Segment reporting

An opportunity to explain the business

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IFRS 8 is the new international accounting standard that requires companies to give disclosures about their 'operating segments'. It was issued in November 2006. At that time, the global economy was relatively stable and performing reasonably well. No one anticipated the turmoil that was to rock the global capital markets and the economic uncertainty that would ensue.

Clear and credible reporting is fundamental to rebuilding trust within the capital markets. Is IFRS 8 a help or hindrance in this process?

PwC's research demonstrates that a thoughtful approach to the adoption of IFRS 8 can differentiate a company from its peers and help investors understand its value. However, management should be aware of some pitfalls along the way.

How did we get to IFRS 8?

The impetus for issuing IFRS 8 included:

- A perception that the management approach of IFRS 8 would result in more meaningful segment reports with both more relevant line items reported for each segment and, possibly, an increase in the number of segments
- Enhanced consistency with management's discussion and analysis
- External interim segments information would be prepared on a more timely basis as reported segment information would be aligned with management information
- Achieving convergence with US GAAP

What do investors want to see?

PwC has carried out surveys in a number of major capital markets to understand the information needed by investment professionals to assess the quality and sustainability of performance.

Models built around segment information
Segment information ranks top of the list in terms of its importance to analysts. Many of the models they use to assess performance are built from the segment up[1].

Differentiating reporting
Segment information was seen by respondents as the greatest gap in reporting today. It was commented that companies that report well in this area have the opportunity to differentiate themselves from their peers[1].

Through management's eyes
Investors expressed some reservations about the 'through management's eyes' approach to segment reporting. Investors are concerned that management might bracket together businesses with different business models and will cherry-pick the metrics that they report[2].

Performance measures
While investors want to see a disaggregation of the entity, they also want meaningful performance measures, which may include non-GAAP results. Where non-GAAP results are presented, the investor will need to understand why the non-GAAP measures are used; how they are defined; and how they reconcile back to GAAP[1].

Consistency
Investors want to be able to link the core segment disclosures with prior-year information and compare segment information to other explanations that management provides when discussing its past performance and its outlook for the future[1].

[1] *Corporate reporting: Is it what investment professionals expect?,* PricewaterhouseCoopers, November 2007
[2] *Performance statement: Coming together to shape the future of reporting,* PricewaterhouseCoopers, December 2007

How will IFRS 8 change reporting?

Number of segments may change

The IASB believes that the number of reported segments will increase under IFRS 8 (basis for conclusion BC6); more information will be available to users. This is supported by the results of an informal survey of finance executives at PwC's 'Meet the Experts' in October 2008, where 51% of respondents (129 in total) who believed IFRS 8 will change the way they look at segments indicated that they expected to increase the number of reported segments.

Composition of segments

Management is required to present its segment reporting in the same way that it views its business. This may change the segment composition if that view is not aligned with the geographic or business segment requirements of IAS 14. Vertically integrated operations that are assessed separately may be reportable segments, even if the majority of their revenues are derived from internal sales.

Quality of information

Non-IFRS compliant measures that are used to assess performance should be used for the segment disclosures. 40% of the finance executives who responded to our informal 'Meet the Experts' survey indicated that they expect their segment information to contain an increased number of non-IFRS compliant line items.

Many believe that the quality and usefulness of the information should improve because it will be derived from the information management uses to operate the business. However, management should take a number of issues into consideration when looking at the information, including:

- How robust is the information?
- What are the controls and procedures that support the information collation?
- What review procedures are used by the finance department to be happy with the information?

One way of addressing these questions is to consider whether the data is subject to the same level of controls and review as other information which is reported externally.

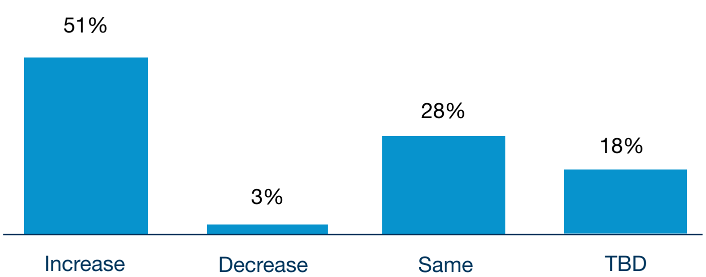
Competitors' reporting

As IFRS 8 is based on the management approach, competitors in the same industry might not report in the same way; segment disclosures could differ. While these differences may hinder comparability between companies, they will provide insight into how management analyses the business.

