IFRS Adviser Alert

Insights into IFRS 8 *Operating Segments*

March 2022

Executive summary

The Grant Thornton International IFRS team has three new publications in the *Insights into IFRS 8* series:

- *Identifying Operating Segments;*
- *Aggregating Operating Segments;*
- *Reportable Segments.*

For entities that operate in a variety of types of businesses, geographical locations, regulatory or economic environments or markets, high quality management accounts are essential. They enable management to monitor performance, allocate resources and devise business and market strategies. IFRS 8 *Operating Segments* requires much of this management information for publicly listed entities to be published externally, so that investors, analysts and other users of the entities' financial statements can review an entity's operations from the same perspective as management.

The *Insights into IFRS 8* series considers key implementation issues, provides interpretational guidance in certain problematic areas and includes several examples illustrating the standard's requirements.

The next three publications in the *Insights into IFRS 8* series are on the following topics:

- *Identifying Operating Segments;*
- *Aggregating Operating Segments;*
- *Reportable Segments.*

Resources

The publications mentioned above follow this *IFRS Adviser Alert*.

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Insights into IFRS 8

Identifying Operating Segments

High quality management accounts are essential to enable management to monitor how they are performing and how they need to allocate their resources. This is particularly key for entities that operate in a variety of classes of business, geographical locations, regulatory or economic environments or markets. IFRS 8 'Operating Segments' aligns external reporting through the identification and reporting of operating segments with what is reported internally by management.

Our 'Insights into IFRS 8' series considers some key implementation issues and includes interpretational guidance in certain problematic areas. We also include several examples illustrating the Standard's requirements. This article sets out the requirements when identifying operating segments.

In many cases, identifying operating segments will be straightforward. However, in some situations the guidance may not give a clear answer. For example, the Chief Operating Decision Maker (CODM) may use more than one set of segment information or the segment characteristics may apply to two or more overlapping sets of components. In these and other situations judgement is required to determine how best to meet IFRS 8's core principle.

Definition of an operating segment

Operating segments are components of an entity with the following three characteristics:
- the component engages in business activities from which it may earn revenues and incur expenses
- the component's operating results are regularly reviewed by the CODM to make decisions about resources to be allocated to the segment and assess its performance, and
- discrete financial information is available for the component.

In addition, an operating segment may engage in business activities for which it has yet to earn revenues, for example, start-up operations may be operating segments before earning revenues.

This approach focuses on how management has organised the entity to make key operating decisions and to assess performance. Using the above criteria to identify operating segments may be straightforward for many entities. However, in less obvious situations each aspect of the definition needs careful consideration. A number of the practical issues are discussed below.

Practical issues in identifying operating segments

The following sections look at some of the most common difficulties in identifying operating segments seen in practice, taking each characteristic in turn. Before applying each characteristic, it is important to be clear who is the CODM.

Chief Operating Decision Maker (CODM)
A key aspect in determining an entity's operating segments is to identify its CODM. IFRS 8 explains that the term 'chief operating decision maker' is intended to mean a function rather than an executive with a specific title. The function is that of allocating resources to operating segments and assessing their performance.

In many entities, it will be clear the CODM is the chief executive. Identifying the CODM can however be more problematic because the applicable function depends on the entity's management structure and processes. The CODM function may for example be carried out by the entity's chief executive, chief operating officer, senior management team or the board of directors. Typically, the CODM will be the highest level of management at which decisions are made, but if a supervisory body is required to provide approval for those decisions then judgement is needed as to whether this supervisory body is the CODM.

However, entities should challenge their identification of the entire board as fulfilling the role of the CODM where such a board has both executive and non-executive directors. As the focus of IFRS 8 is to report the management information that is used to make operating decisions concerning the allocation of resources as well as monitoring performance it seems to contradict what the role of a non-executive director is from a corporate governance perspective.

Segment managers
Certain decisions about resource allocation are inevitably delegated by the CODM and are made at a lower level, by a segment manager for instance. The term 'segment manager' is used to describe a function rather than a specific person. The segment manager is responsible for maintaining direct communication with the CODM to discuss operating activities, financial results, forecasts, or plans for the segment. In certain instances, the CODM may also be the manager for a particular segment.

The relationship between the roles of CODM and segment managers needs to be reviewed carefully to identify when a segment manager is included within the function of CODM. If the CODM is a group of individuals, including segment managers, the identification of operating segments is typically made at a lower level, resulting in the identification of additional operating segments.

Example 1 – Identifying the CODM
Entity A's management organisation consists of a Chief Executive Officer (CEO) who oversees two Chief Operating Officers (COOs) who are responsible for two separate continental regions, each consisting of multiple countries. Each country engages in revenue-generating business activities and discrete financial information is available for each country.

The identification of the CODM either as the individual CEO or as the group consisting of the CEO and COOs in this example rests on whether the CEO individually makes the decisions about resource allocation and performance assessment or whether this is done by the management group.

Scenario 1: CEO is identified as CODM
The COOs regularly review operating results for the individual countries within their respective regions to assess performance and to decide how to allocate their regional resources to individual countries. The COOs report regularly to the CEO, providing summaries of their regional operating results and other financial information but reporting individual country information only by exception (ie when outside defined parameters or when requested by the CEO). The CEO then makes decisions as to how to allocate resources to the two continental regions managed by the two COOs.

In this case, the CEO is identified as the CODM. The operating segments are identified as the two continental regions overseen by the two Chief Operating Officers (segment managers).

Scenario 2: CEO plus COOs are identified as CODM
The COOs regularly review operating results for the individual countries within their respective regions to assess performance. The COOs report regularly to the CEO, providing summaries of their regional operating results and other financial information, supported by an analysis of results broken down by country. The CEO and the COOs then negotiate together to agree how to allocate resources to the regions and countries.

In this case, the CODM is identified as a group consisting of the CEO and the two COOs. The operating segments would be identified at the country – not the continental – level, resulting in a larger number of operating segments.

