IFRS 8 – Operating Segments

ACCA P2 Class

@

TNSS

Applicability

IFRS 8 applies to both the separate or individual financial statements of an entity and the consolidated financial statements of a group with a parent:

(a) whose debt or equity instruments are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets), or

(b) that files, or is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market.

Definition of an Operating Segment

- Component of entity that engages in business activities
  - Earns revenues and incurs expenses (external or internal)
  - Operating Results regularly reviewed by chief operating decision maker (CODM)
  - Discrete financial information available
- Identified based on
  - Internal reports/information regularly reviewed CODM (function, not an individual)
  - To allocate resources to segments and assess its performance
- Other indicators
  - Nature of goods and services
  - Segment manager accountable to CODM
  - Core principle in IFRS 8

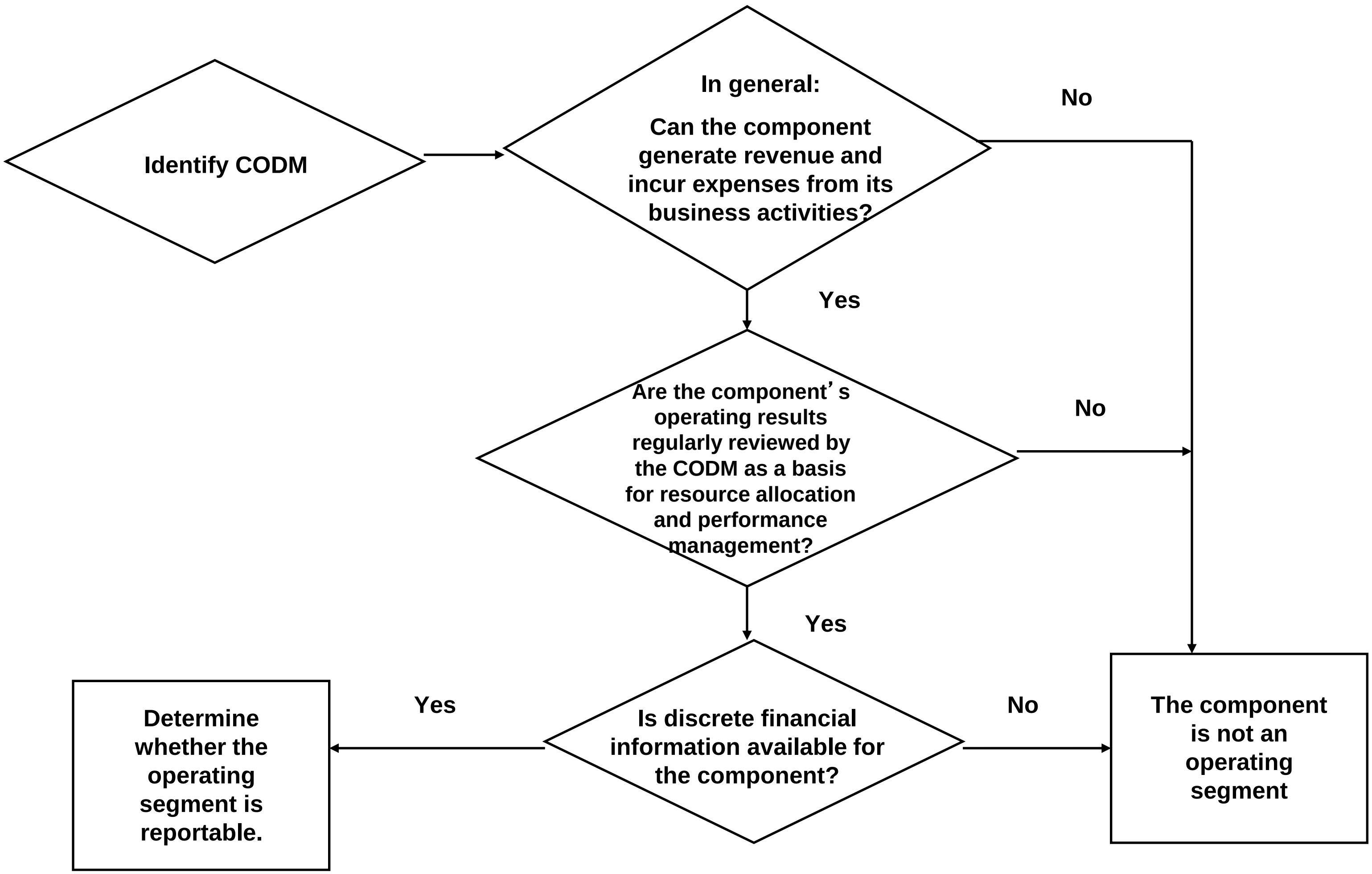
IFRS 8 – Key steps

1. Identify the CODM
2. Identify operating segments
3. Consider aggregation of operating segments
4. Identify reportable operating segments
5. 75% test
6. Disclosure

Case Study - Identifying the CODM

- An entity has a president, a chief executive officer (CEO) and a chief operating officer (COO). All 3 individuals serve on a management committee which makes operating decisions related to the different business activities of the entity.
- The committee operates on the basis of consensus amongst all members.
- In this example the CODM is the management committee.
- Existence of committee does not necessarily mean that the committee is the CODM.
- If the CEO can override the decisions made by the committee, then the CEO is CODM

