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Dear Finance Director

**ANNUAL REPORTS AND ACCOUNTS 2011-12: IMPLEMENTATION OF IFRS
8: OPERATING SEGMENTS**

Purpose

1. The purpose of this letter is to confirm that departments will be required to apply IFRS 8: *Operating Segments* in full without interpretation or adaptation in their 2011-12 accounts.

Scope

2. The guidance provided in this letter applies to all bodies that are covered by the FReM.

Background

3. In previous years, the preparation of a Statement of Net Operating Costs by Departmental Strategic Objectives was taken to meet the requirements of IFRS 8. Following the removal of reporting by Departmental Strategic Objectives (DSOs), a new approach to reporting against operating segments was required. HM Treasury undertook the usual consultation process with departments, including Northern Ireland, and the outcome of this consultation was that

departments will now be required to implement IFRS 8 in full without adaptation or interpretation.

Impact

4. The 2011-12 FReM and Department Yellow have now been amended to reflect this requirement. For clarification, the following changes will apply to departmental annual resource accounts from 2011-12:
 - Ending of requirement to prepare Statement of Net Operating Costs by Departmental Objectives;
 - Removal of assertion that preparation of a Statement of Net Operating Costs by Departmental Objectives will replace the requirement to disclose performance against key performance indicators;
 - Removal of requirement to report average number of staff employed by departmental strategic objective as a note to the accounts.

5. The Statement of Net Operating Costs by Departmental Objectives has been replaced by a note to the Accounts. In the illustrative Department Yellow, issued to accounting contacts in departments in early January and available at the AFMD website at: <http://www.dfpni.gov.uk/index/finance/afmd/afmd-finance/afmd-financial-reporting.htm>, this is shown as Note 8. A copy is also attached to this letter, at Annex A. To comply with IFRS 8, this note should disclose financial information for operating segments for a minimum of 75% of comprehensive net expenditure. Notes 8.1 and 8.2 should then be prepared to reconcile the total reported segmental information and the financial information reported in the Statement of Comprehensive Net Expenditure and Note 2 of the accounts.

6. Please note that subject to the usual materiality considerations and in accordance with IAS 1, accounts should include comparatives for the previous year compiled on the same basis.
7. A department is required to identify its own operating segments, based on the IFRS 8 criteria. Some further guidance to assist in this process is attached at Annex B. The expectation is that a department's operating segments will consist of business activities designed to support the delivery of departmental aims and objectives. Departments should disclose appropriate information to provide an understanding of the interaction between their operating segments and their aims and objectives. This should also logically align with performance reporting in the Annual Report, as required by FReM 5.2.11.

Action

8. Finance directors are requested to circulate this letter to the appropriate accounting staff within their department, agencies, NDPBs, trading funds and any other entities that prepare their accounts using the principles outlined in FReM.

Further advice

9. If you have any queries do not hesitate to contact Cris Farmer on (028) 91 858025 (GTN 68025), email: cris.farmer@dfpni.gov.uk or Joanne Warnock on (028) 91 277683 (GTN 69083), email: joanne.warnock@dfpni.gov.uk.

Yours sincerely

[signed]

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8. Statement of Operating Costs by Operating Segment

Narrative to disclose;

- Describe factors used to identify the reportable segments.
- Describe the types of activities for which each reportable segment attracts funding
- How reportable segments are reported to the CODM (any differences between info and primary financial statements)
- Basis of accounting for any transactions between reportable segments
- Changes from prior year segment identification methods
- Reliance on major customers

Note	2011-12				2010-11			
	Reportable Segment 1	Reportable Segment 2	Reportable Segment 3	Total	Reportable Segment 1	Reportable Segment 2	Reportable Segment 3	Total
Gross Expenditure								
Income								
Net Expenditure								
Total assets*								
Total Liabilities*								
Net assets*								
Other information*								

Description of segments

Describe for each segment what it is, and how it fits into the activities.

Segment 1
Segment 2
Segment 3

*In accordance with IFRS 8, if total assets, net assets or additional information is reported separately to the Chief Operating Decision Maker, disclosure should be made.

Note 8.1 Reconciliation between Operating Segments and SoCNE / SoFP

Note	2011-12	2010-11
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Reportable Segment 1	Reportable Segment 2	Reportable Segment 3	Total	Reportable Segment 1	Reportable Segment 2	Reportable Segment 3	Total
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**Total net expenditure
per statement of
comprehensive net
expenditure by
operating segment**

**Reconciling
items:**

Income #1
Expenditure #2

**Total net expenditure
per Statement of
Comprehensive Net
Expenditure**

Note 8.2 Reconciliation between Operating Segments and Note 2

Note	2011-12				2010-11			
Reportable Segment 1	Reportable Segment 2	Reportable Segment 3	Total	Reportable Segment 1	Reportable Segment 2	Reportable Segment 3	Total	

**Total net expenditure
per statement of
comprehensive net
expenditure by
operating segment**

**Reconciling
items:**

Income #1
Expenditure #2

**Net outturn per
statement of Assembly
supply**

IFRS 8, *Operating Segments* – Implementation guidance

Summary;

1. Departments must apply IFRS 8 *Operating Segments* in full for 2011-12.
2. **For the 2011-12 annual accounts preparation process, departments should;**
 - **identify their operating segments based on the principles set out in IFRS 8;**
 - **consider how to treat overhead costs as part of the segmental analysis;**
 - **comply with the disclosure requirements of IFRS 8;**
 - **prepare a reconciliation between segmental analysis and Net Operating Cost in the Statement of Comprehensive Net Expenditure;**
 - **provide details of how operating segments support the achievement of the department's identified aims and objectives; and**
 - **present comparative information where practicable, applying IAS 1.**
3. This guidance is designed to offer advice to departments to meet the requirements set out above.

