

# A practical guide to segment reporting

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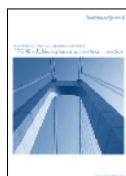
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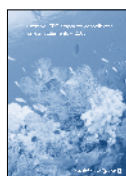
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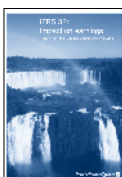
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**Understanding financial instruments – A guide to IAS 32, IAS 39 and IFRS 7**

Comprehensive guidance on all aspects of the requirements for financial instruments accounting. Detailed explanations illustrated through worked examples and extracts from company reports.

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# Introduction

IFRS 8 ('the standard') aligns the identification and reporting of operating segments with internal management reporting. Segment reporting under IFRS 8 should highlight the information and measures that management believes are important and are used to make key decisions. It should also provide a better link between the financial statements and the information reported in management commentaries such as the Operating and Financial Review or Management Discussion and Analysis. The standard converges IFRS with US Accounting Standard SFAS 131 'Disclosure about Segments of an Enterprise and Related Information'.

This publication explains the key requirements of the standard and some practical issues for entities to consider when it is applied for the first time.

# Key implementation issues

The International Accounting Standards Board issued IFRS 8, 'Operating segments' in November 2006. The standard replaces IAS 14, 'Segment reporting'. It applies to annual reporting periods beginning on or after 1 January 2009. Early adoption is permitted.

The key implementation issues are as follows:

- The IASB did not intend to change the range of entities required to present segment information, but we believe IFRS 8 has a wider scope than IAS 14. It applies to entities whose equity or debt securities are publicly traded or that issue, or are in the process of issuing, any class of instrument in a public market. The scope also includes entities that file financial statements with a regulatory organisation for purpose of issuing any instruments in a public market. We believe this means that some entities whose equity and debt securities are not traded publicly and were not within the scope of IAS 14 will have to provide segment disclosures.
- The standard introduces a 'management approach' to identifying and measuring the financial performance of an entity's operating segments. Reported segment information will be based on the information used internally by management. This means that:
  - the way entities identify segments and measure and present segment information could change;
  - there will be more diversity in reported segment information;
  - segment information may not be measured in accordance with IFRS – entities are required to reconcile segment financial information to the consolidated financial statements; and
  - entities will no longer need to prepare two sets of information for internal and external reporting.
- Reportable segments are no longer limited to those that earn a majority of revenue from sales to external parties, so entities may now be required to report the different stages of vertically integrated operations as separate segments.

## Practical experience

IFRS 8 aligns segment reporting under IFRS with the requirements of the equivalent US standard SFAS 131. IFRS 8 adopts the requirements of the US standard almost in its entirety.

### Insight

Experience from PwC in the US shows that:

- Identifying the chief operating decision maker (CODM) can be difficult. Judgements about the components of an entity that are regularly reviewed by the CODM have been challenging and subject to regulatory scrutiny.
- The regulator has challenged companies about the identification of operating segments and the appropriateness of aggregating operating segments.
- Companies subject to Sarbanes-Oxley Section 404 requirements may incur additional costs in ensuring that internal processes and systems are sufficiently robust in capturing internal segment information.

# Key differences between IFRS 8 and IAS 14

	IFRS 8	IAS 14	PwC insight
<b>Who does it apply to?</b>	Entities whose equity or debt securities are publicly traded or that issue equity or debt securities in a public market, or file (or are in the process of filing) financial statements with a regulatory organisation for purposes of issuing securities in a public market.	Entities that have publicly traded securities or are in the process of issuing them in a public securities market.	We believe the scope is broader and includes entities that file financial statements with a regulator in order to sell securities to the public, regardless of whether those securities are traded.
<b>What are operating segments?</b>	Business activities that may earn revenues or incur expenses, whose operating results are regularly reviewed by the chief operating decision maker and for which discrete financial information is available.	Business- or geography-based components that are subject to risks and returns that are different from those of other components.	The composition of segments could change, and there could be an increase in the number of segments disclosed.
<b>What information is reported on operating segments?</b>	Reported information is based on information that management uses to run the business.	Reported information is based on the financial information presented in the consolidated financial statements.	The way in which management assesses the performance of the business should become more transparent. Segment information will be exposed to greater scrutiny from users of financial statements.
<b>What is the measurement of segment disclosures based on?</b>	Segment disclosures are based on management information reported to the chief operating decision maker.	Segment disclosures are based on IFRS-compliant financial information.	Management information may not be supported by the same robust processes and controls, or subject to external audit. Implementing such processes and systems could be costly.

# What to do on first-time adoption of IFRS 8

- Identify the CODM (see p9). Identifying the correct person(s) is fundamental to correctly identifying the reportable segments.
- Be aware that more operating (and therefore reportable) segments may be identified – for example, where vertically-integrated operations are identified or where more components of the business are regularly reviewed by the CODM. Management should consider the implications of presenting this information in the financial statements.
- Consider the impact of the information that will be disclosed. IFRS 8 does not contain a ‘competitive harm’ exemption and requires entities to disclose the financial information that is provided by the CODM. The management accounts reviewed by the CODM may contain commercially sensitive information, and IFRS 8 might require that information to be disclosed externally. This was a key issue for many US companies on initial adoption of SFAS 131.
- Review internal control processes for management accounts, which might not be subject to the same processes and systems as the consolidated financial statements. Entities might need to spend time and money ensuring that their management accounts are sufficiently robust to support external disclosures and audit. IFRS 8 also requires a reconciliation between total reportable segment revenues, total profit or loss, total assets and any other amounts disclosed for reportable segments to corresponding amounts in the financial statements. There should be an audit trail between the management accounts and the consolidated financial information.
- Revisit goodwill impairment. Goodwill cannot be allocated to a group of cash-generating units larger than an operating segment. Management should consider carefully the impact of changes in the identification of operating segments on goodwill impairment.
- Restate the comparatives. Management should consider the impact of IFRS 8, resolve any issues and begin capturing the relevant data well before the initial application of the standard in annual or interim financial statements.

# IFRS 8 at a glance

## What is the scope of IFRS 8?

IFRS 8 applies to entities that prepare financial statements, and:

- whose equity or debt securities are traded in a public market, or
- that file, or are in the process of filing, financial statements with a securities commission or other regulatory organisation for the purposes of issuing any class of instruments in a public market.