Review for changes to the identity of the CODM
Once a CODM has been identified, it is important to reconsider if they still have the role following any business re-organisations, acquisitions or disposals. A change to the function that is undertaken by the CODM may also affect the identification of operating segments. The implications of a change in operating segments will be considered in our article **'Insights into IFRS 8 – Further practical application issues'**.

Practical insight – Changes to information provided to the CODM
If partway during the reporting period, the information provided to the CODM changes, it is usual to provide the revised segment information for the entire reporting period. IFRS 8 requires entities to restate comparatives to the revised segment information unless it is too costly to do so. In our view, it is typical such changes are structured in advance before the actual change is made, and therefore entities are prepared thus making the restatement not too costly.

Components engaged in business activities

IFRS 8 makes clear it is not necessary for a component of a business to actually earn revenues in order to be identified as an operating segment. The component merely needs to be capable of earning revenues or incurring expenses either currently or in the future. Consequently, the following components of the business may be identified as operating segments if discrete financial information is available, and the operating results are regularly reviewed by the CODM.

Pre-operating activities

IFRS 8 includes, as an example of a possible operating segment, start-up operations which may engage in business activities for some time before they generate revenues.

Corporate functions

A head office or other corporate function may be an operating segment. An example is a head office function that undertakes business activities (such as a treasury operation that earns significant investment income and incurs expenses), if the revenues earned are more than incidental to the activities of the entity.

In contrast, a head office function that undertakes activities such as finance and accounting, information technology and human resources (which are normally non-revenue generating, or earn only incidental revenues) would not usually be an operating segment. Examples of incidental revenues include interest income and expenses, and realised and unrealised foreign exchange gains and losses.

The distinction between the two situations is not always clear-cut and so requires management judgement. Even if the revenues are considered incidental, IFRS 8 does not preclude a corporate function or other similar segment from being a reportable segment if management believes the additional information may contribute to a better understanding of the entity.

Components with outputs transferred exclusively to other segments

Some entities may be managed on the basis of cost centres or have vertically integrated activities where the output from the cost centre or from one stage of production is used as the input to another business component or production stage. For example, in the oil industry, most or all of the crude oil production of an entity may be transferred internally to the entity's refining and retailing operations. In such businesses, information about the components engaged in each stage of production may be useful for the users of the financial statements, as different activities within the entity might have significantly different prospects for future cash flow. The definition of operating segments in IFRS 8 includes components of an entity that sell primarily or exclusively to other operating segments of the entity.

Even if a component transfers all of its output to another entity without charging any transfer price, this does not preclude the component from being identified as an operating segment, as long as the other criteria are met.

Example 2 – R&D cost centre with no reported revenue

Entity A has a research and development (R&D) department that is managed as a cost centre and for which discrete financial information is regularly presented to the CODM. The R&D activities are not incidental to the activities of the entity. The R&D department provides an important service to two different manufacturing segments, which would otherwise have to pay external suppliers for similar services. The costs of the R&D department are not recharged to the manufacturing segments but the CODM reviews its operating results to assess whether to continue to perform the R&D activities in-house or to outsource them.

The R&D department satisfies the conditions to be identified as an operating segment.

Interests in joint operations and joint ventures

Joint arrangements (JA) take many different forms and structures and the level of management involvement by an investor can also vary widely. In some situations, particularly in jointly controlled operations, the CODM of the investor regularly reviews the operating results and performance of the JA to decide what resources to allocate to the JA and how they should be managed. Consequently, the JA may be identified as an operating segment when applying the criteria in IFRS 8.

Interests in associates

The investor in an associate does not control the way that resources are used within an associate (instead, it has significant influence). However, the investor's CODM may review the associate's operating results and performance to assess whether to sell or hold the investment. It could be argued this sell or hold decision meets the resource allocation part of the definition of an operating segment. Under this view, an investment in an associate may be an operating segment (provided the other criteria are met).

Our view is an associate is usually classed as an investment, rather than a component of the reporting entity, and is not generally identified as an operating segment for IFRS 8 purposes. We also note that information regarding associates users of the financial statements might require is specifically required by IAS 28 'Investments in Associates and Joint Ventures'.

Discontinued operations

A discontinued operation can meet the IFRS 8 definition of an operating segment, if it continues to engage in business activities during the period it is classified as held for sale.

IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations' 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 discloses the reportable segment in which the non-current asset (or disposal group) classified as held for sale or sold is presented.

If an operating segment is classified as held for sale or discontinued, then the disclosures required by IFRS 8 for reportable segments will no longer apply and instead only those disclosures required by IFRS 5 need be given. Consequently, the measures for this segment will be aggregated with other non-reportable segments in the 'all other segments' category. This is discussed in our article **'Insights into IFRS 8 – Segment Information to be disclosed'**.

Post-employment benefit schemes

Post employments benefits schemes are specifically excluded from being identified as operating segments.

Operating results regularly reviewed

An important criterion for identifying operating segments is the operating results are regularly reviewed by the entity's CODM to make decisions about resources to be allocated to the segment and assess its performance. IFRS 8 does not define 'regularly' so judgment may be needed to decide if this condition is met. In practice, if the CODM reviews information on a quarterly or more frequent basis, this is expected to satisfy the condition.

Data available at different levels

A CODM may receive a monthly reporting pack containing high level information on the major business lines or geographical areas, with more detailed information on individual businesses or cash generating units (CGUs) available on request (a 'drill down by exception' approach). IFRS 8 looks to the level regularly reviewed by the CODM. In this case, the monthly reporting pack would then be the basis to identify segments rather than the 'drill down' data.

In practice, care will be needed to assess factors such as the frequency of review at the more detailed level. For example, the CODM may decide a long-term, regular review of specific, underperforming components is needed.

Important information not reported to the CODM

In some situations, significant management information that could affect decision-making is not reviewed by the CODM (effectively a corporate governance weakness). IFRS 8 bases segments on what is actually reviewed, not what ought to be reviewed in accordance with best practice. In an extreme scenario the resulting reduction in the segment disclosures may alert financial statement users to possible weaknesses in the internal reporting systems.

