Exposure Draft

ED 145
January 2006

Operating Segments

Prepared by the
Australian Accounting Standards Board

Australian Government

Australian Accounting Standards Board

Commenting on this Exposure Draft

Constituents are strongly encouraged to respond to the AASB and the IASB. The AASB is seeking comment by 20 April 2006. This will enable the AASB to consider Australian constituents' comments in the process of formulating its own comments to the IASB, which are due by 19 May 2006. Comments should be addressed to:

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A copy of all non-confidential submissions to the AASB will be placed on public record on the AASB website: www.aasb.com.au.

Obtaining a Copy of this Exposure Draft

This Exposure Draft is available on the AASB website: www.aasb.com.au. Alternatively, printed copies of this Exposure Draft are available by contacting:

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PREFACE

Background

Australian Accounting Standards

The Australian Accounting Standards Board (AASB) makes Australian Accounting Standards applicable by:

(a) entities required by the *Corporation Act 2001* to prepare financial reports;

(b) all reporting entities engaged in either for-profit, not-for-profit or public sectors; and

(c) any other entity that prepares general purpose financial reports.

Australian Accounting Standards that apply to annual reporting periods beginning on or after 1 January 2005 include Australian equivalents to International Financial Reporting Standards (IFRSs). IFRSs comprise accounting standards and interpretations. IFRSs are issued by the International Accounting Standards Board (IASB), and their adoption in Australia is in accordance with a strategic directive made by the Financial Reporting Council. The reasons for adoption of IFRSs in Australia are explained in CLERP Paper No. 9: *Proposals for Reform – Corporate Disclosure* (2002).

Although IFRSs are developed to apply to for-profit entities, the AASB has decided to continue to make sector-neutral accounting standards. Accordingly, Australian Accounting Standards (including Australian equivalents to IFRSs) generally apply to both for-profit and not-for-profit entities, including public sector entities. An Australian equivalent to an IFRS uses the corresponding IFRS as the “foundation” Standard to which the AASB adds material detailing its scope and applicability in the Australian environment. Additions are made, where necessary, to broaden the content of the Australian equivalent to an IFRS to cover domestic, regulatory or other issues. In addition to making accounting standards that are Australian equivalents to IFRSs, the AASB also continues to make other Australian Accounting Standards that are specific to the not-for-profit or public sectors or that are purely of a domestic nature.

The adoption of IFRSs is an ongoing process. Whenever the IASB issues new or amended IFRSs, the AASB must also consider making new or amended Australian equivalents to those IFRSs.

In developing a new or amended IFRS, the IASB releases an Exposure Draft (ED) of the proposed Standard or amendments for public comment. The AASB generally follows a similar due process prior to making or amending Australian Accounting Standards. In the case of changes proposed by the IASB to IFRSs, the AASB also releases an ED containing those proposed changes and specifically invites comments from Australian constituents on, among other things, whether the implementation of the proposals in an Australian equivalent to an IFRS may be affected by the Australian environment (including the legal and regulatory environment) and whether the proposals are in the best interests of the Australian economy.

Purpose of this Exposure Draft

The purpose of this ED is to invite comments from Australian constituents on a proposed replacement of AASB 114 *Segment Reporting*, which is the Australian equivalent of IAS 14 *Segment Reporting*. The proposals are contained in the Exposure Draft ED 8 *Operating Segments* issued by the IASB in January 2006. If these proposals are approved by the IASB, and subsequently by the AASB, they are expected to be applicable to annual reporting periods beginning on or after 1 January 2007.

The AASB has decided to reproduce the IASB Exposure Draft ED 8 *Operating Segments* without amendment as part of this ED.

Not-for-Profit Entities

The AASB proposes to retain the present exemption in respect of not-for-profit entities. Specifically in relation to local governments, government departments and governments the present exemption from applying AASB 114 derives from the inclusion of requirements relating to reporting disaggregated information in accordance with AAS 27 *Financial Reporting by Local Governments*, AAS 29 *Financial Reporting by Government Departments* and AAS 31 *Financial Reporting by Governments*. In September 2005 the Board indicated its intention to propose withdrawal of AAS 27, AAS 29 and AAS 31 and to deal with any specific public sector reporting needs in other standards on a topic-by-topic basis.

In July 2005, the AASB indicated its intention to issue IPSAS 18 *Segment Reporting* as an ED proposing application by not-for-profit entities. However, as part of the current project to replace AASB 114, the AASB decided to defer further consideration of an ED based on IPSAS 18 and to adopt a two-stage process. The Board decided that in the first stage it would seek comments from constituents on the appropriateness and implications of adapting the proposed "management approach" for application by not-for-profit entities in either or both of the public or private sector. In the second stage the Board intends to develop an ED and will determine the basis of the approach following review of the comments on the questions raised in the first stage of the process.

Application

The proposals in the ED are intended to:

(a) replace AASB 114, issued in July 2004; and

(b) consequentially amend, AASB 1023 *General Insurance Contracts* and AASB 1038 *Life Insurance Contracts*, AASB 5 *Non-current Assets Held for Sale and Discontinued Operations*, AASB 6 *Exploration for and Evaluation of Mineral Resources*, AASB 102 *Inventories*, AASB 107 *Cash Flow Statements*, AASB 119 *Employee Benefits*, AASB 134 *Interim Financial Reporting* and AASB 136 *Impairment of Assets*.

The existing requirements of these Standards remain operative until superseded by the proposals in this ED.

The AASB intends to make the Standard to replace AASB 114 applicable to for-profit entities from the same date as the IASB. This is anticipated to be consistent with the proposed application date in ED 8 *Operating Segments* being the first annual reporting period beginning on or after 1 January 2007. Earlier application is proposed to be permitted for annual reporting periods beginning on or after the date the replacement Standard is made by the AASB.

The AASB also intends to repeal paragraphs 17.5 and 17.5.1 of AASB 1023 which refer to compliance with AASB 114 and require geographical segments to be determined on the basis of the location of risks insured. This is because it is inappropriate to retain this requirement under the proposed approach which is based on how information is reported internally. The AASB also intends to repeal paragraph 18.2.2 of AASB 1038 which refers to AASB 114 and to make consequential amendments to AASB 5, AASB 6, AASB 102, AASB 107, AASB 119, AASB 134 and AASB 136 to take account of the changed approach to identifying operating segments in the proposed Standard.

The AASB proposes that the new Standard will have a similar scope to that proposed in the IASB ED. Under the IASB's proposals the Standard would be applied by all entities;

(a) that have filed or are in the process of filing their financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market. (In the Australian context this is likely to be the equivalent of disclosing entities); or

(b) that hold assets in a fiduciary capacity for a broad group of outsiders, such as a bank, insurance company, securities broker/dealer, pension fund, mutual fund or investment banking entity.

AASB 114 currently applies to all reporting entities that are for-profit entities. AASB 114 does not apply to not-for-profit entities.

After considering comments from constituents about the implications of the proposed approach for not-for-profit entities the AASB will subsequently address developing segment reporting requirements for not-for-profit entities as a matter of priority.

Summary of Main Changes to AASB 114

Refer to the IASB ED Summary of Main Changes for a description of the proposed changes to previous requirements and, by extension, to AASB 114.

Request for Comments

Comments are invited on any of the proposals in the ED, including the questions on the proposed replacement of IAS 14 as listed in the Invitation to Comment section of the IASB ED.

Constituents are strongly encouraged to respond to the AASB and the IASB. The AASB is seeking comment by 20 April 2006. This will enable the AASB to consider Australian constituents' comments in the process of formulating its own comments to the IASB, which are due by 19 May 2006. The AASB would prefer that respondents supplement their opinions with detailed comments, whether supportive or critical, on the major issues. The AASB regards both critical and supportive comments as essential to a balanced review and will consider all submissions, whether they address all specific matters, additional issues or only one issue.

Specific Matters for Comment

In addition, the AASB would value comments on:

(a) whether the proposed scope is appropriate, whether the existing scope of AASB 114 should be retained or whether an alternative scope is more appropriate;

(b) whether segment reporting requirements based on the proposals would be appropriate to apply to not-for-profit entities in the:

    (i) public sector;

    (ii) private sector.

    The AASB is particularly interested in learning of practical impediments to adopting a similar approach in respect of not-for-profit entities;

(c) any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals; and

(d) whether the proposals are in the best interests of the Australian economy.

Exposure Draft

ED 8 OPERATING SEGMENTS

Comments to be received by 19 May 2006

ED 8 *Operating Segments* is published by the International Accounting Standards Board (IASB) for comment only. The proposals may be modified in the light of the comments received before being issued as an International Financial Reporting Standard (IFRS). Comments on the draft IFRS and its accompanying documents (see separate booklets) should be submitted in writing so as to be received by **19 May 2006.**

All responses will be put on the public record unless the respondent requests confidentiality. However, such requests will not normally be granted unless supported by good reason, such as commercial confidence. If commentators respond by fax or email, it would be helpful if they could also send a hard copy of their response by post. Comments should preferably be sent by email to: **CommentLetters@iasb.org** or addressed to:

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IASB Exposure Draft January 2006

Invitation to comment

The International Accounting Standards Board invites comments on any aspect of the Exposure Draft of its proposed IFRS *Operating Segments.* It would particularly welcome answers to the questions set out below. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, when applicable, provide a suggestion for alternative wording.

Comments should be submitted in writing so as to be received no later than **19 May 2006**.

Question 1 – Adoption of the management approach in SFAS 131

The draft IFRS adopts the management approach to segment reporting set out in SFAS 131 *Disclosures about Segments of an Enterprise and Related Information* issued by the US Financial Accounting Standards Board.

Is this approach to segment reporting appropriate? If not, why not? What, if any, alternative approach would you propose?

Question 2 – Divergence from SFAS 131

The wording of the draft IFRS is the same as that of SFAS 131 except for changes necessary to make the terminology consistent with that in other IFRSs.

Do you think that the draft IFRS should depart from the management approach in SFAS 131 by setting requirements for

(a) the measurement of specified items or

(b) the disclosure of specified amounts that might otherwise not be given?

If so, identify the requirements you would add and indicate what you see as the relative costs and benefits of any such requirements.

Question 3 – Scope of the standard

The existing standard IAS 14 requires entities whose equity or debt securities are publicly traded and entities that are in the process of issuing equity or debt securities in public securities markets to disclose segment information. The draft IFRS extends the scope to include also entities that hold assets in a fiduciary capacity for a broad group of outsiders.

Do you agree with the scope of the draft IFRS? If not, why not?

Question 4 – Level of reconciliations

The draft IFRS requires an entity to provide, for specified items, reconciliations of total reportable segment amounts to amounts recognised by the entity in accordance with IFRSs. It does not require such reconciliations for individual reportable segments.

Do you agree with the level of reconciliations required in the draft IFRS? If not, indicate what you see as the relative costs and benefits of any other level of reconciliation.

Question 5 – Geographical information about assets

The draft IFRS requires an entity to disclose geographical information about non-current assets excluding specified items. It does not require disclosure of geographical information about total assets.

Do you agree with the requirement to disclose geographical information about non-current assets excluding specified items? If not, for which assets would you require geographical information to be given?

Question 6 – Consequential amendments to IAS 34 *Interim Financial Reporting*

The draft IFRS requires an entity to disclose more segment information in interim financial reports than is currently required, including a reconciliation of the total of the reportable segments' measures of profit or loss to the entity's profit or loss.

Do you agree with the consequential amendments made to IAS 34? If not, why not?

[Draft] International Financial Reporting Standard X *Operating Segments* ([draft] IFRS X) is set out in paragraphs 1-36 and the Appendix. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Definitions of terms are given in the Glossary for International Financial Reporting Standards. [Draft] IFRS X should be read in the context of its core principle and the Basis for Conclusions, the *Preface to International Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Statements.* IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

Reasons for issuing the [draft] IFRS

IN1 [Draft] International Financial Reporting Standard X *Operating Segments* sets out requirements for disclosure of information about an entity's operating segments and also about the entity's products and services, the geographical areas in which it operates, and its major customers.

IN2 Achieving convergence of accounting standards around the world is one of the prime objectives of the International Accounting Standards Board. In pursuit of that objective, the Board and the Financial Accounting Standards Board (FASB) in the United States have undertaken a joint short-term project with the objective of reducing differences between International Financial Reporting Standards (IFRSs) and US generally accepted accounting principles (US GAAP) that are capable of resolution in a relatively short time and can be addressed outside major projects. One aspect of that project involves the two boards considering each other's recent standards with a view to adopting high quality financial reporting solutions. The [draft] IFRS arises from the IASB's consideration of FASB Statement No. 131 *Disclosures about Segments of an Enterprise and Related Information* (SFAS 131) issued in 1997, compared with IAS 14 *Segment Reporting*, which was issued in substantially its present form by the IASB's predecessor body, the International Accounting Standards Committee, in 1997.