### Insight

We expect IFRS 8 to apply to entities that issue instruments on the public market where those instruments can only be redeemed by 'putting them back' to the issuer. For example, XYZ Equity Investment Fund issues units to the public that can be redeemed only by selling them back to the fund. IFRS 8 would apply to XYZ Equity Investment Fund if it was required to file financial statements with a regulator for the purposes of issuing those units.

## When does it apply?

IFRS 8 applies to annual reporting periods beginning on or after 1 January 2009. It may be early adopted, as long as that fact is disclosed in the notes to the financial statements.

## What is the key principle?

IFRS 8 requires disclosures that enable users to evaluate the nature and financial effects of the business activities in which it engages and the economic environment in which it operates.

### Insight

IFRS 8 requires judgement in its application. Management should consider the key principle as it determines its segment disclosures rather than relying on a set of rules. The key concept is that the entity should provide information used by management that will allow users to understand the entity's main activities, where those activities are located and how well those activities are performing.

## What is an operating segment?

An operating segment is a component of an entity:

- that engages in business activities from which it may earn revenues and incur expenses;
- whose operating results are regularly reviewed by the entity's CODM to make decisions about resources to be allocated to the segment and assess its performance; and
- for which discrete financial information is available.

## How are operating segments identified?

There are four key steps. Entities will need to:

- 1 Identify the CODM.
- 2 Identify their business activities (which may not necessarily earn revenue or incur expenses).
- 3 Determine whether discrete financial information is available for the business activities.
- 4 Determine whether that information is regularly reviewed by the CODM.

### Insight

Identifying the CODM and the components that are regularly reviewed by the CODM to make decisions can be difficult. It is also important to reassess regularly the identification of the CODM, particularly following a business reorganisation, acquisition or disposal.

## What or who is a chief operating decision maker?

The CODM is a function and not necessarily a person. That function is to allocate resources to, and assess the performance of, the operating segments. It is likely to vary from entity to entity – it may be the CEO, the chief operating officer, the senior management team or the board of directors. The title or titles of the person(s) identified as CODM is not relevant, as long as it is the person(s) responsible for making strategic decisions about the entity's segments.

See the 'Questions and answers' section for some of the practical implications identifying an entity's operating segments.

## How do I determine an entity's reportable segments?

Not all operating segments need to be separately reported. Operating segments are only required to be reportable if they exceed quantitative thresholds.

### Quantitative thresholds (IFRS 8 para 13)

Information on an operating segment should be separately reported if:

- reported revenue (external and inter-segment) is 10% or more of the combined revenue of all operating segments;
- the absolute amount of the segment's reported profit or loss is 10% or more of the greater of:
  - the combined reported profit of all operating segments that did not report a loss, and
  - the combined loss of all operating segments that reported a loss;
- the segment's assets are 10% or more of the combined assets of all operating segments.

Two or more operating segments may be combined (aggregated) and reported as one if certain conditions are satisfied.

## **Aggregation of operating segments (IFRS 8 para 12)**

Two or more operating segments may be combined as a single reportable segment if:

- aggregation provides financial statement users with information that allows them to evaluate the business and the environment in which it operates;
- they have similar economic characteristics; and
- they are similar in each of the following respects:
  - the nature of the products and services,
  - the nature of the production processes,
  - the type or class of customer for their products and services,
  - the methods used to distribute their products or provide their services, and
  - the nature of the regulatory environment (ie, banking, insurance or public utilities), if applicable.

## **Minimum number of reportable segments**

After determining the reportable segments, the entity should ensure that the total external revenue attributable to those reportable segments is at least 75% of the entity's total revenue. When the 75% threshold is not met, additional reportable segments should be identified (even if they do not meet the 10% thresholds), until at least 75% of the entity's total external revenue is included in its reportable segments.

The sections 'Aggregating and reporting segments' on p19 and 'Segment disclosures' on p27 address some of the practical implications of determining reportable segments.

## Financial statement disclosures

The disclosures focus on the information that management believes is important when running the business. The disclosure requirements are summarised below.

Reference to disclosure requirements	Required disclosures
General information	<ul style="list-style-type: none"> <li>• Factors used to identify the reportable segments.</li> <li>• Types of product/service from which each reportable segment derives its revenue.</li> </ul>
Information about the reportable segment; profit or loss, revenue, expenses, assets, liabilities and the basis of measurement	<ul style="list-style-type: none"> <li>• A measure of profit or loss and total assets.</li> <li>• A number of specific disclosures, such as revenues from external customers if they are included in segment profit or loss and presented regularly to the CODM.</li> <li>• Explanation of the measurement of the segment disclosures.</li> <li>• The basis of accounting for transactions between reportable segments.</li> <li>• The nature of differences between the measurements of segment disclosures and comparable items in the entity's financial report (for example, accounting policy differences and asymmetrical allocations).</li> </ul>
Reconciliations	<ul style="list-style-type: none"> <li>• Totals of segment revenue, segment profit or loss, segment assets and segment liabilities and any other material segment items to corresponding totals within the financial statements.</li> </ul>
Entity-wide disclosures	<ul style="list-style-type: none"> <li>• Revenues from external customers for each product and service, or each group of similar products and services.</li> <li>• Revenues from external customers attributed to the entity's country of domicile and attributed to all foreign countries from which the entity derives revenues.</li> <li>• Revenues from external customers attributed to an individual foreign country, if material.</li> <li>• Non-current assets (other than financial instruments, deferred tax assets, post-employment benefit assets, and rights arising under insurance contracts) located in the entity's country of domicile and in all foreign countries in which the entity holds assets.</li> <li>• Non-current assets in an individual foreign country, if material. Extent of reliance on major customers, including details if any customer's revenue is greater than 10% of the entity's revenue.</li> </ul>

The section 'Other matters for consideration' on p33 outlines some of the practical implications regarding the disclosures required under IFRS 8.

**Note.** There is no longer a primary and secondary segment format. An entity that has determined that its operating segments are based on its products and services then it does not need to provide geographical segment information other than the specific entity-wide disclosures specified above.