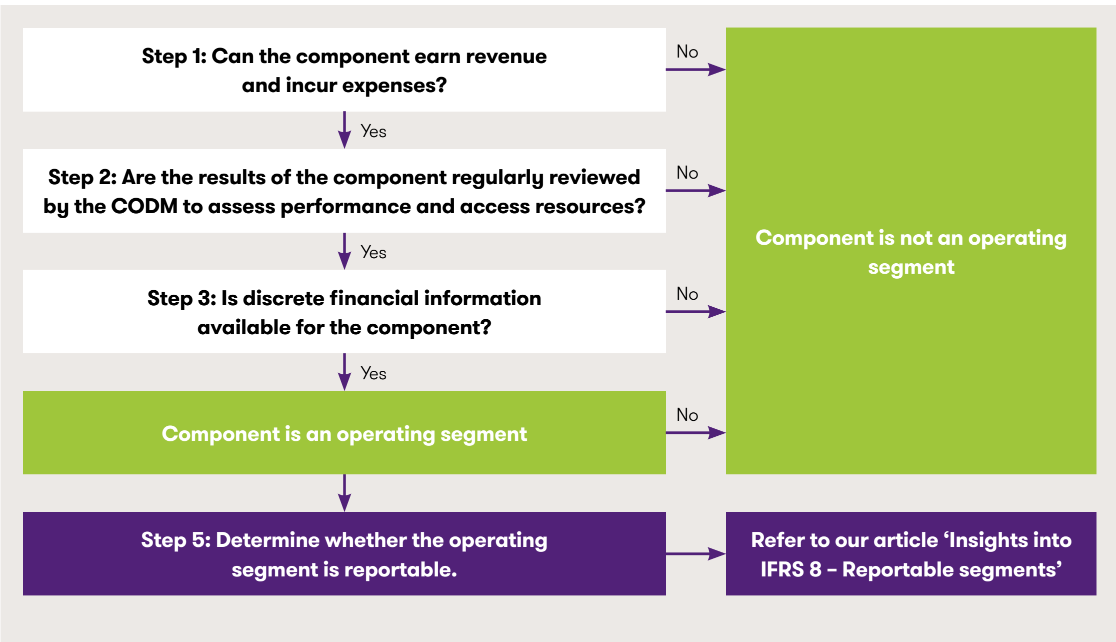
Press releases and other publicly available information

In some cases, an entity may provide regular press releases, analysts reports or other publicly available information relating to components of the business (for example management commentaries on components within quarterly trading updates or accompanying the annual financial statements). This type of information suggests the results of these components are likely to be reviewed by the CODM and are considered significant by senior management. Consequently, regulators or other users of the financial statements may raise questions if the segments identified in the financial statements do not align readily with those identified for other reporting purposes.

Management commentary

In some cases, an entity may provide a detailed explanation of the financial performance and position of key components of its business in the management commentary that accompanies the financial statements. The provision of such a commentary might suggest to both regulators and users of the financial statements that discrete financial information concerning these components may be regularly used by the CODM. Accordingly, where segmental information has been reported on a different basis in the financial statements, entities should consider whether doing so is consistent with the disclosure objective of the Standard.

Summary of characteristics that identify operating segments



Level of discrete information available for CODM review

The definition of an operating segment requires discrete financial information to be available to the CODM. The level of detail needed by the CODM to assess performance and allocate resources to segments is considered to determine whether this condition is met.

Only gross profit margin data is available

The definition of a segment in IFRS 8 uses the phrase 'operating results' but it is not clear whether this means net operating result or can be taken to mean gross operating result. As IFRS 8 takes a 'management approach' to identifying operating segments, then if the CODM decides that gross margin information is sufficient to use for performance measurement and resource allocation decisions then this is the level of operating results that is used to identify segments.

Only revenue data is available

In some entities, the CODM will review data on the revenues earned by a component but they would not review cost or profitability data. For most entities, the review of revenue-only data is not sufficient for decision-making related to resource allocation or performance evaluation of a segment, unless the costs needed to generate such revenues is insignificant or is so stable it does not vary significantly with the level of revenue generated. Consequently, components are unlikely to be identified as operating segments based on only revenue information. However, it is not impossible the result of a segment is represented by its revenue if that is the information is predominantly used to monitor performance and allocate resources. For example, the CODM may review weekly sales reports that will inform as to what actions may be required in certain locations to improve performance.

Only cash flow data is available

In some circumstances, the CODM may only receive information with respect to the cash flows of components of the business, rather than profit figures. In our view, the cash flow information may provide management with a sufficient proxy for profitability. If so, this would be sufficient to satisfy the requirement for discrete financial information.

No segment statement of financial position data is available

A review by the CODM of the operating results of a component is one of the criteria for identifying segments in IFRS 8. In many cases, this requirement can be met with operating performance information only, such as revenue and gross profit by product line. The allocation of assets is not a criterion for the component to be considered an operating segment.

Indeed, IFRS 8 envisages in some situations an entity might allocate depreciation expense to a segment without allocating the related depreciable assets. Similarly, IFRS 8 also acknowledges in some situations the CODM will often not review segment liabilities and may not review segment asset data.

Matrix organisations

The approach for identifying an operating segment in IFRS 8 focuses on how management has organised the entity to make key operating decisions and to assess performance. Based on the above criteria, identifying operating segments may be obvious for many entities. However, some entities produce multiple sets of reports detailing business activities in different ways, representing a matrix-management approach.

In a matrix form of organisation, components of an entity may overlap with different aspects of components for which managers are responsible, with both being reported to the CODM. For example, some regional managers may be responsible for product and service lines worldwide and others may be responsible for different geographical areas. The CODM regularly reviews the operating results of both sets of components and financial information is available for both. In this sort of situation, it is more difficult to determine clearly which set of components should be identified as the entity's operating segments. Under IFRS 8, the management approach requires the entity to determine which set of components represent the operating segments by reference to the Standard's core principle. This core principle requires the entity to disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates.

