

VIEWPOINTS:

Applying IFRSs in the Mining Industry

SEGMENT REPORTING

JULY 2016

Background

IFRS 8 *Operating Segments* sets out requirements for disclosure of information about an entity's operating segments, an entity's products and services, the geographical areas in which it operates and its major customers. The standard's objective is to enable users of financial statements to evaluate the nature and financial effects of an entity's activities and the economic environments in which it operates.

Segmented reporting is important to users of financial statements because it illustrates how management or, more specifically, the chief operating decision maker (CODM) allocates resources to the business. Segmented reporting provides a snapshot of the way the entity's performance is evaluated by the CODM. This evaluation does not have to be and may not be consistent with IFRSs. For example, the CODM may consider economic hedging relationships to be designated as hedges for segmented reporting purposes even though such hedges do not qualify for hedge accounting under IFRS. The CODM may also adjust for items viewed as "non-recurring."

From management's perspective, segmented reporting can be a useful tool for describing the business's results in documents such as the Management Discussion and Analysis (MD&A) or in other discussions of the entity's performance.

The determination of segment information affects reporting beyond disclosure (e.g., how certain assets are allocated for the purposes of impairment testing).

Mining Industry Task Force on IFRSs

International Financial Reporting Standards (IFRSs) create unique challenges for mineral resource companies. Financial reporting in the sector is atypical due to significant differences in characteristics between mineral resource companies and other types of companies. The Chartered Professional Accountants of Canada (CPA Canada) and the Prospectors & Developers Association of Canada (PDAC) created the Mining Industry Task Force on IFRSs to share views on IFRS application issues of relevance to mineral resource companies. The task force views are provided in a series of papers available through free download. These views are of particular interest to chief financial officers, controllers and auditors.

The views expressed in this series are non-authoritative and have not been formally endorsed by CPA Canada, PDAC or the organizations represented by the task force members.

Issue

What are the IFRS requirements and alternatives relating to segmented reporting for a mining entity?

Viewpoints

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 components of the same entity)
- b) whose operating results are regularly reviewed by the entity's CODM to make decisions about resources to be allocated to the segment and assess its performance
- c) for which discrete financial information is available.

An operating segment may engage in business activities for which it has yet to earn revenue. For example, the exploration for and evaluation of mineral resources and/or development projects may be separate operating segments despite no revenue being earned.

Chief Operating Decision Maker

In order to identify an operating segment it is critical to determine the CODM.

The term CODM identifies a function (not necessarily a manager with a specific title) that allocates resources to, and assesses the performance of, the operating segments of an entity. Frequently, but not always, the CODM of a publicly accountable mining entity will be the chief executive officer or chief operating officer.¹

Identifying Operating Segments

In some cases, operating segments can be easily identified. In other cases, identification of operating segments can be more challenging and require judgment.

Often the CODM will receive performance information at multiple levels of aggregation. For example, the CODM may review three levels of reports. Level 3 is the most detailed component level and is represented by 25 individual components. Level 2 contains the Level 3 components aggregated into 10 components and Level 1 is an aggregation of Level 2, yielding three components.

To help identify operating segments, the following factors are useful to consider:

- the regular process used by the CODM to assess performance
- the segment managers and their responsibilities
- the budgeting process (on the assumption the operating and capital budget would be approved or modified by the CODM for the segment as a whole)

¹ In some cases, the CODM may be a group of executive directors or others, such as a management committee consisting of, for example, the entity's chief executive officer, chief operating officer, chief financial officer and possibly others, all of whom have a vote on decisions made by the committee.

- the information sent to the board of directors (the board does not usually receive information at a level lower than the operating segments)
- public statements about how an entity operates its business, including information provided in MD&A and on the entity’s website
- whether the level of the organization viewed makes sense (i.e., whether the presentation of segments at a lower level contributes significantly to the understanding of business activities).

In the experience of the Mining Industry Task Force on IFRSs, the above factors, as well as others, are considered holistically and no one factor is determinative in its own right.