# Questions and answers

## 1. Identifying operating segments

- 1.1 Can the CODM be a group of individuals?
- 1.2 Is the CODM always viewed as the highest level of management at which decisions are made?
- 1.3 Can a head office function be an operating segment?
- 1.4 Does a component meet the definition of a segment if the CODM reviews revenue-only information?
- 1.5 Is a segment balance sheet necessary to conclude that discrete financial information is available?
- 1.6 Can vertically integrated operations and cost centres that do not earn revenues be classified as an operating segment?
- 1.7 Can a research and development function be an operating segment?
- 1.8 Can a discontinued operation be an operating segment?
- 1.9 Are activities conducted through proportionally consolidated joint ventures or associates considered under the definition of operating segment?
- 1.10 A CODM may receive multiple levels of information. How are operating segments determined?
- 1.11 An entity is structured in a matrix style, where the CODM reviews two overlapping sets of financial information. How are the operating segments determined?

## 2. Aggregating and reporting segments

- 2.1 If operating segments are based on geography rather than products or services, can they still be aggregated?
- 2.2 Can a company aggregate start-up businesses with mature businesses?
- 2.3 Can two similar operating segments be combined despite having different long-term average gross margins?
- 2.4 How should an entity perform the 10% test when each of its operating segments reports different measures of segment profitability and segment assets?
- 2.5 How should an entity identify its operating segments under IFRS 8 para 13 (b) when it has both profit- and loss-making segments?
- 2.6 Can information about non-reportable operating segments be combined and disclosed in an 'all other' category, together with items that reconcile the segment information to the statutory information?
- 2.7 Can a company aggregate an 'immaterial non-reportable' segment with a reportable segment, even though the aggregation criteria under IFRS 8 para 12 have not been met?
- 2.8 When applying the 75% test under IFRS 8 para 15, should the next largest operating segment always be selected?

### 3. Segment disclosures

- 3.1 Where the CODM is provided with more than one measure of segment profitability, what measure of segment profitability should be reported?
- 3.2 What measure should be reported when the asset information reported to the CODM is limited or not reviewed at all?
- 3.3 Should the measures of profit or loss and assets and liabilities presented for each operating segment comply with the IFRS accounting policies used in the consolidated financial statements?
- 3.4 Where the CODM only receives information with respect to the entity's cash flows (that is, the CODM receives no profit or asset information), what should that entity disclose in its segmental disclosure?
- 3.5 When should an entity consider and review its segment reporting?
- 3.6 Is restatement of segment information required when a reorganisation causes the composition of reportable segments to change?
- 3.7 Is restatement of segment information required when there is change in the measure of segment profit or loss?
- 3.8 What is the definition of 'material' where an entity is required to disclose separately material revenues and material non-current assets from an individual foreign country?

### 4. Other matters for consideration

- 4.1 The impact of IFRS 8 on accounting for impairment of assets
- 4.2 Segment reporting in the separate company statements of subsidiaries
- 4.3 Convergence with US standard SFAS 131
- 4.4 What's in the pipeline?

## Identifying operating segments

### 1.1 Can the chief operating decision maker be a group of individuals?

Yes. The CODM may be an individual or a group of individuals.

#### Insight

A business activity usually has a unit manager who is directly accountable to, and maintains regular contact with, an individual or group of individuals to discuss operating activities, financial results, forecasts, or plans for the business activity. The CODM is that individual or group of individuals that is responsible for the allocation of resources and assessing the performance of the entity's business units.

### 1.2 Is the CODM always viewed as the highest level of management at which decisions are made?

Typically, yes. In almost every organisation, decisions about the entity's resource allocation and the assessment of the performance of the entity's businesses are made at the highest level of management.

#### Insight

Judgement is required. The CODM will vary from entity to entity and it may be the chief executive officer, chief operating officer, senior management team or in some jurisdictions, the board of directors. We believe that a supervisory board function that simply approves management's decisions would not be the CODM, as it does not allocate resources.

### 1.3 Can a head office function be an operating segment?

Yes. A head office function that undertakes business activities (for example, a treasury operation that earns interest income and incurs expenses) may be an operating segment as long as its revenues earned are more than incidental to the activities of the entity, and discrete financial information is reviewed by the CODM.

A head office function (such as accounting, information technology, human resources and internal audit) that earns revenue that is purely incidental to the entity's activities is not an operating segment and not part of one of the reportable segments. Such functions should be reported in the reconciliation of the segment totals as 'other reconciling items'.

### **Example – Incidental revenues**

Examples of incidental revenues include interest income and expenses, realised and unrealised foreign exchange gains and losses, and the net effect of pension schemes.

#### **1.4 Does a component meet the definition of a segment if the CODM reviews revenue-only information?**

In most cases, no. For most entities, the review of revenue-only data is not sufficient for decision-making related to resource allocation or performance evaluation of a segment.

### **Insight**

Only in rare cases where product sales or service provisions involve minimal costs is the revenue-only data representative of the results. The review of the revenue-only data by the CODM may be sufficient in these rare cases to conclude that the business activity falls within the definition of an operating segment.

#### **1.5 Is a segment balance sheet necessary to conclude that discrete financial information is available?**

No. We believe that in many cases the requirement for discrete financial information can be met with operating performance information only, such as revenue and gross profit by product line.

#### **1.6 Can vertically integrated operations and cost centres that earn no revenues be classified as an operating segment?**

Yes. IFRS 8 defines an operating segment as a 'component of an entity that engages in business activities from which it may earn revenues and incur expenses'. This recognises that not all business activities earn revenues.

### **Example – Cost centres as a separate segment**

Manufacturing entities that are managed by reference to operating cost centres, may not record cost centre revenues because the entity's total customer revenues are not allocated to each cost centre. Care should be exercised when determining whether an internally reported activity constitutes an operating segment (see question 1.3 for more information). As long as discrete financial information is prepared and reviewed by the CODM such components would be considered operating segments.

### **Example – Vertically integrated operation**

Where transfer prices are charged between an entity's stages of production (for example, with oil and gas companies), the fact that the transfer prices are not assessed by the CODM would not exempt such activities from being considered operating segments. The operating segments of an oil and gas company may include exploration, development, production, refining and marketing – if the CODM manages the entity in this way.