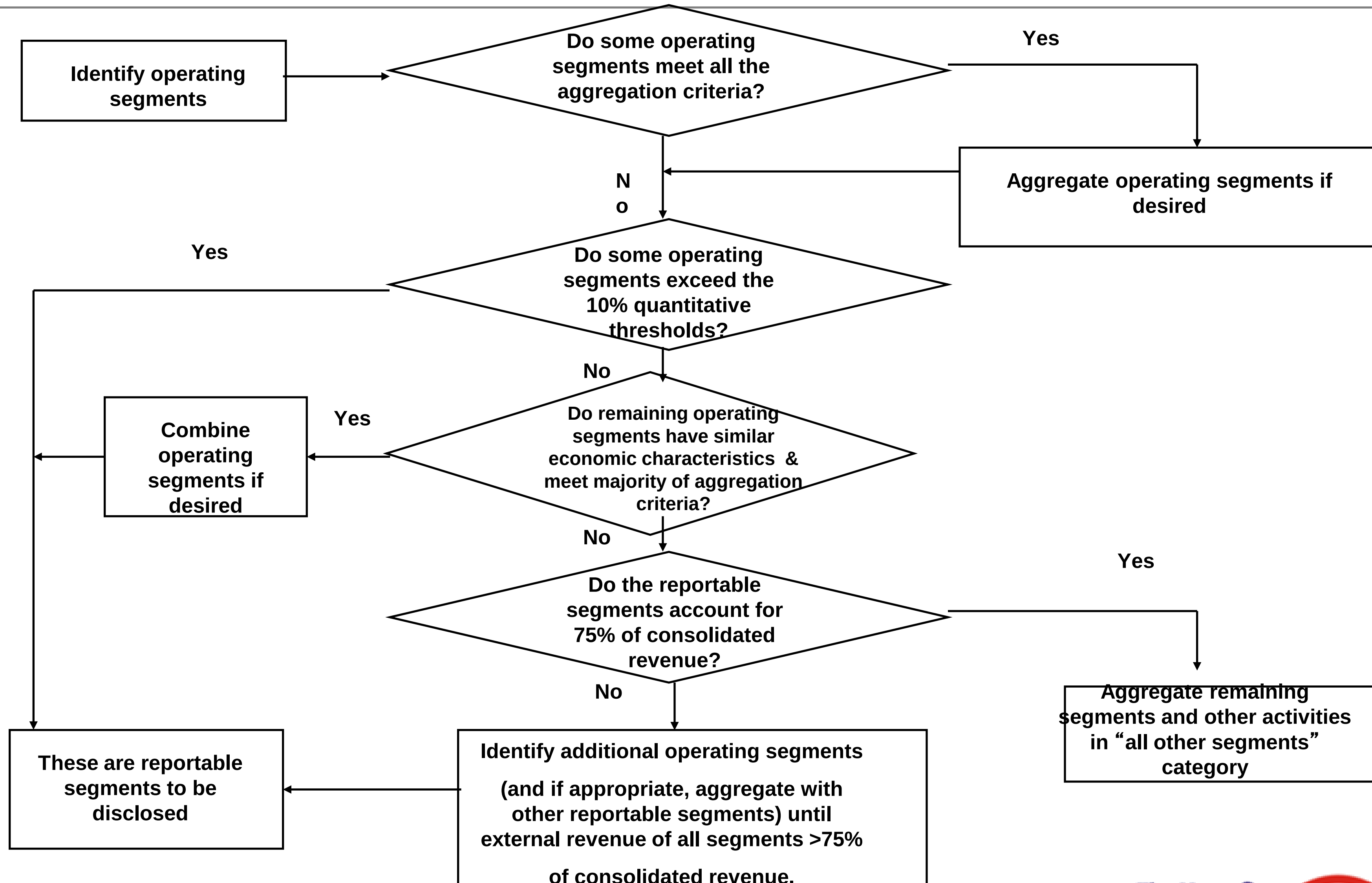
Identifying an Operating Segment



Operating Segments – Reportable?

- If total external revenue of reportable segments < 75% of entity's reported/consolidated revenue
    - Identify additional segments as reportable until > 75% criteria is met
- If not a reportable segment
    - Disclose as reportable segment if of continued significance
- New reportable segment in current year
    - Restate comparative, unless information is not available and cost to develop would be excessive
- Practical limit probably 10 reportable segments
- Included in "other segments" are:
    - Components/activities that did not meet the definition of an operating segment
    - Operating segments that were not reportable

Reportable Segments (summary)



The New Synergy Specialists

Reportable Segments - Disclosures

- General information
  - Factors used to identify reportable segments
  - Types of revenue-generating products and services
- Information about profit or loss, assets and liabilities:
  - A measure of Profit or loss *
  - A measure of Total assets *
  - A measure of Segment liabilities if regularly reported to CODM
  - Specified items if included in segment profit or loss or just provided to CODM
    - Revenue from external customers, revenue from other operating segments, interest revenue, etc.
  - The following, if included in segment assets or just provided to CODM:
    - Investment in equity accounted associates or JV's
    - Certain additions to non-current assets
- No disclosure of cash flow data required

* - Must be disclosed

Entity-wide disclosures (continued)

- For individual customers that generates >= 10% total external revenue
  - Revenue from that customer
  - Segment/segments where the revenue is included
  - No need to disclose the identity of these customers

Other Issues – Interim Report Disclosures (IAS 34.16)

- The following should be disclosed in Interim Reports:
  - Revenues from external customers