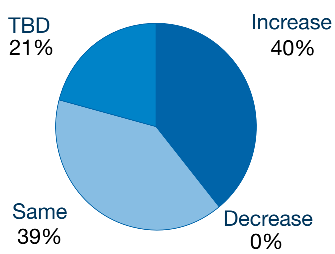
Potential impact on goodwill impairment testing

The impairment standard requires management to identify those components of an entity to which goodwill relates and test the goodwill for impairment at the level of those components, which may be no larger than an operating segment. If segments change upon adoption of IFRS 8, the component at which goodwill is tested might also change. This could happen where companies previously have tested goodwill at the level of either the primary or secondary segments, determined in accordance with the previous standard, IAS 14.

Do you expect the number of segments that you report to change?



Is it likely that the segment information you report under IFRS 8 will include non-GAAP financial items?



From compliance to competitive tool: three steps to good segment reporting

Consider the following to achieve compliance with the standard

- **Through whose eyes?**
  The eyes of the chief operating decision-maker (CODM) – the person or group of people responsible for assessing performance and allocating resources to different parts of the business.

- **Identifying operating segments**
  What components of the business does this CODM look at to allocate resource? This will be a key determinant of the operating segments.

- **'Super segments'**
  Combining operating segments for disclosure may be possible in limited circumstances; but aggregating significant dissimilar or unrelated businesses is not appropriate

- **Related disclosures**
  Beyond the basic segment disclosures of revenue, profit and assets, additional entity-wide disclosures looking at key business risks are required – even if the company has only one segment.

Consider the following to enhance your segment disclosures

- Put yourself in the shoes of an investor. Report those segments that will allow users to understand your business. This may involve reporting a segment that is immaterial to the company today but that could add to the understanding of the business – for example, a segment that is expected to grow in the future.

- Investors value companies based on cash flow models and the return generated on invested capital. Consider providing information on operating cash flow, working capital and capital employed by segment.

- Be clear in your disclosure of how certain costs are allocated (or not).

- Ensure that the reconciliations are clearly explained so the users can bridge the gap between the segment measures and the IFRS-compliant income statement.

- If you expect to change segments, tell the reader of the change and explain the reason why.

- Consider providing the same level of segment disclosures in the interim reports as in the annual accounts.

- Ensure the management commentary is consistent with the segment disclosures.

Consider the following as best practice in your management commentary

- Are operating measures used by management to assess performance? Consider reporting them to investors in the management commentary.

- Help the reader to understand underlying performance by highlighting any material non-recurring income or costs, the impact of currency on the results, the influence of acquisitions or disposals, etc.

- Ensure that qualitative comments regarding the performance of a segment are supported, where possible, by quantifications and financial evidence.

How can PricewaterhouseCoopers help?

PricewaterhouseCoopers publication *A practical guide to segment reporting* provides an overview of the key requirements of IFRS 8, 'Operating segments', and some points to consider as management prepares for the application of this standard for the first time. It also includes a question and answer section. To order your copy, please contact your local PwC office or visit www.cch.co.uk/ifrsbooks to order online.

For examples of good reporting practice, visit www.corporatereporting.com.

For further information on issues around IFRS 8, please contact your PwC representative or one of the following contacts to discuss how we can help you with your IFRS 8 issues.

Contacts

Global Accounting Consulting Services

Tony Debell
tony.m.debell@uk.pwc.com
+44 207 213 5336

Mark Lohmann
mark.lohmann@uk.pwc.com
+44 207 212 4482

Americas

James Saloman
james.s.saloman@ca.pwc.com
+1 416 941 8249

Dusty Stallings
dusty.stallings@us.pwc.com
+1 973 236 4062

Asia Pacific

Samying Huie
samying.s.huie@cn.pwc.com
+86 21 2323 3054

Julie Smith
julie.a.smith@au.pwc.com
+61 3 8603 2410

Europe

Udo Kalk
udo.kalk@de.pwc.com
+49 69 9585 1144

Rich Sharko
rich.sharko@ru.pwc.com
+7 495 9676054

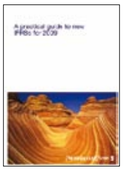
Katie Woods
katie.woods@uk.pwc.com
+ 44 207 804 6238

PricewaterhouseCoopers' IFRS and corporate governance publications and tools 2008

IFRS technical publications

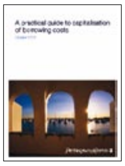
IFRS manual of accounting 2009

PwC's global IFRS manual provides comprehensive practical guidance on how to prepare financial statements in accordance with IFRS. Includes hundreds of worked examples, extracts from company reports and model financial statements.



