

Welcome to the series

Our series of *IFRS for Investment Funds* publications addresses practical application issues that investment funds may encounter when applying IFRS. It discusses the key requirements and includes interpretative guidance and illustrative examples. The upcoming issues will cover such topics as classification of redeemable shares, fair value and IFRS 9 *Financial Instruments*.

This series considers accounting issues from currently effective IFRS as well as forthcoming requirements. Further discussion and analysis about IFRS is included in our publication *Insights into IFRS*.

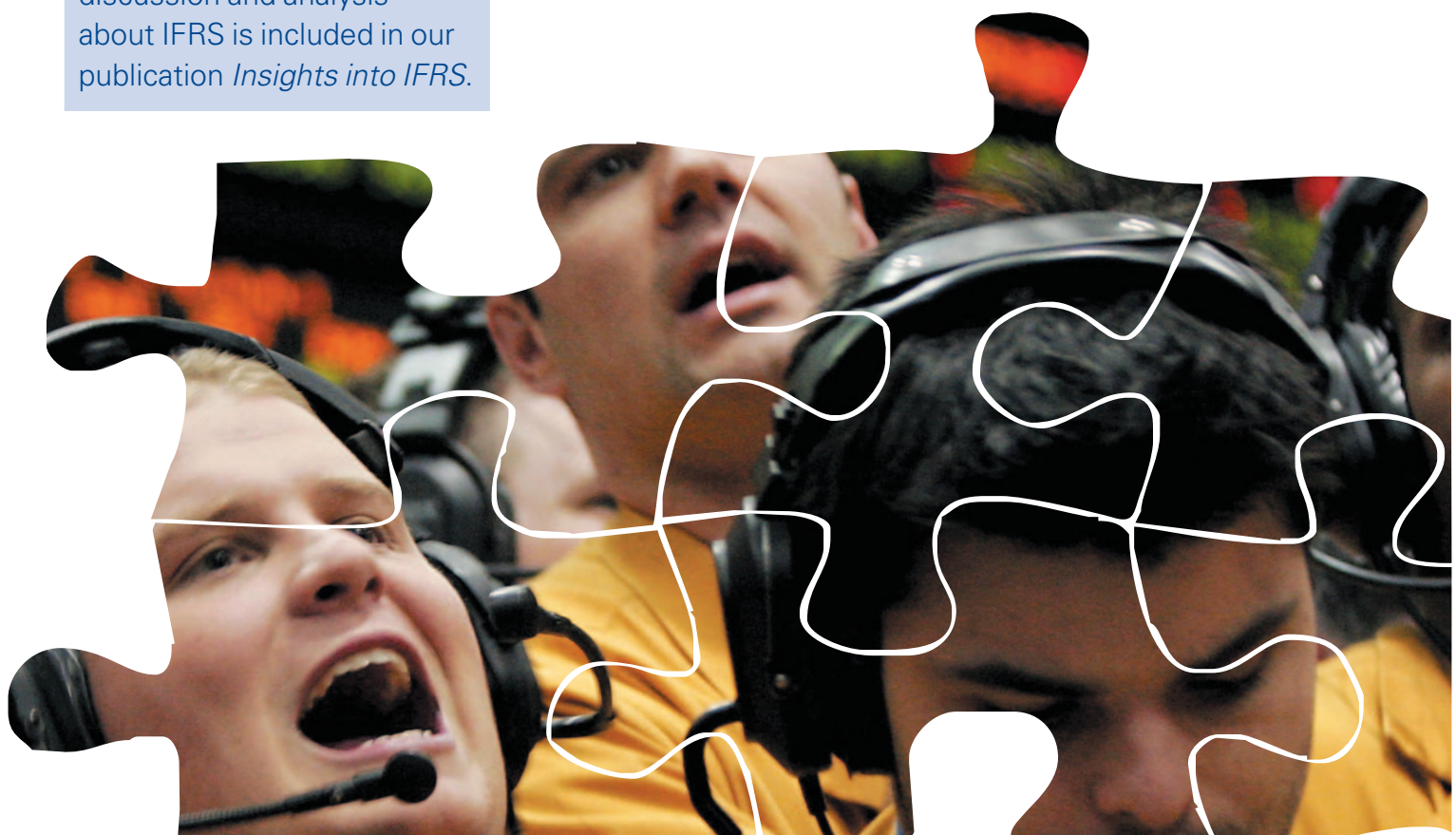
In this issue: Segment reporting

IFRS 8 *Segment Reporting* introduced segmental disclosure requirements based on the information that management uses to make decisions about operating matters. The application of the standard by investment funds may require a significant amount of judgement. This issue covers the following IFRS 8 requirements.

