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A Digital Learning Platform for Generation Z:
Passport to IFRS®

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IFRS® Standard 8 Operating Segments

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IFRS® Standard 8 Operating Segments

Scope and Key Definitions

In order to ensure a successful business growth and manage various business risks, entities will not stop at one activity. Often businesses engage in several activities that may be of similar or different nature. Businesses are often expanding into different regions and are constantly looking for new markets. Therefore, there is a need for users of financial statements to disclose information about different operating segments within an entity. By obtaining this information, users of financial statements can assess the diversity of business activities, analyse the economic environment, the nature of the activities and their financial impact.

The IFRS® Standard 8 Operating segments applies to both the separate financial statements of an entity and the consolidated financial statements of a group of entities, provided the following criteria are met – the debt or equity instruments are traded in the public market, or its financial statements are submitted to the Securities Commission or another regulatory body for the purpose of issuing any class of instruments in the public market.

If an entity is not required to disclose segment information in accordance with IFRS 8, but chooses to disclose such information and the disclosed operating segments do not meet the requirements of IFRS 8, such disclosures shall not be considered as segment information.

If a parent entity applies the IFRS 8, segment information needs to be presented only in the consolidated financial statements.

<u>Key definitions (IFRS 8.AppendixA):</u>

Operating segment – an activity of an entity that generates revenue and incurs expenses, the results of this activity are reviewed regularly; based on this information, resource management decisions are made, and separate financial information is available about these activities.

Chief operating decision maker – it is an employee whose function is to make decisions related to the operating segment on business activities and the allocation of resources and to perform operating segment assessment.

Fundamental Issues: Recognition

An operating segment is defined as an entity that generates revenue and incurs expenses, and for which separate financial information is available. However, it should be noted that the operating segment in some cases does not earn revenue, for example, new business activities that will generate revenue in the future.

An operating segment can be defined as part of an entity. However, in some cases, a separate part of an entity is not always considered as an operating segment. For example, a non-revenue-generating or receiving incidental revenue unit of an entity would not be considered as an operating segment.

In entities, the functions of the chief operating decision maker are often performed by the head of the entity, the chief operating officer or a group of executive directors, and other persons. In the majority of entities, the operating segments have three of the characteristics mentioned above (the activity generating revenue; the activity is reviewed on a regular basis; separate financial information is available), but such an entity may report and present its business in different ways. This depends on whether the chief operating decision maker uses more than one set of segment information. Various factors can determine how the operating segment is formed and how responsible managers are assigned. Typically, an operating segment has a segment manager who reports directly and communicates with the chief operating decision maker.

The operating segment manager prepares plans or forecasts of the segment, its financial results and discusses them with the chief operating decision maker. It should be noted that the chief operating decision maker may also be the head of the operating segment, and the head of the operating segment may be the manager of several segments. In different entities, operation managers may be responsible for different components. In some entities, managers are responsible for different products or services; in others, managers are responsible for geographical areas. The chief operating decision maker must then review the performance of both sets of components (product/service or geography) on a regular basis to determine whether the financial information for both components is available. Based on this information, the entities operating segments are formed. Table 1 provides examples of the operating segments.

Table 1. Examples of the operating segments

Type of an operating segment	Examples
Geographical areas	Entity Z has identified its operating segments based on the nature and location of its customers – Europe, Asia, and America.
Business divisions	Entity X has three divisions; the first division sells equipment to persons, the second one to entities, and the third one to public institutions. Entity X has determined operating segments by these divisions.
Services	Entity Y provides the rental of servers, online consulting and IT equipment repairing services. These three services are identified as operating segments.
Products	Entity D produces fresh dairy products (milk, sour cream, and yogurt), cheese and other dairy products. These three product groups are considered as operating segments in the entity.

Fundamental Issues: Measurement

An entity shall disclose information about operating segments to users of financial statements, provided those operating segments meet the criteria set in the IFRS 8. Each operating segment is assessed in accordance with the criteria established, but in some cases, several operating segments may be combined into a single operating segment. Several operating segments may be combined into a single operating segment, provided their economic characteristics are similar, the nature of the products/services or production processes are similar, the distribution methods are similar as well, and the same regulatory environment applies.

In order to determine it, information must be provided about the operating segment to users of the financial statements, the operating segment's revenue, while profit (loss) and assets are measured by against the thresholds set. These thresholds are presented in Figure 1.