## 1.7 Can a research and development function be an operating segment?

Yes, as long as discrete information is reviewed by the CODM. Typically, an entity's research and development (R&D) function is a vertically integrated operation (see question 1.6), in which the R&D activities serve as an integral component of the entity's business. The definition of operating segment envisages that part of an entity that earns revenue and incurs expenses relating to transactions with other components of the same entity may still qualify as an operating segment even if all of its revenue and expenses derive from intra-group transactions.

### Insight

Where entities allocate entity-wide R&D costs into the business activities for which the R&D is specifically being performed, the R&D function will be a separate operating segment as long as the CODM separately reviews discrete R&D activity and data. It will not be separate segment if the CODM does not review discrete financial data for the criteria.

## 1.8 Can a discontinued operation be an operating segment?

Yes. A discontinued operation can meet the definition of an operating segment if:

- it continues to engage in business activities;
- the operating results are regularly reviewed by the CODM; and
- discrete financial information is available to facilitate the review.

### Example – Insurance company disposing of its workers' compensation business

An insurance company discontinues its 'workers' compensation' line of business.

The discontinuation meets the criteria for 'discontinued operations' under IFRS 5, 'Non-current assets held for sale and discontinued operations'. For internal purposes, separate financial results are maintained for this business, and they are reviewed by the CODM until the discontinuance is complete. The operation is still being managed by the CODM and would continue to meet the definition of an operating segment.

Conversely, if the CODM no longer reviews discrete financial information on the discontinuing operation, it would no longer fall within the definition of an operating segment. For example, a furniture manufacturing plant shuts down its operations in Asia. The plant is no longer producing inventory and it has been reclassified under IFRS 5 as 'assets held for sale'. Discrete financial information is no longer reported. As a result, it would not be considered an operating segment.

**Note.** Disclosures would still be presented in accordance with IFRS 5.

## 1.9 Are activities conducted through proportionally consolidated joint ventures or associates considered under the definition of operating segment?

We believe that where (1) a company manages its joint-venture operations or associates separately and (2) the criteria for identifying operating segments in (a)-(c) of IFRS 8 para 5 are met, the joint-venture operations qualify as an operating segment. The asset and profit/loss information (reported to the CODM) regarding the joint-venture or

associate's activities that comprise the segment are therefore disclosed. The external reporting of the joint-venture activities may be on a proportionate consolidation basis or a full consolidation basis. If the full financial results are reviewed by the CODM, the total of all segments' financial amounts should be reconciled to the corresponding amounts reported in the consolidated financial statements, so appropriate eliminations should be reflected in the reconciling column for amounts reported in excess of those amounts reflected in the consolidated financial statements. For example, an associate revenue information is not included in the revenue amount reported in the consolidated financial statements. An elimination of the revenue amount disclosed for the associate should be reflected as a reconciling item.

### 1.10 A CODM may receive multiple levels of information. How are operating segments determined?

IFRS 8 para 8 states that the following factors should be considered when an entity is determining the set of components that constitutes its operating segments:

- The nature of business activities of each component. To the extent that the higher-level segment information is represented by components that contain dissimilar business activities, while the lower level components contain similar business activities, the lower level components may be more representative of the company's operating segments.
- The existence of managers responsible for each component. It is likely that those components that have individuals responsible for the components' results (such as a segment manager, business-unit CFO, or vice president) and who are directly accountable to, and maintain regular contact with, the CODM to discuss operating activities, financial results, forecasts, or plans for the segment, are an entity's operating segments. Segment managers may be responsible for more than one operating segment. IFRS 8 para 9 states that generally, if there is only one set of components for which segment managers are held responsible, that set of components constitutes the operating segments.
- The information provided to the board of directors. The information provided to the company's board of directors, when not considered to be the CODM, may indicate the level at which (1) overall performance is assessed and (2) decisions are made about resource allocation to different areas of an entity's business.

We believe entities should consider qualitative factors in addition to those outlined above in determining the appropriate operating segments. These should include an assessment of whether the resultant operating segments are consistent with the core principle of IFRS 8 and whether the identified operating segments could realistically represent the level at which the CODM is assessing performance and allocating resources. We would also expect the identified operating segments to be consistent with other information the entity produces, such as press releases, interviews with management, company websites, management discussions and other public information about the entity.

#### Insight

In the US, this has been an area of the standard that has required significant judgement. It is also an area where several entities have been challenged by the regulator.

### 1.11 An entity is structured in a matrix style, where the CODM reviews two overlapping sets of financial information. How are the operating segments determined?

IFRS 8 para 10 addresses the issue of matrix structures. It uses the example of an entity where some managers are responsible for product and service lines worldwide, whereas other managers are responsible for specific geographical areas.

The CODM reviews the operating results of both sets of components, and discrete financial information is available for both. In this situation, the entity should determine which set of components constitutes the operating segments, taking account of what users of the financial statements would need to know in order to evaluate the entity's business activities and the environment it operates in.

#### Insight

Matrix-structured entities use judgement to determine their operating segments. Such entities should consider the importance of the factors that have led to the matrix structure. For example, if an entity's priority is to increase total sales, market share and geographic spread, the most relevant information for shareholders would be based on geographic markets. An entity that aims to improve the sales of individual products, with a CODM that believes that improving and maintaining product quality is the key to achieving this, might conclude that the most relevant information for shareholders would be based on products.

This approach would be acceptable under IFRS 8 if:

- the entity can sufficiently support the basis for how it determined its segments; and
- the entity's basis for determining segments enables users of its financial statements to evaluate its activities and financial performance, and the business environment it operates in.

## Aggregating and reporting segments

### 2.1 If operating segments are based on geography rather than products or services, can they still be aggregated?

Yes, as long as the individual country segments have similar economic characteristics and are similar in each of the other areas set out in IFRS 8 para 12.

#### Insight

The requirement for segments to have similar economic characteristics may be difficult to overcome when combining individual countries. This is because the individual countries need to have similar economic conditions, exchange control regulations and underlying currency for them to have similar economic characteristics.

Even when aggregation of geographic segments is permitted, IFRS 8 para 33 requires the separate disclosure of revenues and assets for each material foreign country. This disclosure allows users of the financial statements to assess the dependence of the entity on customers based in one particular country.

### 2.2 Can a company aggregate start-up businesses with mature businesses?

Yes. One of the objectives of requiring disclosures about segments is to help users assess the future prospects of an entity's business. Segments with similar economic characteristics often exhibit similar long-term financial performance. To the extent that the future financial performance (including the competitive and operating risks) of the start-up businesses is expected to be similar to that of a company's mature businesses, the economic characteristics requirement for aggregation might be satisfied.