Consequently, when the CODM reviews more than one set of information, other factors should be considered in identifying the components that constitute operating segments. In particular, factors such as the nature of the business activities of each component, the existence of managers responsible for them, and how information is presented to the board of directors (ie those charged with governance) may aid in the operating segment identification.

Example 3 – Identifying segments in a matrix organisation

An entity sells food and grocery products through wholesale and retail operations in two geographical markets in Europe and North America. There is discrete financial information available for each selling activity for each product in each country in each geographical region.

The CODM reviews a monthly management pack that contains a summary of the wholesale and retail operating results in each region. More detailed breakdowns of the sales and operating results by product-line and by country is available but is only reviewed by the CODM by exception.

For each of the wholesale and retail operations, there is a global sales director who is responsible for all worldwide sales and to whom each regional sales manager reports. There are also global operating directors responsible for each of the wholesale and retail activities worldwide. The sales directors report to these operating directors, who in turn report directly to the CODM, which in this case is the chief executive officer.

The management reporting structure reflects the entity's priority to improve the profitability of individual product-lines. The CODM believes improving and maintaining product quality is the key to achieving this and that different geographical markets will respond similarly to product improvements, but the wholesale and retail sales will react differently.

In this situation, both the sales markets and the geographic areas may meet the criteria for operating segments set out in IFRS 8. They are components of the entity that engage in business activities for which there is discrete financial information available and whose operating results are reviewed regularly by the CODM. Therefore, other factors need to be taken into account and judgement applied to determine which components should be reported as operating segments.

In this case, the management structure reflects the CODM's emphasis on product-lines (or business units responsible for those products) rather than geographical locations. The wholesale and retail operating directors report directly to the CODM and are likely to be classed as 'segment managers'. The regional sales managers and global sales directors do not report direct to the CODM so would probably not be regarded as segment managers. Changes in product quality are not expected to result in different reactions in different geographic regions, suggesting the economic environment in the wholesale and retail markets are more significant than those of the geographic regions.

Therefore, it is likely for this entity, the operating segments would be identified as the wholesale and retail segments.

The process described above (applying the core principle and professional judgement as necessary) will result in the identification of the operating segments. Entities are of course able to report additional segmental information if they choose to do so. For example, in the scenario above the operating segments are business units and management may elect to provide additional information on a geographic basis. Although not required by IFRS 8, a matrix presentation can be very useful to users of the financial statements.

IFRS 8 also requires some entity-wide disclosures which are discussed in our article **'Insights into IFRS 8 – Entity Wide Disclosures'**.

Only one operating segment identified

One common issue identified in practice is where only one operating segment is identified. Entities still need to apply the requirements of IFRS 8 if they only have one operating segment.

Practical insights – Groups

The segment reporting for the subsidiaries can be different to that of the overall group. It is possible management information is provided in a different way for the subsidiaries and therefore the segment information is not binding for the main group and different thresholds may apply.

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.

Insights into IFRS 8

Aggregation of operating segments

Management needs to monitor how they are performing, how they need to allocate their resources and how they can create successful strategies in their markets, so high quality management accounts are key to helping them achieve this. IFRS 8 'Operating Segments' aligns external reporting with what is reported internally by management by identifying and reporting operating segments.

Our 'Insights into IFRS 8' series considers some key implementation issues and includes interpretational guidance in certain problematic areas. We also include several examples illustrating the Standard's requirements. This article sets out the requirements when aggregating operating segments, which is closely linked to reportable segments. Refer to our article **'Insights into IFRS 8 – Reportable segments'**

Aggregation of operating segments prior to identifying reportable segments

As noted above, IFRS 8 permits (but does not require) operating segments to be aggregated for reporting purposes if and only if certain criteria are satisfied. Aggregation often improves the usefulness of the disclosures by avoiding excessive detail and focusing more readily on the overall trends and key information. The criteria (discussed below) ensure that only segments with similar economic risks and prospects are aggregated.

Once aggregation has been considered, single operating segments or groups of operating segments (where permitted) are reportable segments if they exceed certain quantitative thresholds. The thresholds are based on a comparison of segment revenues, profit or loss and assets with equivalent amounts for all the operating segments.

Any identified segments or groups of segments that do not meet the criteria for separate disclosure as reportable segments may nonetheless need to be reported to meet the 75% revenue test in **'Insights to IFRS 8 – Reportable Segments'**. The remaining operating segments or groups are combined and disclosed in an 'all other segments' category. However, an entity is allowed to report segment information for any of these smaller operating segments or aggregations of operating segments if it is considered useful to users of the financial statements.

Criteria for aggregation

IFRS 8 explains the first stage of aggregating operating segments as follows:

Two or more operating segments may be aggregated into a single operating segment if aggregation is consistent with the core principle of this IFRS, the segments have similar economic characteristics, and the segments are similar in each of the following respects:

- the nature of the products and services
- the nature of the production processes
- the type or class of customer for their products and services
- the methods used to distribute their products or provide their services, and
- if applicable, the nature of the regulatory environment, for example, banking, insurance or public utilities.

The Standard also notes operating segments often exhibit similar long-term financial performance (eg similar long-term average gross margins) if they have similar economic characteristics. It may be difficult to assert similar economic characteristics if gross margins differ significantly but other performance factors such as trends in sales growth, returns on assets employed and operating cash flow may also be considered in making this decision. Differences in current-year margins may not preclude aggregation if the segments are expected to have similar long-term average gross margins and other trends over the long-term. Similarly, two operating segments that have similar gross margins in the current reporting period, but are expected to have dissimilar gross margins in the future, should not be aggregated. Another example is that segments in locations with different currencies are likely not to have similar economic characteristics.

Example 1 – Consideration of long-term gross profit margins
Entity A is a retail chain that operates ten stores, each of which meets the definition of an operating segment. Seven of the stores are long-established in two geographic regions – Southern Europe and Northern Europe. The long-term average gross profit margin of stores is 20% in Southern Europe and 25% in Northern Europe.