1. How does a fund determine whether it falls within the scope of IFRS 8?
2. How is 'traded in a public market' defined?
3. What steps should you go through to determine reportable segments under IFRS 8?
4. How do you identify the chief operating decision maker (CODM) for a fund?
5. How do you identify operating segments?
6. When may a fund aggregate operating segments?

IFRS 8 requires segment disclosure based on the components (operating segments) of the fund that management monitors in making decisions about operating matters (the 'management approach'). The adoption of the management approach results in the disclosure of information for segments in substantially the same manner as they are reported internally and used by the fund's CODM for the purpose of evaluating performance and making resource allocation decisions. In that way, financial statement users are able to see the entity *through the eyes of management*.

The application of the 'through the eyes of management' concept in IFRS 8 can impact the comparability of disclosures from entity to entity when two funds with similar asset composition have different operating segments. However, the requirements provide an opportunity for investment funds to communicate with investors, regulators and other stakeholders so that they obtain a better understanding of how a specific fund operates.



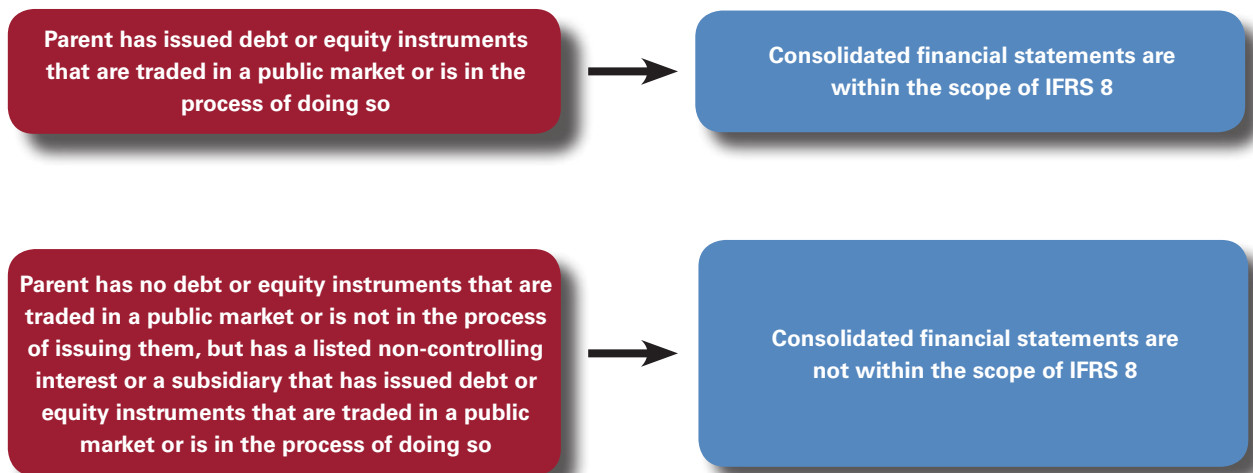
1. How does a fund determine whether it falls within the scope of IFRS 8?

A fund that prepares IFRS financial statements falls within the scope of IFRS 8 if it meets one of the following criteria:

- its debt or equity is traded in a public market; or
- it files or is in the process of filing its financial statements with a regulator (e.g. securities commission) for the purpose of issuing a class of instruments in a public market.

When considering the latter, in our view segment information is required only when the entity has taken active steps to obtain a listing, rather than simply planning to obtain it. When an entity prepares financial statements for inclusion in a prospectus in preparation for a listing, segment information should be included in those financial statements.

To determine whether consolidated financial statements fall within the scope of IFRS 8, it is necessary to review the instruments issued by the parent, as shown below.