#### Example – A retail chain opens new stores

A retail chain has mature businesses (store locations) in five major cities in a given country. In the current year, the retail chain opens additional stores in those cities. Each store constitutes a separate operating segment, as the CODM of the retail chain reviews financial results and makes decisions on a store-by-store basis. These 'start-up' stores may meet the economic characteristics requirement for aggregation with mature stores if management determines that the future long-term financial performance of the stores is expected to be similar.

## 2.3 Can two similar operating segments be combined despite having different long-term average gross margins?

Yes. Management should consider all relevant factors to determine whether the economic characteristics of its segments are similar.

IFRS 8 states that similar long-term average gross margins for two operating segments are expected if their economic characteristics are similar. However, other performance factors such as trends in sales growth, returns on assets employed and operating cash flow may also be considered by management to assess whether segments have substantially similar economic characteristics.

### Insight

When management reviews financial performance measures and compares segments, it should consider not only the quantitative results, but also the reasons why the results are similar or dissimilar before reaching a conclusion about whether the economic characteristics are similar/dissimilar. The basis for conclusions states that, “separate reporting of segment information will not add significantly to an investor’s understanding of an enterprise if its operating segments have characteristics so similar that they can be expected to have essentially the same future prospects”. We consider these comments regarding aggregation to be consistent with the core principle of IFRS 8. Entities should ensure their facts and circumstances support aggregation.

Management should be aware that:

- An entity that cannot demonstrate ‘similar economic characteristics’ cannot rely on the other criteria in IFRS 8 para 12 to aggregate operating segments. This is a high hurdle.
- It is important to consider a variety of factors, such as trends in growth of the products, gross margins and management’s long-term expectations for the product lines.
- Several years of both historical and future financial performance should be considered.
- Segment reporting should be consistent with other public information and disclosures, such as websites and other financial information presented outside of the financial statements.
- Management should document their conclusion that segments are economically similar.

### Example – A retailer of women’s coats

A retailer of women’s coats has the following operating segments: store label – wool coats; other designer brands – wool coats; and fur coats. The following table shows limited financial information for each segment:

	Store label wool coats	Other designer brands wool coats	Fur coats
Average gross-margin percentage	25%	30%	33%
Sales volume	500,000 units	375,000 units	20,000 units
Average sales price	175 per unit	265 per unit	4,200 per unit
Growth rate per year	3% (steady)	2% (steady)	-5% (declining)

The company’s fur coats line of business has experienced sales decline in recent years and the rate of decline is expected to continue. Management believes that the sales decrease is principally in response to the growing consumer focus on animal rights. Management expects that it can maintain the profit margin at 33% for at least the next three years. While management views the ‘fur coats’ line as still favourably contributing to its operations, it has indicated that after a five-year period it will deliberate whether to maintain the line.

The wool for the ‘store label’ and ‘other designer brands’ segments is purchased from the same manufacturer. Average margins and gross sales of the two segments differ but there are lines in the ‘other designer brands’ segment with margins and sales prices very similar to the ‘store label’ segment. The growth rates of the two segments have moved in tandem over the past 10 years, and management expects this to continue in the future.

The ‘store label’ and ‘other designer brands’ segments possess similar economic characteristics, despite the difference in average gross margins. The ‘fur coats’ segment has different economic characteristics because of the ongoing differences in growth and the operating risks, despite the similarity of its average gross margins to that of the ‘other designer brands’ segment.

Management should be aware that certain regulators may challenge the conclusion above due to the differences in gross margins between ‘store label’ and ‘other designer brands’. Management should exercise caution when aggregating operating segments with disparate gross margins to ensure that they are economically similar despite the differences in margins. As long-term gross margins of operating segments become more divergent, we would expect it to become more difficult to support the assertion that the operating segments are economically similar.

## 2.4 How should an entity perform the 10% test when each of its operating segments reports different measures of segment profitability and segment assets?

Where segments report different measures of segment profitability, assets and liabilities, a consistent measure should be developed for the purposes of assessing the 10% test. This measure should be used regardless of whether the CODM uses that measure when evaluating the segments' performance.

### **Example – Segments use different measures of profitability**

An entity has three operating segments, none of which can be combined under the aggregation criteria.

The following is reported to the CODM:

- Segment 1 measures profitability based on operating income, with pension amounts reported on a cash basis. Segment 1 is the only segment for which pension expense is reported; pension expense is not allocated to the other two segments. Asset information is limited to the presentation of accounts receivable.
- Segment 2 measures profitability based on pre-tax income, which includes an internal cost-of-capital amount, charged by 'corporate' that is assessed to segment 2 only. Asset information includes only accounts receivable and fixed assets.
- Segment 3 measures profitability based on post-tax income. Asset information is limited to accounts receivable.

Operating income is the lowest measure of profitability that is available and that is provided to the CODM for all three segments. This should be the measure used in the 10% test. The same approach would apply for assets. Accounts receivable would therefore be the most consistent measure of assets to perform the 10% test.

**2.5 How should an entity identify its reportable segments under IFRS 8 para 13(b) when it has both profit- and loss-making segments?**

Where an entity is applying the 10% test to segment results, the entity is required to ascertain whether the absolute amount of its reported profit or loss is 10% or more of the greater, in absolute amount, of:

- (i) the combined reported profit of all operating segments that did not report a loss; and
- (ii) the combined reported loss of all operating segments that reported a loss.

**Example – Determining reportable segments**

Entity A has operating segments A-F (below). The revenues (internal and external), profits and assets are set out below. Entity A needs to determine how many reportable segments it has. The figures are in the same proportions as in the previous year.

Segment	Total revenue	Profit/loss	Total assets
A	11,000	2,000	25,000
B	7,500	1,000	15,500
C	3,000	(1,000)	10,500
D	3,500	(500)	7,000
E	4,000	600	7,000
F	1,500	400	3,500
	30,500	2,500	68,500

Segments A, B, D and E clearly satisfy the revenue and assets tests under IFRS 8 paras 13(a) and (c), and they are separate reportable segments. There is no need to consider the profits test.

