Grant Thornton

Accounting

Advisory

Global

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**

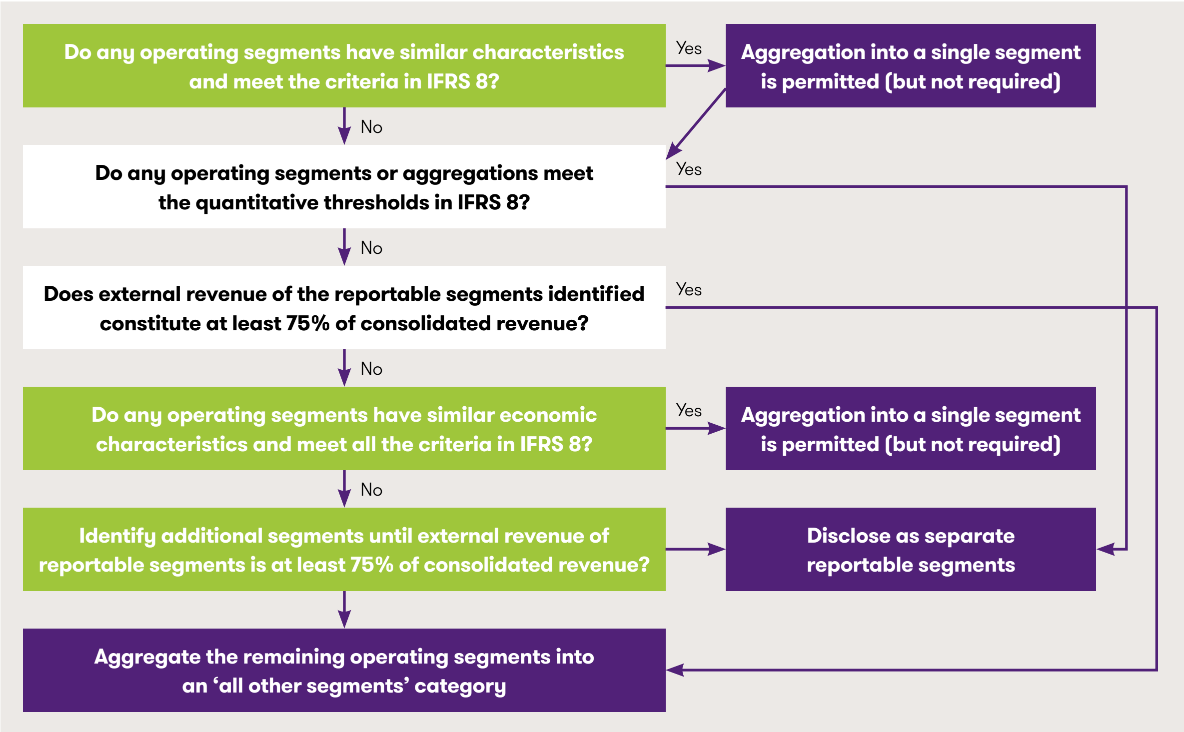
Segment B has similar economic characteristics to Segment C and to Segment G. B shares the majority but not all of the aggregation criteria in IFRS 8 in either case. Segments C and G share with each other the majority but not all of the criteria in IFRS 8.

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.

grantthornton.global