2. How is 'traded in a public market' defined?

Investment funds issue units that are classified either as equity or as a financial liability. These units are frequently bought and sold, normally between investors in the fund or between investors and the fund. The question arises whether such transactions are considered to be 'traded in a public market'.

IFRS 8 does not define 'traded in a public market'. In our view, determining what it means depends on facts and circumstances, and can vary based on local requirements from securities commissions and/or regulators.

Public markets include:

- a domestic or foreign stock exchange; and
- over-the-counter markets, including local and regional markets.

We believe that if a buyer or a seller can contact a broker and obtain a quoted price, then this is an indicator that the debt or equity instruments are publicly traded. The frequency of trading is not relevant for the analysis.

The following factors may indicate that a fund is not traded in a public market.

- The fund is listed at an exchange as a convenience listing or marketing purposes only and cannot be traded on the stock market.
- The fund's shares are exchanged through a fund agent/administrator only, i.e. subscriptions and redemptions of units are handled by a transfer agent/administrator directly associated with the fund.
- Subscription and redemption prices are based on the fund prospectus valuation principles and therefore would not be established by market trading.

The factors mentioned above are not exhaustive and judgement is required when assessing whether a fund is traded in a public market.

Example 1 – Convenience listing

Fund X is an open-ended fund listed on an exchange as a convenience listing. The shares are issued and redeemed on a regular basis through an administrator, who is directly associated with the fund. Transactions cannot take place directly between investors. Subscription and redemption prices are based on the fund's prospectus valuation principles.

Is X within the scope of IFRS 8?

X does not fall within the scope of IFRS 8 because its issued instruments are not traded in a public market.

Example 2 – Exchange traded

Fund Y is a closed-ended fund listed and traded on an exchange. Transactions can take place directly between investors. The shares are traded at a market price that may be different from the net asset value per share of Y.

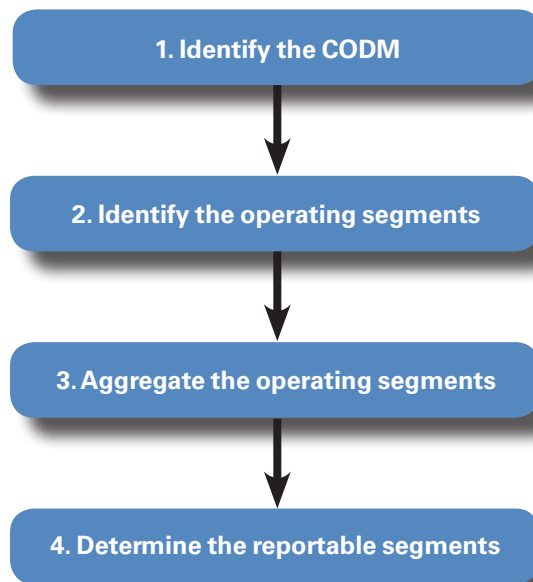
Is Y within the scope of IFRS 8?

Y does fall within the scope of IFRS 8 because its issued instruments are traded in a public market.

3. What steps should you go through to determine reportable segments under IFRS 8?

Once a fund has established that it falls within the scope of IFRS 8, it should apply the core principle of IFRS 8 in determining its segment disclosures. The core principle requires the disclosure of information to enable users of financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environment in which it operates. The core principle is considered when forming a judgement about what information is disclosed and the format of the disclosure.

The practical approach to determining reportable segments under IFRS 8 includes the following four steps.



The analysis is performed from the reporting entity's perspective, because the standard applies to separate, individual and consolidated financial statements. For example, if an umbrella fund structure performs the analysis for the purpose of its consolidated financial statements, then the analysis is performed at the consolidated financial statements level. However, if the analysis is performed for the purpose of the financial statements of an individual sub-fund in an umbrella fund structure, then the analysis is performed at the sub-fund level.

4. How do you identify the CODM for a fund?

The CODM is the highest level of management at which resource allocation decisions and performance assessments are made, rather than a supervisory body established as a governance oversight.

Identifying the CODM may be difficult. It could be chief executive, board of directors, executive committee or even an external party, such as the investment manager of a particular fund. The function of the CODM may be performed by a single individual or a group.