Revenue test

The revenue of an operating segment ≥ 10% of all operating segments revenue

Profit (loss) test

The profit of an operating segment ≥ 10% of all profitable operating segments profit	The loss of a operating segment ≥ 10% of all unprofitable operating segments loss

Asset test

The assets of an operating segment ≥ 10% of combined assets of all operating segments

Figure 1. Quantitative thresholds of operating segments

As shown in Figure 1, the revenue test of the operating segment is performed first; if the revenue of the operating segment exceeds 10 per cent of the total revenue, then the segment is considered to be selected. If the operating segment does not meet threshold of the revenue test, then the profit (loss) test is performed. It should be noted here that profitable and unprofitable operating segments are assessed separately. If the operating segment does not meet the quantitative threshold of the profit (loss) test, then the asset test is performed. The financial statements present selected operating segments in accordance with the established quantitative thresholds. An example is given in Table 2.

Table 2. Examples of the selection of an operating segment

<table>
<tr><th>Steps for selecting the operating segments</th><th>Examples</th></tr>
<tr><td>Identification of operating segments</td><td>Entity D has three operating segments: fresh dairy products; cheese products; other dairy products. Such data was obtained during a certain period of time:
<table>
<tr><td>Operating segments</td><td>Revenue, CU</td><td>Profit (loss), CU</td><td>Assets, CU</td></tr>
<tr><td>Fresh dairy products</td><td>86,000</td><td>40,000</td><td>27,000</td></tr>
<tr><td>Cheese products</td><td>8,000</td><td>4,000</td><td>10,000</td></tr>
<tr><td>Other dairy products</td><td>6,000</td><td>(2,000)</td><td>3,000</td></tr>
<tr><td>Total:</td><td>100,000</td><td>44,000 and (2,000)</td><td>40,000</td></tr>
</table>
</td></tr>
</table>

Revenue test	The total revenue is CU100,000; therefore, the 10% threshold is used to select the operating segments with revenues over CU10,000 (CU100,000 x 10%). In this case, only the operating segment *Fresh dairy products* is more than CU10,000, while the other two segments (*Cheese products and Other dairy products*) are not selected, because the revenue is less than CU10,000.
Profit (loss) test	Unprofitable segments are assessed separately from the profitable segments. In this case, the operating segment *Other dairy products* will be selected, as it is the only unprofitable segment and will account for 100% of all losses. From the profitable activities with the total profit of CU44,000, the *Fresh dairy products* operating segment is selected (same as in the revenue tests) and the operating segment *Cheese products* does not meet the 10% threshold.
Asset test	The assets of all operating segments are CU40,000, and the operating segment with more than CU4,000 (CU40,000 x 10%) will be selected. Segment *Cheese products* will be selected (CU10,000 > CU4,000) and segment *Fresh dairy products* satisfy the threshold, but it has already been selected for the revenue test.
Reportable segments	In Entity D case, all operating segments have met the thresholds by different tests and will be disclosed to users of the financial statements – fresh dairy products; cheese products; other dairy products.

If an operating segment does not meet the quantitative income, profit (loss) or asset thresholds, it is not included in the financial report. However, in certain cases, if the management believes that information about an operating segment (that has not met the quantitative thresholds) is useful to the users of the financial statements, an entity may present it in the financial report.

After selecting the operating segments according to the quantitative criteria, revenue of selected operating segments must make up at least 75 percent of all the revenue (see Fig. 2).

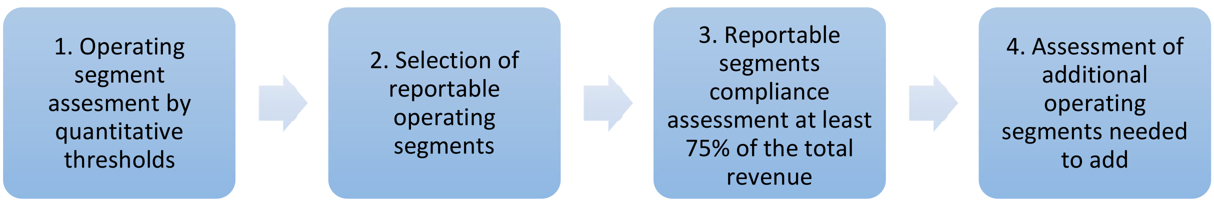

Figure 2. Steps of reportable segments selection

If the revenue from the selected operating segments represents less than 75 percent of the total revenue, the entities must additionally select the operating segments which do not meet the quantitative thresholds (see Fig. 3).