    - If included in measure of segment profit or loss reported to CODM / otherwise regularly provided to CODM
  - Intersegment revenues
    - If included in measure of segment profit or loss reported to CODM / otherwise regularly provided to CODM
  - Measure of segment profit or loss
  - Total assets
    - If there has been a material change from the amount disclosed in the last FS
  - Description of differences (from last annual financial statements) in
    - Basis of segmentation or
    - Basis of measurement

IFRS 8 – Potential Issues

- Possibility of using a “dual system” of management accounts in order to manipulate segment disclosures
- Management may hide loss-making segments by excluding information from management accounts or combining information with other segments
  - Data communicated informally should be considered in audit
- Less comparability between companies in same industry
- Disclosure of discontinued operations
- Changing economic circumstances could lead to change reportable operating segments (outside control of the reporting entity)

The New Synergy Specialists

IAS 12 - Income Taxes

Highlights

- ✓ **Introduction**
- ✓ **Scope**
- ✓ **Definitions**
- ✓ **Recognition and Measurement**
- ✓ **Recognition of current and deferred tax**
- ✓ **Presentation and Disclosure**
- ✓ **Practical Examples**

Scope

- IAS 12 requires fiscal effects of a transaction to be considered in the same period during which the transaction takes place (current and future fiscal consequences)
- For the purposes of this Standard, income taxes include
  - all domestic and foreign taxes which are based on taxable profits
  - withholding taxes, which e.g. are payable by a subsidiary, associate or joint venture on distributions to the reporting enterprise.
- IAS 12 does not deal
  - with the methods of accounting for government grants (IAS 20), ***OR***
  - investment tax credits
- However, IAS 12 does deal with the accounting for temporary differences that may arise from such grants or investment tax credits