Generally, an operating segment has a segment manager who is directly accountable to and maintains regular contact with the CODM to discuss operating activities, financial results, forecasts, or plans for the segment. The term “segment manager” identifies a function, not necessarily a manager with a specific title. The CODM also may be the segment manager for some operating segments. A single manager may be the segment manager for more than one operating segment.

The following are illustrative examples of situations mining companies may face:

Illustrative Example: Individual Mine or Project

ABC Inc. is a producer of gold, silver, copper and zinc with various producing mines and exploration projects in North and South America. ABC Inc.’s CODM monitors results and makes capital expenditure decisions at the mine or the project level. ABC Inc. determined that each mine or project is an operating segment.

Illustrative Example: Phases

EFG Corp. is a mining entity engaged in the production, development and exploration for gold. EFG Corp. has a producing mine in Argentina, two development properties in Chile and an exploration project in Mexico. EFG Corp.’s CODM allocates resources, evaluates performance and presents EFG Corp.’s results to the board of directors based on the current phase of each property. EFG Corp., therefore, identified three operating segments: production, development, and exploration.

Illustrative Example: Multiple Levels of Aggregation

LM Inc. is a mining entity with operating mines and development projects in Australia, Canada, and Ghana. The CODM receives results on an aggregated basis for each commodity produced. The CODM also receives results on an aggregated basis for each of its Australian, Canadian, and Ghanaian operations. In determining its operating segments, LM Inc. also considers the information presented to the board of directors. The board of directors is presented with results only by commodity. In determining the operating segments, the CODM considered the various sources of information used to allocate resources and assess the performance and determined that on balance such decisions are primarily based on commodities it produces. LM Inc. therefore determined that its operating segments are based on the commodities it produces.

REPORTABLE SEGMENTS

Once the operating segments have been determined, some optional methods may be applied to report more aggregated information in the financial statements.

Aggregation Criteria

IFRS 8.12 sets out the aggregation criteria for operating segments.

Two or more operating segments *may* be aggregated into a single operating segment if aggregation is consistent with the core principle of IFRS 8: the segments have 1) similar economic characteristics, and are 2) similar in each of the following respects:

- nature of the products and services
- nature of the production processes
- type or class of customer for their products and services
- methods used to distribute their products or provide their services
- nature of the regulatory environment (e.g., banking, insurance or public utilities) if applicable.

IFRS 8 *permits* operating segments meeting the aggregation criteria to be combined for external reporting purposes. It does not, however, require such combination; mining entities may choose to report the operating segments separately.

Similar Economic Characteristics

IFRS 8 does not define the term “similar” and does not provide prescriptive guidance about what is similar for aggregation purposes. As such, the determination of whether two or more operating segments share similar economic characteristics requires judgment and is dependent on entity-specific facts and circumstances.

Operating segments with similar economic characteristics often exhibit similar long-term financial performance.

Quantitative and qualitative factors are considered when determining whether the economic characteristics of two or more operating segments are similar.

In the experience of the Mining Industry Task Force on IFRSs, a range of information may provide insights into the similarity of economic characteristics of two or more operating segments, including, but not limited to, an analysis of the extent of:

- similarity in key performance metrics (e.g., long-term gross margins or other appropriate measures of operating performance used by the CODM to assess performance and allocate resources, such as sales growth, earnings before interest, taxes, depreciation and amortization (EBITDA), return on assets, or cash flow)
- exposure to similar competitive, operating, and financial risks.

If operating segments are located in different geographical areas, entities may also need to evaluate factors such as economic and political conditions, currency risks, and foreign exchange control regulations.

The above information sources are not exhaustive. Other relevant information may need to be considered and analyzed.

The criteria used by an entity to aggregate operating segments into reporting segments for note disclosure purposes are a long-time area of focus by securities regulators, who often challenge companies about the application of the aggregation criteria. For example, they could challenge an entity that operates mines that have different functional currencies as not meeting the “similar economic characteristics” test or that, as long-term gross margins become more divergent, it may be more difficult to support the assertion that operating segments are economically similar.

When relying on the similar economic characteristics test, an entity should ensure that it has a robust quantitative and qualitative analysis of the facts and circumstances that support aggregating the operating segments.

