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## IFRS 8 Operating Segments

On 30 November 2006, the International Accounting Standards Board issued IFRS 8 **Operating Segments**, which replaces IAS 14 **Segment Reporting**. IFRS 8 is mandatory for annual financial statements for periods beginning on or after 1 January 2009, although earlier application is permitted. Once IFRS 8 is effective, segment reporting under International Financial Reporting Standards and US Generally Accepted Accounting Principles will be converged except for some minor differences.

### What's changed?

#### Identifying segments

Upon adoption of IFRS 8, the identification of an entity's segments may or may not change, depending on how the entity has applied IAS 14 in the past. IFRS 8 requires operating segments to be identified on the basis of internal reports about components of the entity that are regularly reviewed by the chief operating decision maker in order to allocate resources to the segment and to assess its performance. IAS 14 required an entity to identify two sets of segments (business and geographical), using a risks and rewards approach, with the entity's "system of internal financial reporting to key management personnel" serving only as the starting point for the identification of such segments. One set of segments was regarded as primary and the other as secondary. If under IAS 14 an entity identified its primary segments on the basis of the reports provided to the person whom IFRS 8 regards as the chief operating decision maker, those might become the 'operating segments' for the purposes of IFRS 8.

IFRS 8 states that a component of an entity that sells primarily or exclusively to other operating segments of the entity will meet the definition of an operating segment if the entity is managed that way. IAS 14 limited reportable segments to those that earn a majority of their revenue from sales to external parties and did not require the different stages of a vertically-integrated entity to be identified as separate segments.

#### Measurement of segment information

The IFRS requires the amount reported for each segment item to be the measure reported to the chief operating decision maker for the purposes of allocating resources to that segment and assessing its performance. IAS 14 required segment information to be prepared in conformity with the accounting policies adopted for the preparation and presentation of the consolidated financial statements.

In contrast to IAS 14, IFRS 8 does not define segment revenue, segment expense, segment result, segment assets or segment liabilities, but does require an explanation of how segment profit or loss, segment assets and segment liabilities are measured for each operating segment. As a consequence, entities will have more discretion in determining what is included in segment profit or loss under IFRS 8, limited only by their internal reporting practices.

## Disclosure

New disclosures include information about how the entity identifies its operating segments and the types of products and services from which each segment derives its revenues.

Interest revenue and interest expense must be reported separately for each reportable segment, if the amounts are included in the measure of segment profit or loss, or are otherwise regularly reported to the chief operating decision maker, unless the majority of the segment's revenues are from interest and the chief operating decision maker relies primarily on net interest revenue when making resource allocation decisions and to assess segment performance.

## Core principle

IFRS 8's core principle is that an entity should disclose information to enable users of its financial statements to evaluate the nature and financial effects of the types of business activities in which it engages and the economic environments in which it operates. The Board does not elaborate on this core principle, but it is consistent with the Objective and Basic Principle in the US standard on this topic (SFAS 131 **Disclosures about Segments of an Enterprise and Related Information**), and with the broader objectives of financial reporting discussed in the IASB's **Framework for the Preparation and Presentation of Financial Statements**.

## Scope

IFRS 8 applies to the separate or individual financial statements of an entity (and to the consolidated financial statements of a group with a parent):

- whose debt or equity instruments are traded in a public market; or
- that files, or is in the process of filing, its (consolidated) financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market.

However, when both separate and consolidated financial statements for the parent are presented in a single financial report, segment information need be presented only on the basis of the consolidated financial statements.

## Operating segments

IFRS 8 defines an operating segment as follows.

An operating segment is a component of an entity:

- that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same entity);
- whose operating results are reviewed regularly by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance; and
- for which discrete financial information is available.

Not all operations of an entity will necessarily be an operating segment (nor part of one). For example, the corporate headquarters or some functional departments may not earn revenues or they may earn revenues that are only incidental to the activities of the entity. These would not be operating segments. In addition, IFRS 8 states specifically that an entity's post-retirement benefit plans are not operating segments.