Definitions (I)

- **Current tax** is the amount of income tax payable (recoverable) in respect of the taxable profit (tax loss) for a period

- **Deferred tax liabilities** are the amounts of income taxes payable in future periods in respect of taxable temporary differences

- **Deferred tax assets** are the amounts of income taxes recoverable in future periods in respect of:
  - deductible temporary differences
  - the carry forward of unused tax losses, ***AND***
  - the carry forward of unused tax credits

Definitions (II)

- The **tax base** of an asset or liability is the amount attributed to that asset or liability for tax purposes

- **Temporary differences** are differences between the carrying amount of an asset or liability in the statement of financial position and its tax base. Temporary differences may be either:
  - **taxable temporary differences**, which are temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled, ***OR***
  - **deductible temporary differences,** which are temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled

Definitions (III) - Examples

- Taxable temporary differences:
  - Accelerated depreciation for tax purposes
  - Fair values above tax base in a business combination
  - Fair value above the book value of an asset in revaluation
  - Special Case: undistributed earnings from subsidiaries
- Deductible temporary differences:
  - Pension liabilities not recognised by the tax authorities
  - Fair values below tax base in a business combination
- Permanent differences:
  - Expenses disallowed by tax authorities
  - Non-taxable government grants

Quiz

- What is deferred tax, according to IAS 12?

1. The amount that the tax authorities assess to be payable for the period, calculated according to their own rules
2. The profit (loss) for a period, determined in accordance with the rules established by the tax authorities, upon which income taxes are payable (recoverable)
3. The difference between the carrying amount of an asset or liability and its tax base
4. Taxes that have an effect on future tax cash flows

Quiz

- Which of the following statements is **not** an example of a temporary difference?

1. Certain income or expense is taxed on a cash basis.
2. Assets are revalued for book purposes but not for tax purposes.
3. The tax base of an asset on initial recognition is different from its carrying amount.
4. Fair values are allocated after an acquisition with no equivalent adjustment for tax purposes.
5. All are examples of temporary differences

Recognition (I)

Taxable temporary differences

- A deferred tax liability shall be recognised for all taxable temporary differences, except to the extent that the deferred tax liability arises from:
  - the initial recognition of goodwill, ***OR***
  - the initial recognition of an asset or liability in a transaction which:
    - is not a business combination; and
    - at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss).
- Temporary differences of subsidiaries and equity investments
  - Deferred taxes must be recognised for all temporary differences
  - Exception: if the parent controls the investment and if it is highly probable that the temporary differences will not reverse in the foreseeable future (e.g. distribution of reserves)

Recognition (II)

Deductible temporary differences

- A deferred tax asset shall be recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised, unless the deferred tax asset arises from
  - the initial recognition of an asset or liability in a transaction that:
    - is not a business combination, ***AND***
    - at the time of the transaction, affects neither accounting profit nor taxable profit (tax loss)

- Deferred tax assets, whether recognised or unrecognised, must be reviewed at the end of each reporting date

Measurement

- Taxable temporary difference (TTD) =
  - Book value of asset > its tax base
  - Book value of Liability < its tax base
- TTD x Tax rate = Deferred tax liability

- Taxable temporary difference (TTD) =
  - Book value of asset > its tax base
  - Book value of Liability < its tax base
- TTD x Tax rate = Deferred tax liability

Case Study

Complete the following tables

Assets	Carrying amount	Tax base	Temporary difference
Machine cost N100,000 with depreciation to date N18,000 and capital allowances of N30,000.			
Interest receivable in the statement of financial position is N180,000. The interest will be taxed when received.			
Trade receivables have a carrying amount of N280,000. The revenue has already been included in taxable profit.			
An entity writes down its inventory down by N500 to a net realisable value of N4,500. The reduction is ignored for tax purposes until the inventory is sold			

Case Study

Complete the tables

Liabilities	Carrying amount	Tax base	Temporary difference
Current liabilities include accrued expenses of N1,288,000. This is deductible for tax on cash paid basis.			
Accrued expenses have a carrying amount of N685,000. The related expense has been deducted for tax purposes.			

