What do operating segments reveal about impairment?

February 2025

Operating Segments (AASB 8) is often perceived to be solely a disclosure standard. Often overlooked, however, is the interaction with *Impairment of Assets (AASB 136)* that applies to ***all*** entities[1]. This publication provides guidance on the linkage between impairment and operating segments.

Introduction

The link between operating segments and impairment is often overlooked, especially in cases where an unlisted entity may not be required to comply with the disclosures for its reporting segments.

Financial statement preparers should therefore remain alert to any internal or external changes that affect the way in which an entity manages its business - this could range from large acquisitions and restructurings to smaller changes such as divisional downsizing.

Awareness is especially important when operational changes alter the financial information reviewed by the chief operating decision maker (CODM) for decision-making, as this can lead to a change in operating segments.

Changes in operating segments not only impact financial statement disclosures (for listed entities) but can also have recognition and measurement implications. These may arise when performing impairment testing on assets or cash-generating units (CGUs). This makes operating segments somewhat relevant to all entities that have goodwill[2].

This publication explores this link between operating segments and the CODM, and how that can flow into the key requirements for recognising and measuring impairment losses.

Starting with the CODM

The executive(s) charged with reviewing the performance and determining the use of assets of an entity's segments is referred to as the CODM. Identifying the CODM is a crucial first step in determining the operating segments.

The CODM does not refer to a specific managerial title, but rather to the executive(s) responsible for allocating resources to and assessing the performance of the operating segments.

[1] References to AASB include the NZ GAAP equivalent standard.
[2] AASB 136.80

The better the question.
The better the answer.
The better the world works.

Judgement is required to identify the CODM and will be dependent on the company's operations. The CODM can be the CEO and Managing Director, the board's executive directors, or a sub-committee. The CODM usually excludes non-executive directors because they tend to be removed from day-to-day operations. However, the CODM could include non-executive directors if they are involved with relevant operational decision-making.

The components of a group that engages in business activities and has discrete financial information reviewed by the CODM will drive the identification of operating segments and affect the determination of reporting segments (operating segments to be disclosed).

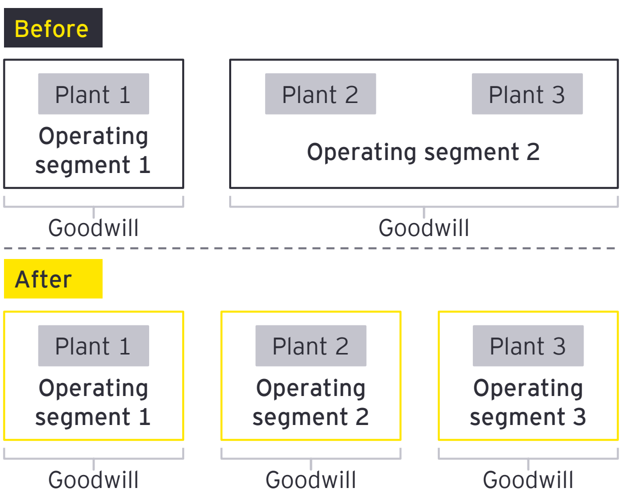
What happens when the CODM changes?

The CEO was the CODM for a manufacturing company, but as the business grew, it became unattainable for a single person to manage all the decision-making responsibilities. The CEO reviewed information and allocated resources by country, which resulted in two operating segments (plants 2 and 3 being in the same country).

The Executive Committee has now assumed these responsibilities; as such it is the new CODM. The Committee now reviews discrete financial information and allocates resources by production plant because of larger volumes produced. This changes the number of operating segments from two to three.

Goodwill cannot be allocated to a group of CGUs larger than the operating segment. Goodwill must be reallocated on the relative values of the CGUs. An impairment test of the existing CGUs and their allocated goodwill needs to be performed before and after goodwill is reallocated from two to three segments.

**Note that impairment tests are performed at CGU level, which can be smaller than the operating segments.*



How do operating segments impact impairment testing of assets and CGUs?

The first step of impairment testing is to identify the smallest group of assets that generates largely independent cash inflows (the CGUs).

The impairment standard is ***applicable to all entities***, and it references to operating segments as defined by AASB 8 for purposes of impairment testing of CGUs[3]. As such, the operating segments determine the highest level where goodwill can be allocated for impairment testing. Operating segments can therefore impact the timing and measurement of impairment losses.

Acquired goodwill is allocated to each (group of) CGU expected to benefit from synergies. If goodwill is not allocated to an individual CGU or goodwill is not monitored at this lowest level, it may be allocated to a larger group, but for impairment testing it cannot be allocated at a level higher than the operating segment. Conversely, where a CGU is larger than an operating segment, the CGU assets and goodwill would need to be allocated to the lower operating segment level for impairment testing. Although certain criteria may allow grouping of operating segments together into reporting segments for disclosure, this does not change the ceiling or level where goodwill is to be allocated for impairment testing.