The CODM has the following general characteristics:

- it is a function, rather than a manager with a specific title;
- it is usually the highest level of management; and
- it allocates resources of an entity to the operating segments and assesses their performance.

An entity cannot have more than one CODM.

In our view, the mere existence of an executive committee, management committee or other high-level committee does not necessarily mean that one of those committees constitutes the CODM.

Also, it is important to distinguish between the CODM and the lower levels of management. The latter may make decisions about resource allocation that relate to part of the entity, while the CODM allocates resources and assesses performance for the whole entity. These lower levels of management cannot be the entity's CODM; however, they may be the segment manager for an operating segment.

5. How do you identify operating segments?

An operating segment is a component of a fund with the following characteristics:

- it engages in activities from which it may earn revenues and incur expenses;
- its operating results are reviewed regularly by the CODM to assess performance and allocate resources; and
- discrete financial information is available in respect of it.

The standard does not require expenses incurred to be allocated to the component of an entity in order for it to meet the definition of an operating segment.

Identifying the appropriate operating segments is not always obvious. Entities are required to consider all types of information provided to the CODM when identifying operating segments. For some funds, the characteristics described above would clearly identify the operating segments. However, some funds organise and report financial information to the CODM in more than one way; as a result, operating segments might not be evident.

For example, information reviewed by the CODM of a fund can be analysed by investment strategy, geography, legal entity, types of investments etc. The CODM may review more than one set of financial information or review financial information with different levels of supporting documentation. Judgement is necessary in determining the single set of operating segments, and will depend on the individual facts and circumstances of the fund. In such situations the fund determines which set of components constitutes the operating segments by reference to the core principle of IFRS 8 (see Question 3).

When multiple types of segment information exist, the following additional factors can be considered in determining the appropriate operating segments:

- the nature of the business activities of each component;
- the existence of managers responsible for the components;
- information presented to the board of directors;
- information provided to external financial analysts and on the entity's website; and
- information presented in the front/end of the financial statements, e.g. the management report.

The biggest question for a fund in applying IFRS 8 is whether it has one or more operating segments. Funds may argue that they are involved in only a single business activity or industry, i.e. investment management. However, determination of the industry in which a business component of an entity operates generally is not decisive for the purpose of identifying all of the operating segments under IFRS 8.

Depending on the facts and circumstances, an investment fund may have a single or multiple operating segments. The table below sets out example indicators to help with this judgement.

	Indicators of a single operating segment	Indicators of multiple operating segments
Operating results monitoring by the CODM	Operating results are monitored by the CODM for the entity as a whole	Performance is monitored by the CODM per segment
Asset allocation by CODM	Resource (e.g. asset) allocation is pre-determined in the prospectus	The CODM decides on resource (e.g. asset) allocation to the sub-portfolios
Discrete financial information	Available for the entire fund only	Available for each segment

	Indicators of a single operating segment	Indicators of multiple operating segments
Management team	One for the whole fund	Separate management team for each segment
Investment strategy	Single, narrowly defined strategy	Multi-strategy. Broad investment mandate

As a result of the through the eyes of management approach adopted by the standard, the comparability of disclosures between funds with similar investment strategies and asset composition may be reduced, because they may be managed differently.

Example 3 – Focus on managing asset pools within one strategy

Fund K pursues a global macro strategy by investing in equities, debt and commodities. The CODM reviews the operating results of each investment type and allocates funding to the pools (equities, debt and commodities) based on the returns generated and future performance expectations. Operating results for equities, debt and commodities are presented separately in the monthly investor reports.

How many segments does K identify?

Despite having one investment strategy, K concludes that it has multiple segments and each of the three pools/investment types is an operating segment under IFRS 8.

Frequently, performance-related information reviewed by the CODM will be driven by the investment strategy adopted. Nevertheless, operating results reviewed by the CODM are key when identifying operating segments.

Example 4 – Focus on investment strategy as one asset pool

Fund L pursues a global macro strategy by investing in equities, debt and commodities with a narrow pre-determined ratio of asset allocation per category. The CODM reviews the fund's operating results on an overall basis.