IN3 The [draft] IFRS achieves convergence with the requirements of SFAS 131. The wording of the [draft] IFRS is the same as that of SFAS 131 except for changes necessary to make the terminology consistent with that in other IFRSs.

Main features of the [draft] IFRS

IN4 The [draft] IFRS sets out the way that an entity should report information about its operating segments in annual financial statements and, as a consequential amendment to IAS 34 *Interim Financial Reporting*, requires an entity to report selected information about its operating segments in interim financial reports. It also sets out requirements for related disclosures about products and services, geographical areas and major customers.

IN5 The [draft] IFRS requires an entity to report financial and descriptive information about its reportable segments. Reportable segments are operating segments or aggregations of operating segments that meet specified criteria. Operating segments are components of an entity about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. Generally, financial information is required to be reported on the basis that it is used internally for evaluating operating segment performance and deciding how to allocate resources to operating segments.

IN6 The [draft] IFRS requires an entity to report a measure of operating segment profit or loss, particular income and expense items, and assets. It requires reconciliations of total reportable segment revenues, total profit or loss, total assets, and other amounts disclosed for reportable segments to corresponding amounts in the entity's financial statements. It requires an entity to report information about the revenues derived from its products or services (or groups of similar products and services), about the countries in which it earns revenues and holds assets, and about major customers, regardless of whether that information is used by management in making operating decisions. However, the [draft] IFRS does not require an entity to report information that is not prepared for internal use if the necessary information is not available and the cost to develop it would be excessive.

IN7 The [draft] IFRS also requires an entity to give descriptive information about the way that the operating segments were determined, the products and services provided by the segments, differences between the measurements used in reporting segment information and those used in the entity's financial statements, and changes in the measurement of segment amounts from period to period.

IN8 The [draft] IFRS is effective for periods beginning on or after 1 January 2007.

Changes from previous requirements

IN9 The main changes from IAS 14 are described below.

Scope of the [draft] IFRS

IN10 IAS 14 requires entities whose equity or debt securities are publicly traded and entities that are in the process of issuing equity or debt securities in public securities markets to disclose segment information. The [draft] IFRS extends the scope to include also entities that hold assets in a fiduciary capacity for a broad group of outsiders.

Identification of segments

IN11 The requirements of the [draft] IFRS are based on the information about the components of the entity that management uses to make decisions about operating matters. The [draft] IFRS requires identification of operating segments on the basis of internal reports that are regularly reviewed by the entity's chief operating decision maker in order to allocate resources to the segment and assess its performance. IAS 14 requires identification of two sets of segments—one based on related products and services, and the other on geographical areas. IAS 14 regards one set as primary segments and the other as secondary segments.

IN12 A component of an entity that sells primarily or exclusively to other operating segments of the entity is included in the [draft] IFRS definition of an operating segment if the entity is managed that way. IAS 14 limits reportable segments to those that earn a majority of their revenue from sales to external customers and therefore does not require the different stages of vertically integrated operations to be identified as separate segments.

Measurement of segment information

IN13 The [draft] IFRS requires the amount of each operating segment item reported to be the measure reported to the chief operating decision maker for the purposes of allocating resources to the segment and assessing its performance. IAS 14 requires segment information to be prepared in conformity with the accounting policies adopted for preparing and presenting the financial statements of the consolidated group or entity.

IN14 IAS 14 defines segment revenue, segment expense, segment result, segment assets, and segment liabilities. The [draft] IFRS does not define these terms, but requires an explanation of how segment profit or loss and segment assets are measured for each reportable segment.

Disclosure

IN15 The [draft] IFRS requires an entity to disclose the following information:

(a) factors used to identify the entity's operating segments, including the basis of organisation (for example, whether management organises the entity around differences in products and services, geographical areas, regulatory environments, or a combination of factors and whether segments have been aggregated), and

(b) types of products and services from which each reportable segment derives its revenues.

IAS 14 does not require this information.

IN16 IAS 14 requires the entity to disclose specified items of information about its primary segments. The [draft] IFRS requires an entity to disclose specified amounts about each reportable segment, if the specified amounts are included in the measure of segment profit or loss or assets reviewed by the chief operating decision maker.

IN17 The [draft] IFRS requires an entity to report interest revenue separately from interest expense for each reportable segment unless a majority of the segment's revenues are from interest and the chief operating decision maker relies primarily on net interest revenue to assess the performance of the segment and to make decisions about resources to be allocated to the segment. IAS 14 does not require disclosure of interest income and expense.

IN18 The [draft] IFRS requires an entity, including an entity with a single reportable segment, to disclose information for the entity as a whole about its products and services, geographical areas and major customers. This requirement applies, regardless of the entity's organisation, if the information is not included as part of the disclosures about segments. IAS 14 does not require an entity with a single reportable segment to provide information for the entity as a whole about its products and services, geographical areas and major customers.

[Draft] International Financial Reporting Standard X *Operating Segments*

Core principle

1 This [draft] IFRS requires an entity to disclose information to enable users of its financial statements to evaluate the nature and financial effects of the types of business activities in which it engages and the economic environments in which it operates.

Scope

2 This [draft] IFRS shall be applied by all entities that:

(a) have filed, or are in the process of filing, their financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; or

(b) hold assets in a fiduciary capacity for a broad group of outsiders, such as a bank, insurance company, securities broker/dealer, pension fund, mutual fund or investment banking entity.

3 If an entity that is not required to apply this [draft] IFRS chooses to disclose segment information in financial statements that comply with International Financial Reporting Standards, that entity shall comply with the requirements of this [draft] IFRS.

Operating segments

4 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 chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and

(c) for which discrete financial information is available.

An operating segment may engage in business activities for which it has yet to earn revenues, for example, start-up operations may be operating segments before earning revenues.

5 Not every part of an entity is necessarily an operating segment or part of an operating segment. For example, a corporate headquarters or some functional departments may not earn revenues or may earn revenues that are only incidental to the activities of the

entity and would not be operating segments. For the purposes of this [draft] IFRS, an entity's post-employment benefit plans are not regarded as operating segments.

6 The term 'chief operating decision maker' identifies a function, not necessarily a manager with a specific title. That function is to allocate resources to and assess the performance of the operating segments of an entity. Often the chief operating decision maker of an entity is its chief executive officer or chief operating officer, but for example it may be a group of executive directors or others.

7 For many entities, the three characteristics of operating segments described in paragraph 4 clearly identify its operating segments. However, an entity may produce reports in which its business activities are presented in a variety of ways. If the chief operating decision maker uses more than one set of segment information, other factors may identify a single set of components as constituting an entity's operating segments, including the nature of the business activities of each component, the existence of managers responsible for them, and information presented to the board of directors.

8 Generally, an operating segment has a segment manager who is directly accountable to and maintains regular contact with the chief operating decision maker 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 chief operating decision maker also may be the segment manager for some operating segments. A single manager may be the segment manager for more than one operating segment. If the characteristics in paragraph 4 apply to more than one set of components of an organisation but there is only one set for which segment managers are held responsible, that set of components constitutes the operating segments.

9 The characteristics in paragraph 4 may apply to two or more overlapping sets of components for which managers are held responsible. That structure is sometimes referred to as a matrix form of organisation. For example, in some entities, some managers are responsible for different product and service lines worldwide, whereas other managers are responsible for specific geographical areas. The chief operating decision maker regularly reviews the operating results of both sets of components, and financial information is available for both. In that situation, the components based on products and services would constitute the operating segments.

Reportable segments

10 An entity shall report separately information about each operating segment that

(a) has been identified in accordance with paragraphs 4–9 or results from aggregating two or more of those segments in accordance with paragraph 11, and

(b) exceeds the quantitative thresholds in paragraph 12.

Paragraphs 13–18 specify other situations in which separate information about an operating segment shall be reported.

Aggregation criteria

11 Operating segments often exhibit similar long-term financial performance if they have similar economic characteristics. For example, similar long-term average gross margins for two operating segments would be expected if their economic characteristics were similar. Two or more operating segments may be aggregated into a single segment if aggregation is consistent with the core principle of this [draft] IFRS, the segments have similar economic characteristics, and the segments are similar in each of the following respects:

(a) the nature of the products and services;

(b) the nature of the production processes;

(c) the type or class of customer for their products and services;

(d) the methods used to distribute their products or provide their services; and

(e) if applicable, the nature of the regulatory environment, for example, banking, insurance, or public utilities.

Quantitative thresholds

12 An entity shall report separately information about an operating segment that meets any of the following quantitative thresholds:

(a) Its reported revenue, including both sales to external customers and intersegment sales or transfers, is 10 per cent or more of the combined revenue, internal and external, of all operating segments.

(b) The absolute amount of its reported profit or loss is 10 per cent or more of the greater, in absolute amount, of (i) the combined reported profit of all operating segments that did not report a loss and (ii) the combined reported loss of all operating segments that reported a loss.

(c) Its assets are 10 per cent or more of the combined assets of all operating segments.

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

13 An entity may combine information about operating segments that do not meet the quantitative thresholds with information about other operating segments that do not meet the quantitative thresholds to produce a reportable segment only if the operating segments share a majority of the aggregation criteria listed in paragraph 11.

14 If the total external revenue reported by operating segments constitutes less than 75 per cent of the entity's revenue, additional operating segments shall be identified as

reportable segments (even if they do not meet the criteria in paragraph 12) until at least 75 per cent of the entity's revenue is included in reportable segments.

15 Information about other business activities and operating segments that are not reportable shall be combined and disclosed in an 'all other segments' category separately from other reconciling items in the reconciliations required by paragraph 27. The sources of the revenue included in the 'all other segments' category shall be described.

16 If management judges that an operating segment identified as a reportable segment in the immediately preceding period is of continuing significance, information about that segment shall continue to be reported separately in the current period even if it no longer meets the criteria for reportability in paragraph 12.

17 If an operating segment is identified as a reportable segment in the current period in accordance with the quantitative thresholds, segment data for a prior period presented for comparative purposes shall be restated to reflect the newly reportable segment as a separate segment even if that segment did not satisfy the criteria for reportability in paragraph 12 in the prior period unless the necessary information is not available and the cost to develop it would be excessive.

18 There may be a practical limit to the number of reportable segments that an entity separately discloses beyond which segment information may become too detailed. Although no precise limit has been determined, as the number of segments that are reportable in accordance with paragraphs 12–17 increases above ten, the entity should consider whether a practical limit has been reached.

Disclosure

19 An entity shall disclose information to enable users of its financial statements to evaluate the nature and financial effects of the types of business activities in which it engages and the economic environments in which it operates.

20 To give effect to the principle in paragraph 19, an entity shall disclose the following for each period for which an income statement is presented:

(a) general information as described in paragraph 21;

(b) information about reported segment profit or loss, including specified revenues and expenses included in reported segment profit or loss, segment assets, and the basis of measurement, as described in paragraphs 22–26; and

(c) reconciliations of the totals of segment revenues, reported segment profit or loss, segment assets, and other material segment items to corresponding entity amounts as described in paragraph 27.

Reconciliations of balance sheet amounts for reportable segments to the entity's balance sheet amounts are required for each date at which a balance sheet is presented. Previously reported information for prior periods shall be restated as described in paragraphs 28 and 29.

General information

21 An entity shall disclose the following general information:

(a) factors used to identify the entity's reportable segments, including the basis of organisation (for example, whether management has chosen to organise the entity around differences in products and services, geographical areas, regulatory environments, or a combination of factors and whether operating segments have been aggregated), and

(b) types of products and services from which each reportable segment derives its revenues.

Information about profit or loss and assets

22 An entity shall report a measure of profit or loss and total assets for each reportable segment. An entity shall also disclose the following about each reportable segment if the specified amounts are included in the measure of segment profit or loss reviewed by the chief operating decision maker or are otherwise regularly provided to the chief operating decision maker, even if not included in that measure of segment profit or loss:

(a) revenues from external customers;

(b) revenues from transactions with other operating segments of the same entity;

(c) interest revenue;

(d) interest expense;

(e) depreciation and amortisation;

(f) material items of income and expense disclosed in accordance with paragraph 86 of IAS 1 *Presentation of Financial Statements*;

(g) the entity's interest in the profit or loss of associates and joint ventures accounted for by the equity method;

(h) income tax expense or income; and

(i) material non-cash items other than depreciation and amortisation.

