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Insights into IFRS 8

Other application issues and Standards involving operating segments

High quality management accounts enable management to monitor performance, allocate resources and devise business and market strategies. Therefore, they are particularly important for entities that operate in a variety of classes of business, geographical locations, regulatory or economic environments or markets.

IFRS 8 'Operating Segments' sets out requirements for public listed entities to disclose most of this management information in their financial statements so investors, analysts and other users of entities' financial statements can review an entity's operations from the same perspective as management.

Our 'Insights into IFRS 8' series is designed to illustrate how IFRS 8 should be applied and it provides guidance and insight in some problematic areas. We also include several examples illustrating the Standard's requirements. This article sets out further application issues and information regarding other standards involving operating segments.

Further application issues

Management reports include more than one measure of segment results, assets or liabilities

As noted in our article '**Insights into IFRS 8 – Reportable segments**', the CODM sometimes uses more than one measure of profit, assets or liabilities. In these circumstances, the segment measures to be reported should be those that are determined in accordance with the measurement principles most consistent with those used in measuring the corresponding amounts in the entity's financial statements. For example, if the CODM uses both net profit before tax, interest, depreciation and fair value changes, and also net profit before tax but after these items, the latter measure would be used for IFRS 8 purposes. The basis of measurement of this profit would also be disclosed (see '**Insights into IFRS 8 – Segment information to be disclosed**').

IFRS 8 sets out the minimum disclosure requirements and the basis of measurement for those disclosures. An entity may wish to disclose both measures, but it must be clear which is most consistent with the figures used in the primary financial statements. Each amount disclosed must be reconciled to the entity-wide figures (as described in Reconciliation to IFRS primary financial statements **Insights into IFRS 8 – Segment information to be disclosed**).

Ratios are reported to the CODM but not the underlying asset or liability amounts

In some entities, the CODM uses ratios derived from asset and liability balances (such as liquidity and working capital ratios) rather than the asset and liability amounts directly. This raises a question as to what asset or liability disclosures that are needed when this circumstance exists.

In our view, the ratio is not a measure of the underlying asset or liability amounts so the ratio does not need to be disclosed. Similarly, the underlying components of assets and liabilities do not need to be disclosed because this is not information used by the CODM.

Allocations of central costs and assets/liabilities

Centrally managed borrowings and interest costs may or may not be allocated to individual segments for the purpose of reporting to the CODM. Practices on allocation or non-allocation of other central costs, assets and liabilities also vary. IFRS 8 makes clear these types of items are allocated in the segment disclosures only if they are included in the measures reported to the CODM. However, there is an additional requirement that any such allocations to reported segment amounts should be made on a reasonable basis. In rare cases, this may lead to questions addressing situations in which allocations made for internal reporting needs are not 'reasonable'.

Adjustments to segment measures

Typically, adjustments are made to segment figures in preparing the entity's annual (and any interim) consolidated financial statements. These adjustments typically include the elimination of intra-segment transactions, the recognition of fair value changes and the correction of any errors in the segment amounts previously reported to the CODM. These items would normally not be adjusted for at the segment level but instead an adjustment would be made in total in order to reconcile the segment information with that reported for the consolidated entity as a whole.

Such adjustments are disclosed as reconciling items at this entity-wide level. Similar to central allocations, such adjustments are incorporated into the disclosed segment measures only if this is consistent with the reporting to the CODM.

Other Standards involving operating segments

Several other standards refer to segment information or the identification of segments in accordance with IFRS 8. In some circumstances, additional disclosures relating to segments are only required for entities within the scope of IFRS 8 (see '**Insights into IFRS 8 – IFRS 8 Principles in brief**'). However, in some situations, the requirements of other standards relating to segments apply to all entities, including those outside the scope of IFRS 8.

IAS 36 Impairment of Assets

IAS 36 'Impairment of Assets' requires goodwill acquired in a business combination to be allocated to the cash-generating units (CGUs) or groups of CGUs of the acquiring entity expected to benefit from the synergies of the combination. Each CGU (or group of CGUs) should not be larger than an operating segment determined in accordance with IFRS 8. Operating segments identified for the purpose of goodwill allocation are those defined by IFRS 8 before any aggregation is permitted. Consequently, all entities that have goodwill should consider whether their allocation to CGUs (or groups of CGUs) is consistent with this requirement.

Impact of segment structure on goodwill allocation

The segment structure acts as an upper limit on aggregation for goodwill allocation purposes and will not therefore affect impairment testing if goodwill is allocated at a lower level. For example, if an entity has allocated goodwill to individual CGUs which are smaller than segments (as defined in IFRS 8) the segment limit has no effect.

Prospective or retrospective application of changes to segments for impairment testing

If implementation of IFRS 8 requires a new or more detailed goodwill allocation, this raises the question as to whether this should be done retrospectively or prospectively.

We consider that the effect of IFRS 8 on goodwill impairment (if any) should be dealt with prospectively. We do not consider that testing goodwill at a lower level of allocation is a change of accounting policy. Rather, the accounting policy is the requirement for goodwill to be tested annually and carried at no more than its recoverable amount.

Additional impairment disclosures for entities within the scope of IFRS 8

In addition to the general impairment disclosures required by IAS 36, an entity within the scope of IFRS 8 gives additional segmental information relating to impairment.

- The entity discloses the amounts recognised in profit or loss and in other comprehensive income during the period for each reportable segment for the following items:
  - impairment losses, and
  - reversals of impairment losses.
- If an impairment loss on an individual asset (including goodwill) is recognised or reversed in the period and is material to the entity's financial statements as a whole, the reportable segment to which the asset belongs is disclosed.
- If the material impairment loss or reversal relates to a cash generating unit rather than individual asset, the entity should give a description of the unit (such as whether it is a product line, a plant, a business operation, a geographical area, or a reportable segment as defined in IFRS 8) and also disclose the amount of the impairment loss recognised or reversed by class of assets and by reportable segment.

IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations'

IFRS 5 sets out the disclosure requirements where a non-current asset (or disposal group) has, during the period, either been classified as held for sale or has been sold. When the entity reports segmental information in accordance with IFRS 8, the entity shall disclose the reportable segment in which the non-current asset (or disposal group) classified as held for sale or sold is presented.

IFRS 6 'Exploration for and Evaluation of Mineral Resources'

IFRS 6 requires that an entity determines an accounting policy for allocating exploration and evaluation assets to cash-generating units or groups of cash-generating units for the purpose of assessing such assets for impairment.

Consistent with the requirements of IAS 36 discussed above, the cash-generating unit or group of units to which an exploration and evaluation asset is allocated is not larger than an operating segment determined in accordance with IFRS 8.

IAS 34 Interim Financial Statements

For entities within the scope of IFRS 8 (see '**Insights into IFRS 8 – Principles in brief**'), IAS 34 'Interim Financial Reporting' also requires segment disclosures in interim financial statements.

If an entity publishes an interim financial report in accordance with IAS 34, it may choose to present either a complete set or a condensed set of financial statements.

A complete set of financial statements published in an interim report conform to the requirements of IAS 1 'Presentation of Financial Statements', which requires compliance with all the requirements of IFRS. Consequently, if an entity presents a complete set of financial statements as interim financial statements, the full requirements of IFRS 8 described in our article '**Insights into IFRS 8 – Segment Information to be disclosed**'.

Alternatively, an entity may elect to present condensed financial statements and selected notes in its interim report. IAS 34 sets out the minimum contents of such condensed financial statements (see below) but does not prohibit or discourage entities from disclosing more than the minimum required. In some jurisdictions, additional items may be required to be disclosed but such local requirements are outside the scope of this article.

Similarly, some jurisdictions may have other interim requirements under local legislation that are not covered in this article, so careful consideration should be given as to how these IAS 34 requirement for segment reporting interact with local requirements.

Identification of reportable segments in interim periods

IAS 34 sets out the minimum segment information to be disclosed but does not discuss the identification of reportable segments in interim periods. This raises a question as to whether entities are required to apply the quantitative tests to their operating segments for each interim period when determining their reportable segments for the interim period?

Interim information is intended to be an update of the information that was presented in the most recent annual financial statements. Generally, therefore, an entity need not apply the quantitative tests in each interim period.

However, if facts and circumstances change that would suggest that application of the quantitative tests in an interim period would reveal a change in reportable segments, for example a change in the structure of an entity's internal organisation or a substantial change in the significance of a segment that is expected to persist at the next annual reporting date, then segment information should be provided based on the assessment of quantitative thresholds at the interim date. This conclusion is consistent with the basic principle of interim financial reporting in IAS 34, which states an entity should apply the same accounting policies in its interim financial statements as are applied in its annual financial statements, except for accounting policy changes made after the date of the most recent annual financial statements that are to be reflected in the next annual financial statements.

The conclusion is also supported by the requirement in IAS 34 to disclose a description of any differences from the last annual financial statements in the basis of segmentation (refer to '**Insights into IFRS 8 – Interim financial statements**'). If a change in the reporting segments is recognised in the interim period, then comparative figures should be restated.

Minimum content of segment information in condensed interim financial statements

Entities should disclose the information listed below, as a minimum, in the notes to their condensed interim financial statements, if material and if not disclosed elsewhere in the interim financial report. The information is normally reported on a financial year-to-date basis, but the entity should also disclose any events or transactions that are material to an understanding of the current interim period. For example, if an entity reports on a quarterly basis the segment information for the second quarter should cover the six months of the financial year to date, but any significant events or transactions in the second quarter should be disclosed.

The following segment information should be disclosed:

- segment external revenues, if included in the measure of segment profit or loss reviewed by the chief operating decision maker (CODM) or otherwise regularly provided to the CODM
- inter-segment revenues if included in the measure of profit or loss reviewed by the CODM or otherwise provided to the CODM
- a measure of segment profit or loss
- total assets for which there has been a material change from the amount disclosed in the last annual financial statements
- a description of any differences from the last annual financial statements in the basis of segmentation or in the basis of measurement of segment profit or loss, and
- a reconciliation of the total reportable segments' measure of profit or loss to the entity's profit or loss before tax and discontinued operations; unless the entity allocates tax or discontinued operations to segments, in which case the reconciliation is to the entity's profit after such items. The reconciliation should identify and describe separately each material reconciling item.

IAS 7 Statement of Cash Flows

In addition to the disclosure of material non-cash items required by IFRS 8 (see '**Insights into IFRS 8 – Segment information to be disclosed**'), IAS 7 'Statement of Cash Flows' encourages, but does not mandate, disclosure of additional cash flow information for entities reporting in accordance with IFRS 8.

IAS 7 notes that additional information about cash flows may be relevant to users in understanding the financial position and liquidity of an entity. Disclosure of this information, together with a commentary by management, is encouraged. The additional information to be disclosed may include the amount of cash flows arising from the operating, investing and financing activities of each segment reported in accordance with IFRS 8.

As disclosure of this information is encouraged rather than required, the extent of the disclosure varies widely. We suggest that if it is included it should reflect the segment information presented to management and need not be specifically generated for the purpose of this disclosure (consistent with the management approach of IFRS 8).

How we can help

We hope you find the information in this article helpful in giving you some insight into IFRS 8. If you would like to discuss any of the points raised, please speak to your usual Grant Thornton contact or visit **www.grantthornton.global/locations** to find your local member firm.

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