Segment C does not satisfy the revenue test, but it does satisfy the assets test and it is a reportable segment. Therefore, there is no need to consider the profits test.

Segment F does not satisfy the revenue or the assets tests, but it does satisfy the profits test because its profit of 400 is 10% of the greater of the absolute amount of losses of those segments in loss (1,500) and those that either break even or make a profit (4,000 including segment F). Therefore segment F is a reportable segment.

**2.6 Can information about non-reportable operating segments be combined and disclosed in an ‘all other’ category, together with items that reconcile the segment information to the statutory information?**

No. IFRS 8 para 16 requires that, all non-reportable operating segments and other business activities should be combined and disclosed in an ‘all other’ category on a stand-alone basis. The disclosure of ‘other reconciling items’ should be presented separately in the reconciliation of segment totals to the consolidated financial statement totals.

## 2.7 Can a company aggregate an 'immaterial non-reportable' segment with a reportable segment, even though the aggregation criteria under IFRS 8 para 12 have not been met?

No. Two or more operating segments may only be combined if all of the aggregation criteria are met. An exception to this is IFRS 8 para 14, which allows the aggregation of two or more immaterial non-reportable segments (ie, operating segments that do not meet the 10% quantitative threshold) where the operating segments have similar economic characteristics and share a majority of the five aggregation criteria.

### Insight

An entity has identified two operating segments – one is a reportable segment and the other is a non-reportable segment. In such situations, an entity may treat the immaterial non-reportable segment in one of the following ways (assuming the 75% test in IFRS 8 para 15 is met):

- include the segment in an 'all other' category;
- voluntarily report the segment separately; or
- if applicable, aggregate the segment with other non-reportable segments in accordance with IFRS 8 para 14.

## 2.8 When applying the 75% test under IFRS 8 para 15, should the next largest operating segment always be selected?

No. The entity should select the next most meaningful operating segment.

### Insight

The next most meaningful operating segment may be the next largest in terms of revenue, but it need not be. Entities should consider both quantitative and qualitative factors when determining which segment would be most useful to users of financial statements. For example, an entity may select a small segment in terms of revenue contribution because it is a potential growth segment, which is expected to contribute materially to group revenue in the future.

Immaterial segments can only be aggregated with material segments if aggregation is consistent with the core principle, are economically similar, and meet all of the aggregation criteria in IFRS 8 para 12.

## Example – Selecting the meaningful operating segment

Entity A has identified the following operating segments.

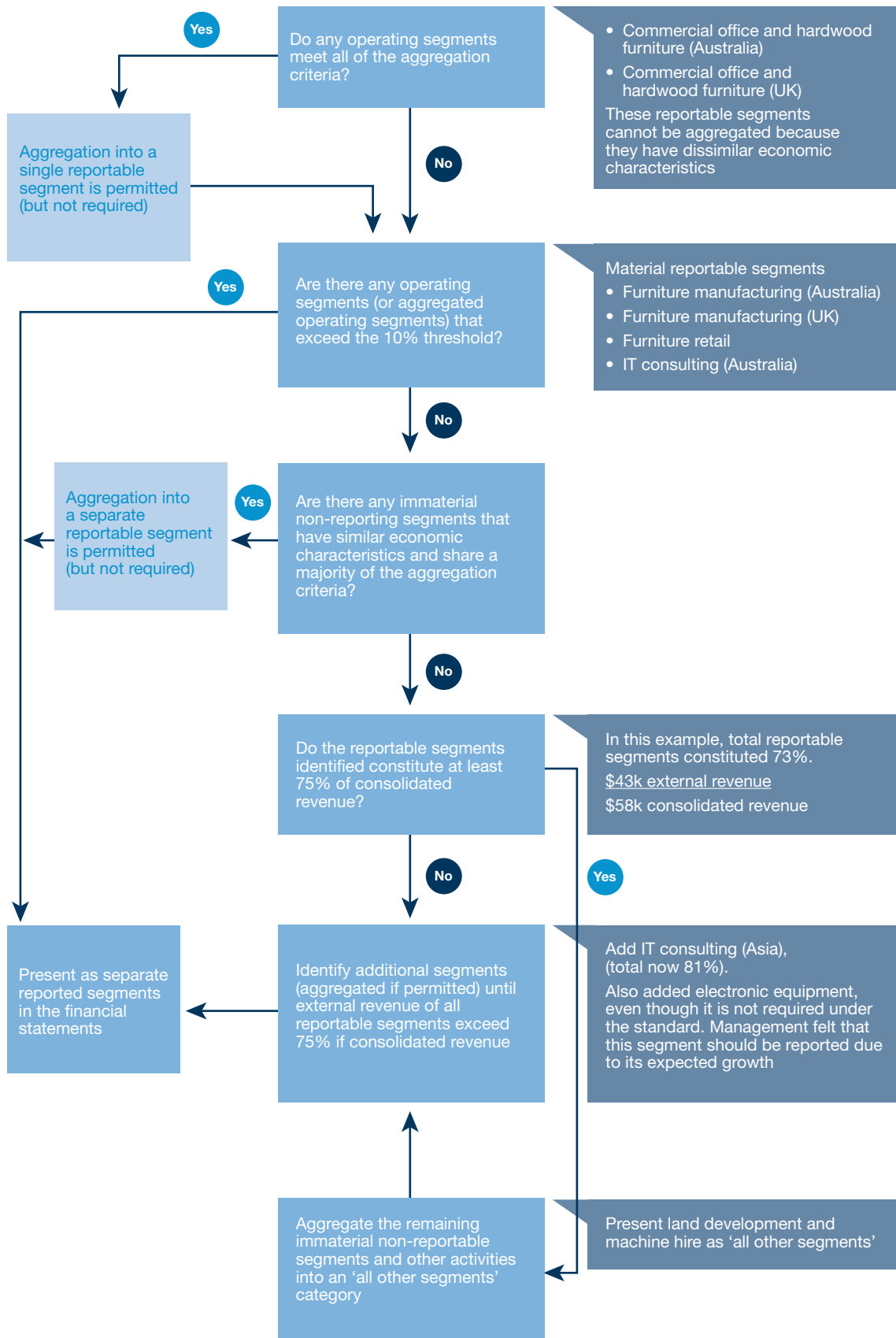
Segment	Total revenue \$'000	% of segment revenue	EBITDA \$'000	% of EBITDA	Total assets \$'000	% of segment assets
<b>Australia furniture manufacturing:</b>						
– Domestic	9,000	25	2,020	24	7,000	23
– Commercial office	<u>6,100</u>		<u>1,370</u>		<u>4,730</u>	
	15,100		3,390		11,730	
<b>UK furniture manufacturing:</b>						
– Domestic	3,000	9	820	10	3,300	11
– Commercial office	<u>2,100</u>		<u>580</u>		<u>2,200</u>	
	5,100		1,400		5,500	
<b>Furniture retail</b>	11,600	20	1,900	14	11,600	23
<b>IT consulting (Australia)</b>	13,300	22	4,000	28	9,640	19
<b>IT consulting (Asia)</b>	4,100	7	700	5	3,500	7
<b>Electronic equipment</b>	3,850	6	900	6	2,590	5
<b>Land development</b>	5,500	9	1,000	7	4,500	9
<b>Machinery hire</b>	1,100	2	897	6	1,718	3
<b>Total of all segments</b>	<b>59,650</b>		<b>14,187</b>		<b>50,778</b>	