Quantitative Thresholds

IFRS 8.13-.19 sets out various quantitative thresholds based on revenue, profit or loss, and assets to determine which information an entity should disclose separately about an operating segment.

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

The aggregation criteria set out in IFRS 8.12 take precedence over the quantitative thresholds in IFRS 8.13-.19. Therefore, if two or more components of a business meet the aggregation criteria, they may be combined into a single operating segment, notwithstanding that they may individually exceed the quantitative thresholds.

Illustrative Example: Aggregation

PZQ Limited has two underground gold mines. One of the mines has a mine plan of nine years and the other has a mine plan of 10 years. The all-in sustaining cost of production of the two mines is also similar. PZQ Limited determined that each mine is an operating segment. Nevertheless, PZQ Limited has aggregated the two mines into one reportable segment because both mines exhibit similar long-term financial performance and economic characteristics.

Impairment Testing

For the purposes of impairment testing (e.g., in IAS 36 *Impairment of Assets* or IFRS 6 *Exploration for and Evaluation of Mineral Resources*) reference to operating segments is to those segments *before* aggregation, irrespective of whether the entity is within the scope of IFRS 8.² IAS 36.80 indicates that goodwill cannot be tested for impairment at a level greater than an operating segment.³

² IFRS 8 is not mandatory for certain private companies. See IFRS 8.2.

³ Note that in some cases, goodwill may be tested at a lower level than an operating segment (based on IAS 36.80) but it can never be tested at a level higher than an operating segment.

Furthermore, IFRS 6.21 indicates that, where an entity's policy is to test exploration and evaluation (E&E) assets together with related cash-generating units, the level at which E&E is allocated and tested cannot exceed an operating segment.

REPORTING SEGMENTED INFORMATION

IFRS 8 provides flexibility in reporting segmented information. Generally, only those items regularly reported to the CODM need to be disclosed. Since IFRS 8 requires segment information to be provided on the same basis as information reported to the CODM, information presented in the segment note does not necessarily need to be presented in accordance with IFRSs.

Presentation of amounts in the segment note on a basis other than that reported in the primary financial statements will affect the explanation of the measurements of segment amounts under IFRS 8.27 and will result in the inclusion of the reconciliations required to be presented under IFRS 8.28.

Illustrative Example: Unrealized Items

RST Ltd.'s CODM reviews segmented operating profits, which include only realized hedging gains and losses (i.e., those not designated for hedge accounting under IFRS), and exclude unrealized gains and losses from derivatives. If this is the basis on which the CODM allocates resources to the segments and reviews their performance, then this approach to calculating operating profits is the measure that should be applied in the segment reporting note. To comply with IFRS 8.21(c) and to enable users to understand the differences in the basis of accounting applied in the segment note, RST Ltd. reconciles the information reported in the segment note with the primary financial statements. All other disclosures required by IFRS 8 are also included.

Illustrative Example: Proportionate Consolidation

XYZ Inc. is a party to several joint ventures (as defined in IFRS 11 *Joint Arrangements*). In accordance with IFRS 11, the entity accounts for all joint ventures using the equity method. The CODM of XYZ Inc. allocates resources to, and reviews the performance of, the segments based on operating results prepared using the proportionate consolidation method. In preparing its segment note, XYZ Inc. presents a measure of performance on the same basis as the information reported to the CODM, which is that resulting from applying the proportionate consolidation method. To comply with IFRS 8.21(c) and to enable users to understand the differences in the basis of accounting applied in the segment note, XYZ Inc. reconciles the proportionally consolidated information presented in the segment note with the primary financial statements prepared using the equity method. All other disclosures required by IFRS 8 are also included.

Entity-Wide Disclosures

Even if the mining entity, as a whole, is viewed as one segment, the standard still requires some information to be reported for all entities within the scope of IFRS 8. This additional information is called "entity-wide disclosures" and consists of three categories:

- *Information about Products and Services:* Revenue from different products or services should generally be reported (e.g., an entity with both copper and nickel sales might disclose the sale of each commodity separately).
- *Information about Geographical Areas:* Revenue and information about certain non-current assets should be reported based on the different countries in which the revenue is earned or where the assets are domiciled.
- *Information about Major Customers:* Where an individual customer⁴ accounts for more than 10% of revenue, this fact should be disclosed (although the identity of the customer is not required to be disclosed).