Selection of reportable segments

Revenue from the segments selected:

- A - CU10,000;
- C - CU15,000.

Revenue from other segments:

- B - CU4,200;
- D - CU4,000;
- E - CU4,400;
- F - CU4,200;
- G - CU3,200.

Tests of 75% revenue

The total revenue of all segments is CU45,000.

75% of revenue is CU33,750 (CU45,000 x 75%).

Revenue from selected segments is ~56% (CU25,000 / CU45,000) of total income.

Additional segments must be assigned to meet the 75% test.

Assignment of additional segments

Management determined that:

- segment E is significant and its revenue threshold is close to 10% (i.e. ~ 9.8%)
- the nature of segments D and G is similar and the segments must be merged into one segment. Then the new segment DG revenue is 16% of the total revenue.

As a result, the reportable segments are A, C, E, DG and theirs revenue is CU36,600 (~81.3%).

Figure 3. Example of 75% test for reportable segment selection

As already discussed, management is free to determine which operating segments are relevant to users or to combine similar operating segments into one segment. In some cases, the operating segment could be presented in the previous year and would not meet the criteria of the current year, but if this operating segment is a significant one, then it is presented in the financial statements of the current year.

If a segment is presented in the current year and has not been presented in the previous year, comparative information for the previous year shall be provided. However, if preparation of such comparative information is costly, an exception can be made, and comparable information may be omitted.

Even though there is no limit to the number of operating segments that can be disclosed, it is recommended to make a review of segment information, if the number of operating segments exceeds ten segments.

Fundamental Issues: Procedures

The main procedures include the selection of operating segments for reportable segments. Before preparing the financial statement information about reportable segments, the information should be calculated based on the financial data. This information consists of different accounting elements (revenue, expenses, liabilities, assets, etc.) about the reportable segment.

The table below represents how an entity has calculated the assets and liabilities for each segment (see Table 3).

Table 3. Examples of liability and asset identification by segments

Elements	Segments					
	A		B		C	
	20x1, CU	20x0, CU	20x1, CU	20x0, CU	20x1, CU	20x0, CU
Buildings	180,000	150,000	450,000	430,000	340,000	300,000
Equipment	25,000	30,000	90,000	100,000	70,000	60,000
Inventories	2,000	1,000	22,000	22,000	12,000	15,000
Receivable amounts	12,000	14,000	33,000	42,000	10,000	8,000
Long-term liabilities	80,000	65,000	250,000	160,000	130,000	133,000
Short-term liabilities	260,000	240,000	240,000	247,000	199,000	191,000

In the example presented in Table 3, the entities have taken into consideration the accounting rules and other criteria to show the amount of assets and liabilities attributable to the individual segments. This information may be relevant to the users of the financial statements. Accordingly, the entities would present the results of the income statement by segment.

Disclosures

Segment information is disclosed to users of financial statements in accordance with the requirements set in Table 4.

Table 4. Requirements for disclosures

Type of operating segment	Requirements for disclosures
Products/services information	The entity must report about its revenue for each product/service (or a group of similar products/services) from external customers. *Exemptions apply, if the costs for preparing such information are very high.*
Geographical areas information	The entities must report the revenue from its external customers: ● Attributed to the entity's country. ● Attributed to foreign countries. If an individual foreign country is significant, such revenue must be disclosed separately. The entities must report fixed assets (without financial instruments, deferred tax assets, post-employment benefits, right and insurance): ● Located in the entities country. ● Located in foreign countries. If an individual foreign country is significant, those assets must be disclosed separately. *Exemptions apply, if the costs for preparing such information are very high.*

Major customer information	The entities must report information about the dependency on the major customers. If the revenue from one external customer is 10 per cent or higher, that fact shall be disclosed: ● The total amount of the revenue from such a customer is provided. ● Identification of a segment or segments that present this customer's revenue.

When presenting information in the financial statements, the amounts reported must be based on the financial information. An entity may also present subtotals for geographical regions by a country group.

An entity shall disclose the general information presented in the statement of comprehensive income for each period, detailing the reportable segments profit or loss, revenue and expenses, liabilities and the basis of measurement. Moreover, it shall disclose other significant amounts of reportable segments.

