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IFRS Technical Bulletin

IFRS 8 'Operating segments'
The management approach

The introduction of the new standard signifies the beginning of a fundamental change to reporting requirements.

IFRS 8 ‘Operating segments’ is the new standard on segmental reporting which replaces IAS 14 ‘Segmental reporting’ and is the beginning of a fundamental change to the reporting requirements for companies.

The wording of the scope in IFRS 8 has changed as compared to IAS 14, however it is not the IASB’s intention to fundamentally change the scope of segmental reporting. IFRS 8 applies to entities whose debt or equity instruments are traded in a public market, or that files/is in the process of filing its financial statements with a securities commission or other regulatory organisation in a public market. A public market includes domestic or foreign stock exchanges or an over-the-counter market. IFRS 8 therefore applies to both listed companies in Ireland and quoted companies on IEX/AIM.

First-time application

IFRS 8 is effective for accounting periods beginning on or after 1 January 2009 and must also be applied in full for an entity publishing a full set of interim financial statements, in accordance with IAS 34, along with full comparative disclosures.

Key principles

The key principle in IFRS 8 is that an entity must provide disclosures about its operating segments based upon the information that is provided internally to management for evaluating the performance and deciding on how to allocate resources to those operating segments.

There are five main areas which should be considered when understanding the new disclosure requirements of IFRS 8. These are discussed below:

Identifying the operating segments

An operating segment is a component of the entity:

- which engages in business activities from which it may earn revenues and incur expenses. These include both internal and external revenues and expenses;
- whose operating results are regularly reviewed by the chief operating decision maker (“CODM”) and
- for which discrete financial information is available.

Ascertaining the chief operating decision maker (“CODM”)

The term CODM identifies a function within the entity and therefore the CODM may be an individual, for example the chief executive officer, or a group of individuals, for example the executive management board.

The CODM is responsible for making decisions about the allocation of resources to operating segments within the entity and assessing their performance.

Determining the reportable segments

Separate information about an operating segment should be reported when it meets any of the following quantitative thresholds:

a) Reported revenue, including both sales to external customers and inter-segment sales or transfers, is 10% or more of the combined internal and external revenue of all operating segments.

b) The absolute amount of its reported profit or loss is 10% or more of the greater, in absolute terms, 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.

c) Its assets are 10% or more of the combined assets of all operating segments.

The total external revenue reported by operating segments must be more than 75% of the entity’s revenue otherwise additional operating segments must be identified as reportable segments.

Two or more operating segments may be aggregated into a single operating segment if it is considered that they exhibit similar long-term financial performance and economic characteristics.

Measuring the operating segments

The amount of each operating segment that must be reported is the measure that is provided to the CODM.

Unlike IAS 14 which specifically stated what should be measured in the reporting segment's profit or loss, assets and liabilities, an entity must now provide the measures of the segment's assets, liabilities and profit or loss that are used by the CODM.

These therefore can include non-GAAP measures as well as GAAP measures which was only previously required under IAS 14. As a result an entity will now have less constraint over what it discloses for its reportable operating segments, which maybe more or less detailed depending on what is reported to the CODM.

Progressing the required disclosures

Disclosures must be made on the basis of what is reported regularly to the CODM and this therefore may include non-GAAP measures along with GAAP measures.

Where this is the case, an entity must provide reconciliations of the total reportable segment's revenues, profit or loss, assets, liabilities and any other material items to those disclosed by the entity.

IFRS 8 requires specific information to be included about reported profit or loss, where they are reviewed by the CODM, including revenues from external customers, interest revenue and expense, depreciation and amortisation.

In addition to the above, IFRS 8 requires additional entity-wide information to be disclosed which is a change from the previous Standard, including:

- General information about the factors used to identify the entity's operating segments and the types of products and services from which each reportable segment derives its revenues;
- Revenues from external customers about the entity's products and services;*
- Revenues from external customers and some non-current assets based on the entity's geographical locations;* and
- Information about an entity's reliance on major customers, including total amounts of revenues from each major customer along with the identity of the reporting segment. The entity need not disclose the identity of the major customer nor the amounts of revenues from each reportable segment.

