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Insights into PFRS 8

Segment information to be disclosed

Segment reporting is intended to give information to investors and stakeholders regarding the financial results and financial position of the entity that are used by the entity's chief operating decision maker (CODM). Given this, PFRS 8, *Operating Segments*, provides the guidance to preparers on this area.

Our 'Insights into PFRS 8' series is designed to illustrate how PFRS 8 should be applied and it provides guidance and insight in some problematic areas. We also include several examples illustrating the standard's disclosure requirements. This article sets out the segment information that needs to be disclosed in the consolidated financial statements of the reporting entity.

PFRS 8's 'management approach' has the effect that reportable segments and segment information will vary according to the information used by the CODM. As a result, disclosures will not be consistent between entities, even those operating in similar industries. It is therefore important that users are provided with an explanation of how management have identified both the entity's CODM and its operating segments and how the information reported to the CODM reconciles to the primary financial statements.

The disclosures required in PFRS 8 include both narrative and quantitative information.

Disclosure of the factors used to identify segments

PFRS 8 requires an entity to disclose the following general information:

- factors used to identify the entity's reportable segments, including the basis of organization; and,
- types of products and services from which each reportable segment derives its revenues.

The factors disclosed under the first bullet point above provide the readers of the financial statements with information as to how management has organized the entity. These disclosures should clearly indicate whether segments are based on products and services, geographical areas, regulatory environments or a combination of factors. It should also indicate whether different operating segments have similar economic characteristics and have therefore been aggregated (see 'Insights into PFRS 8 –Aggregation of operating segments'). PFRS 8 requires quantitative information to be disclosed using the amounts presented to the CODM. This will often be different to the amounts reported under PFRS appearing in the primary financial statements. Probably, the most important judgement made in the application of PFRS 8 is the identity of the function of the CODM, as it is the information that is regularly used by the CODM that forms the basis for segmental reporting. In light of this, while not a formal disclosure requirement in PFRS 8, we believe it is good practice to disclose the individual or group identified as the CODM.

Quantitative information about profit or loss, assets and liabilities

The amounts disclosed for each segment item reflects what has been reported to the CODM. They should be the same amounts the CODM has used to allocate resources to the segment and assess its performance. These amounts will often be different from the measures used in the primary financial statements. Further disclosures are therefore needed to reconcile the segment measures to the primary statements (see reconciliation to PFRS primary financial statements on page 5).

Although PFRS 8 generally requires disclosure on the basis of information used in the business, there are limited circumstances in which entity es may need to obtain additional information to meet the requirements of PFRS 8 and they are set out below and in the succeeding page.

Measure of segment profit or loss

The IASB anticipate some sort of measure of segment profit or loss will be regularly reported to the CODM and so PFRS 8 requires an entity reports a measure of segment profit or loss in all cases.

In practice, the measure used by the CODM is likely to vary significantly between entities. Clear disclosure of the measurement basis used to prepare segment results will therefore be very important (see disclosure of measurement policies on page 4).

Measure of segment assets

Where a measure of segment assets is reported to the CODM, that measure is required to be disclosed. In accordance with PFRS 8, the disclosure is based on what is reported to the CODM. If the internal reporting includes, say, cash, inventory and accounts receivables, the sum of those three items is what needs to be disclosed.

PFRS 8 requires disclosure of a measure of segment assets. However, the IASB acknowledge, whilst a measure of segment profit or loss is expected in every entity's internal reporting, there may be circumstances where a measure of segment assets is not included. As a result, a measure of segment assets should only be disclosed when such information is provided to the CODM. This is consistent with the management approach and with the requirement for disclosure of a measure of segment liabilities only when such a measure is reported to the CODM (see next page).

Measure of segment liabilities

PFRS 8 requires an entity reports a measure of liabilities for each reportable segment if, and only if, such an amount is regularly provided to the CODM.

Other specified segment measures

PFRS 8 requires disclosure of items when they are either included in the measure of segment profit or loss reviewed by the CODM or they are otherwise regularly provided. This means the management reports presented to the CODM must be reviewed to identify whether these items are either included as separately disclosed amounts or have been charged/credited in arriving at segment results. If so, they must be disclosed. The specified amounts to be disclosed in these circumstances are:

- revenues from external customers;
- revenues from transactions with other operating segments of the same entity;
- interest revenue;
- interest expense;
- depreciation and amortization;
- material items of income and expense disclosed in accordance with PAS 1, *Presentation of Financial Statements*;
- the entity's interest in the profit or loss of associates and joint ventures accounted for by the equity method;
- income tax expense or income; and,
- material non-cash items other than depreciation and amortization.