The remaining three stores opened in Southern European cities during the current reporting period. Two of these achieved gross profit margins of approximately 17% due to initial sales promotions but indications are that profitability will increase to an average of 20% within the next two years. The third achieved a gross profit margin of 14% which, due to economic and cultural conditions in the country, is only expected to increase to 16% in the foreseeable future.

The difference in gross margins between Southern Europe and Northern Europe is not 5% (25% - 20% = 5%), but is 25% [(25% - 20%) ÷ 20% = 25%]. This suggests the geographic regions do not meet the aggregation criteria, so must be viewed separately. However, the similarity of gross margins for the established stores indicates the economic characteristics within each region are sufficiently similar that the stores can be aggregated with others in the same region.

Although two of the newly opened stores currently have different gross profit margins, the expected trend is an increase to the long-term average for other established stores in Southern Europe and so, assuming other aggregation criteria are met, these two new stores can be aggregated with the established Southern European stores to form a single operating segment for IFRS 8 purposes. The third new store is clearly subject to different economic conditions and these differences are expected to continue so the aggregation criteria are not met.

Consequently, entity A can identify three operating segments or groups of segments against which it will test the reportable segment quantitative thresholds (see below) as follows: Northern European stores; the atypical single new Southern European store; and all other new and established Southern European stores.

Impact of aggregating segments prior to consideration of quantitative thresholds for reportable segments

IFRS 8 provides the order in which the steps for identifying reportable segments are performed. That process is summarised in our article **'Insights into IFRS 8 – Reportable segments'** and is also illustrated in the IFRS 8 Illustrative Guidance.

In summary:
- identify operating segments in accordance with IFRS 8 – refer to our article **'Insights into IFRS 8 – Identifying operating segments'**
- aggregate identified operating segments with similar economic characteristics in accordance with IFRS 8 (see flowchart on page 7)
- measure identified operating segments (or groups of aggregated segments, if applicable) against the IFRS 8 quantitative thresholds for reportable segments **'Insights into IFRS 8 – Reportable segments'**
- consider further aggregation of identified segments or groups of segments (see page 5).

If one or more of the aggregated segments has reported a profit but another has reported a loss, the net profit or loss is considered for the purpose of determining the reportable threshold for segment results. In some cases, this can change the number of reportable segments identified. However, the fact one segment did not meet the quantitative thresholds prior to the aggregation of other segments does not preclude it from being considered a reportable segment subsequent to that aggregation.

Example 2 – Impact of aggregation on quantitative threshold test

An entity has identified six operating segments, for which the operating profit (loss) is as follows:

	Operating profit/(loss) CU
Segment A	10
Segment B	(50)
Segment C	20
Segment D	90
Segment E	90
Segment F	(10)
Total net profit	**150**

Based on the above information (and an evaluation of revenues and assets), Segments A, C and F do not meet any of the quantitative threshold criteria.

Segments B and E are economically similar and meet all of the aggregation criteria in IFRS 8. The entity chooses to aggregate them into a single operating segment.

Threshold calculations are as follows:

	Prior to Aggregation CU	Subsequent to Aggregation CU
Combined reported profits of segments not reporting a loss	210	160
Combined reported losses of segments reporting a loss	(60)	(10)
Greater absolute amount	210	160
10 per cent threshold	21	16

When the segments are evaluated against the post-aggregation quantitative thresholds, Segment C (which previously did not meet any of the quantitative thresholds) now meets the 10% of segment profit or loss criterion and so is reportable as well as Segment D and Segment B+E (aggregated).

Aggregation of operating segments after identifying reportable segments

Once the reportable segments have been identified (including segments that are reported to meet the 75% revenue test – see **'Insights into IFRS 8 – Reportable segments'**), information about all remaining non-reportable operating segments is combined and disclosed in an 'all other segments' category. The sources of revenue included in this 'all other segments' category is disclosed.

The totals for all segments are then used as the basis for the reconciliations required by IFRS 8.

Some entities may decide this approach does not provide the most useful information to users. This may be for example because the total number of reportable segments is considered excessive or because disaggregated information for 'all other segments' is considered more useful. Such entities may then wish to combine various segments together into reporting segments that will assist the users of the financial statements. The following paragraphs discuss some areas where IFRS 8 either permits or prohibits additional flexibility. This is followed by a flowchart that summarises the steps.

Combining operating segments that individually do not meet the quantitative thresholds

Once the first stage aggregation permitted by IFRS 8 has been considered and the reportable segments or groups identified, an entity has a limited further opportunity to aggregate some segments that are not individually reportable. An entity may combine information about operating segments that do not meet the quantitative thresholds for reportable segments with information about other operating segments of the same status if and only if the operating segments concerned have similar economic characteristics and share a majority of the aggregation criteria listed in IFRS 8. This new aggregation may be used to identify additional reportable segments.

As noted, for the purpose of combining segments in these circumstances only a majority of the aggregation criteria need to be met. This is slightly less restrictive than the first stage aggregation described above, for which all the criteria must be met.

Combining a reportable segment with a segment that does not meet the quantitative thresholds

In some cases, the external revenue of reportable segments is below the 75% of total revenue threshold required (see our article **'Insights into IFRS 8 – Reportable segments'**) and so additional segments need to be identified as reportable. An entity may wish to aggregate another operating segment with an existing reportable segment to satisfy the 75% test rather than report another segment separately.

This is not permissible unless aggregation is consistent with the core principle, the segments are economically similar, and meet all of the aggregation criteria in IFRS 8.

Example 3 – Identifying reportable segments to achieve the 75% external revenue requirement (combining segments)
Entity X has identified seven operating segments. Segments A and C exceed at least one of the quantitative thresholds and are identified as reportable segments. None of the five remaining segments is individually large enough to constitute a reportable segment.

However, the total external revenues generated by Segments A and C represent only 73% of the entity's total external revenues, as indicated below.