Basis for change

4. The performance regime of Public Service Agreements (PSAs) and Departmental Strategic Objectives (DSOs) has ended. In previous years, a department identified its DSOs as operating segments to comply with the Government Financial Reporting Manual (FReM) interpretation of IFRS 8 *Operating segments*. To reflect the change all references to PSAs and DSOs have been removed from the 2011-12 FReM, including the interpretation of IFRS 8, following the consultation process for FReM amendments.
5. The core principle of IFRS 8 is that an entity shall disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates.

6. Therefore a department should identify its operating segments based on its main areas of activity, or its key business drivers. Departments will need to be able to demonstrate the rationale for the identification of operating segments to their auditors. It is important therefore that departments have a sound basis for the decisions taken.

Identification of operating segments

7. IFRS 8 requires entities to identify operating segments as those activities reported separately to the “Chief Operating Decision Maker (CODM)”. The CODM for departments will normally be the Accounting Officer and the Executive Management Board, and may extend to the full Board. Management information reviewed by the Board will be a good starting point to identify operating segments.
8. In principle, departments should have a clear understanding of their different activities. These activities might be divided into directorates within a department, or be clearly evident from the different classes of activities carried out. In some situations these activities might also be grouped by the objective they have been designed to achieve.
9. In practical terms, a department should be able to identify segments as the different strands of activity in the management information reviewed by the Board. This may be supported by the structure of cost centres within the finance system. Alternatively, this might be a summary of the different finance systems within a department, presented in a consolidated format.
10. In the process of identifying operating segments, departments are able to combine segments that share similar characteristics. IFRS 8 offers guidance on the aggregation criteria that might be similar across different discrete segments. In the process of identifying operating segments, departments should carry out an exercise to assess whether there is scope to aggregate segments. This might be useful if a department’s initial investigation identifies a large number of possible segments.
11. Once a department has identified its operating segments, it should consider the activities of the other entities within its departmental boundary. Each entity will have identified its own operating segments, and these might not be consistent with those identified by the department. In consolidated accounts, a subsidiary entity’s segmental information should be reported within one of the segments identified by the department.

Only one operating segment?

12. A department might come to the conclusion that it only has one business activity, and therefore one operating segment. While this might be the case, it is important that a thorough review of all supporting business activities is undertaken, and that a justification is prepared to support the decision that a department does only have one operating segment.
13. If the information presented to the Board is completely consolidated (i.e. not split between different activities or objectives) then further investigation might be required to review the different types of activity that form this consolidated information. Such an investigation might identify the different business activities or objectives of the department, which can be interpreted to be the operating segments.

Treatment of overhead costs

14. IFRS 8 requires an operating segment to be a business activity. Therefore it will be difficult to argue that a support function within a department, such as Head Office functions, represents an operating segment. The expectation would be that overheads should be apportioned to the identified segments where this is appropriate.

Disclosure requirements

15. Annex A includes an example disclosure note for the annual accounts, based on the assumption that total and net assets are reported to the CODM.
16. IFRS 8 sets out a number of disclosure requirements for operating segments. Departments should therefore consider these requirements in the light of their activities, and apply them accordingly. Departments should disclose sufficient information to explain the basis of identification of operating segments to users.
17. The spirit of IFRS 8 requires presentation of information in a comparable format to that used by the Board to make business decisions. 'Business decisions' actually means the delivery of public services. Therefore any disclosures in the annual accounts should be presented with this in mind.
18. While IFRS 8 sets out the minimum information requirements for each segment, **it is important to remember that, if additional information is reported to the CODM, this should also be disclosed in the accounts for each segment.** For example, if departments report information on segmental assets and liabilities to the CODM, this information should also be disclosed in the accounts for each segment.

19. There is no requirement to disclose segmental information separately for the core department, and the departmental group. The implication is that only the information that gets presented to the CODM should be presented. This might include information relating to other entities within the departmental boundary, too – especially where the accounting officer is responsible for the entity.
20. Where Departments or ALBs have undertaken the exercise to identify their segments and reached the conclusion that they only have one operating segment, justification for this should be disclosed in the accounts, and considered in accordance with the information presented to the CODM.
21. Departments may report information to the CODM that is not prepared on the same basis as the annual accounts (e.g. management information rather than information drawn from the nominal ledger). In this situation, the segmental information in the annual accounts should be in the same format as that reported to the CODM.
22. The segmental information should be reconciled to the information presented in the primary statements required by IFRS (i.e. the Net Operating Cost in the Statement of Comprehensive Net Expenditure). This will also be achieved by reconciling to note 2, to reconcile segments to Assembly's analysis of spend.
23. The publication of additional, relevant material is encouraged where this enhances the user's understanding of the information being reported. However, departments should ensure that any additional information is relevant, to avoid inclusion of 'clutter' in the accounts.
24. Comparative information should be provided as far as is practicable, in accordance with IAS 1.

Annual reporting in 2011-12

25. The expectation is that the information reported to the CODM helps inform decisions on delivery of its objectives, and the business as usual activities included in the departmental business plan, where the department has produced one. A department should be able to demonstrate how the operating segments reported in the accounts provide information to the CODM on achievement of the performance objectives it reports against in its annual report.
26. If the segmental activities do not appear to support delivery of the department's objectives, explanation should be provided of what the activities are designed to support, and how this then relates to the

performance objectives reported by the department.

27. It is anticipated that the information presented in 2011-12 is consistent with how departments will be expected to report on their performance in future years. Therefore the format of the performance reporting, and the links between activities (operating segments) and objectives (performance measures), should be discussed and agreed by each department to encourage consistent reporting each year.