\* The difference between the segments revenue and the consolidated reported revenue is due to internal sales between the furniture businesses.

The domestic and the commercial manufacturing segments in Australia and the UK have similar economic characteristics and are similar in all five of the areas listed in IFRS 8 para 12.

The following flow chart demonstrates the steps required when determining which segments should be presented separately as reportable segments and which segments constitute immaterial non-reportable segments and should be disclosed under the 'all other segments' category.

# Reporting segments



## Segment disclosures

### 3.1 Where the CODM is provided with more than one measure of segment profitability, what measure of segment profitability should be reported?

When more than one measure of profitability is provided to the CODM, the measure most relied upon by the CODM for assessing performance and deciding on the allocation of resources should be disclosed. When two or more measures are equally relied upon by the CODM, the measure most consistent with those used in measuring the corresponding amounts in the entity's financial statements should be used.

Additional disclosure may need to be made in some circumstances. An example of this is shown below.

#### **Example – Company A uses two measures of profit**

Company A provides the CODM with two measures of profitability by operating segment, which is operating profit and profit before income tax expense. Segment operating profit is determined based on the same measurement principles that are used in the preparation of consolidated operating profit. However, segment profit before income tax expense includes certain internal cost-of-capital charges that are eliminated in determining consolidated profit before income tax expense. Segment operating profit would be the measure reported externally because this measure is the most consistent with its corresponding amount in the entity's financial statements.

Additional disclosure would be made for interest income and expense because that information is included in the profit before income tax expense measure provided to the CODM.

The measure of segment profitability may differ for each operating segment, as different operating segments may report different measures of profitability to the CODM. IFRS 8 para 27 requires companies to explain the measurement basis of segment profitability for each reportable segment.

### 3.2 What measure should be reported when the asset information reported to the CODM is limited or not reviewed at all?

IFRS 8 para 25 states that only those assets that are included in the measure of the segment's assets that are used by the CODM should be reported.

Scenario	Basis of asset measurement
<b>Asset information, although available, is not reported or used by the CODM.</b>	No measure of segment asset is disclosed*. Disclose in the notes that asset information is not reported.
<b>Asset information is reported but is not used by the CODM.</b>	Asset information is included in other reports provided to the CODM is disclosed even if the information is not used by the CODM.
<b>Asset information reported is limited to cash, inventory and accounts receivables.</b>	The sum of the total of those asset items is disclosed as segment assets. The total of the reported segment assets is then reconciled to the total consolidated assets. An explanation of the basis of measurement is disclosed.
<b>The CODM is provided with, and reviews ratios derived from, current asset balances (ie, working capital). The components that form the ratios are not separately provided.</b>	The specific asset information or working capital amount is not required to be disclosed. Although it has an asset component, the current asset component is not what is relevant to the CODM's decision-making. However, an entity may elect to voluntarily report total working capital, and then reconcile that figure to total consolidated working capital.

Non-current assets by geographical area are also required to be disclosed (IFRS 8 para 33(b)) even if such information is not reviewed by the CODM.

\* The Basis of Conclusions to IFRS 8 para BC35 states that a measure of total segment assets should be disclosed for all segments regardless of whether those measures are reviewed by the CODM. In December 2007, the IASB concluded that BC35 should be changed to state that a measure of segment assets should only be disclosed when such information is provided to the CODM. This change will become effective as part of the IASB's 2009 Annual Improvements project. Until this change becomes effective, we think it is best for companies to disclose segment assets as required by BC35.

### 3.3 Should the measures of profit or loss and assets and liabilities presented for each operating segment comply with the IFRS accounting policies used in the consolidated financial statements?

No. IFRS 8 para 25 requires the information presented to be the same basis as it is reported internally, even if the segment information does not comply with IFRS or the accounting policies used in the consolidated financial statements.

#### Insight

Examples of such situations include segment information reported on a cash basis (as opposed to an accruals basis), and reporting on a local GAAP basis for segments that are comprised of foreign subsidiaries.

Although the basis of measurement is flexible, IFRS 8 para 27 requires entities to provide an explanation of:

- the basis of accounting for transactions between reportable segments;
- the nature of any differences between the segments' reported amounts and the consolidated totals. For example, those resulting from differences in accounting policies and policies for the allocation of centrally incurred costs that are necessary for an understanding of the reported segment information. The nature of any changes from prior periods in the measurement methods and the effect of those changes should also be disclosed; and
- the nature and effect of any asymmetrical allocations to reportable segments. For example, an entity might allocate depreciation expense to a segment without allocating the related depreciable assets to that segment.

In addition, IFRS 8 para 28 requires reconciliations between the segments' reported amounts and the consolidated financial statements.

### 3.4 Where the CODM only receives information with respect to the entity's cash flows (that is, the CODM receives no profit or asset information), what should that entity disclose in its segmental disclosure?

The entity should only disclose information that is used by the CODM to evaluate segment results and allocate resources; therefore the entity should disclose the cash-flow information and then reconcile these cash flows to the entity's total revenues, profit or loss before tax and total assets.