An entity shall report interest revenue separately from interest expense for each reportable segment unless a majority of the segment's revenues are from interest and

the chief operating decision maker relies primarily on net interest revenue to assess the performance of the segment and make decisions about resources to be allocated to the segment. In that situation, an entity may report that segment's interest revenue net of its interest expense and disclose that it has done so.

23 An entity shall disclose the following about each reportable segment if the specified amounts are included in the determination of segment assets reviewed by the chief operating decision maker or are otherwise regularly provided to the chief operating decision maker, even if not included in the determination of segment assets:

(a) the amount of investment in associates and joint ventures accounted for by the equity method, and

(b) total expenditures for additions to non-current assets other than financial instruments, deferred tax assets, post-employment benefit assets (see IAS 19 *Employee Benefits* paragraphs 54–58) and rights arising under insurance contracts.

Measurement

24 The amount of each segment item reported shall be the measure reported to the chief operating decision maker for the purposes of making decisions about allocating resources to the segment and assessing its performance. Adjustments and eliminations made in preparing an entity's financial statements and allocations of revenues, expenses, and gains or losses shall be included in determining reported segment profit or loss only if they are included in the measure of the segment's profit or loss that is used by the chief operating decision maker. Similarly, only those assets that are included in the measure of the segment's assets that is used by the chief operating decision maker shall be reported for that segment. If amounts are allocated to reported segment profit or loss or assets, those amounts shall be allocated on a reasonable basis.

25 If the chief operating decision maker uses only one measure of an operating segment's profit or loss and only one measure of the segment's assets in assessing segment performance and deciding how to allocate resources, segment profit or loss and assets shall be reported at those measures. If the chief operating decision maker uses more than one measure of an operating segment's profit or loss and more than one measure of the segment's assets, the reported measures shall be those that management believes are determined in accordance with the measurement principles most consistent with those used in measuring the corresponding amounts in the entity's financial statements.

26 An entity shall provide an explanation of the measurements of segment profit or loss and segment assets for each reportable segment. At a minimum, an entity shall disclose the following:

(a) the basis of accounting for any transactions between reportable segments.

(b) the nature of any differences between the measurements of the reportable segments' profits or losses and the entity's profit or loss before income tax expense or income and discontinued operations (if not apparent from the reconciliations described in paragraph 27). Those differences could include accounting policies and policies for allocation of centrally incurred costs that are necessary for an understanding of the reported segment information.

(c) the nature of any differences between the measurements of the reportable segments' assets and the entity's assets (if not apparent from the reconciliations described in paragraph 27). Those differences could include accounting policies and policies for allocation of jointly used assets that are necessary for an understanding of the reported segment information.

(d) the nature of any changes from prior periods in the measurement methods used to determine reported segment profit or loss and the effect, if any, of those changes on the measure of segment profit or loss.

(e) the nature and effect of any asymmetrical allocations to reportable segments. For example, an entity might allocate depreciation expense to a segment without allocating the related depreciable assets to that segment.

Reconciliations

27 An entity shall provide reconciliations of all of the following:

(a) the total of the reportable segments' revenues to the entity's revenue.

(b) the total of the reportable segments' measures of profit or loss to the entity's profit or loss before income tax expense or income and discontinued operations. However, if an entity allocates to reportable segments items such as income tax expense or income, the entity may reconcile the total of the segments' measures of profit or loss to the entity's profit or loss after those items.

(c) the total of the reportable segments' assets to the entity's assets.

(d) the total of the reportable segments' amounts for every other material item of information disclosed to the corresponding amount for the entity. For example, an entity may choose to disclose liabilities for its reportable segments, in which case the entity would reconcile the total of reportable segments' liabilities to the entity's liabilities if the segment liabilities are material.

All material reconciling items shall be separately identified and described. For example, the amount of each material adjustment needed to reconcile reportable segment profit or loss to the entity's profit or loss arising from different accounting policies shall be separately identified and described.

Restatement of previously reported information

28 If an entity changes the structure of its internal organisation in a manner that causes the composition of its reportable segments to change, the corresponding information for earlier periods, including interim periods, shall 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 shall be made for each individual item of disclosure. Following a change in the composition of its reportable segments, an entity shall disclose whether it has restated the corresponding items of segment information for earlier periods.

29 If an entity has changed the structure of its internal organisation in a manner that causes the composition of its reportable segments to change and if segment information for earlier periods, including interim periods, is not restated to reflect the change, the entity shall disclose in the year in which the change occurs segment information for the current period on both the old basis and the new basis of segmentation, unless the necessary information is not available and the cost to develop it would be excessive.

Entity-wide disclosures

30 Paragraphs 31–33 apply to all entities subject to this [draft] IFRS including those entities that have a single reportable segment. Some entities' business activities are not organised on the basis of differences in related products and services or differences in geographical areas of operations. Such an entity's reportable segments may report revenues from a broad range of essentially different products and services, or more than one of its reportable segments may provide essentially the same products and services. Similarly, an entity's reportable segments may hold assets in different geographical areas and report revenues from customers in different geographical areas, or more than one of its reportable segments may operate in the same geographical area. Information required by paragraphs 31–33 shall be provided only if it is not provided as part of the reportable segment information required by this [draft] IFRS.

Information about products and services

31 An entity shall report the revenues from external customers for each product and service or each group of similar products and services, unless the necessary information is not available and the cost to develop it would be excessive, in which case that fact shall be disclosed. The amounts of revenues reported shall be based on the financial information used to produce the entity's financial statements.

Information about geographical areas

32 An entity shall report the following geographical information, unless the necessary information is not available and the cost to develop it would be excessive:

(a) revenues from external customers (i) attributed to the entity's country of domicile and (ii) attributed to all foreign countries in total from which the entity derives revenues. If revenues from external customers attributed to an individual foreign country are material, those revenues shall be disclosed separately. An entity shall disclose the basis for attributing revenues from external customers to individual countries.

(b) non-current assets other than financial instruments, deferred tax assets, post-employment benefit assets, and rights arising under insurance contracts (i) located in the entity's country of domicile and (ii) located in all foreign countries in total in which the entity holds assets. If assets in an individual foreign country are material, those assets shall be disclosed separately.

The amounts reported shall be based on the financial information that is used to produce the entity's financial statements. If the necessary information is not available and the cost to develop it would be excessive, that fact shall be disclosed. An entity may provide, in addition to the information required by this paragraph, subtotals of geographical information about groups of countries.

Information about major customers

33 An entity shall provide information about the extent of its reliance on its major customers. If revenues from transactions with a single external customer amount to 10 per cent or more of an entity's revenues, the entity shall disclose that fact, the total amount of revenues from each such customer, and the identity of the segment or segments reporting the revenues. The entity need not disclose the identity of a major customer or the amount of revenues that each segment reports from that customer. For the purposes of this [draft] IFRS, a group of entities known to a reporting entity to be under common control shall be considered a single customer, and a national government, a local government (for example, a county or municipality), or a foreign government each shall be considered a single customer.

Transitional provisions and effective date

34 An entity shall apply this [draft] IFRS in its annual financial statements for periods beginning on or after 1 January 2007. Earlier application is encouraged. If an entity applies this [draft] IFRS in its financial statements for a period before 1 January 2007, it shall disclose that fact.

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35 Segment information for prior years that is reported as comparative information for the initial year of application shall be restated to conform to the requirements of this [draft] IFRS, unless the necessary information is not available and the cost to develop it would be excessive.

Withdrawal of IAS 14

36 This [draft] IFRS supersedes IAS 14 *Segment Reporting*.

Appendix
Amendments to other IFRSs

The amendments in this appendix shall be applied for annual periods beginning on or after [1 January 2007]. If an entity applies this [draft] IFRS for an earlier period, these amendments shall be applied for that earlier period. In the amended paragraphs, new text is underlined and deleted text is struck through.

A1 In International Financial Reporting Standards, including International Accounting Standards and Interpretations, applicable at [date of issue of IFRS], references to IAS 14 *Segment Reporting* are amended to IFRS [X] *Operating Segments*.

A2 In IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, paragraph 41 is amended as follows:

41 An entity shall disclose the following information in the notes in the period in which a non-current asset (or disposal group) has been either classified as held for sale or sold:

…

(d) if applicable, the <u>reportable</u> segment in which the non-current asset (or disposal group) is presented in accordance with ~~IAS 14 *Segment Reporting*~~<u>IFRS [X] *Operating Segments*.</u>

A3 In IFRS 6 *Exploration for and Evaluation of Mineral Resources*, paragraph 21 is amended as follows:

21 An entity shall determine an accounting policy for allocating exploration and evaluation assets to cash-generating units or groups of cash-generating units for the purpose of assessing such assets for impairment. Each cash-generating unit or group of units to which an exploration and evaluation asset is allocated shall not be larger than ~~a segment based on either the entity's primary or secondary reporting format~~<u>an operating segment</u> determined in accordance with ~~IAS 14 *Segment Reporting*~~<u>IFRS [X] *Operating Segments*</u>.

A4 In IAS 2 *Inventories*, paragraphs 26 and 29 are amended as follows:

26 For example, inventories used in one ~~business~~<u>operating</u> segment may have a use to the entity different from the same type of inventories used in another ~~business~~<u>operating</u> segment. However, a difference in geographical location of inventories (or in the respective tax rules), by itself, is not sufficient to justify the use of different cost formulas.

29 Inventories are usually written down to net realisable value item by item. In some circumstances, however, it may be appropriate to group similar or related items. This may be the case with items of inventory relating to the same product line that have similar purposes or end uses, are produced and marketed in the same geographical area, and cannot be practicably evaluated separately from other items in that product line. It is not appropriate to write inventories down on the basis of a classification of inventory, for example, finished goods, or all the inventories in a particular ~~industry or geographical~~<u>operating</u> segment. Service providers generally accumulate costs in respect of each service for which a separate selling price is charged. Therefore, each such service is treated as a separate item.

A5 In IAS 7 *Cash Flow Statements*, paragraph 50 is amended as follows:

50 Additional information may be relevant to users in understanding the financial position and liquidity of an entity. Disclosure of this information, together with a commentary by management, is encouraged and may include:

…

(d) the amount of the cash flows arising from the operating, investing and financing activities of each ~~reported industry and geographical~~<u>reportable</u> segment (see ~~IAS 14 *Segment Reporting*~~<u>IFRS [X] *Operating Segments*</u>).

A6 In IAS 19 *Employee Benefits*, the example illustrating paragraph 115 is amended as follows:

Example illustrating paragraph 115

An entity discontinues ~~a business~~<u>an operating</u> segment and employees of the discontinued segment will earn no further benefits…

A7 In IAS 34 *Interim Financial Reporting*, paragraph 16 is amended as follows:

16 An entity shall include the following information, as a minimum, in the notes to its interim financial statements, if material and if not disclosed elsewhere in the interim financial report. The information shall normally be reported on a financial year-to-date basis. However, the entity shall also disclose any events or transactions that are material to an understanding of the current interim period:

…

(g) <u>the following</u> segment ~~revenue and segment result for business segments or geographical segments, whichever is the entity's primary basis of segment reporting~~<u>information</u> (disclosure of segment ~~data~~<u>information</u> is required in an entity's interim financial report only

if ~~IAS 14 *Segment Reporting*~~IFRS [X] *Operating Segments* requires that entity to disclose segment ~~data~~information in its annual financial statements):

(i) revenues from external customers

(ii) intersegment revenues

(iii) a measure of segment profit or loss

(iv) total assets for which there has been a material change from the amount disclosed in the last annual financial statements

(v) a description of differences from the last annual financial statements in the basis of segmentation or in the basis of measurement of segment profit or loss

(vi) a reconciliation of the total of the reportable segments' measures of profit or loss to the entity's profit or loss before income tax expense or income and discontinued operations. However, if an entity allocates to reportable segments items such as income tax expense, the entity may reconcile the total of the segments' measures of profit or loss to profit or loss after those items. Material reconciling items shall be separately identified and described in that reconciliation;

…

A8 IAS 36 *Impairment of Assets* is amended as described below.

In the Introduction, paragraph IN11 is amended as follows:

IN11 The previous version of IAS 36 required goodwill acquired in a business combination to be tested for impairment as part of impairment testing the cash-generating unit(s) to which it related. It employed a 'bottom-up/top-down' approach under which the goodwill was, in effect, tested for impairment by allocating its carrying amount to each cash-generating unit or smallest group of cash-generating units to which a portion of that carrying amount could be allocated on a reasonable and consistent basis. The Standard similarly requires goodwill acquired in a business combination to be tested for impairment as part of impairment testing the cash-generating unit(s) to which it relates. However, the Standard clarifies that:

…

(b) each unit or group of units to which the goodwill is allocated should:

(i) represent the lowest level within the entity at which the goodwill is monitored for internal management purposes; and

(ii) not be larger than ~~a~~an operating segment ~~based on either the entity's primary or the entity's secondary reporting format~~ determined in accordance with ~~IAS 14 *Segment Reporting*~~IFRS [X] *Operating Segments*.

