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# IFRS® Standard 8 Operating Segments



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## CASE STUDY – IFRS 8 OPERATING SEGMENTS

### Introduction

Businesses often diversify their operations in order to manage business risks in the changing market and earn more profit. It might extend to entity's geographical area it operates in, a business division, or services/products. It is important for an entity to follow the results of such operating segments and at the same time, to disclose information on operating segments to the users of financial statements.

Aim of this case study is to familiarize students with the requirements for reportable operating segments selection. The following issues are addressed in this case study:

- Examination and application of the measurement procedures established by the standard when determining operating segments;
- Getting acquainted with reportable operating segments selection in practice and finding a suitable alternative for solving the selection problem for ensuring a sufficient income threshold.

### The Case Information

Local Store Inc. (LS) sells various types of footwear in one geographical region. The LS is one of the most popular stores in region, standing out for its well-selected suppliers, ensuring shoe quality and comfort at an affordable price. The range of products is wide: from casual shoes to sports shoes for men, women and children.

For the assessment of better revenue components and profitability, the LS follows operating segments based on its product types. In a table below, there is information provided on the entity's operating segments.

Segments	Men's shoes	Men's sports shoes	Women's shoes	Women's sports shoes	Kids' shoes	Kids' sports shoes	Total
Revenue, CU	149,000	40,000	168,000	39,000	35,000	15,000	446,000
Profit (loss), CU	58,110	9,500	67,200	5,500	2,000	-1,700	140,610
Assets, CU	61,000	20,000	95,000	12,500	7,500	22,500	218,500

It is known that:

- entity LS has got an external customer Axes Wear Inc. (AW) which buys 27% per cent of men's shoes and men's sports shoes;
- the entity is considering to stop trading sports footwear in the future.

**Discussion Questions**

1. Perform the necessary tests and determine LS entity's reportable operating segments; present the results in a table;
2. If not all conditions of the revenue test are met, offer an alternative to reach the revenue test threshold;
3. Explain and present how the information in the financial statements is affected by the fact that LS has a buyer whose purchases make up 27 per cent of product revenue in one segment?

## SOLUTION OF CASE STUDY – IFRS 8 OPERATING SEGMENTS

Information about operating segments must be disclosed in financial statements if those segments are in line with the criteria's set with the standard IFRS 8. There are 3 quantitative thresholds set for measuring operating segments that will be performed in the table below.

Table with quantitative thresholds performed:

Segments	Revenue test		Profit (loss) test				Asset test	
	Amount , CU	%	Profit		Loss		Amount, CU	%
			Amount, CU	%	Amount, CU	%		
Men's shoes	149,000	<u>33.41</u>	58,110	<u>40.83</u>			61,000	<u>27.92</u>
Men's sports shoes	40,000	8.97	9,500	6.68			20,000	9.15
Women's shoes	168,000	<u>37.67</u>	67,200	<u>47.22</u>			95,000	<u>43.48</u>
Women's sports shoes	39,000	8.74	5,500	3.86			12,500	5.72
Kids' shoes	35,000	7.85	2000	1.41			7,500	3.43
Kids' sports shoes	15,000	3.36			-1,700	100.00	22,500	<u>10.30</u>
Total	446,000	100.00	142,310	100.00	-1,700	100.00	218,500	100.00

According to the revenue test, the revenue of an operating segment should comprise  $\geq 10\%$  of the revenue of all operating segments. The table suggests that the operating segments Men Shoes and Women shoes are selected.

According to the profit (loss) test, the profit of an operating segment should comprise  $\geq 10\%$  of the profit of all profitable operating segments, and the loss should be evaluated separately – the loss of an operating segment shall comprise  $\geq 10\%$  of the loss of all unprofitable operating segments. The segments of Men Shoes and Women Shoes are selected as profitable, but no additional segments are added to them. The operating segment Kids sports shoes is selected as unprofitable.

Based on the asset test, the assets of an operating segment must be  $\geq 10\%$  of combined assets of all operating segments. No additional segments have been selected after the asset test.

After performing all three tests, the reportable operating segments selected include Men's Shoes, Women's shoes and Kids' sports shoes. Then we have to check, if the revenue of these segments comprises 75% of the total of the entity's revenue.

CU149,000 (Men's Shoes) + CU168,000 (Women's shoes) + CU15,000 (Kids' sports shoes) = CU332,000

CU332,000 (revenue from selected segments) / CU446,000 (total revenue) x 100 = 74.44%

The check shows that the revenue of selected operating segments is less than 75% of the total revenue. The entity must add additional segments to fulfil the condition.

Alternative:

Since entity LS plans to quit the sales of sports footwear, it allows merging certain product groups, i.e. Men's shoes + Men's sports shoes; Women's shoes + Women's sports shoes; Kids' shoes + Kids' sports shoes.

Segments	Revenue test		Profit (loss) test				Asset test	
	Amount , CU	%	Profit		Loss		Amount, CU	%
			Amount, CU	%	Amount, CU	%		
Men shoes	189,000	<b><u>42.38</u></b>	67,610	<b><u>48.08</u></b>			81,000	<b><u>37.07</u></b>
Women shoes	207,000	<b><u>46.41</u></b>	72,700	<b><u>51.70</u></b>			107,500	<b><u>49.20</u></b>
Kids shoes	50,000	<b><u>11.21</u></b>	300	0.21			30,000	<b><u>13.73</u></b>
Total	446,000	100.00	140,610	100.00			218,500	100.00

After merging the segments, all three segments now – Men's shoes, Women's shoes and Kids' shoes become reportable operating segments and will be presented in the financial statements.

Information disclosure requirements also state that dependency on major customers should be reported in the financial statements. Therefore, entity LS should disclose the facts about customer Axes Wear Inc. (AW) as sales to this customer comprise 27 per cent of revenue from the men's shoes segment.

Information disclosure:

The total revenue amount of customer AW: CU189,000 x 27% = CU51,030, segment identification – Men's shoes.