FAQs: Goodwill and operating segments

If an entity is not in scope of AASB 8, does it still need to define operating segments for impairment testing?

- Yes, this will be necessary in cases where an entity has goodwill (as this will be the highest level at which goodwill can be allocated). If the entity has no goodwill, then the identification of operating segments will not be necessary for impairment testing.

Can goodwill allocation be at a level higher than the operating segment when management only allocates and monitors goodwill at the whole of entity level?

- No, goodwill cannot be tested for impairment on its own and must be allocated to a (or a group of) CGU, which cannot be larger than an operating segment.

[3] AASB 136.80

What are the consequences of changes in operating segments?

When contemplating a restructure, acquisition or part-disposal of a business, there are potential accounting impacts that arise from changes in operating segments.

Changes in the operating segments could result in an impairment loss to be recognised. If goodwill was previously allocated to CGUs affected by the change in operating segments, that goodwill must be reallocated based on the relative values of the components included in the impacted CGUs before and after the change. An impairment test must be performed before the reallocation. Consequently, impairment cannot be avoided by simply changing the composition of the operating segments (e.g., moving an underperforming business into an operating segment with sufficient headroom).

What types of external factors can trigger a change in operating segments?

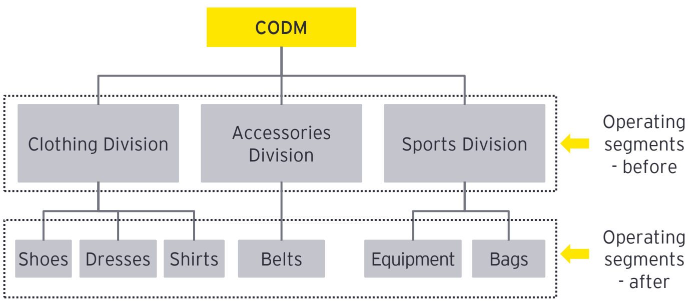
Changes in global market trends (such as rising interest rates, inflation, and slowing growth) and increased climate awareness have necessitated many businesses to rethink the way they manage risks, allocate resources and measure performance.

These external changes could lead to changes in the operating segments as shown in examples below.

Practical examples

Example 1

A manufacturing company needs to reduce its carbon emissions in line with the new local laws. As a result, decision-making, review and resource allocation are now by product, instead of by division, to better monitor the total carbon emissions per product. This will cause a disaggregation of existing operating segments (divisions) into smaller operating segments (products), which could require impairment testing and potentially goodwill reallocation (if applicable).



Example 2

A technology company operates in several countries in Latin America, which it presents as a separate operating segment. Following the disposal of its operations in several Latin American countries and a significant step-up acquisition in Brazil, the company's remaining operations in Latin America have become insignificant and financial information is no longer separately provided to the CEO (CODM) for giving strategic direction. Hence, information reviewed by management is amended.

Given the significance of the acquisition in Brazil and the high-growth potential of this market, the CEO has started to review Brazil operations separately. Consequently, the company discloses a separate operating segment for its Brazilian operations and aggregates the remaining operations in Latin America. This change in segment reporting is disclosed retrospectively.

Last words

Being alert to internal or external changes is crucial for identifying potential changes in operating segments and the potential impact on impairment testing. This is especially important when these changes affect the financial information reviewed by the CODM for decision-making purposes.

Rapid growth, restructures, downsizing, and major contractual or asset changes all have the potential to impact operating segments and impairment. External factors and global trends could have a similar impact.

Care should be taken not to identify CGUs merely at operating segment level, as this could cause the (group of) CGUs being identified inappropriately at too high a level, which could result in recognising impairment losses too late.

It is important to remember that the reallocation of goodwill to CGUs will require impairment testing of the CGUs, including goodwill in their current allocations, as well as after the reallocation.

In addition to the recognition and measurement implications of impairment, changes in operating segments will require retrospective disclosure, possibly resulting in additional preparation and audit procedures, which require adequate planning.

To discuss further, contact your local EY adviser.

EY | Building a better working world

EY is building a better working world by creating new value for clients, people, society and the planet, while building trust in capital markets.

Enabled by data, AI and advanced technology, EY teams help clients shape the future with confidence and develop answers for the most pressing issues of today and tomorrow.

EY teams work across a full spectrum of services in assurance, consulting, tax, strategy and transactions. Fueled by sector insights, a globally connected, multi-disciplinary network and diverse ecosystem partners, EY teams can provide services in more than 150 countries and territories.

All in to shape the future with confidence.

EYSCORE 001084-25-AUNZ
ED None