	External Revenue CU
Segment A	40
Segment B	9
Segment C	33
Segment D	7
Segment E	6
Segment F	3
Segment G	2
Total net profit	**100**

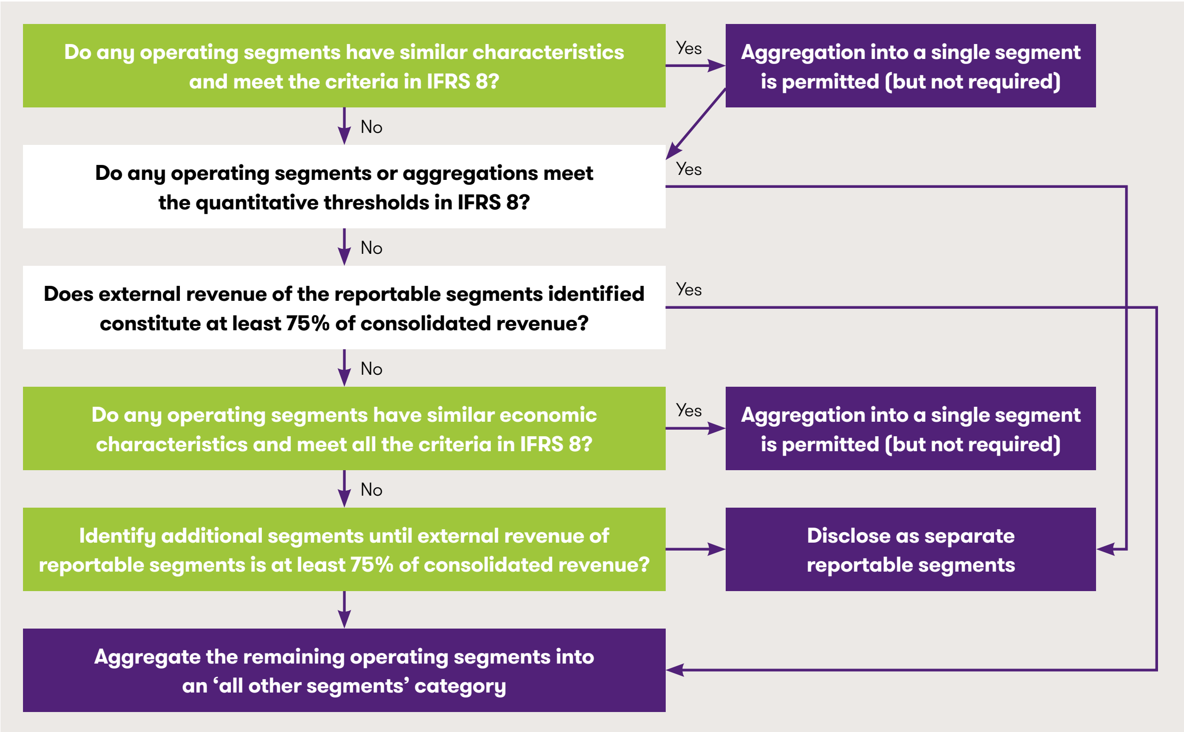
Segment B has similar economic characteristics to Segment C and to Segment G. B shares the majority but not all of the aggregation criteria in IFRS 8 in either case. Segments C and G share with each other the majority but not all of the criteria in IFRS 8.

In order to satisfy the requirement for the external revenue of reportable segments to represent at least 75% of the entity's external revenue **'Insights into IFRS 8 – Reportable segments'**, Entity X would like to aggregate Segments B and C.

Entity X cannot aggregate Segments B and C for this purpose because only some, not all, of the aggregation criteria in IFRS 8 are met.

Another segment must be identified as a reportable segment to reach the 75% threshold. This may be any other individual segment or it may be Segments B and G combined, as neither individually exceeds the quantitative thresholds (see page 5). In addition, they share similar economic characteristics.

The following flowchart takes into account the requirements noted in this article as well as **'Insights into IFRS 8 – Reportable segments'** to describe the process involved in aggregating operating segments:



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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Reportable segments

The balance between presenting enough information to users of the financial statements and presenting too much information so that the overall picture and usefulness of what is being disclosed is not masked by detail is a fine one. For some large or complex entities, the number of operating segments identified when applying IFRS 8 'Operating Segments' may be excessive and the benefit of disclosing segmental information for each separate segment may be insufficient to justify the cost.

Our 'Insights into IFRS 8' series considers some key implementation issues and includes interpretational guidance in certain problematic areas. We also include several examples illustrating the Standard's requirements. This article sets out the requirements of identifying reportable segments, which is closely linked to aggregating operating segments. Refer to our article '**Insights into IFRS 8 – Aggregating operating segments**'.

IFRS 8 generally does not require disclosure of each separate operating segment. Instead, quantitative thresholds are set to select the more significant segments requiring separate disclosure. Some aggregation is permitted where segments have similar economic characteristics or fall below the quantitative thresholds. However, IFRS 8 also sets a minimum level for separate segment disclosure, based on external revenue levels.

The process for determining reportable segments can be confusing. The IASB has included a flow chart in the Implementation Guidance to IFRS 8 to assist. This is reproduced at the back of this article. The process may be summarised as follows:

- Identify operating segments, as discussed in our article **'Insights into IFRS 8 – Identifying operating segments'**.
- (Optional step): Determine whether any operating segments meet all the aggregation criteria in IFRS 8 (see our article **'Insights into IFRS 8 – Aggregation of operating segments'**) and if so aggregate them.
- Review the identified operating segments and aggregated groups of operating segments to see if they meet the quantitative thresholds and so need to be treated as reportable segments (see below).
- (Optional step – may be done here or after testing whether the external revenues of reportable segments represent 75% or more of the entity's external revenue): For the remainder, determine whether any of the identified operating segments or aggregated groups of operating segments meet a majority of the aggregation criteria in IFRS 8. If they do, aggregate them and treat as reportable segments if they meet the quantitative thresholds (see our article **'Insights into IFRS 8 – Aggregation of operating segments'**).
- Test whether the external revenues of reportable segments identified so far represent 75% or more of the entity's external revenue. If not, additional reportable segments must be identified (either individual segments or aggregations of segments identified), until the total of reportable segments reaches the 75% point (see page 3).
- Aggregate the remaining segments not identified as reportable segments into an 'all other segments' category (see flowchart on page 7).