## Reportable segments

### Quantitative thresholds and aggregation

Segment information is required to be disclosed about any operating segment that meets any of the following quantitative thresholds:

- its reported revenue, from both external customers and intersegment sales or transfers, is 10 per cent or more of the combined revenue, internal and external, of all operating segments; or

- the absolute measure of its reported profit or loss is 10 per cent 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; or
- its assets are 10 per cent or more of the combined assets of all operating segments.

If the total external revenue reported by operating segments constitutes less than 75 per cent of the entity's revenue, additional operating segments must be identified as reportable segments (even if they do not meet the quantitative thresholds set out above) until at least 75 per cent of the entity's revenue is included in reportable segments.

IFRS 8 has detailed guidance about when operating segments may be combined to create a reportable segment. This guidance is generally consistent with the aggregation criteria in IAS 14.

## Disclosure

The disclosure principle in IFRS 8 is that an entity should disclose 'information to enable users of its financial statements to evaluate the nature and financial effects of the types of business activities in which it engages and the economic environments in which it operates.' In meeting this principle, an entity must disclose:

- general information about how the entity identified its operating segments and the types of products and services from which each operating segment derives its revenues;
- information about the reported segment profit or loss, including certain specified revenues and expenses included in segment profit or loss, segment assets and segment liabilities and the basis of measurement; and
- reconciliations of the totals of segment revenues, reported segment profit or loss, segment assets, segment liabilities and other material items to corresponding items in the entity's financial statements.

In addition, there are prescribed entity-wide disclosures that are required even when an entity has only one reportable segment. These include information about each product and service or groups of products and services.

Analyses of revenues and certain non-current assets by geographical area are required – with an expanded requirement to disclose revenues/assets by individual foreign country (if material), irrespective of the identification of operating segments. If the information necessary for these analyses is not available, and the cost to develop it would be excessive, that fact must be disclosed.

The Standard has also introduced a requirement to disclose information about transactions with major customers. If revenues from transactions with a single external customer amount to 10 per cent or more of the entity's revenues, the total amount of revenue from each such customer and the segment or segments in which those revenues are reported must be disclosed. The entity need not disclose the identity of a major customer, nor the amount of revenues that each segment reports from that customer. For this purpose, a group of entities known to the reporting entity to be under common control will be considered a single customer, and a government and entities known to the reporting entity to be under the control of that government will be considered to be a single customer.

## Amendments to IAS 34 Interim Financial Reporting

IFRS 8 will expand significantly the requirements for segment information at interim reporting dates. Because amounts reported will be consistent with those reported internally, the Board has concluded that it will now be possible to expand segment information in interim reports without undue cost or delay.

## Amendments to IAS 36 Impairment of Assets

IAS 36 requires goodwill to be tested for impairment as part of impairment testing the cash-generating unit to which it relates. In identifying the units (or groups of units) to which goodwill is allocated for the purpose of impairment testing, IAS 36 limits the size of such units or groups of units by reference to the entity's reported segments. As a result of IFRS 8 replacing IAS 14, that maximum limit is now determined by reference to the entity's operating segments as determined in accordance with IFRS 8 – which may differ from the limit previously arrived at in the context of IAS 14.

## Effective date and transition

IFRS 8 is effective for annual financial statements for periods beginning on or after 1 January 2009. Earlier adoption is permitted. If an entity adopts IFRS 8 early, the amendments to IAS 34 (and other consequential amendments) are also triggered. Prior year segment information presented as comparative information in the year of transition must be restated to conform to IFRS 8 requirements, unless the necessary information is unavailable and the cost to develop it would be excessive.

## Remaining differences between IFRS 8 and SFAS 131

The Basis for Conclusions notes three differences between IFRS 8 and SFAS 131:

- Under IFRSs, non-current assets include intangible assets – but the guidance accompanying SFAS 131 appears to restrict the “long-lived” assets referred to in that standard to hard assets that cannot be readily removed. This difference arises because of inherent differences between the two sets of standards that could not be resolved in the operating segments project.
- IFRS 8 requires disclosure of a measure of segment liabilities if that measure is provided regularly to the chief operating decision maker. This disclosure is not required by SFAS 131.
- SFAS 131 requires an entity with a ‘matrix’ form of organisation to determine operating segments based on products and services. IFRS 8 requires such an entity to determine its operating segments in accordance with the core principle.

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