

Insights into PFRS 8

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 PFRS 8, *Operating Segments*, may be excessive and the benefit of disclosing segment information for each separate segment may be insufficient to justify the cost.

Our 'Insights into PFRS 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 PFRS 8 – Aggregating operating segments'](#).



PFRS 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, PFRS 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 summarized as follows:

- Identify operating segments, as discussed in our article [‘Insights into PFRS 8 – Identifying operating segments’](#).
- (Optional step): Determine whether any operating segments meet all the aggregation criteria in PFRS 8 (see our article [‘Insights into PFRS 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 PFRS 8. If they do, aggregate them and treat as reportable segments if they meet the quantitative thresholds (see our article [‘Insights into PFRS 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 PFRS 8 so as to limit the disclosures to a reasonable level.

The thresholds

PFRS 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 percent or more of the combined revenue, internal and external, of all operating segments.
- The absolute amount of its reported profit or loss is 10 percent 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 percent 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 x 10%)

Operating results: CU30 (300 x 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 x 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

PFRS 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. PFRS 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 PFRS 8. This may result in a large number of reportable segments. Aggregation criteria is discussed in our article [‘Insights into PFRS 8 – Aggregation of Operating Segments’](#).

PFRS 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. PFRS 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.

PFRS 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 PFRS 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.

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 PFRS 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.

PFRS 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 center 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. PFRS 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

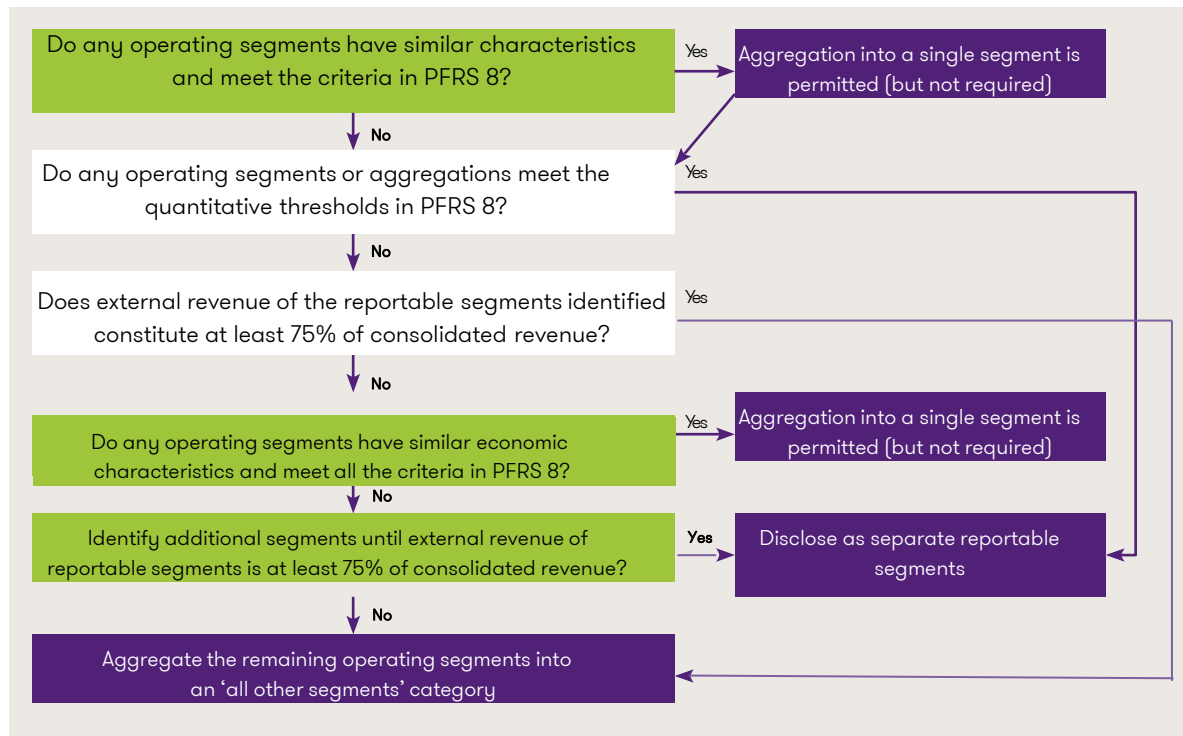
An entity has three operating segments, none of which can be combined under the aggregation criteria. The following is reported to the chief operating decision maker:

- 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 PFRS 8 – Aggregation of operating segments' to describe the process involved in aggregating operating segments:



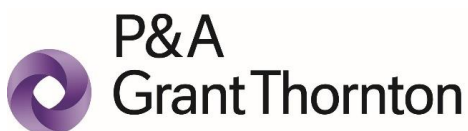
How we can help

We hope you find the information in this article helpful in giving you some insight in the accounting implications of Insights into PFRS 8. If you would like to discuss any of the points raised, please speak to your usual P&A Grant Thornton contact or visit www.grantthornton.com.ph/Contact.

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