Quantitative thresholds for reportable segments

Once the entity's operating segments have been identified, it must then determine which operating segments are reportable. Reportable segments are those operating segments, or groups of operating segments, that meet the quantitative thresholds for separate disclosure. Quantitative thresholds are included in IFRS 8 so as to limit the disclosures to a reasonable level.

The thresholds

IFRS 8 provides guidance on quantitative thresholds for an entity as follows:

- Its reported revenue, including both sales to external customers and intersegment sales or transfers, is 10 per cent or more of the combined revenue, internal and external, of all operating segments.
- The absolute amount of its reported profit or loss is 10 per cent or more of the greater, in absolute amount, of
  - the combined reported profit of all operating segments that did not report a loss, and
  - the combined reported loss of all operating segments that reported a loss.
- Its assets are 10 per cent or more of the combined assets of all operating segments.

The amounts considered when looking at the thresholds are the amounts reported to the CODM, before elimination of any intersegment transactions. If any one of the three criteria noted above is present, disclosure, either individually or in aggregate will be required.

Example 1 – Application of quantitative thresholds

Segment	Segment Revenue CU	Segment profit/(loss) CU	Segment assets CU
Wholesale	900	100	80
Retail	1,400	200	750
Transport	200	(35)	70
Total	**2,500**	**265**	**900**

Further information

The wholesale segment includes internal sales to the retail segment of CU600.

The transport segment derives revenue of CU160 from internal services provided to both the wholesale and retail segments.

Threshold amounts (calculated before any intersegment eliminations): Total revenue: CU250 (2,500 × 10%)

Operating results: CU30 (300 × 10%), being 10% of the greater of the absolute amount of all operating segments not reporting a loss (100 + 200) and all operating segments reporting a loss (35).

Total assets: CU90 (900 × 10%).

Considering each of the operating segments in turn:

Segment	Segment Revenue	Segment profit/(loss)	Segment assets
Wholesale	Exceeds	Exceeds	Does not exceed
Retail	Exceeds	Exceeds	Exceeds
Transport	Does not exceed	Exceeds	Does not exceed

Accordingly, all three segments meet at least one threshold and therefore all are reportable.

Minimum number of reportable segments – the 75% revenue test

IFRS 8 does not explicitly require a minimum number of reportable segments but it does contain a requirement that may result in the identification of additional reportable segments after performing the quantitative threshold tests.

External revenue of reportable segments must constitute at least 75% of total consolidated revenue. Consolidated revenue for the purpose of this comparison would, by definition, mean external revenue, as inter-segment revenue would be eliminated on consolidation. Identification of additional reportable segments is not required if this minimum threshold is met.

If this minimum external revenue threshold is not met, additional operating segments or aggregated operating segments must be identified as reportable segments until at least 75% of the entity's revenue is included in reportable segments. IFRS 8 does not prescribe which additional segments should be included to reach the 75% threshold. Consequently, entities are not required to identify the additional reportable segments in order of size.

However, we believe entities should consider both quantitative and qualitative factors when determining which additional operating segments should be disclosed. In making this assessment, entities should consider the disclosure objectives of the Standard.

Example 2 – Identifying additional reportable segments to achieve the 75% external revenue requirement (significance of segments)

	External Revenue CU
Segment A	40
Segment B	9
Segment C	33
Segment D	7
Segment E	6
Segment F	3
Segment G	2
Total net profit	**100**

After Segments A and C have been selected, none of the five remaining segments are individually large enough to constitute a reportable segment. Segment F is a new business unit that began contributing to revenue only two months before the end of the year. Management expects this segment to make a significant contribution to external revenue in future reporting periods. The remaining segments are expected to remain stable. Consequently, the entity designates this start-up segment as a reportable segment, making the total external revenues attributable to reportable segments 76% of total entity revenues.

Reporting segments that do not meet the reportable thresholds

An entity may identify one or more operating segments that do not exceed any of the quantitative thresholds for reportable segments but management believes that information about the segment(s) would be useful to users of the financial statements. For example, as noted above, there may be a start-up segment that is expected to exceed the thresholds in the future and make a significant contribution to the future success of the entity. An entity may therefore choose to consider such a segment as reportable and so disclose it separately.

Combining reportable segments

Generally, reportable segments cannot be combined. In large and diverse groups however, the CODM may regularly review information about every subsidiary. If the subsidiaries have different economic characteristics then aggregation may not be permitted by IFRS 8. This may result in a large number of reportable segments. Aggregation criteria is discussed in our article **'Insights into IFRS 8 – Aggregation of Operating Segments'**.

IFRS 8 notes there may be a practical limit to the number of reportable segments an entity separately discloses beyond which segment information may become too detailed. IFRS 8 does not set a precise limit but does suggest if the number of reportable segments increases above ten, the entity should consider whether a practical limit has been reached.

IFRS 8 does not provide any guidance as to the actions to be taken if a practical limit has been reached. In our view, an entity should exercise caution in aggregating segments in these circumstances. If aggregation is needed at this stage, only segments that firstly have similar economic characteristics, and secondly have a majority of the criteria listed in IFRS 8 should be aggregated. In addition, the disclosure of the factors used to identify the entity's reportable segments should explain the reportable segments formed as a result of this aggregation process only share a majority of the criteria for aggregation but have been combined in order to reduce the number of reportable segments to a practical level. Refer to our article **'Insights into IFRS 8 – Segment Information to be Disclosed'**.

