

SLFRS 08 : Operating Segments

Chartered Accountancy Corporate Level Financial Reporting and Governance (FRG)

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SLFRS 08

OPERATING SEGMENTS

An operating segment is a component of an entity:

- (a) That engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other items of the same entity)
- (b) Whose operating results are regularly reviewed by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and
- (c) For which discrete financial information is available.

Two or more operating segments may be aggregated if the segments have similar economic characteristics, and the segments are similar in *all* of the following respects:

- The nature of the products or services
- The nature of the production process
- The type or class of customer for their products or services
- The methods used to distribute their products or provide their services
- If applicable, the nature of the regulatory environment

In order for an identified operating segment to be reportable, the segment total should be 10% or more of the total:

- (a) Revenue (internal and external), or
- (b) All segments not reporting a loss (or all segments in loss if greater), or
- (c) Assets

If those segments that meet the quantitative threshold do not represent at least 75% of total external revenue, additional segments must be identified (even if they do not meet the 10% thresholds).

Additional Requirement

At least 75% of total external revenue must be reported by operating segments. Where this is not the case, additional segments must be identified (even if they do not meet the 10% thresholds).

Two or more operating segments below the thresholds may be aggregated to produce a reportable segment if the segments have similar economic characteristics, and the segments are similar in a majority of the aggregation criteria above.

Operating segments that do not meet any of the quantitative thresholds may be reported separately if management believes that information about the segment would be useful to users of the financial statements.

Example 01

Klancet produces and sells its range of drugs through three separate divisions. In addition, there are two laboratories which carry out research and development activities.

In the first of these laboratories, the research and development activity is funded internally and centrally for each of the three sales divisions. It does not carry out research and development activities for other entities. Each of the three divisions is given a budget allocation which it uses to purchase research and development activities from the laboratory. The laboratory is directly accountable to the division heads for this expenditure.

The second laboratory performs contract investigation activities for other laboratories and pharmaceutical companies. This laboratory earns 75% of its revenues from external customers and these external revenues represent 18% of the organisation's total revenues.

The performance of the second laboratory's activities and of the three separate divisions is regularly reviewed by the chief operating decision maker (CODM). In addition to the heads of divisions, there is a head of the second laboratory. The head of the second laboratory is directly accountable to the CODM and they discuss the operating activities, allocation of resources and financial results of the laboratory.

Klancet is uncertain as to whether the research and development laboratories should be reported as two separate segments under IFRS 8 *Operating Segments*, and would like advice on this issue. (8 marks)

Example 02

(a) In its annual financial statements for the year ended 31 March 2013, Verge, a public limited company, had identified the following operating segments:

- (i) Segment 1 local train operations
- (ii) Segment 2 inter-city train operations
- (iii) Segment 3 railway constructions

The company disclosed two reportable segments. Segments 1 and 2 were aggregated into a single reportable operating segment. Operating segments 1 and 2 have been aggregated on the basis of their similar business characteristics, and the nature of their products and services. In the local train market, it is the local transport authority which awards the contract and pays Verge for its services. In the local train market, contracts are awarded following a competitive tender process, and the ticket prices paid by passengers are set by and paid to the transport authority. In the inter-city train market, ticket prices are set by Verge and the passengers pay Verge for the service provided. (5 marks)

How to decided a reportable segment

The operating segments of a diversified professional services company, AB Professional PLC are:

<i>Operating segment</i>	<i>Revenue</i>	<i>Profit</i>	<i>Assets</i>
	%	%	%
Tax services	55	65	58
Accounting	8	6	9
Legal	7	8	7
Risk consultancy	9	5	7
Corporate finance	8	8	6
PR and marketing	6	6	8
Secretarial services	7	2	5
	100	100	100

No two operating segments share all of the SLFRS 8 aggregation criteria. All sales are made to external customers with the exception of the Secretarial Services division which makes all of its sales to other internal segments.

Required

Advise how the principles in SLFRS 8 *Operating segments* for the determination of a company's reportable operating segments would be applied using the information given above.

Only the Tax services segment meets the 10% quantitative threshold for a reportable segment.

This segment only provides 55% of total revenue generated by the Company and 59% ($55/93 \times 100\%$) of external revenue. Therefore additional operating segments must be identified as reportable.

It may be the case that certain other segments have similar economic characteristics and meet a majority of the SLFRS 8 aggregation criteria in which case they may be joined to form a reportable segment.

It may also be the case that the management of AB Professional wish to report the results of particular segments that don't qualify as reportable in order to provide useful information to users.

If this is not the case then other operating segments must be designated as reportable in order to achieve the required 75% of external revenue in reportable segments.

The logical way to achieve this would be to designate the next largest segments in terms of revenue until the 75% threshold were achieved.

Risk consultancy provides $(9/93 \times 100\%) = 10\%$ of external revenue; if this is reported separately, total external revenue reported becomes $59\% + 10\% = 69\%$.

A further segment must be reported. This could be any of Accounting, Legal, Corporate Finance and PR and Marketing, all of which contribute more than 6% external revenues.



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