Paragraphs .31-.34 of IFRS 8 apply to all entities within the scope of the standard, including those entities with a single reportable segment. A complete list of disclosures is provided in IFRS 8.

Reevaluating Conclusions

The determination of the CODM, operating segments, and reportable segments should be reevaluated when facts and circumstances change (e.g., corporate reorganizations, restructuring, major acquisitions or dispositions).

If a mining entity changes the structure of its internal organization in a manner that causes the composition of its reportable segments to change, the corresponding information for earlier periods, including interim periods, should be restated unless the information is not available and the cost to develop it would be excessive. The determination of whether the information is not available and the cost to develop it would be excessive should be made for each individual item of disclosure.

Disclosure of Judgments

IAS 1 *Presentation of Financial Statements* requires the disclosure of significant judgments made in the application of an entity's accounting policies, as well as major sources of estimation uncertainty. Such disclosure may include, for example, the judgments made in identifying the CODM or in deciding whether two or more operating segments meet the criteria to be combined into a single reportable segment.

IFRS 8 specifically requires the disclosure of the judgments made by management in applying the aggregation criteria. This includes a brief description of the operating segments that have been aggregated and the economic indicators that have been assessed in determining that the aggregated operating segments share similar economic characteristics.

Consistency of Segment Disclosures

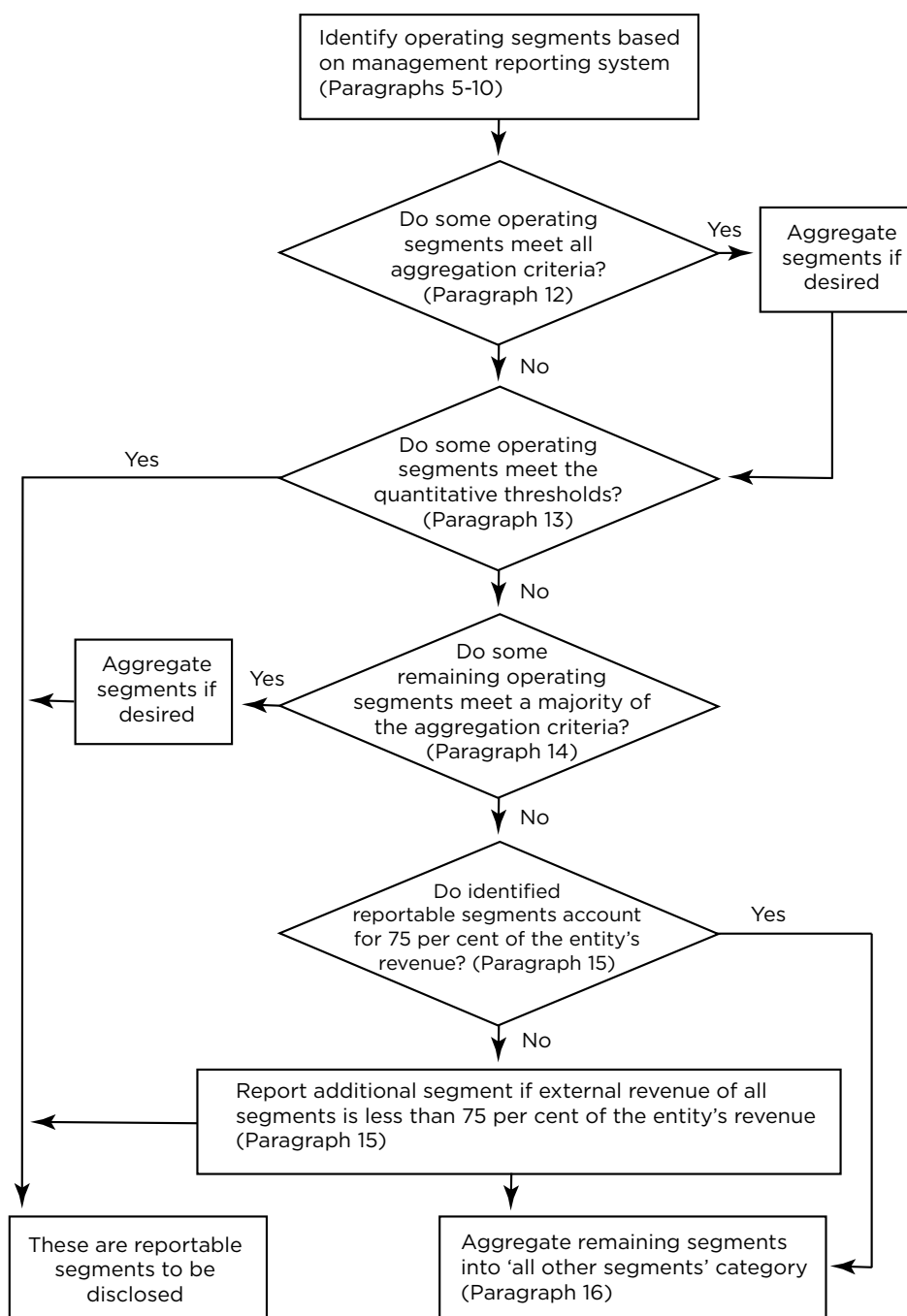
In some instances, information presented outside the financial statements (e.g., in the MD&A) includes information about an entity's business components. A mining entity should take care to ensure the information provided outside the financial statements is consistent with the segments identified in the financial statements. When the information provided outside the financial statements is not consistent with disclosures within the financial statements, a mining entity should consider the reason for the inconsistency and whether it is supportable.