An entity reports interest revenue separately from interest expense for each reportable segment unless a majority of the segment's revenues are from interest and the CODM relies primarily on net interest revenue to assess performance and make decisions. In that situation, an entity may report that segment's interest revenue net of its interest expense and disclose that it has done so.

Example 1 – Disclosure of depreciation and amortisation expense when the CODM uses EBITDA to assess segment results

The CODM evaluates the performance of the entity's segments based on earnings before interest, income taxes, depreciation and amortisation (EBITDA).

Included in the management reports reviewed by the CODM are summaries of depreciation and amortisation expense related to each of the segments, even though these amounts are not allocated within the segment results reported.

No allocations of interest or income taxes are made and only entity-wide amounts for these items are reported to the CODM.

Should the segment amounts for interest, income taxes, depreciation and amortisation be separately disclosed in accordance with PFRS 8?

Although in this example, depreciation and amortisation expense is not included in the measure of segment profit or loss that is reviewed by the CODM, such amounts are included in the information pack. Therefore, disclosure of depreciation and amortisation expense by each reportable segment is required.

However, as no segment analysis of interest or income taxes is provided to the CODM, no amounts for these items need be disclosed.

Disclosures for non-reportable segments

Information about other business activities and operating segments that are not separately reportable (after all preceding stages of aggregation and identification of reporting segments have been performed) is then combined and disclosed in an 'all other segments' category. A description of the sources of revenue included in this category is required by PFRS 8.

Disclosure of measurement policies

As noted in the quantitative information paragraphs in the preceding pages, PFRS 8 requires disclosure of segment information based on amounts reported to the CODM. Information used for internal management reporting purposes varies widely from entity to entity. For example, the CODM may use profit figures that exclude certain items such as reorganisation costs, non-recurring or unusual items and fair value changes. CODMs in some entities may rely primarily on cash flow-based results.

In developing PFRS 8, the International Accounting Standards Board (IASB) decided that the cost of reduced comparability of information between entities was outweighed by the benefits of increased relevance of the management approach. They also recognised that, in view of the diversity of disclosure bases that arises under a management approach, some explanation and reconciliation of the segmental information would be necessary.

In addition to a numerical reconciliation between the segment measures reported and those used in the primary financial statements (see reconciliation to PFRS primary financial statements in the succeeding page), PFRS 8 requires an entity to disclose an explanation that enables users to understand the basis on which segmental information is measured.

The explanation should cover as a minimum:

- The basis of accounting for transactions between reportable segments, including transfer pricing policies (e.g., market prices, cost, or cost-plus).
- The nature of the description of the measurement basis for each reported measure of segment profit or loss, segment assets and segment liabilities, in particular the nature of any differences between these measurements and those used for the entity's reported profit or loss before income tax expense or income and discontinued operations, or assets and liabilities in the entity's statement of financial position (unless apparent from the reconciliations described in the succeeding page).
- The nature of any changes from prior periods in the measurement methods used and the effect of the changes.
- The nature and effect of any asymmetrical allocations to reportable segments, for example an entity might allocate depreciation expense to a segment without allocating the related depreciable assets to the segment.

The numerical reconciliations described in the succeeding page may be sufficient to explain some of the more obvious reconciling items, such as inclusion of non-segment revenue from corporate functions that are not operating segments and exclusion of inter-segment revenue in the entity total. The narrative explanation described above may then focus on a description of other differences such as differences in accounting policies and policies for allocating centrally incurred costs or central assets and liabilities.

Reconciliation to PFRS primary financial statements

In addition to the narrative explanations described in the preceding page, PFRS 8 requires disclosures to reconcile the segment items with the equivalent entity amounts.

Segment measures to be reconciled

PFRS 8 requires reconciliations of:

- the total of the reportable segments' revenues to the entity's revenue;
- the total of the reportable segments' measures of profit or loss to the entity's profit or loss before tax expense (tax income) and discontinued operations. However, if an entity allocates to reportable segments items such as tax expense (tax income), the entity may reconcile the total of the segments' measures of profit or loss to the entity's profit or loss after those items;
- the total of the reportable segments' assets to the entity's assets;
- the total of the reportable segments' liabilities to the entity's liabilities (if segment liabilities are reported); and,
- the total of the reportable segments' amounts for every other material item of information disclosed to the corresponding amount for the entity.

Examples of reconciling items include: conversion of segment information reported on a local GAAP basis for segments; inclusion of activities of corporate functions that are not identified as operating segments; and elimination of intra-segment amounts.

The actual amount of each material adjusting item should be disclosed as well as a description.

Amounts relating to the 'all other segments' category are disclosed separately from other reconciling items.

See our article 'Insights into 'PFRS 8 – Example disclosures of segmental information' for example disclosures.

How we can help

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

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