*Where this information is not available and the cost to produce it would be excessive, that fact must be disclosed.

Anticipated consequences from the adoption of IFRS 8

A key change from the previous requirement

IFRS 8 has a core principle that is fundamentally different from IAS 14 – it requires information to be disclosed that is based on what is reported internally to management in order to make decisions about the allocation of resources and assessment of performance to operating segments. IAS 14 however required information to be provided based on two clear sets of segments – business and geographical. The new requirements therefore will mean that some non-GAAP measures may be required to be disclosed that may be considered sensitive to the internal operations of a business.

The question of comparability

The focus of the new requirements is that information must be disclosed to enable users of the financial statements to assess the internal management of the business's activities and the economic environments in which it operates. This will therefore result in a reduction in comparability with competitors' disclosures but will of course enhance the relevance of information to users.

Time to prepare the new disclosure requirements

As the reportable information about components of the entity will be based on information that is already provided internally to the CODM, it is anticipated that the information will not take any further time to collate, thus no excessive costs for an entity. There will however be a one-off cost required in relation to amending the disclosures for the first set of interim and annual financial statements after the effective date.

Key questions and answers for first-time application

1. Should comparative disclosures be restated upon first-time application?

- Yes, comparative information should be provided for both annual financial statements as well as interim financial statements.

2. What is the required disclosure level for the 2009 interim accounts?

- In accordance with IAS 34, it depends on whether the company/group publishes comprehensive financial statements or summarised financial statements. An entity publishing a full set of financial statements in its interim financial report should present all the disclosures required under IFRS 8. An entity publishing summarised financial statements in its interim financial report should theoretically present only the disclosures required under paragraph IAS 34.16(g). However, as the first-time application of IFRS 8 involves a change in accounting policy, the disclosures required under IAS 34.16(a) should also be provided. When the changes in the presentation of segment disclosures from prior periods are significant, the entity may supplement the disclosures by providing:
  - i. The general disclosures required under IFRS 8.22; and
  - ii. The measurement methods used in determining performance assessments and the segment assets and liabilities.

3. How should operating segments be determined?

- Identification of operating segments should be made based on internal reporting. There is the potential to aggregate operating segments under certain conditions as described in the standard. In this case a company/group should not be expected to reasonably present more than ten segments.

4. What are the practical issues for identifying operating segments from internal reporting?

- There are likely to be difficulties in identifying the "chief operating decision maker" of the entity (this should be the person(s) who regularly reviews the operating results of the segments in order to allocate resources to those segments and assess their performance, for example: Chairman & CEO, CEO, operating directors etc.
- There are likely to be difficulties in implementing the definition of an "operating segment" under IFRS 8.5. Subject to the quantitative thresholds defined in IFRS 8, operating segments may be presented by entity, by operation, by geographical area, or include a combination of these elements. In addition, a component of the entity meeting the definition of an operating segment under IFRS 8 may only generate revenues within the group. For example, vertically integrated operations, R&D units and functional departments (such as the centralised management of treasury) reviewed separately in internal reports should be presented as operating segments, provided that they exceed the quantitative thresholds defined in IFRS 8. Start-up operations may also meet the definition of an operating segment.

5. Could the application of IFRS 8 have an impact on goodwill impairment?

- Yes, the recognition of potential additional impairments of goodwill could be required due to changes in the allocation to CGUs resulting from a change in the scope of operating segments.
- Reminder of IAS 36.80 on the allocation of goodwill to CGUs for the purpose of impairment tests: "For the purpose of impairment testing, goodwill acquired in a business combination shall, from the acquisition date, be allocated to each of the acquirer's cash-generating units, or groups of cash-generating units, that is expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units or groups of units. Each unit or group of units to which the goodwill is so allocated shall:
  - a) represent the lowest level within the entity at which the goodwill is monitored for internal management purposes; and
  - b) not be larger than an operating segment determined in accordance with IFRS 8 Operating Segments."

Please get in touch...

Mazars has a specialist Financial Reporting Advisory Team dedicated to providing support on accounting under IFRS. For more information on understanding IFRS 8 and how to prepare the operating segment disclosures for your organisation, please contact:

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