⁴ The term "individual customer" includes certain entities under common control. Where common control is by a government, judgment is required to assess whether multiple government entities are a "single customer."

Appendix 1 – Diagram to Assist in Identifying Reportable Segments

A diagram to assist in identifying reportable segments is included in the ‘Guidance on Implementing IFRS 8 *Operating Segments*’ section of IFRS 8. This diagram is reproduced below.

The following diagram, reproduced directly from IFRS 8, illustrates how to apply the main provisions for identifying reportable segments as defined in IFRS 8. The diagram is a visual supplement to IFRS 8. It should not be interpreted as altering or adding to any requirements of the IFRS, nor should it be regarded as a substitute for the requirements.



The Mining Industry Task Force on IFRSs

Members

Ronald P. Gagel, CPA, CA (Chair)
Prospectors & Developers Association
of Canada
Toronto, Ontario

Susan Bennett, CPA, CA
Deloitte & Touche LLP
Toronto, Ontario

Bryndon L. Kydd, CPA, CA
BDO Canada LLP
Vancouver, British Columbia

Stéphanie Laframboise, CPA, CA
Raymond Chabot Grant Thornton LLP
Montreal, Quebec

Blake Langill, CPA, CA
Ernst & Young LLP
Toronto, Ontario

James Lusby, CPA, CA
PricewaterhouseCoopers LLP
Toronto, Ontario

Keith McKay, CPA, CA
Dalradian Resources Inc.
Toronto, Ontario

Ken McKay, CPA, CA
KPMG LLP
Toronto, Ontario

Rebecca Ng, CPA, CA
Century Iron Mines Corporation
Toronto, Ontario

Maruf Raza, CPA, CA
MNP LLP
Toronto, Ontario

Julie Robertson, CPA, CA
Barrick Gold Corporation
Toronto, Ontario

Andrew Snowden, CPA, CA
Sherritt International Corporation
Toronto, Ontario

Staff

Rosemary McGuire, CPA, CA
CPA Canada
Toronto, Ontario

Comments on this *Viewpoints* or suggestions for future *Viewpoints* should be sent to:

Rosemary McGuire, CPA, CA
Principal, Reporting & Capital Markets
Research, Guidance and Support
Chartered Professional Accountants of Canada
277 Wellington Street West
Toronto, Ontario M5V 3H2

For more information on IFRSs visit:

email: rmcguire@cpacanada.ca

www.cpacanada.ca/viewpointsmining