Recognition

- A deferred tax asset should be recognised for the carry forward of unused tax losses and unused tax credits to the extent that it is probable that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised; following criteria shall be considered in assessing the probability:
  - whether the enterprise has sufficient taxable temporary differences relating to the same taxation authority and the same taxable entity, which will result in taxable amounts against which the unused tax losses or unused tax credits can be utilised before they expire;
  - whether it is probable that the enterprise will have taxable profits before the unused tax losses or unused tax credits expire;
  - whether the unused tax losses result from identifiable causes which are unlikely to recur; ***AND***
  - whether tax planning opportunities are available to the enterprise that will create taxable profit in the period in which the unused tax losses or unused tax credits can be utilised.

Quiz

- Which of the following is **not** a required criterion to be considered before a deferred tax asset can be recognized in respect of unused losses or credits?

1. Whether the entity has enough taxable temporary differences relating to the same tax authority and the same taxable entity to create taxable amounts against which the losses or credits can be used before they expire
2. Whether the entity will have sufficient taxable profits in the future
3. Whether the unused tax losses result from identifiable causes that are unlikely to recur
4. Whether tax-planning opportunities are available to allow taxable profits to be created in the period in which the losses or credits can be used
5. All are required criteria

Presentation and Disclosures (I)

- Separate presentation of current tax payable and deferred tax liabilities in the statement of financial position
  - Disclosure in the notes is insufficient
  - Disclosure under non-current assets and liabilities
  - Distinction between deferred taxes and actual tax debts
- Offsetting deferred tax assets and deferred tax liabilities is permitted if and only if:
  - Legally enforceable right to set off current tax assets against current tax liabilities, ***AND***
  - Taxes are levied by the same taxation authority
- If the item giving rise to the deferred tax is dealt with in the income statement, the related deferred tax should also be presented in the income statement.

Presentation and Disclosures (II)

- If the item giving rise to the deferred tax is dealt with in other comprehensive income, the related deferred tax should be disclosed as relating to other comprehensive income and recorded in equity
- One of the main disclosures is reconciliation between expected and effective tax rate
- Purpose of the tax reconciliation
  - The tax reconciliation enables users of financial statements
    - to understand whether the effective tax rate is unusual, ***AND***
    - to understand the significant factors that affect the tax rate
- Main items for the tax reconciliation
  - Non-tax deductible expenses (such as goodwill impairment, depreciation)
  - Non-taxable revenues
  - Not recognised carry-forward of unused tax losses
  - Taxes related to prior periods
  - Changes of the expected tax rate

IAS 19 – Employee Benefits

Highlights

- ✓ **Underlying Principle**
- ✓ **Definitions and Classification**
- ✓ **Accounting Treatment**
- ✓ **Disclosure**
- ✓ **Practical Examples**

Definition

Employee benefits are all forms of consideration given by an entity in exchange for service rendered by employees

Objective

To prescribe the accounting and disclosure for employee benefits. It requires an entity to recognise:

a liability when an employee has provided service in exchange for employee benefits to be paid in the future;

and

an expense when the entity consumes the economic benefit arising from service provided by an employee in exchange for employee benefits.

Basic Principle:

The cost of providing employee benefits should be recognised in the period in which the benefit is earned by the employee, rather than when it is paid or payable

Underlying Principle

Recognition :

- **DR Expense:**
  - When entity *receives* services provided by employees.
- **CR Bank/Liability**:
  - When an employee has provided services in exchange for employee benefits, to be paid in the future. (Liability)

Definitions & Classification

<u>REMEMBER IT'S SPOT OR STOP!</u>

Short-term employee benefits

- Fall due within 12 months of the period in which the employee rendered the related service.

Post-employment employee benefits

- Fall due after completion of employment

Types of post-employment benefits

- Defined contribution plan
- Defined benefit plan

Definitions & Classification

Other long term employee benefits

- Do not fall due within 12 months of the period in which the employee rendered the related service.
- Not termination benefits & not post-employment benefits.