Paragraph 80 is amended as follows:

80 For the purpose of impairment testing, goodwill acquired in a business combination shall, from the acquisition date, be allocated to each of the acquirer's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units or groups of units. Each unit or group of units to which the goodwill is so allocated shall:

…

(b) not be larger than ~~a~~an operating segment ~~based on either the entity's primary or the entity's secondary reporting format~~ determined in accordance with ~~IAS 14 *Segment Reporting*~~IFRS [X] *Operating Segments*.

Paragraph 129 is amended as follows:

129 An entity that reports segment information in accordance with ~~IAS 14 *Segment Reporting*~~IFRS [X] *Operating Segments* shall disclose the following for each reportable segment ~~based on an entity's primary reporting format~~:

In paragraph 130, subparagraphs (c)(ii) and (d)(ii) are amended as follows:

130(c)(ii) if the entity reports segment information in accordance with ~~IAS 14~~IFRS [X], the reportable segment to which the asset belongs~~, based on the entity's primary reporting format~~.

130(d)(ii) the amount of the impairment loss recognised or reversed by class of assets and, if the entity reports segment information in accordance with ~~IAS 14~~IFRS [X], by reportable segment ~~based on the entity's primary reporting format~~; and

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Draft Implementation Guidance

ED 8 OPERATING SEGMENTS

Comments to be received by 19 May 2006

ED 145

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This draft Implementation Guidance accompanies the proposed International Financial Reporting Standard (IFRS) set out in ED 8 *Operating Segments* (see separate booklet). Comments on the draft IFRS and its accompanying documents should be submitted in writing so as to be received by **19 May 2006.**

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CONTENTS

[DRAFT] Guidance on implementing IFRS X *Operating Segments*

This [draft] guidance accompanies, but is not part of, [draft] IFRS X.

Introduction

IG1 This implementation guidance provides examples that illustrate the disclosures that are required by the [draft] IFRS and a diagram for identifying reportable segments. The formats in the illustrations are not requirements. The Board encourages a format that provides the information in the most understandable manner in the specific circumstances. The following illustrations are for a single hypothetical entity referred to as Diversified Company.

Descriptive information about an entity's reportable segments

IG2 The following is an illustration of the disclosure of descriptive information about an entity's reportable segments (the paragraph references are to the relevant requirements in the [draft] IFRS).

Description of the types of products and services from which each reportable segment derives its revenues (paragraph 21(b))

Diversified Company has five reportable segments: car parts, motor vessels, software, electronics and finance. The car parts segment produces replacement parts for sale to car parts retailers. The motor vessels segment produces small motor vessels to serve the offshore oil industry and similar businesses. The software segment produces application software for sale to computer manufacturers and retailers. The electronics segment produces integrated circuits and related products for sale to computer manufacturers. The finance segment is responsible for portions of the company's financial operations including financing customer purchases of products from other segments and property lending operations.

Measurement of operating segment profit or loss and assets (paragraph 26)

The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies except that pension expense for each operating segment is recognised and measured on the basis of cash payments to the pension plan. Diversified Company evaluates performance on the basis of profit or loss from operations before income tax expense not including non-recurring gains and losses and foreign exchange gains and losses.

Diversified Company accounts for intersegment sales and transfers as if the sales or transfers were to third parties, ie at current market prices.

Factors management used to identify the entity's reportable segments (paragraph 21(a))

Diversified Company's reportable segments are strategic business units that offer different products and services. They are managed separately because each business requires different technology and marketing strategies. Most of the businesses were acquired as a unit, and the management at the time of the acquisition was retained.

Information about reportable segment profit or loss and assets

IG3 The following table illustrates a suggested format for disclosing information about reportable segment profit or loss and assets (paragraphs 22 and 23). The same type of information is required for each year for which an income statement is presented. Diversified Company does not allocate income tax expense or income or non-recurring gains and losses to reportable segments. In addition, not all reportable segments have material non-cash items other than depreciation and amortisation in profit or loss. The amounts in this illustration, denominated as 'currency units (CU)', are assumed to be the amounts in reports used by the chief operating decision maker.

	Car	Motor	Software	Electronics	Finance	All other	Totals
	CU	CU	CU	CU	CU	CU	CU
Revenues from external customers	3,000	5,000	9,500	12,000	5,000	1,000 (a)	35,500
Intersegment revenues	–	–	3,000	1,500	–	–	4,500
Interest revenue	450	800	1,000	1,500	–	–	3,750
Interest expense	350	600	700	1,100	–	–	2,750
Net interest revenue (b)	–	–	–	–	1,000	–	1,000
Depreciation and amortisation	200	100	50	1,500	1,100	–	2,950
Reportable segment profit	200	70	900	2,300	500	100	4,070
Other material non-cash items:							
Impairment of assets	–	200	–	–	–	–	200
Reportable segment assets	2,000	5,000	3,000	12,000	57,000	2,000	81,000
Expenditures for reportable segment non-current assets	300	700	500	800	600	–	2,900

(a) Revenues from segments below the quantitative thresholds are attributable to four operating segments of Diversified Company. Those segments include a small property business, an electronics equipment rental business, a software consulting practice and a warehouse leasing operation. None of those segments has ever met any of the quantitative thresholds for determining reportable segments.

(b) The finance segment derives a majority of its revenue from interest. In addition, management primarily relies on net interest revenue, not the gross revenue and expense amounts, in managing that segment. Therefore, as permitted by paragraph 22, only the net amount is disclosed.

Reconciliations of reportable segment revenues, profit or loss and assets

IG4 The following are illustrations of reconciliations of reportable segment revenues, profit or loss, and assets, to the entity's corresponding amounts (paragraph 27(a), 27(b) and 27(c)). Reconciliations also are required to be shown for every other material item of information disclosed (paragraph 27(d)). For example, if Diversified Company disclosed reportable segment liabilities, the total reportable segment liabilities are required to be reconciled to the entity's liabilities. The entity's financial statements are assumed not to include discontinued operations. As discussed earlier in paragraph IG2, the entity recognises and measures pension expense of its reportable segments on the basis of cash payments to the pension plan, and it does not allocate certain items to its reportable segments.

Revenues	CU
Total revenues for reportable segments	39,000
Other revenues	1,000
Elimination of intersegment revenues	(4,500)
Entity's revenues	35,500

Profit or loss	CU
Total profit or loss for reportable segments	3,970
Other profit or loss	100
Elimination of intersegment profits	(500)
Unallocated amounts:	
Litigation settlement received	500
Other corporate expenses	(750)
Adjustment to pension expense in consolidation	(250)
Income before income tax expense	3,070

Assets	CU
Total assets for reportable segments	79,000
Other assets	2,000
Elimination of receivable from corporate headquarters	(1,000)
Goodwill not allocated to reportable segments	4,000
Other unallocated amounts	1,000
Entity's assets	85,000

Other material items	Reportable segment totals CU	Adjustments CU	Entity totals CU
Interest revenue	3,750	75	3,825
Interest expense	2,750	(50)	2,700
Net interest revenue (finance segment only)	1,000	–	1,000
Expenditures for assets	2,900	1,000	3,900
Depreciation and amortisation	2,950	–	2,950
Impairment of assets	200	–	200

The reconciling item to adjust expenditures for capital assets is the amount incurred for the corporate headquarters building, which is not included in segment information. None of the other adjustments are material.

Geographical information

IG5 The following illustrates the geographical information required by paragraph 32. (Because Diversified Company's reportable segments are based on differences in products and services, no additional disclosures of revenue information about products and services are required (paragraph 31).)

Geographical information	Revenues[a] CU	Non-current assets CU
United States	19,000	11,000
Canada	4,200	–
China	3,400	6,500
Japan	2,900	3,500
Other countries	6,000	3,000
Total	31,000	24,000

(a) Revenues are attributed to countries on the basis of the customer's location.

Information about major customers

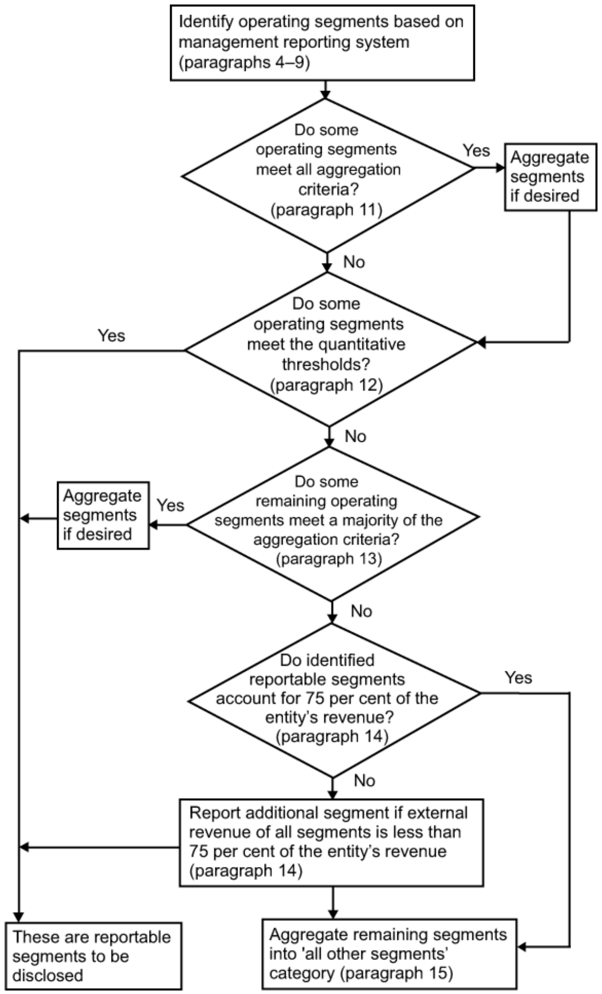
IG6 The following is an illustration of the information about major customers required by paragraph 33. Neither the identity of the customer nor the amount of revenues for each operating segment is required.

> Revenues from one customer of Diversified Company's software and electronics segments represent approximately CU5,000 of the Company's total revenues.

Diagram for identifying reportable segments

IG7 The following diagram illustrates how to apply the main provisions for identifying reportable segments as defined in the [draft] IFRS. The diagram is a visual supplement to the [draft] IFRS. It should not be interpreted as altering or adding to any requirements of the [draft] IFRS nor should it be regarded as a substitute for the requirements.

Diagram for identifying reportable segments



Appendix
Amendments to other Implementation Guidance

This appendix contains amendments to guidance on other IFRSs that are necessary in order to ensure consistency with [draft] IFRS [X]. In the amended paragraphs, new text is underlined and deleted text is struck through.

IGA1 In the Guidance on Implementing IFRS 4 *Insurance Contracts*, paragraph IG43 is amended as follows:

IG43 Under ~~IAS 14 *Segment Reporting*~~IFRS [X] *Operating Segments*, the identification of reportable segments reflects ~~differences in the risks and returns of an entity's products and services~~the way in which management allocates resources and assesses performance. ~~IAS 14 takes the position that the segments identified in an organisational and management structure and internal financial reporting system normally provide an appropriate segmentation for financial reporting.~~ An insurer might adopt a similar approach to identify broad classes of insurance contracts for disclosure purposes, although it might be appropriate to disaggregate disclosures down to the next level. For example, if an insurer identifies life insurance as a reportable segment for ~~IAS 14~~IFRS X, it might be appropriate to report separate information about, say, life insurance, annuities in the accumulation phase and annuities in the payout phase.

IGA2 In the Illustrative Examples accompanying IAS 36 *Impairment of Assets*, paragraph IE80 is amended as follows:

IE80 Entity M is a multinational manufacturing firm that uses geographical segments ~~as its primary format~~ for reporting segment information. M's three reportable segments ~~based on that format~~ are Europe, North America and Asia. Goodwill has been allocated for impairment testing purposes to three individual cash-generating units—two in Europe (units A and B) and one in North America (unit C)—and to one group of cash-generating units (comprising operation XYZ) in Asia. Units A, B and C and operation XYZ each represent the lowest level within M at which the goodwill is monitored for internal management purposes.