A practical guide to new IFRSs for 2009

40-page guide providing high-level outline of the key requirements of new IFRSs effective in 2009, in question and answer format.



A practical guide to capitalisation of borrowing costs

Guidance in question and answer format addressing the challenges of applyiing IAS 23R, including how to treat specific versus general borrowings, when to start capitalisation and whether the scope exemptions are mandatory or optional.

A practical guide to segment reporting

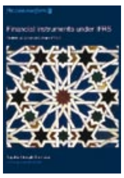
Provides an overview of the key requirements of IFRS 8, 'Operating Segments' and some points to consider as entities prepare for the application of this standard for the first time. Includes a question and answer section. Also available: Eight-page flyer on high level management issues.

A practical guide to share-based payments

Answers the questions we have been asked by entities and includes practical examples to help management draw similarities between the requirements in the standard and their own share-based payment arrangements. November 2008.

Adopting IFRS – A step-by-step illustration of the transition to IFRS

Illustrates the steps involved in preparing the first IFRS financial statements. It takes into account the effect on IFRS 1 of the standards issued up to and including March 2004.



Financial instruments under IFRS

High-level summary of the revised financial instruments standards issued in December 2003, updated to reflect IFRS 7 in September 2006. For existing IFRS preparers and first-time adopters.

Financial reporting in hyperinflationary economies – understanding IAS 29

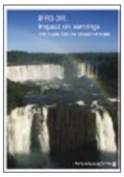
2006 update (reflecting impact of IFRIC 7) of a guide for entities applying IAS 29. Provides an overview of the standard's concepts, descriptions of the procedures and an illustrative example of its application.

IAS 39 – Achieving hedge accounting in practice

Covers in detail the practical issues in achieving hedge accounting under IAS 39. It provides answers to frequently asked questions and step-by-step illustrations of how to apply common hedging strategies.

IAS 39 – Derecognition of financial assets in practice

Explains the requirements of IAS 39, providing answers to frequently asked questions and detailed illustrations of how to apply the requirements to traditional and innovative structures.



IFRS 3R: Impact on earnings – the crucial Q&A for decision-makers

Guide aimed at finance directors, financial controllers and deal-makers, providing background to the standard, impact on the financial statements and controls, and summary differences with US GAAP.

IFRS disclosure checklist 2008

Outlines the disclosures required by all IFRSs published up to October 2008.

IFRS for SMEs (proposals) – pocket guide 2007

Provides a summary of the recognition and measurement requirements in the proposed 'IFRS for Small and Medium-Sized Entities' published by the International Accounting Standards Board in February 2007.

IFRS pocket guide 2008

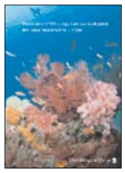
Provides a summary of the IFRS recognition and measurement requirements. Including currencies, assets, liabilities, equity, income, expenses, business combinations and interim financial statements.

IFRS news

Monthly newsletter focusing on the business implications of the IASB's proposals and new standards. Subscribe by emailing corporatereporting@uk.pwc.com.

Illustrative interim financial information for existing preparers

Illustrative information, prepared in accordance with IAS 34, for a fictional existing IFRS preparer. Includes a disclosure checklist and IAS 34 application guidance. Reflects standards issued up to 31 March 2008.



Illustrative consolidated financial statements

- Banking, 2006
- Corporate, 2008
- Insurance, 2006
- Investment funds, 2008
- Investment property, 2008
- Private equity, 2008

Realistic sets of financial statements – for existing IFRS preparers in the above sectors – illustrating the required disclosure and presentation.

Share-based payment – a practical guide to applying IFRS 2

Assesses the impact of the new standard, looking at the requirements and providing a step-by-step illustration of how to account for share-based payment transactions. June 2004.

SIC-12 and FIN 46R – The substance of control

Helps those working with special purpose entities to identify the differences between US GAAP and IFRS in this area, including examples of transactions and structures that may be impacted by the guidance.

Understanding financial instruments – A guide to IAS 32, IAS 39 and IFRS 7

Comprehensive guidance on all aspects of the requirements for financial instruments accounting. Detailed explanations illustrated through worked examples and extracts from company reports.

Understanding new IFRSs for 2009 – A guide to IAS 1 (revised), IAS 27 (revised), IFRS 3 (revised) and IFRS 8

Supplement to IFRS Manual of Accounting. Provides guidance on these new and revised standards that will come into force in 2009 and will help you decide whether to early adopt them. Chapters on the previous versions of these standards appear in the IFRS Manual (see above).