Termination benefits

- Benefits payable on termination by employer before normal retirement date; or
- Employee accepts voluntary redundancy in exchange for benefits.

Short – Term Benefits

Recognition:

- A liability (amounts not already paid) and
- An expense unless otherwise permitted by other standards (e.g. IAS 2 and IAS 16)
- Undiscounted amount of benefit due.

Disclosure:

- IAS 24
- IAS 1

- Short term compensated absences (e.g. Paid annual leave, paid sick leave) payable within 12 months after the reporting period
- Profit-sharing and bonus plans payable within 12 months after reporting period.

Example 1:

- Company A has 20 employees.
- Each employee is entitled to 15 days leave per year.
- The leave days accumulated through-out the period as the employee renders the service.

a) What category of employee benefit is this? Why?

b) What would the accounting treatment be?

Solution 1:

a) What category of employee benefit is this? Why?

Short-term employee benefit

Defined as employee benefits (other than termination benefits) that are due to be settled within twelve months after the end of the period in which the employees render the related service (IAS 19:7)

b) What would the accounting treatment be?

DR Income Statement (Expense)

CR SFP (Bank/Liability)

Vesting = Recognise Full Obligation;

Non-Vesting = Estimate

Profit Sharing & Bonus Plans

- **Only** recognised if:
  - Present or legal / constructive obligation as result of past events; **and**
  - Reliable estimate made:
    - Plan contains formula to determine amount,
    - Amounts determined before Financial Statements are authorised for issue; *or*
    - Past practice evidences amount.

Example 2:

- In the recent years company A granted staff members a profit share based on 5% of the profit for the period.
- In the past this payment was approved by the remuneration committee before year-end.
- In the current year the remuneration committee only approved the profit share payment after year-end.

a) What category of employee benefit is this? Why?

b) When would Company A recognise the expense?

Solution 2:

a) What category of employee benefit is this? Why?

Short-term employee benefit

b) When would Company A recognise the expense?

- IAS 19:
  - Entity has a present (legal or constructive) obligation; **and**
  - Reliable estimate of the obligation can be made.
- IAS 10:
  - Adjusting event after reporting period
  - Evidence of condition that existed at y/e

Example 3:

- In February 2008 Company A grants an employee a bonus of N50,000 based upon the performance of the employee in 2007, payable in February 2011 on condition that the employee remains in the employer's service for at least next 3 years.

a) Is this a “short term employee benefit” or an “other long term employee benefit”?

b) How is the liability calculated and allocated over the vesting period?

Solution 3:

a) Is this a “short term employee benefit” or an “other long term employee benefit”?

“Other long term employee benefit”

b) How is the liability calculated and allocated over the vesting period?

Liability calculated using projected unit credit method

- Amortised on straight-line basis over vesting period.
- Defined benefit obligation initially recognised at grant date (February 2008)
- Accrued on straight-line basis over vesting period (to 2011).
- Although bonus determined by performance in 2007, only granted in 2008 and conditional upon future services. No expense recognised in 2007.

Example 4:

- In Jan 2008, Company B implemented a 'retention plan' which aims to keep its senior, strategic staff.
- A cash bonus was paid to these employees on 1 Feb 2008.
- The contract states that the bonus is for services rendered in 2008 and to be rendered up to end of 2011.
- Should the employee leave before end of Jan 2011, the full cash bonus is repayable.

a) How should the payment of the lump sum be treated?

Solution 4:

a) Recognise expense over 4 years from 2008-2011.

On payment of bonus:

DR Prepaid employee expense

CR Bank

As benefit vests (annual entry):

DR Employee expense ¼ of amount

CR Prepaid employee expense ¼ of amount

If employee leaves at end of year 3, entire amount repayable:

DR Prepaid employee expense ¾ of amount

CR Employee expense ¾ of amount

Recognise expense as employee renders the service.

Example 5

- In Jan 2008, Company C implemented a ‘retention plan’ with aim to keep its senior, strategic staff.
- A cash bonus was paid to these employees on 1 Feb 2008.
- The contract states that the bonus is for services rendered from 2007 to end of 2011.
- Should the employee leave before end of Jan 2011, the full cash bonus is repayable.

a) How should the payment of the lump sum be treated?