IASB Exposure Draft January 2006 – Basis for Conclusions

Basis for Conclusions on Exposure Draft

ED 8 OPERATING SEGMENTS

Comments to be received by 19 May 2006

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paragraphs

BASIS FOR CONCLUSIONS
ED 8 *OPERATING SEGMENTS*

Basis for Conclusions on ED 8 *Operating Segments*

This Basis for Conclusions accompanies, but is not part of, the draft IFRS.

Introduction

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching the conclusions in ED 8 *Operating Segments*. Individual Board members gave greater weight to some factors than to others.

BC2 In September 2002 the Board decided to add a short-term convergence project to its active agenda. The objective of the project is to reduce differences between IFRSs and United States generally accepted accounting principles (US GAAP) that are capable of resolution in a relatively short time and can be addressed outside major projects.

BC3 As part of the project, the Board identified differences between IAS 14 *Segment Reporting* and SFAS 131 *Disclosures about Segments of an Enterprise and Related Information*, reviewed academic research findings on segment reporting, in particular relating to the implementation of SFAS 131, and had meetings with users of financial statements.

Differences between IAS 14 and SFAS 131

BC4 The requirements of SFAS 131 are based on the way that the management regards an entity, focusing on information about the components of the business that management uses to make decisions about operating matters. In contrast, IAS 14 requires the disaggregation of the entity's financial statements into segments based on related products and services, and on geographical areas.

BC5 The requirements of SFAS 14 *Financial Reporting for Segments of a Business Enterprise*, the predecessor to SFAS 131, were similar to those of IAS 14. This is because the accounting policies underlying the disaggregated information were required to be the same as those underlying the entity information, since segment information was regarded as a disaggregation of the entity information. The approach to segment disclosures in SFAS 14 was criticised for not providing information about segments based on the structure of an entity's internal organisation that could enhance a user's ability to predict actions or reactions of management that could significantly affect the entity's prospects for future cash flows.

Academic research findings

BC6 Most of the academic research findings on segment reporting indicated that application of SFAS 131 resulted in more useful information than its predecessor, SFAS 14. According to the research, the management approach of SFAS 131:

(a) increased the number of reported segments and provided a greater quantity of information;

(b) enabled users to see an entity through the eyes of management;

(c) enabled an entity to provide timely segment information for external reporting with relatively low incremental cost;

(d) enhanced consistency with the management discussion and analysis or other annual report disclosures; and

(e) provided various measures of segment performance.

Meetings with users

BC7 The Board discussed segment reporting at several meetings with users of financial statements. Most of the users supported the management approach of SFAS 131 for the reasons mentioned in the previous paragraph. In particular, they supported an approach that would enable more segment information to be provided in interim financial reports.

Adoption of management approach

BC8 The Board noted that the primary benefits of adopting the management approach in SFAS 131 are that:

(a) entities will report segments that correspond to internal management reports;

(b) entities will report segment information that will be more consistent with other parts of their annual reports;

(c) some entities will report a greater number of segments; and

(d) entities will report more segment information in interim financial reports.

In addition, the proposed IFRS will reduce the cost of providing disaggregated information for many entities because it uses segment information that is generated for management's use.

BC9 The Board noted concerns that the management approach could lead to disclosure of segment amounts measured in accordance with accounting policies different from those used in the entity's financial statements. In particular, concern was expressed that segments would be reported in accordance with national GAAP in various jurisdictions, because internal management is based on information prepared in accordance with national GAAP. Some argued that this would damage the credibility of the use of IFRSs in the entity's financial statements.

BC10 However, the Board also noted comments that corporate governance issues relating both to internal management and external reporting are likely to encourage management to use a single set of information (that used for external reporting) for all purposes. It is increasingly unlikely that substantially different policies will be used to determine the amount reported in external financial statements and internal measures, and hence the segment information. The Board also noted the requirements in SFAS 131 for an explanation of the measurements of segment profit or loss and segment assets and for reconciliations of the segment amounts to the amounts recognised in the entity's financial statements, and it was satisfied that users would be able to understand and judge appropriately the basis on which the segment amounts were determined.

BC11 The Board concluded that the advantages of the management approach, in particular the ability of entities to prepare segment information on a sufficiently timely basis for inclusion in interim financial reports, outweighed any disadvantages arising from the potential for segments to be reported in accordance with non-IFRS accounting policies.

BC12 The Board therefore decided that the proposed IFRS should converge with SFAS 131, except for changes necessary to make the terminology consistent with that in other IFRSs. Given the Board's support for the principles of the management approach required by SFAS 131 and the objectives of the short-term convergence project, the Board decided that the simplest and most complete way to achieve convergence would be to use the text of SFAS 131 for the proposed IFRS without redeliberating the detailed requirements.

BC13 The FASB's thinking behind the management approach of SFAS 131 is set out in its Background Information and Basis for Conclusions, which is reproduced in Appendix A to this Basis for Conclusions.

BC14 However, there is one potential difference between SFAS 131 and the proposed IFRS, relating to the scope of the disclosure about non-current assets. The FASB *Guidance on Applying Statement 131* indicates that the FASB staff believe that 'long-lived assets', as that phrase is used in paragraph 38 of SFAS 131, implies hard assets that cannot be readily removed, which would appear to exclude intangibles.

BC15 The term 'long-lived assets' in SFAS 131 is changed to 'non-current assets' in the proposed IFRS. The Board did not agree with the FASB *Guidance on Applying Statement 131* and could see no reason why intangible assets should be excluded from non-current assets. The Board concluded that non-current assets should include intangible assets.

Scope of the standard

BC16 The Board considered extending the scope of the proposed IFRS to all entities that have public accountability rather than just entities whose securities are publicly traded. The Board noted that it is too early to adopt the proposed definition of public accountability that is being considered in a separate Board project on small and medium-sized entities (SMEs). However, the Board decided that the scope of the standard should be extended to include entities that hold assets in a fiduciary capacity for a broad group of outsiders. The Board believes that the SMEs project is the most appropriate context in which to decide whether to extend the scope of the requirements on segment reporting to other entities.

Transitional provisions

BC17 Under its transitional provisions, SFAS 131 was not required to be applied to interim financial statements in the initial year of its application. However, in the second year of application, comparative information relating to interim periods in the initial year of application was required. The Basis for Conclusions on SFAS 131 explained that the reason for these transitional requirements was that some of the information that is required to be reported for interim periods is based on information reported in the most recent annual financial statements. Interim segment information would not be as meaningful without a full set of annual segment information to use as a comparison and to provide an understanding of the basis on which it is provided.

BC18 However, the Board did not agree with the transitional provision for interim financial statements in SFAS 131. The proposed IFRS adopts the management approach, which the Board believes enables entities to provide comparative annual and interim figures even in the initial year of application. Furthermore, IFRS 1 *First-time Adoption of International Financial Reporting Standards* requires the use of IFRSs in interim financial reports in the first year of adoption of IFRSs, even though there would be no previous full set of IFRS annual statements. The Board concluded that it would be consistent with its decision in IFRS 1 to require the proposed IFRS to be applied in interim financial reports in the first year of application. In particular, the Board was aware of entities that will not be adopting IFRSs until 2007 and that may wish to move directly to the proposed new approach rather than use IAS 14.

Alternative view on the proposed IFRS *Operating Segments*

AV1 Three Board members voted against the publication of the Exposure Draft of the proposed IFRS *Operating Segments*. Their alternative view is set out below.

Alternative view of the Board members

AV2 The Board members voted against the publication of the Exposure Draft of the proposed IFRS because it does not require a defined measure of segment profit or loss to be disclosed and does not require the measure of profit or loss reported to be consistent with the attribution of assets to reportable segments.

AV3 By not defining segment profit or loss, the proposed IFRS allows the reporting of any measure of segment profit or loss as long as that measure is reviewed by the chief operating decision maker. Items of revenue and expense directly attributable to a segment need not be included in the reported profit or loss of that segment, and allocation of items not directly attributable to any given segment is not required. The Board members believe that the proposed IFRS should require amounts directly incurred by or directly attributable to a segment to be included in that segment's profit or loss, and measurement of a segment's profit or loss to be consistent with the attribution of assets to the segment.

AV4 The Board members support the disclosure of information to enable users of financial statements to evaluate the activities of an entity and the economic environment in which it operates. However, they believe the proposed IFRS will not meet this objective, even with the required disclosures and reconciliation to the entity's annual financial statements, because it does not define segment profit or loss and does not require consistent attribution of assets and profit or loss to segments.

AV5 The Board members support the management approach for defining reportable segments and support requiring disclosure of selected segment information in interim financial reports. The Board members believe, however, that the definitions of segment revenue, expense, result, assets and liabilities in paragraph 16 of IAS 14 *Segment Reporting* should be retained in the proposed IFRS and applied to segments identified by the management approach. The Board members believe that proper external reporting of segment information should not permit the use of non-GAAP measures because they might mislead users.

AV6 The Board members also believe that the proposed changes from IAS 14 are not justified by the need for convergence with the FASB standard. Segment reporting is a disclosure standard and therefore does not affect the reconciliation of IFRS amounts to US GAAP, though additional disclosure might be needed to comply with US GAAP.

Appendix A
Background information and basis for conclusions of the US Financial Accounting Standards Board on SFAS 131

Introduction

41. This appendix summarizes considerations that were deemed significant by Board members in reaching the conclusions in this Statement. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

Background Information

42. FASB Statement No. 14, *Financial Reporting for Segments of a Business Enterprise*, was issued in 1976. That Statement required that business enterprises report segment information on two bases: by industry and by geographic area. It also required disclosure of information about export sales and major customers.

43. The Board concluded at the time it issued Statement 14 that information about components of an enterprise, the products and services that it offers, its foreign operations, and its major customers is useful for understanding and making decisions about the enterprise as a whole. Financial statement users observe that the evaluation of the prospects for future cash flows is the central element of investment and lending decisions. The evaluation of prospects requires assessment of the uncertainty that surrounds both the timing and the amount of the expected cash flows to the enterprise, which in turn affect potential cash flows to the investor or creditor. Users also observe that uncertainty results in part from factors related to the products and services an enterprise offers and the geographic areas in which it operates.

44. In its 1993 position paper, *Financial Reporting in the 1990s and Beyond*, the Association for Investment Management and Research (AIMR) said:

> [Segment data] is vital, essential, fundamental, indispensable, and integral to the investment analysis process. Analysts need to know and understand how the various components of a multifaceted enterprise behave economically. One weak member of the group is analogous to a section of blight on a piece of fruit; it has the potential to spread rot over the entirety. Even in the absence of weakness, different segments will generate dissimilar streams of cash flows to which are attached disparate risks and which bring about unique values. Thus, without disaggregation, there is no sensible way to predict the overall amounts, timing, or risks of a complete enterprise's future cash flows. There is little dispute over the analytic usefulness of disaggregated financial data. [pages 59 and 60]

45. Over the years, financial analysts consistently requested that financial statement data be disaggregated to a much greater degree than it is in current practice. Many analysts said

that they found Statement 14 helpful but inadequate. In its 1993 position paper, the AIMR emphasized that:

> There is no disagreement among AIMR members that segment information is totally vital to their work. There also is general agreement among them that the current segment reporting standard, Financial Accounting Standard No. 14, is inadequate. Recent work by a subcommittee of the [Financial Accounting Policy Committee] has confirmed that a substantial majority of analysts seek and, when it is available, use quarterly segment data. [page 5]

46. The Canadian Institute of Chartered Accountants (CICA) published a Research Study, *Financial Reporting for Segments*, in August 1992. An FASB Research Report, Reporting Disaggregated Information, was published in February 1993. In March 1993, the FASB and the Accounting Standards Board (AcSB) of the CICA agreed to pursue their projects jointly.

47. In May 1993, the FASB and the AcSB jointly issued an Invitation to Comment, *Reporting Disaggregated Information by Business Enterprises*. That Invitation to Comment identified certain issues related to disclosure of information about segments, solicited comments on those issues, and asked readers to identify additional issues. The boards received 129 comment letters from U.S. and Canadian respondents.

48. In late 1993, the FASB and the AcSB formed the Disaggregated Disclosures Advisory Group to advise and otherwise support the two boards in their efforts to improve disaggregated disclosures. The members of the group included financial statement issuers, auditors, financial analysts, and academics from both the United States and Canada. In January 1994, the FASB and the AcSB began discussing changes to Statement 14 and CICA Handbook Section 1700, "Segmented Information." The two boards met with and otherwise actively solicited the views of analysts and preparers of financial statements about possible improvements to the current segment reporting requirements. FASB and AcSB members and staff also discussed disaggregated disclosures at meetings of several groups of analysts, including the AIMR's Financial Accounting Policy Committee.

