authorities to draw a conclusion as to whether the standard is likely to be conducive to the European public good.

The analysis revealed a few potential conceptual issues with the proposed segment reporting rules under IPSAS 18.

- Transparent and relevant segment information would provide useful information to the users of the GPFSs and would improve the overall quality of financial reporting in the public sector. However, the relevance and usefulness of segment reporting required by IPSAS 18 could be improved. The purpose of any future EPSAS requirement on segment reporting would need to be clearly described. For example, the future EPSAS standard setter could consider alignment based on IFRS 8 principles (which present segment reporting through the eyes of management) and/or functional classification and budgeting dimensions. 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, the alignment between budgeting statistics and financial reporting could be achieved. However, in the latter case it should also be considered whether that would really serve the wider range of future users of EPSAS or primarily EU, national and international institutions.

- Provided that the segment reporting structure is aligned to the statistical reporting and other information used internally for decision-making, accountability and evaluation of the entity's past performance, the segment disclosure requirements will provide useful information to the users of the GPFSs and will improve the overall quality of financial reporting in the public sector. Implementation of the standard could result in a moderate to (relatively) significant one-off cost upon transition and in a more moderate cost or be relatively cost-neutral on an ongoing basis for preparers, depending on the robustness of the internal reporting system in place.

The analysis has not identified any adverse effect of the standard to the European economy, including financial stability and economic growth, or any factors, other than

the ones mentioned above, that would mean the standard is not conducive to the European public good.

Conclusion

Assessing IPSAS 18 against the criteria formulated in the draft EPSAS framework

The analysis has revealed a few potential conceptual issues with IPSAS 18 ‘Segment Reporting’ and this might to some extent affect the consistency between IPSAS 18 and the draft EPSAS framework.

Following the screening analysis summarised in the present report, the future standard setter could consider the following conclusions. The information resulting from the application of IPSAS 18:

- might have important limitations identified under the QC of relevance;
- would provide reliable, complete, prudent, neutral, verifiable, economically substantive, understandable, timely and comparable information needed for making economic decisions and achieving the necessary level of financial transparency and comparability of financial reporting in the European Union;
- would not be contrary to the true and fair view principle; and
- would be conducive to European public good.

In order to achieve consistent application of the new standard within the EU context and therefore better address the relevance of EPSAS financial statements, further improvements in certain areas might be desirable.

- *Identification of segments.* Government entities might not be structured along the reporting requirements of IPSAS 18. The relevance of the proposed segmentation is limited in the situations where different approaches to segmentation are used internally for decision-making, accountability and performance evaluation. An alignment based on IFRS 8 principles (which present segment reporting through the eyes of management) and/or a COFOG classification, which is also used for ESA reporting purposes, might be considered. In making this determination, it should be taken into account which option for a common classification would best serve the wider range of future users of EPSAS or primarily EU, national and international institutions.

- *Disclosure of segment assets and liabilities.* Disclosure of assets and liabilities per segment is useful as it provides information about the resources that are managed by the various segments of the government entity. The EPSAS standard setter might however wish to reassess these requirements when it reassesses the requirements for identifying the segments.

- *Judgment and comparability.* The use of judgment and estimates is inherent in the preparation of financial statements and may to some extent affect the comparability of financial statements. This may especially be the case concerning the allocation of segment revenue, expenses, assets and liabilities to the segments identified in accordance with IPSAS 18.

The analysis has not identified any adverse effect of the standard to the European economy, including financial stability and economic growth, or other factors, other than the ones mentioned above, that would mean the standard is not conducive to the European public good. The fundamental question of the most relevant segmentation basis for governments should be resolved before the endorsement of any future EPSAS standard on segment reporting.

The future standard setter could consider the conclusions of this assessment and the consequences of using the requirements of IPSAS 18 as a starting point in developing an equivalent EPSAS, considering the need for improvements in the areas identified in the present EPSAS screening report. The future standard setter could also consider the conclusions of this assessment in the context of the ongoing discussions on the EPSAS Reporting Entity definition.