Examples

Entity Z supplies oil. In the previous period, entity Z defined its operating segments as a chain of suppliers and consumers. However, after the reorganisation, entity Z has made the changes in the management reporting system; the head of the entity now looks at the operating segments through the geographical activities. Below is information on the operating segments:

Segments	Eastern Europe	Northern Europe	Western Europe	Asia	Eastern America	Northern America	Total
Revenue, CU	50,000	55,000	120,000	45,000	50,000	280,000	600,000
Profit (loss), CU	-1,000	5,000	40,000	-14,000	-1,500	90,000	118,500
Assets, CU	5,000	10,000	80,000	5,000	8,000	150,000	258,000

It is known that reportable segments must meet the following criteria:

- Revenue represents 10% or more of the revenue of all the operating segments;
- Profit or loss is 10% or more:
  - than the total profit of all profitable activities;
  - than the total loss of all unprofitable activities;
- Assets account for 10% or more of the total assets of the segment.

Based on these criteria, income, profit (loss) and asset tests for segment selection are performed in the table below.

Segments	Revenue test		Profit (loss) test				Assets tests	
	Amount, CU	%	Profitable activities		Unprofitable activities			
			Amount, CU	%	Amount, CU	%	Amount, CU	%
Eastern Europe	50,000	8.33			-1,000	6.06	5,000	1.94
Northern Europe	55,000	9.17	5,000	3.70			10,000	3.88
Western Europe	120,000	20.00	40,000	29.63			80,000	31.00
Asia	45,000	7.50			-14,000	84.85	5,000	1.94
Eastern America	50,000	8.33			-1,500	9.09	8,000	3.10
Northern America	280,000	46.67	90,000	66.67			150,000	58.14
Total	600,000	100.00	135,000	100.00	-16,500	100.00	258,000	100.00

It can be seen from the revenue test that the operating segments Western Europe and Northern America are selected. The profit (loss) test is followed. Here, the profitable and unprofitable activities are assessed separately. No additional segment is assigned from profitable activities. The operating segment *Asia* is assigned from the unprofitable activities. Then, the asset test was performed, in which case no additional segments have been selected. Three segments Western Europe, Northern America and Asia are selected following the tests of the revenue, profit (loss) and assets. Then it is necessary to check whether the revenue of the selected operating segment represents 75 per cent of the total revenue.

CU120,000 (Western Europe) + CU45,000 (Asia) + CU280,000 (Northern America) = CU445,000
CU445,000 (selected segments revenue) / CU600,000 (total revenue) x 100 = 74.17%

Examination of the selected operating segments has shown that their revenues are less than 75% of the total revenue. Therefore, it is necessary to add additional segments. Two possible alternatives are presented below.

Alternative 1

Management is considering the need to merge certain regions due to their similarities and leave only three regions in total – Europe, Asia and America.

Segments	Revenue test		Profit (loss) test				Asset tests	
	Amount, CU	%	Profitable activities		Unprofitable activities			
			Amount, CU	%	Amount, CU	%	Amount, CU	%
Europe	225,000	37.50	44,000	33.21			95,000	36.82
Asia	45,000	7.50			-14,000	100.00	5,000	1.94
America	330,000	55.00	88,500	66.79			158,000	61.24
Total	600,000	100.00	132,500	100.00	-14,000	100.00	258,000	100.00

As shown in the table above by the segments merged, all three segments (Europe, Asia and America) would be reportable segments.

Alternative 2

The management has started to expand its operations in Northern Europe. Even though this operating segment (Northern Europe) has not met the quantitative criteria, the management believes that it would be important to provide information to users of financial statements. Therefore, adding this operating segment (Northern Europe) verifies that the 75 per cent revenue criterion is met.

CU120,000 (Western Europe) + CU45,000 (Asia) + CU280,000 (Northern America) + CU55,000 (Northern Europe) = CU500,000
CU500,000 (revenue from the segments selected) / CU600,000 (total revenue) x 100 = 83.33%

Reportable operating segments will be presented in the financial statements – Northern Europe, Western Europe, Asia and Northern America.

Conclusion

In summary, the quantitative criteria for selecting operating segments must be followed. If the 75 per cent revenue criteria is not met, the management must decide on the basis of which additional criteria they are to select the additional segments. Finally, after selecting the reportable segments, all financial information related to the segments must be provided to the user of the financial statements.