49. In 1991, the AICPA formed the Special Committee on Financial Reporting (the Special Committee) to make recommendations to improve the relevance and usefulness of business reporting. The Special Committee, which comprised financial statement auditors and preparers, established focus groups of credit analysts and equity analysts to assist in formulating its recommendations. The Special Committee issued its report, *Improving Business Reporting—A Customer Focus*, in 1994. That report listed improvements in disclosures of business segment information as its first recommendation and included the following commentary:

> …for users analyzing a company involved in diverse businesses, financial information about business segments often is as important as information about the company as a whole. Users suggest that standard setters assign the highest priority to improving segment reporting because of its importance to their work and the perceived problems with current reporting of segment information. [page 68]

50. The report of the Special Committee listed the following as among the most important improvements needed:

    (a) Disclosure of segment information in interim financial reports

    (b) Greater number of segments for some enterprises

    (c) More information about segments

    (d) Segmentation that corresponds to internal management reports

    (e) Consistency of segment information with other parts of an annual report

    Similar recommendations had been made in each of the last 20 years in evaluations of corporate reporting conducted by the AIMR.

51. The two boards reached tentative conclusions about an approach to segment reporting that was substantially different from the approach in Statement 14 and Section 1700. Key characteristics of the new approach were that (a) information would be provided about segments of the enterprise that corresponded to the structure of the enterprise's internal organization, that is, about the divisions, departments, subsidiaries, or other internal units that the chief operating decision maker uses to make operating decisions and to assess an enterprise's performance, (b) specific amounts would be allocated to segments only if they were allocated in reports used by the chief operating decision maker for evaluation of segment performance, and (c) accounting policies used to produce the disaggregated information would be the same as those used in the reports used by the chief operating decision maker in allocating resources and assessing segment performance.

52. In February 1995, the staffs of the FASB and the CICA distributed a paper, "Tentative Conclusions on Financial Reporting for Segments" (Tentative Conclusions), to selected securities analysts, the FASB Task Force on Consolidations and Related Matters, the Disaggregated Disclosures Advisory Group, the FASB's Emerging Issues Task Force, the Financial Accounting Standards Advisory Council, the AcSB's list of Associates[2], and members of representative organizations that regularly work with the boards. The paper also was announced in FASB and CICA publications and was sent to anyone who requested a copy. Board and staff members discussed the Tentative Conclusions with various analyst and preparer groups. Approximately 80 comment letters were received from U.S. and Canadian respondents.

53. In January 1996, the FASB and the AcSB issued virtually identical Exposure Drafts, *Reporting Disaggregated Information about a Business Enterprise*. The FASB received 221 comment letters and the AcSB received 73 comment letters in response to the Exposure Drafts. A field test of the proposals was conducted in March 1996. A public meeting was held in Toronto in October 1996 to discuss results and concerns

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2 Associates are individuals and organizations with a particular interest in financial reporting issues that have volunteered to provide an outside reaction to AcSB positions at an early stage in the AcSB's deliberations.

with field test participants. Other interested parties attended a public meeting in Norwalk in October 1996 to discuss their concerns about the proposals in the Exposure Drafts. The FASB decided that it could reach an informed decision on the project without holding a public hearing.

54. The FASB and the AcSB exchanged information during the course of redeliberating the proposals in their respective Exposure Drafts. AcSB members and CICA staff attended FASB meetings, and FASB members and staff attended AcSB meetings in late 1996 and in 1997 to discuss the issues raised by respondents. Both boards reached agreement on all of the substantive issues to achieve virtually identical standards for segment reporting in the United States and Canada. Members of the Segment Disclosures Advisory Group (formerly the Disaggregated Disclosures Advisory Group) discussed a draft of the standards section in March 1997.

55. The International Accounting Standards Committee (IASC) issued an Exposure Draft of a proposed International Accounting Standard that would replace International Accounting Standard IAS 14, *Reporting Financial Information by Segment*, in December 1995. Although many of its provisions are similar to those of the FASB and AcSB Exposure Drafts, the IASC's proposal is based on different objectives and is different from those Exposure Drafts. A member of the IASC Segments Steering Committee participated in FASB meetings during the redeliberations of the Exposure Draft, and members of the FASB participated in meetings of the IASC Segments Steering Committee. Many of the respondents to the Exposure Drafts encouraged the FASB and the AcSB to work closely with the IASC to achieve similar standards for segment reporting. The IASC expects to issue a standard on segment reporting later in 1997. Although there likely will be differences between the IASC's requirements for segment reporting and those of this Statement, the boards expect that it will be possible to prepare one set of segment information that complies with both the IASC requirements and those of this Statement.

56. This Statement addresses the following key issues:

(a) What is the appropriate basis for defining segments?

(b) What accounting principles and allocations should be used?

(c) What specific items of information should be reported?

(d) Should segment information be reported in condensed financial statements for interim periods?

Defining Operating Segments of an Enterprise

57. The Board concluded that the *industry approach* to segment disclosures in Statement 14 was not providing the information required by financial statement users and that disclosure of disaggregated information should be based on operating segments. This Statement defines an operating segment as a component of an enterprise (a) that

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engages in business activities from which it may earn revenues and incur expenses, (b) whose operating results are regularly reviewed by the enterprise's chief operating decision maker to make decisions about resources to be allocated to the segment and to assess its performance, and (c) for which discrete financial information is available.

58. The AIMR's 1993 position paper and the report of the AICPA Special Committee criticized Statement 14's industry segment approach to reporting segment information. The AIMR's position paper included the following:

> FAS 14 requires disclosure of line-of-business information classified by "industry segment." Its definition of segment is necessarily imprecise, recognizing that there are numerous practical problems in applying that definition to different business entities operating under disparate circumstances. That weakness in FAS 14 has been exploited by many enterprises to suit their own financial reporting purposes. As a result, we have seen one of the ten largest firms in the country report all of its operations as being in a single, very broadly defined industry segment. [page 60]

The report of the Special Committee said that "[financial statement users] believe that many companies define industry segments too broadly for business reporting and thus report on too few industry segments" [page 69].

59. The report of the AICPA Special Committee also said that "… the primary means to improving industry segment reporting should be to align business reporting with internal reporting" [page 69], and the AIMR's 1993 position paper recommended that:

> …priority should be given to the production and dissemination of financial data that reflects and reports sensibly the operations of specific enterprises. If we could obtain reports showing the details of how an individual business firm is organized and managed, we would assume more responsibility for making meaningful comparisons of those data to the unlike data of other firms that conduct their business differently. [pages 60 and 61]

Almost all of the users and many other constituents who responded to the Exposure Draft or who met with Board and staff members agreed that defining segments based on the structure of an enterprise's internal organization would result in improved information. They said that not only would enterprises be likely to report more detailed information but knowledge of the structure of an enterprise's internal organization is valuable in itself because it highlights the risks and opportunities that management believes are important.

60. Segments based on the structure of an enterprise's internal organization have at least three other significant advantages. First, an ability to see an enterprise "through the eyes of management" enhances a user's ability to predict actions or reactions of management that can significantly affect the enterprise's prospects for future cash flows. Second, because information about those segments is generated for management's use, the incremental cost of providing information for external reporting should be relatively low. Third, practice has demonstrated that the term industry is subjective. Segments based on an existing internal structure should be less subjective.

61. The AIMR and other users have commented that segment information is more useful if it is consistent with explanatory information provided elsewhere in the annual report. They note that the business review section and the chairman's letter in an annual report frequently discuss the enterprise's operations on a basis different from that of the segment information in the notes to the financial statements and the management's discussion and analysis section, which is required by SEC rules to correspond to the segment information provided to comply with Statement 14. That appears to occur if the enterprise is not managed in a way that corresponds to the way it defines segments under the requirements of Statement 14. Segmentation based on the structure of an enterprise's internal organization should facilitate consistent discussion of segment financial results throughout an enterprise's annual report.

62. Some respondents to the Exposure Draft opposed the Board's approach for several reasons. Segments based on the structure of an enterprise's internal organization may not be comparable between enterprises that engage in similar activities and may not be comparable from year to year for an individual enterprise. In addition, an enterprise may not be organized based on products and services or geographic areas, and thus the enterprise's segments may not be susceptible to analysis using macroeconomic models. Finally, some asserted that because enterprises are organized strategically, the information that would be reported may be competitively harmful to the reporting enterprise.

63. The Board acknowledges that comparability of accounting information is important. The summary of principal conclusions in FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information*, says: "Comparability between enterprises and consistency in the application of methods over time increases the informational value of comparisons of relative economic opportunities or performance. The significance of information, especially quantitative information, depends to a great extent on the user's ability to relate it to some benchmark." However, Concepts Statement 2 also notes a danger:

> Improving comparability may destroy or weaken relevance or reliability if, to secure comparability between two measures, one of them has to be obtained by a method yielding less relevant or less reliable information. Historically, extreme examples of this have been provided in some European countries in which the use of standardized charts of accounts has been made mandatory in the interest of interfirm comparability but at the expense of relevance and often reliability as well. That kind of uniformity may even adversely affect comparability of information if it conceals real differences between enterprises. [paragraph 116]

64. The Board was concerned that segments defined using the approach in Statement 14 may appear to be more comparable between enterprises than they actually are. Statement 14 included the following:

> Information prepared in conformity with [Statement 14] may be of limited usefulness for comparing an industry segment of one enterprise with a similar industry segment of another enterprise (i.e., for interenterprise comparison). Interenterprise comparison of industry segments would require a fairly detailed prescription of the basis or bases of disaggregation

> to be followed by all enterprises, as well as specification of the basis of accounting for intersegment transfers and methods of allocating costs common to two or more segments. [paragraph 76]

65. Statement 14 explained why the Board chose not to develop a detailed prescription of the bases of disaggregation:

> …differences among enterprises in the nature of their operations and in the extent to which components of the enterprise share common facilities, equipment, materials and supplies, or labor force make unworkable the prescription of highly detailed rules and procedures that must be followed by all enterprises. Moreover, … differences in the accounting systems of business enterprises are a practical constraint on the degree of specificity with which standards of financial accounting and reporting for disaggregated information can be established. [paragraph 74]

Those same considerations persuaded the Board not to adopt more specific requirements in this Statement. Both relevance and comparability will not be achievable in all cases, and relevance should be the overriding concern.

66. The AICPA Special Committee, some respondents to the Exposure Draft, and other constituents recommended that the Board require that an enterprise use an alternative method of segmentation for external reporting if its internal organization is not based on differences in products and services or geography. Some specifically recommended adoption of the proposal in the IASC Exposure Draft that was commonly referred to as a "safety net." The IASC Exposure Draft approach to identifying primary and secondary operating segments calls for review of management's organization of segments, but both primary and secondary segments are required to be defined either on the basis of related products and services or on the basis of geography. That is, regardless of management's organization, segments must be grouped either by related products and services or by geographic areas, and one set must be presented as primary segments and the other as secondary segments.

67. The Board recognizes that an enterprise may not be divided into components with similar products and services or geographic areas for internal purposes and that some users of financial statements have expressed a desire for information organized on those bases. However, instead of an alternative method of segmentation, which would call for multiple sets of segment information in many circumstances, the Board chose to require disclosure of additional information about products and services and about geographic areas of operations for the enterprise as a whole if the basic segment disclosures do not provide it.

68. One reason for not prescribing segmentation along bases of only related products and services or geography is that it is difficult to define clearly the circumstances in which an alternative method that differs from the management approach would be applied consistently. An enterprise with a relatively narrow product line may not consider two products to be similar, while an enterprise with a broad product line may consider those same two products to be similar. For example, a highly diversified enterprise may consider all consumer products to be similar if it has other businesses such as financial

services and road construction. However, an enterprise that sells only consumer products might consider razor blades to be different from toasters.

69. A second reason for rejecting that approach is that an alternative method of segmentation would increase the cost to some enterprises to prepare the information. A management approach to defining segments allows enterprises to present the information that they use internally and facilitates consistent descriptions of the components of an enterprise from one part of the annual report to another. An enterprise could be organized by its products and services, geography, a mixture of both products and services and geography, or other bases, such as customer type, and the segment information required by this Statement would be consistent with that method of organization. Furthermore, the enterprise-wide disclosures about products and services will provide information about the total revenues from related products and services, and the enterprise-wide disclosures about geography will provide information about the revenues and assets of an enterprise both inside and outside its home country. If material, individual foreign country information also is required.