### 3.5 When should an entity consider and review its segment reporting?

There is no specific guidance in IFRS 8 on what changes trigger a change in an entity's reportable operating segments. Change in the CODM and/or the information provided to and reviewed by the CODM for the purposes of evaluating performance and allocating resources would impact the identified operating segments. Therefore, at each reporting date management should consider whether the current operating segment disclosure continues to be appropriate.

#### Insight

Determining operating segments is an area of significant judgement and scrutiny, so it is important that entities consider how internal organisational change will impact the identification and measurement of their operating segments.

Management should consider the following when determining its operating segments:

- Who is the CODM and what is reviewed by the CODM?
- Has the CODM changed (ie, have reporting lines changed)?
- How has the CODM reporting package changed?
- Has the organisational chart changed (ie, acquisition/disposal of business activities)?
- Has the person the CODM meets with changed?
- Have there been any changes in the budgeting process, or level at which budgets are set?
- What is the company communicating to external parties such as investors, creditors and customers?

Situations that may impact identified operating segments:

- Entering a new line of business.
- Line of service versus geography (ie, a company has hired a new CEO and the internal reporting structure is changing from a model of geographical reporting to that of product line reporting).
- New system and reporting tools (ie, implementation of a new system that includes various reporting tools has enabled the entity to report on and manage its business activities differently).

### 3.6 Is restatement of segment information required when a reorganisation causes the composition of reportable segments to change?

Yes. An entity that changes the structure of its internal organisation in a manner that causes the composition of its reportable segments to change, should restate the corresponding information for earlier periods (including interim periods), unless the information is not available and the cost to develop it would be excessive.

Management should determine, for each disclosure item, whether the information is available and if not, whether the cost to develop it would be excessive. This means that an entity's disclosures may consist of some comparatives that have been restated and some that have not; disclosures to this effect should be made.

Other examples where restatement is required are shown below.

Scenario	Restatement required?	Insight
A previously immaterial non-reportable segment becomes material in the current year	Yes. Restate prior year to reflect new reportable segments	Restatement is required even if it is anticipated that the segment would not meet the 10% threshold in the future (ie, non-recurring event)
A previously reportable segment becomes a non-reportable segment in the current year	No. If management views the segment to be of continuing significance, it should continue to report it as a separate reportable segment	Information to the effect that it does not meet the quantitative thresholds but is considered to be of significance should be disclosed
	Yes. If it is not considered to be of continuing significance, it should not be separately disclosed and the prior year should be restated to conform to the current year's presentation	Disclosure should be made describing the restatement
Initial year of application	Yes	N/A

### 3.7 Is restatement of segment information required when there is a change in the measure of segment profit or loss?

No. IFRS 8 only requires restatement (if practicable) when there has been a change in the composition of the segments resulting from changes in the structure of an entity's internal organisation. Although restatement is not required, we believe it might be appropriate to show all segment information on a comparable basis to the extent it is practicable to do so. If prior years' information is not restated, IFRS 8 para 27(e) nonetheless requires disclosure of "the nature of any changes from prior periods in the measurement methods used to determine reported segment profit or loss and the effect, if any, of those changes on the measure of segment profit or loss".

### 3.8 What is the definition of ‘material’ where an entity is required to disclose separately material revenues and material non-current assets from an individual foreign country?

IFRS 8 does not define the term ‘material’ for the purpose of determining whether an individual country’s revenue or non-current assets should be separately disclosed.

The entity should consider materiality from both quantitative and qualitative perspectives. When considering materiality quantitatively, the standard uses the threshold of 10% or more in determining whether an operating segment is a reportable segment. Therefore, it may be appropriate to apply the same test to determine whether an individual country’s revenue or assets are material for the purpose of separate disclosure.

#### Insight

PwC believes the materiality test should be applied by comparing the country’s revenue or assets to total entity external revenue or assets (including the country of domicile) rather than comparing those figures to the relevant totals of foreign countries’ revenues and assets (excluding the country of domicile).

# Other matters for consideration

## 4.1 The impact of IFRS 8 on accounting for impairment of assets

The release of IFRS 8 has required a consequential amendment to IAS 36, 'Impairment of assets'. IAS 36 required goodwill acquired in a business combination to be allocated to existing cash-generating units of the acquiring entity. The amendment to IAS 36 states that each cash-generating unit or group of cash-generating units to which the goodwill is allocated should not be larger than an operating segment determined in accordance with IFRS 8.

Consequently, all entities should consider whether their cash-generating units are in line with this amendment ahead of impairment reviews.

## 4.2 Segment reporting in the separate company statements of listed subsidiaries

Listed subsidiaries are required to present segment information. The listed subsidiary would need to analyse its segments in the same manner as the parent company. This would include identifying its CODM, determining its operating segments based on its CODM's review and disclosure of its reportable segments in accordance with IFRS 8. We expect the separate subsidiary's reportable segments will not be consistent with the parent company's disclosures of the activities of the listed subsidiary in many cases. It would not be uncommon for the listed subsidiary's reportable segments to be more detailed than the corresponding segment disclosures in the parent company financial statements.

## 4.3 Convergence with US standard SFAS 131

IFRS 8 is almost identical to SFAS 131. There are still some minor differences between the standards, which are outlined in the basis for conclusion within IFRS 8.

IFRS 8	SFAS 131	Impact
Uses the term 'non-current assets'.	Uses the term 'long lived assets'.	'Long lived assets' is limited to physical assets, whereas non-current assets include intangible assets.
Includes the disclosure of segment liabilities when information is regularly provided to the CODM.	Does not require this disclosure.	Disclosure impact for some companies.
Allows matrix structures to determine their segments on either product/services or geography.	Requires matrix structures to determine their segments based on products or services.	Under IFRS 8 entities must use judgement to determine which basis provides the most useful information.

## 4.4 What's in the pipeline?

The International Accounting Standards Board has indicated that the scope paragraph of IFRS 8 is likely to be amended upon finalisation of the IFRS standard for small and medium-sized entities ('IFRS for private entities'). The intention is that IFRS 8 will apply to all entities that have public accountability. This means that IFRS 8 would have to be applied whenever an entity has to apply full IFRS and is not able to use the 'IFRS for private entities'.



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### IFRS 7: Potential impact of market risks

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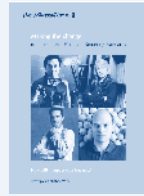
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