Further practical application issues

Single customer satisfies thresholds for a reportable segment

Information may be separately reported to the CODM for the business conducted with a major customer. If the customer qualifies as a reporting segment using the IFRS 8 criteria described above, then the segment information for this customer should be separately disclosed. The identity of the customer need not be given but the segment should be appropriately described.

CODM is presented with more than one measure for segment profitability and/or assets

The quantitative thresholds refer to internally reported profit (or loss) and internally reported assets when considering the 10% test. However, in some cases, different measures of profit or loss and of assets are used by management so a consistent measure should be used for the purposes of assessing the 10% test.

IFRS 8 is not explicit as to which measure of profitability or of assets should be used for the purpose of the threshold test. However, using the management approach, it would seem logical to use the measure most relied upon by the CODM for assessing performance and deciding on the allocation of resources. If this does not give a clear answer, we recommend the use of the measure that is most consistent with the measurement principles used elsewhere in the entity's financial statements.

Example 3 – Selecting an operating profit measure to identify segments when more than one measure is used by the CODM

Each segment manager in entity A provides the CODM with two measures of profitability: operating profit and profit before income tax. Both measures are used by the CODM for profitability assessment and resource allocation decisions.

Segment operating profit is determined based on similar measurement principles to those used in the preparation of consolidated operating profit.

However, segment profit before income tax expense includes certain internal recharges and adjustments, such as corporate cost centre recharges; cost-of-capital charges; and the elimination of fair value changes in financial instruments that are adjusted in determining consolidated profit before income tax reported in the financial statements.

In this case, segment operating profit would be the measure reported externally because this measure is the most consistent with its corresponding amount in the entity's financial statements. This would also be the measure used for determining the 10% threshold.

CODM uses different profitability or asset measures for different segments

The measure of segment profitability or segment assets may differ for each operating segment, as different operating segments may report different measures of profitability to the CODM. IFRS 8 does not contain any specific guidance in such circumstances. In our view, management should determine a reasonable and consistent basis to compare segments for the 10% result or asset test.

Example 4 – Selecting a measure to identify reportable segments when the CODM uses different measures for different segments

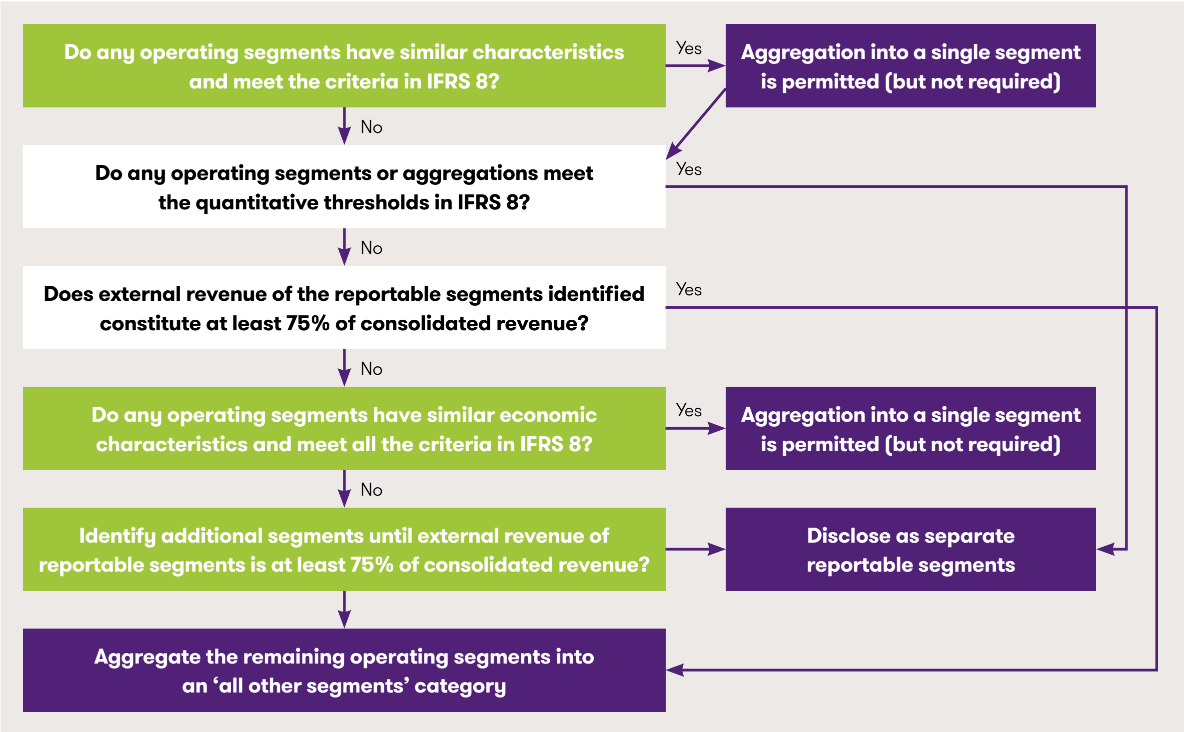
An entity has three operating segments, none of which can be combined under the aggregation criteria. The following is reported to the chief operating decision maker:

- Segment 1 measures profitability based on net profit after pension cost allocations and internal cost-of-capital recharges. Asset information includes inventory, accounts receivable, tangible and intangible assets.
- Segment 2 measures profitability based on net profit after internal cost-of-capital recharges but excluding pension cost allocations. Asset information includes inventory, accounts receivable and tangible assets but excludes intangible assets.
- Segment 3 measures profitability based on net profit before any internal cost-of-capital recharges or pension cost allocations. Asset information is limited to accounts receivable.

Management have concluded that the most appropriate measure for determining the 10% threshold is the lowest level of profitability and assets reported to the CODM for all segments, as this provides the most consistent comparison.

The profit measure used for the quantitative threshold test is therefore the net profit before any internal cost-of-capital recharges or pension cost allocations. The asset measure used is accounts receivable.

The following flowchart takes into account the requirements noted in this article as well as **'Insights into IFRS 8 – Aggregation of operating segments'** to describe the process involved in aggregating operating segments:



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