70. The Board recognizes that some enterprises organize their segments on more than one basis. Other enterprises may produce reports in which their activities are presented in a variety of ways. In those situations, reportable segments are to be determined based on a review of other factors to identify the enterprise's operating segments, including the nature of the activities of each component, the existence of managers responsible for them, and the information provided to the board of directors. In many enterprises, only one set of data is provided to the board of directors. That set of data generally is indicative of how management views the enterprise's activities.

Reportable Segments

71. The Board included a notion of reportable segments, a subset of operating segments, in this Statement by defining aggregation criteria and quantitative thresholds for determining which operating segments should be reported separately in the financial statements.

72. A so-called pure management approach to segment reporting might require that an enterprise report all of the information that is reviewed by the chief operating decision maker to make decisions about resource allocations and to assess the performance of the enterprise. However, that level of detail may not be useful to readers of external financial statements, and it also may be cumbersome for an enterprise to present. Therefore, this Statement uses a modified management approach that includes both aggregation criteria and quantitative thresholds for determining reportable operating segments. However, an enterprise need not aggregate similar segments, and it may present segments that fall below the quantitative thresholds.

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Aggregation of Similar Operating Segments

73. The Board believes that separate reporting of segment information will not add significantly to an investor's understanding of an enterprise if its operating segments have characteristics so similar that they can be expected to have essentially the same future prospects. The Board concluded that although information about each segment may be available, in those circumstances the benefit would be insufficient to justify its disclosure. For example, a retail chain may have 10 stores that individually meet the definition of an operating segment, but each store may be essentially the same as the others.

74. Most respondents commented on the aggregation criteria in the Exposure Draft. Many said that the criteria were unreasonably strict, to the extent that nearly identical segments might not qualify for aggregation. Some respondents linked their concerns about competitive harm and too many segments directly to the aggregation criteria, indicating that a relaxation of the criteria would significantly reduce those concerns. To better convey its intent, the Board revised the wording of the aggregation criteria and the introduction to them. However, the Board rejected recommendations that the criteria be indicators rather than tests and that the guidance require only the expectation of similar long-term performance of segments to justify aggregation because those changes might result in a level of aggregation that would cause a loss of potentially valuable information. For the same reason, the Board also rejected suggestions that segments need be similar in only a majority of the characteristics in paragraph 17 to justify aggregation. The Board recognizes that determining when two segments are sufficiently similar to justify aggregating them is difficult and subjective. However, the Board notes that one of the reasons that the information provided under Statement 14 did not satisfy financial statement users' needs is that segments with different characteristics in important areas were at times aggregated.

Quantitative Thresholds

75. In developing the Exposure Draft, the Board had concluded that quantitative criteria might interfere with the determination of operating segments and, if anything, might unnecessarily reduce the number of segments disclosed. Respondents to the Exposure Draft and others urged the Board to include quantitative criteria for determining which segments to report because they said that some enterprises would be required to report too many segments unless specific quantitative guidelines allowed them to omit small segments. Some respondents said that the Exposure Draft would have required disclosure of as many as 25 operating segments, which was not a result anticipated by the Board in its deliberations preceding the Exposure Draft. Others said that enterprises would report information that was too highly aggregated unless quantitative guidelines prevented it. The Board decided that the addition of quantitative thresholds would be a practical way to address respondents' concerns about competitive harm and proliferation of segments without fundamentally changing the management approach to segment definition.

76. Similar to the requirements in Statement 14, the Board decided to require that any operating segment that constitutes 10 percent or more of reported revenues, assets, or profit or loss be reported separately and that reportable segments account for at least 75 percent of an enterprise's external revenues. The Board decided to retain that guidance for the quantitative thresholds because it can be objectively applied and because preparers and users of financial statements already understand it.

77. Inclusion of quantitative thresholds similar to those in Statement 14 necessitates guidance on how to report operating segments that do not meet the thresholds. The Board concluded that enterprises should be permitted to aggregate information about operating segments that do not meet the thresholds with information about other operating segments that do not meet the thresholds if a majority of the aggregation criteria in paragraph 17 are met. That is a more liberal aggregation provision than that for individually material operating segments, but it prohibits aggregation of segments that are dissimilar.

78. Paragraph 125 of Concepts Statement 2 states that "… magnitude by itself, without regard to the nature of the item and the circumstances in which the judgment has to be made, will not generally be a sufficient basis for a materiality judgment." That guidance applies to segment information. An understanding of the material segments of an enterprise is important for understanding the enterprise as a whole, and individual items of segment information are important for understanding the segments. Thus, an item of segment information that, if omitted, would change a user's decision about that segment so significantly that it would change the user's decision about the enterprise as a whole is material even though an item of a similar magnitude might not be considered material if it were omitted from the consolidated financial statements. Therefore, enterprises are encouraged to report information about segments that do not meet the quantitative thresholds if management believes that it is material. Those who are familiar with the particular circumstances of each enterprise must decide what constitutes material.

Vertically Integrated Enterprises

79. The Board concluded that the definition of an operating segment should include components of an enterprise that sell primarily or exclusively to other operating segments of the enterprise if the enterprise is managed that way. Information about the components engaged in each stage of production is particularly important for understanding vertically integrated enterprises in certain businesses, for example, oil and gas enterprises. Different activities within the enterprise may have significantly different prospects for future cash flows, and users of financial statements have asserted that they need to know results of each operation.

80. Some respondents to the Exposure Draft opposed the requirement to report vertically integrated segments separately. They said that the segment results may not be comparable between enterprises and that transfer prices are not sufficiently reliable for external reporting purposes. The Board considered an approach that would have

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required separate reporting of vertically integrated segments only if transfer prices were based on quoted market prices and if there was no basis for combining the selling segment and the buying segment. However, that would have been a significant departure from the management approach to defining segments. The Board also was concerned that the criteria would be unworkable. Therefore, the Board decided to retain the Exposure Draft's provisions for vertically integrated segments.

Accounting Principles and Allocations

81. The Board decided that the information to be reported about each segment should be measured on the same basis as the information used by the chief operating decision maker for purposes of allocating resources to segments and assessing segments' performance. That is a management approach to measuring segment information as proposed in the Exposure Draft. The Board does not think that a separate measure of segment profit or loss or assets should have to be developed solely for the purpose of disclosing segment information. For example, an enterprise that accounts for inventory using a specialized valuation method for internal purposes should not be required to restate inventory amounts for each segment, and an enterprise that accounts for pension expense only on a consolidated basis should not be required to allocate pension expense to each operating segment.

82. The report of the AICPA Special Committee said that the Board "should allow companies to report a statistic on the same basis it is reported for internal purposes, if the statistic is reported internally. The usefulness of information prepared only for [external] reporting is questionable. Users want to understand management's perspective on the company and the implications of key statistics." It also said that "key statistics to be reported [should] be limited to statistics a company has available…" [page 72].

83. Respondents to the Exposure Draft had mixed reactions to its measurement guidance. Very few suggested that the Board require allocations solely for external reporting purposes. Most agreed that allocations are inherently arbitrary and may not be meaningful if they are not used for management purposes. No respondents suggested that intersegment transfers should be reported on any basis other than that used internally. However, some respondents recommended that information about each segment be provided based on the accounting principles used in the enterprise's general-purpose financial statements. Some observed that unadjusted information from internal sources would not necessarily comply with generally accepted accounting principles and, for that reason, might be difficult for users to understand. Other respondents argued that comparability between enterprises would be improved if the segment information were provided on the basis of generally accepted accounting principles. Finally, a few questioned the verifiability of the information.

84. The Board decided not to require that segment information be provided in accordance with the same generally accepted accounting principles used to prepare the consolidated financial statements for several reasons. Preparing segment information in accordance

with the generally accepted accounting principles used at the consolidated level would be difficult because some generally accepted accounting principles are not intended to apply at a segment level. Examples include allocation of the cost of an acquisition to individual assets and liabilities of a subsidiary using the purchase method of accounting, accounting for the cost of enterprise-wide employee benefit plans, accounting for income taxes in an enterprise that files a consolidated income tax return, and accounting for inventory on a last-in, first-out basis if the pools include items in more than one segment. In addition, there are no generally accepted accounting principles for allocating joint costs, jointly used assets, or jointly incurred liabilities to segments or for pricing intersegment transfers. As a consequence, it generally is not feasible to present segment profitability in accordance with generally accepted accounting principles.

85. The Board recognizes that segment information is subject to certain limitations and that some of that information may not be susceptible to the same degree of verifiability as some other financial information. However, verifiability is not the only important qualitative characteristic of accounting information. Verifiability is a component of reliability, which is one of two characteristics that contribute to the usefulness of accounting information. The other is relevance, which is equally important. Concepts Statement 2 states:

> Although financial information must be both relevant and reliable to be useful, information may possess both characteristics to varying degrees. It may be possible to trade relevance for reliability or vice versa, though not to the point of dispensing with one of them altogether. … trade-offs between characteristics may be necessary or beneficial.
>
> In a particular situation, the importance attached to relevance in relation to the importance of other decision specific qualities of accounting information (for example, reliability) will be different for different information users, and their willingness to trade one quality for another will also differ. [paragraphs 42 and 45]

86. It is apparent that users are willing to trade a degree of reliability in segment information for more relevant information. The AIMR's 1993 position paper states:

> Analysts need financial statements structured so as to be consistent with how the business is organized and managed. That means that two different companies in the same industry may have to report segment data differently because they are structured differently themselves. [page 20]

But, as previously noted, the position paper says that, under those circumstances, analysts "would assume more responsibility for making meaningful comparisons of those data to the unlike data of other firms that conduct their business differently" [page 61].

87. The Board believes that the information required by this Statement meets the objective of reliability of which both representational faithfulness and verifiability are components. An auditor can determine whether the information reported in the notes to

the financial statements came from the required source by reviewing management reports or minutes from meetings of the board of directors. The information is not required to be provided on a specified basis, but the enterprise is required to explain the basis on which it is provided and to reconcile the segment information to consolidated enterprise totals. Adequate explanation and an appropriate reconciliation will enable a user to understand the information and its limitations in the context of the enterprise's financial statements. The auditor can test both the explanation of segment amounts and the reconciliations to consolidated totals. Furthermore, because management uses that information in its decision-making processes, that information is likely to be highly reliable. The information provided to comply with Statement 14 was more difficult to verify in many situations and was less reliable. Because it was prepared solely for external reporting purposes, it required allocations that may have been arbitrary, and it was based on accounting principles that may have been difficult to apply at the segment level.

88. Paragraph 29 requires amounts allocated to a segment to be allocated on a reasonable basis. However, the Board believes that the potential increased reliability that might have been achieved by requiring allocation of consolidated amounts is illusory because expenses incurred at the consolidated level could be allocated to segments in a variety of ways that could be considered "reasonable." For example, an enterprise could use either the number of employees in each segment or the segment's total salary expense in relation to the consolidated amounts as a basis for allocating pension expense to segments. Those two approaches to allocation could result in significantly different measures of segment profit or loss. However, both the number of employees and the total salary expense might be reasonable bases on which to allocate total pension expense. In contrast, it would not seem reasonable for an enterprise to allocate pension expense to a segment that had no employees eligible for the pension plan. Because of the potential for misleading information that may result from such allocations, the Board decided that it is appropriate for this Statement to require that amounts allocated to a segment be allocated on a reasonable basis.

89. The Board also considered explicitly requiring that revenues and expenses directly incurred by or directly attributable to an operating segment be reported by that segment. However, it decided that, in some cases, whether an item of revenue or expense is attributable to an operating segment is a matter of judgment. Further, such an explicit requirement would be an additional modification of the management approach to measurement. While the Board decided not to include an explicit requirement, it believes that many items of revenue or expense clearly relate to a particular segment and that it would be unlikely that the information used by management would omit those items.

90. To assist users of financial statements in understanding segment disclosures, this Statement requires that enterprises provide sufficient explanation of the basis on which the information was prepared. That disclosure must include any differences in the basis of measurement between the consolidated amounts and the segment amounts. It also must indicate whether allocations of items were made symmetrically. An enterprise

may allocate an expense to a segment without allocating the related asset; however, disclosure of that fact is required. Enterprises also are required to reconcile to the consolidated totals in the enterprise's financial statements the totals of reportable segment assets, segment revenues, segment profit or loss, and any other significant segment information that is disclosed.

91. In addition, the advantages of reporting unadjusted management information are significant. That practice is consistent with defining segments based on the structure of the enterprise's internal organization. It imposes little incremental cost on the enterprise and requires little incremental time to prepare. Thus, the enterprise can more easily report segment information in condensed financial statements for interim periods and can report more information about each segment in annual financial statements. Information used by management also highlights for a user of financial statements the risks and opportunities that management considers important.