How many segments does L identify?

L concludes that it has one operating segment.

Example 5 – Fund of funds

Fund M invests in three hedge funds, each having a different investment strategy, as follows: equity long/short, emerging markets and discretionary trading. The CODM of M receives information about the operating results of the investments in each hedge fund. Based on the operating results of each fund, the CODM decides whether to retain the investor-investee relationship.

How many segments does M identify?

M concludes that each hedge fund is an operating segment.

6. When may a fund aggregate operating segments?

Once the operating segments have been identified, the next step is to determine whether the identified segments may be aggregated for reporting purposes.

Operating segments may be aggregated only if all of the following criteria are met:

- the aggregation is consistent with IFRS 8's core principle on disclosing information that enables users of the financial statements to evaluate the nature and financial effects of the business activities in which the fund engages and the economic environment in which it operates;
- the segments have similar economic characteristics; and
- the segments are similar in respect of the nature of products, services and processes, and the type of customers, distribution and, if applicable, nature of the regulatory environment; for an investment fund, the key criterion is the nature of products.

In determining whether operating segments have similar economic characteristics, IFRS 8 gives only an example of similar long-term average gross margins. However, in our view it may be appropriate to use other economic factors to determine whether two or more operating segments have similar economic characteristics. Those factors should be fund-specific and should be based on the primary factors that the CODM uses in assessing the performance of and allocating resources to individual segments.

If a fund has very few operating segments, then it may be evident that the operating segments also are reportable segments.

Example 6 – Aggregating segments

Fund S has performed an analysis and concludes that it has two operating segments: investment grade bonds and high-yield bonds. S considers aggregating the two operating segments into one segment, 'fixed income securities'.

Is it possible to aggregate these operating segments into one for reporting purposes?

Investment grade bonds and high-yield bonds have different expected returns and credit risks and therefore S concludes that these two segments do not have similar characteristics. These segments cannot be aggregated for reporting purposes.

Other KPMG publications

Segment reporting

Example disclosures of segment reporting for a multiple segment fund are illustrated in Appendix II of our publication [Illustrative financial statements: Investment funds](#), published in December 2010 (the next edition is due out in the next few weeks).

We released [The Application of IFRS: Segment reporting](#) in September 2010. Although this publication is not specific to the investment management sector, it discusses a number of practical application issues across different industries and may be useful in considering entity-specific issues.

See also chapter 5.2 in the 8th Edition 2011/12 of our publication *Insights into IFRS* for more detail on segment reporting.

General publications

A more detailed discussion of the general accounting issues that arise from the application of IFRS can be found in our publication *Insights into IFRS*. In addition, we have a range of publications that can help you further, including:

- Illustrative financial statements: Investment funds
- Illustrative financial statements for interim and annual periods
- IFRS compared to US GAAP
- IFRS Handbooks, which include extensive interpretative guidance and illustrative examples to elaborate or clarify the practical application of a standard, including IFRS Handbook: First-time adoption of IFRSs
- New on the Horizon publications, which discuss consultation papers
- First Impressions publications, which discuss new pronouncements
- Newsletters, which highlight recent accounting developments
- IFRS Practice Issues publications, which discuss specific requirements of pronouncements
- Disclosure checklist.

IFRS-related technical information also is available at kpmg.com/ifrs.

For access to an extensive range of accounting, auditing and financial reporting guidance and literature, visit KPMG's Accounting Research Online. This web-based subscription service can be a valuable tool for anyone who wants to stay informed in today's dynamic environment. For a free 15-day trial, go to aro.kpmg.com and register today.

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Our member firms combine their depth of local knowledge with our global network's cross-border experience to deliver practical, effective and insightful advice to our global investment management clients. Our professionals in Audit, Tax and Advisory are specialists in their fields and have deep experience in the issues and needs of investment management businesses.

We offer professional services to a wide range of industry participants at a local, national and global level. Our clients include investment managers, wealth managers, fund administrators and service providers who focus on retail/mutual funds, hedge funds, private equity funds, real estate funds, infrastructure funds and other alternative investment funds (such as distressed debt and environmental assets), as well as sovereign wealth funds and pension funds.

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