Solution 5:

a) Plan same as previous example, except that contract states that benefit is for services rendered 1 year prior to granting of bonus.

Does this affect the recognition? What is the vesting period?

- Benefit accounted for over vesting period, from grant date.
- Grant date is Jan 2008.Therefore recognised from 2008 to 2011 i.e. over 4 years. Therefore same journals as in previous example.
- Account for expense from grant date over the vesting period

Example 6

- Company D has implemented a ‘retention plan’ with the aim to keep its senior, strategic staff.

- A cash bonus will be paid to these employees, with the expectation that they will be incentivised to remain in the company’s employment

a) How should the payment of the lump sum be treated?

Solution 6:

a) No terms stated in ‘retention plan’.

Therefore employee fully entitled to amount at date paid with no obligation to repay.

Therefore recognised in full when paid.

DR Employee benefit expense

CR Bank

Example 7:

- A strategic member of Company E has resigned.
- The company has paid a lump sum to the employee, as a restraint of trade.
- If the employee is found to be rendering any ‘competitive services’ in a period of 5 years, the amount shall be repayable immediately.

a) How should the payment of the lump sum be treated?

Solution 7:

- Payment fully vested as not conditional on future employment.
- Paying employee not to do something, rather than to do something.
- Therefore all expected services have been rendered & expense recognised immediately.
- On payment:

  Dr Employee expense

  Cr Bank

Types of post-employment benefits

Defined contribution

- Pension received by former employee is a function of contributions made
- Cost to employer is fixed and predictable
- No legal or constructive obligation to meet shortfall

Defined benefit

- Pension based on formula not just contributions made
- Eventual cost to employer is more difficult to predict
- Employer retains a risk that not enough to pay pension / medical benefits

Defined contribution plans

- Charge for period is contribution due for service rendered during the period
- Contributions paid in advance or arrears are prepayments or accruals
- Any accrued contributions not due within 12 months of reporting date should be discounted to their present value
- Disclose expense for the period

Defined benefit plans

- Value the plan at
  - fair value of plan assets (if any), *less*
  - present value of the obligation to pay pensions

- Resulting asset or liability adjusted by
  - any unrecognised actuarial gains and losses or past service costs, *and* / *or*
  - a ceiling test to restrict any net asset to the present value of future refunds or reduced contributions

Defined benefit plans - cont'd

- The amount to be shown in the statement of comprehensive income may include the following:
  - current service cost for period
  - interest cost for period
  - expected return on any plan assets
  - any past service cost recognised (to the extent that they are recognised).
  - effect of any curtailments or settlements

- NOT necessarily contributions paid

Defined benefit liability / asset

- A **defined benefit liability** is calculated as follows (IAS 19.54):

Present value of Defined Benefit Obligation

+/- actuarial gains/losses not recognised

- past service cost not yet recognised

- fair value of plan assets out of which the obligations are to be settled directly

Defined benefit liability/asset

If the result is an asset, IAS 19.58 has to be applied (IFRIC 14)

Disclosures

Includes:

- Analysis of plan assets (% or amount) for each major category;
- Description of basis used to determine expected rate of return;
- Effect of 1% increase / decrease in assumed medical cost trend rates on CSC and interest cost, and accumulated benefit obligation;
- Amounts for current & previous 4 annual periods of obligation, plan assets, experience adjustments;
- Employer's best estimate of contributions payable during next annual period.

Example 9:

- Employees are entitled to a plan where:
  - Employees may contribute up to 6% of their salaries.
  - The company matches employees' contributions.
  - The company guarantees employees a 5% return on contributions.
  - On retirement, employees elect to receive lump sum or monthly payments.
    - If monthly payments are selected, they will be paid until no further amounts remain invested.

a) Is this a defined benefit or defined contribution plan?

Solution 9:

a) Defined benefit plan

Company has guaranteed 5 % return on the contribution made by the employee and the entity.

The company therefore accepts investment risk and it is under obligation to pay further contributions if investment return is insufficient to fund the future benefits.