SEGMENT REPORTING

As companies diversify internationally or in the lines of business in which they operate, the usefulness of consolidated financial statements diminishes. There are different risks and growth potential associated with different parts of the world, just as there are different risks and opportunities associated with different lines of business. The aggregation of all of a company's revenues, expenses, assets, and liabilities into consolidated totals masks these differences.

United Technologies Inc., parent company of Otis (elevators), Carrier (air conditioners), and Sikorsky (helicopters), reported consolidated revenues of $53 billion and operating profit of $6.4 billion in 2009. Analysts and others might find it useful to know how much of that total was generated from each of the company's major lines of business, as there are different risks and growth prospects associated with each. In 2009, Coca-Cola Company reported consolidated revenues of $31 billion and operating income of $8.2 billion. Financial analysts and other financial statements users might want to know how much of this revenue was generated in North America, and how much was generated in Latin America, Eurasia and Africa, and other parts of the world where risks are higher.

To facilitate the analysis and evaluation of financial statements, in the 1960s several groups began to request that consolidated amounts be disaggregated and disclosed on a segment basis. Required line-of-business disclosures were introduced in the United Kingdom in 1965, and in the United States in 1969. The European Union's Fourth Directive on accounting, issued in 1978, requires both line-of-business and geographic disclosures, as does IAS 14, Segment Reporting, which was originally issued in 1981. Thus, segment reporting has been a part of the international accounting landscape for many years.

In 2002, segment reporting was added to the agenda of the short-term convergence project of the IASB and the FASB. After several years of study, the IASB issued IFRS 8, Operating Segments, in November 2006, which substantially converges IFRS with U.S. GAAP on the issue of segment reporting. [5] With the issuance of IFRS 8, the IASB adopted the so-called management approach to segment reporting introduced by the FASB in 1996.

Operating Segments—The Management Approach

The management approach to determining segments is based on the way that management disaggregates the enterprise for making operating decisions. These disaggregated components are referred to as operating segments, which should be evident from the enterprise's organization structure. An operating segment is a component of an enterprise if:

- It engages in business activities from which it earns revenues and incurs expenses.
- If its operating results are regularly reviewed by the chief operating decision maker to assess performance and make resource allocation decisions.
- Discrete financial information is available for it.

Even if all of an organizational unit's revenue and expense are derived from transactions with other segments it still can be an operating segment. But not all parts of a company necessarily are included in an operating segment. For example, a research and development unit that incurs expenses but does not earn revenues would not be an operating segment. After a company has identified its operating segments based on its internal reporting system, management must decide which of these segments should be reported separately. Generally, information must be reported separately for each operating segment that meets one or more quantitative thresholds.

After determining whether any segments are to be aggregated, management next must determine which of its operating segments are significant enough to justify separate disclosure. An operating segment is considered significant if it meets any one of the following tests:

1. ***Revenue test:*** Segment revenues, both external and intersegment, are ***10 per cent*** or more of the combined revenue, internal and external, of all reported operating segments.
2. ***Profit or loss test***: Segment profit or loss is ***10 per cent*** or more of the higher (in absolute terms) of the combined reported profit of all profitable segments or the combined reported loss of all segments incurring a loss.
3. ***Asset test:*** Segment assets are ***10 per cent*** or more of the combined assets of all operating segments.
4. ***Overall size test:*** If the combined sales to unaffiliated (external) customers of segments determined to be significant are less than ***75 per cent*** of total company sales made to outsiders, additional segments must be disclosed separately even though they fail to meet one of the quantitative thresholds, until the 75% mark is reached. This ***overall size test*** is to ensure that all entities present a sufficient level of information regarding their individual activities to ensure that users of the financial statements can make informed economic decisions.

All segments that are neither separately reported nor combined should be included in the segment reporting disclosures as an unallocated reconciliation item or in an “all other” category.

Where a segment was separately reported in the previous period, it should continue to be reported separately even if the thresholds are not met in the current period, where the segment has been identified as being of continuing significance. Equally, where a segment meets the 10% threshold in the current period it should be separately reported for both the current and the previous period even if it was not separately reported in the previous period, assuming that it is practicable to do so.

IFRS 8 does not set an upper limit as to the number of operating segments that should be separately reported. However, the standard sets out that if the number of separately reported segments exceeds ten then it is likely that the information may become too detailed and consequently lose its usefulness.

Illustration

A quoted company reports six different types of business to its chief executive. In the most recent financial year, the revenue of these six operations, as a percentage of total revenue (including those to internal customers), were as follows:

Business Type	**% Internal**	**% External**	**% Total**
1	0	40	40
2	0	20	20
3	12	6	18
4	5	5	10
5	0	7	7
6	0	5	5
% **Total**	17	83	100

Note that the external revenue of segments reportable under the 10% test represents 71 (40 + 20 + 6 + 5) out of the 83 percentage points which comprise external sales. They therefore represent 85.5% of external revenue and no additional segments needed to be reported under the "75% rule."

What has to be reported?

The purpose of disclosing segmental information is to provide additional information to the users of the financial statements so that they will be able to evaluate the nature and financial effects of an entity's business activities as well as the economic environment in which it operates.

IFRS 8 requires the disclosure of general information, such as the ***type of products and services*** from which each reportable segment generates its revenue along with factors that have been used by management to identify its reportable segments.

A ***measure of profit or loss*** and ***total assets*** should be disclosed for each reportable segment. Segment liabilities are only required to be disclosed if this information is regularly provided for internal reporting purposes. Specified components of the operating segment's profit or loss and segment assets are also required to be disclosed where such information is regularly provided to the chief operating decision maker.

A number of reconciliations should be provided in relation to the total of segment revenues, reported segment profit or loss, segment assets and liabilities and other material items, to corresponding items in the entity's financial statements.