Information to Be Disclosed about Segments

92. The items of information about each reportable operating segment that must be disclosed as described in paragraphs 25–31 represent a balance between the needs of users of financial statements who may want a complete set of financial statements for each segment and the costs to preparers who may prefer not to disclose any segment information. Statement 14 required disclosure of internal and external revenues; profit or loss; depreciation, depletion, and amortization expense; and unusual items as defined in APB Opinion No. 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*, for each segment. Statement 14 also required disclosure of total assets, equity in the net income of investees accounted for by the equity method, the amount of investment in equity method investees, and total expenditures for additions to long-lived assets. Some respondents to the Exposure Draft objected to disclosing any information that was not required by Statement 14, while others recommended disclosure of additional items that are not required by this Statement. This Statement calls for the following additional disclosures only if the items are included in the measure of segment profit or loss that is reviewed by the chief operating decision maker: significant noncash items, interest revenue, interest expense, and income tax expense.

93. Some respondents to the Exposure Draft expressed concern that the proposals would increase the sheer volume of information compared to what was required to be reported under Statement 14. The Board considers that concern to be overstated for several reasons. Although this Statement requires disclosure of more information about an individual operating segment than Statement 14 required for an industry segment, this Statement requires disclosure of information about only one type of segment-reportable operating segments-while Statement 14 required information about two types of segments-industry segments and geographic segments. Moreover, Statement 14 required that many enterprises create information solely for external reporting, while

almost all of the segment information that this Statement requires is already available in management reports. The Board recognizes, however, that some enterprises may find it necessary to create the enterprise-wide information about products and services, geographic areas, and major customers required by paragraphs 36–39.

94. The Board decided to require disclosure of significant noncash items included in the measure of segment profit or loss and information about total expenditures for additions to long-lived segment assets (other than financial instruments, long-term customer relationships of a financial institution, mortgage and other servicing rights, deferred policy acquisition costs, and deferred tax assets) if that information is reported internally because it improves financial statement users' abilities to estimate cash-generating potential and cash requirements of operating segments. As an alternative, the Board considered requiring disclosure of operating cash flow for each operating segment. However, many respondents said that disclosing operating cash flow in accordance with FASB Statement No. 95, *Statement of Cash Flows*, would require that they gather and process information solely for external reporting purposes. They said that management often evaluates cash generated or required by segments in ways other than by calculating operating cash flow in accordance with Statement 95. For that reason, the Board decided not to require disclosure of cash flow by segment.

95. Disclosure of interest revenue and interest expense included in reported segment profit or loss is intended to provide information about the financing activities of a segment. The Exposure Draft proposed that an enterprise disclose gross interest revenue and gross interest expense for all segments in which reported profit or loss includes those items. Some respondents said that financial services segments generally are managed based on net interest revenue, or the "spread," and that management looks only to that data in its decision-making process. Therefore those segments should be required to disclose only the net amount and not both gross interest revenue and expense. Those respondents noted that requiring disclosure of both gross amounts would be analogous to requiring nonfinancial services segments to disclose both sales and cost of sales. The Board decided that segments that derive a majority of revenue from interest should be permitted to disclose net interest revenue instead of gross interest revenue and gross interest expense if management finds that amount to be more relevant in managing the segment. Information about interest is most important if a single segment comprises a mix of financial and nonfinancial operations. If a segment is primarily a financial operation, interest revenue probably constitutes most of segment revenues and interest expense will constitute most of the difference between reported segment revenues and reported segment profit or loss. If the segment has no financial operations or only immaterial financial operations, no information about interest is required.

96. The Board decided not to require the disclosure of segment liabilities. The Exposure Draft proposed that an enterprise disclose segment liabilities because the Board believed that liabilities are an important disclosure for understanding the financing activities of a segment. The Board also noted that the requirement in FASB Statement No. 94, *Consolidation of All Majority-Owned Subsidiaries*, to disclose assets, liabilities, and profit or loss about previously unconsolidated subsidiaries was continued from

APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, pending completion of the project on disaggregated disclosures. However, in commenting on the disclosures that should be required by this Statement, many respondents said that liabilities are incurred centrally and that enterprises often do not allocate those amounts to segments. The Board concluded that the value of information about segment liabilities in assessing the performance of the segments of an enterprise was limited.

97. The Board decided not to require disclosure of research and development expense included in the measure of segment profit or loss. The Exposure Draft would have required that disclosure to provide financial statement users with information about the operating segments in which an enterprise is focusing its product development efforts. Disclosure of research and development expense was requested by a number of financial statement users and was specifically requested in both the report of the AICPA's Special Committee and the AIMR's 1993 position paper. However, respondents said that disclosing research and development expense by segment may result in competitive harm by providing competitors with early insight into the strategic plans of an enterprise. Other respondents observed that research and development is only one of a number of items that indicate where an enterprise is focusing its efforts and that it is much more significant in some enterprises than in others. For example, costs of employee training and advertising were cited as items that often are more important to some enterprises than research and development, calling into question the relevance of disclosing only research and development expense. Additionally, many respondents said that research and development expense often is incurred centrally and not allocated to segments. The Board therefore decided not to require the disclosure of research and development expense by segment.

Interim Period Information

98. This Statement requires disclosure of limited segment information in condensed financial statements that are included in quarterly reports to shareholders, as was proposed in the Exposure Draft. Statement 14 did not apply to those condensed financial statements because of the expense and the time required for producing segment information under Statement 14. A few respondents to the Exposure Draft said that reporting segment information in interim financial statements would be unnecessarily burdensome. However, users contended that, to be timely, segment information is needed more often than annually and that the difficulties of preparing it on an interim basis could be overcome by an approach like the one in this Statement. Managers of many enterprises agree and have voluntarily provided segment information for interim periods.

99. The Board decided that the condensed financial statements in interim reports issued to shareholders should include disclosure of segment revenues from external customers, intersegment revenues, a measure of segment profit or loss, material changes in segment assets, differences in the basis of segmentation or the way segment profit or

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loss was measured in the previous annual period, and a reconciliation to the enterprise's total profit or loss. That decision is a compromise between the needs of users who want the same segment information for interim periods as that required in annual financial statements and the costs to preparers who must report the information. Users will have some key information on a timely basis. Enterprises should not incur significant incremental costs to provide the information because it is based on information that is used internally and therefore already available.

Restatement of Previously Reported Information

100. The Board decided to require restatement of previously reported segment information following a change in the composition of an enterprise's segments unless it is impracticable to do so. Changes in the composition of segments interrupt trends, and trend analysis is important to users of financial statements. Some financial statement issuers have said that their policy is to restate one or more prior years for internal trend analysis. Many reorganizations result in discrete profit centers' being reassigned from one segment to another and lead to relatively simple restatements. However, if an enterprise undergoes a fundamental reorganization, restatement may be very difficult and expensive. The Board concluded that in those situations restatement may be impracticable and, therefore, should not be required. However, if an enterprise does not restate its segment information, the enterprise is required to provide current-period segment information on both the old and new bases of segmentation in the year in which the change occurs unless it is impracticable to do so.

Enterprise-Wide Disclosures

101. Paragraphs 36–39 require disclosure of information about an enterprise's products and services, geographic areas, and major customers, regardless of the enterprise's organization. The required disclosures need be provided only if they are not included as part of the disclosures about segments. The Exposure Draft proposed requiring additional disclosures about products and services and geographic areas by segment. Many respondents said that that proposal would have resulted in disclosure of excessive amounts of information. Some enterprises providing a variety of products and services throughout many countries, for example, would have been required to present a large quantity of information that would have been time-consuming to prepare and of questionable benefit to most financial statement users. The Board decided that additional disclosures provided on an enterprise-wide basis rather than on a segment basis would be appropriate and not unduly burdensome. The Board also agreed that those enterprise-wide disclosures are appropriate for all enterprises including those that have a single operating segment if the enterprise offers a range of products and services, derives revenues from customers in more than one country, or both.

102. Based on reviews of published information about public enterprises, discussions with constituents, and a field test of the Exposure Draft, the Board believes that most

enterprises are organized by products and services or by geography and will report one or both of those types of information in their reportable operating segment disclosures. However, some enterprises will be required by paragraphs 36–39 to report additional information because the enterprise-wide disclosures are required for all enterprises, even those that have a single reportable segment.

Information about Products and Services

103. This Statement requires that enterprises report revenues from external customers for each product and service or each group of similar products and services for the enterprise as a whole. Analysts said that an analysis of trends in revenues from products and services is important in assessing both past performance and prospects for future growth. Those trends can be compared to benchmarks such as industry statistics or information reported by competitors. Information about the assets that are used to produce specific products and deliver specific services also might be useful. However, in many enterprises, assets are not dedicated to specific products and services and reporting assets by products and services would require arbitrary allocations.

Information about Geographic Areas

104. This Statement requires disclosure of information about both revenues and assets by geographic area. Analysts said that information about revenues from customers in different geographic areas assists them in understanding concentrations of risks due to negative changes in economic conditions and prospects for growth due to positive economic changes. They said that information about assets located in different areas assists them in understanding concentrations of risks (for example, political risks such as expropriation).

105. Statement 14 requires disclosure of geographic information by geographic region, whereas this Statement requires disclosure of individually material countries as well as information for the enterprise's country of domicile and all foreign countries in the aggregate. This Statement's approach has two significant benefits. First, it will reduce the burden on preparers of financial statements because most enterprises are likely to have material operations in only a few countries or perhaps only in their country of domicile. Second, and more important, it will provide information that is more useful in assessing the impact of concentrations of risk. Information disclosed by country is more useful because it is easier to interpret. Countries in contiguous areas often experience different rates of growth and other differences in economic conditions. Under the requirements of Statement 14, enterprises often reported information about broad geographic areas that included groupings such as Europe, Africa, and the Middle East. Analysts and others have questioned the usefulness of that type of broad disclosure.

106. Respondents to the Exposure Draft questioned how revenues should be allocated to individual countries. For example, guidance was requested for situations in which

products are shipped to one location but the customer resides in another location. The Board decided to provide flexibility concerning the basis on which enterprises attribute revenues to individual countries rather than requiring that revenues be attributed to countries according to the location of customers. The Board also decided to require that enterprises disclose the basis they have adopted for attributing revenues to countries to permit financial statement users to understand the geographic information provided.

107. As a result of its decision to require geographic information on an enterprise-wide basis, the Board decided not to require disclosure of capital expenditures on certain long-lived assets by geographic area. Such information on an enterprise-wide basis is not necessarily helpful in forecasting future cash flows of operating segments.

Information about Major Customers

108. The Board decided to retain the requirement in Statement 14, as amended by FASB Statement No. 30, *Disclosure of Information about Major Customers*, to report information about major customers because major customers of an enterprise represent a significant concentration of risk. The 10 percent threshold is arbitrary; however, it has been accepted practice since Statement 14 was issued, and few have suggested changing it.

Competitive Harm

109. A number of respondents to the Exposure Draft noted the potential for competitive harm as a result of disclosing segment information in accordance with this Statement. The Board considered adopting special provisions to reduce the potential for competitive harm from certain segment information but decided against it. In the Invitation to Comment, the Tentative Conclusions, and the Exposure Draft, the Board asked constituents for specific illustrations of competitive harm that has resulted from disclosing segment information. Some respondents said that public enterprises may be at a disadvantage to nonpublic enterprises or foreign competitors that do not have to disclose segment information. Other respondents suggested that information about narrowly defined segments may put an enterprise at a disadvantage in price negotiations with customers or in competitive bid situations.

110. Some respondents said that if a competitive disadvantage exists, it is a consequence of an obligation that enterprises have accepted to gain greater access to capital markets, which gives them certain advantages over nonpublic enterprises and many foreign enterprises. Other respondents said that enterprises are not likely to suffer competitive harm because most competitors have other sources of more detailed information about an enterprise than that disclosed in the financial statements. In addition, the information that is required to be disclosed about an operating segment is no more detailed or specific than the information typically provided by a smaller enterprise with a single operation.

111. The Board was sympathetic to specific concerns raised by certain constituents; however, it decided that a competitive-harm exemption was inappropriate because it would provide a means for broad noncompliance with this Statement. Some form of relief for single-product or single-service segments was explored; however, there are many enterprises that produce a single product or a single service that are required to issue general-purpose financial statements. Those statements would include the same information that would be reported by single-product or single-service segments of an enterprise. The Board concluded that it was not necessary to provide an exemption for single-product or single-service segments because enterprises that produce a single product or service that are required to issue general-purpose financial statements have that same exposure to competitive harm. The Board noted that concerns about competitive harm were addressed to the extent feasible by four changes made during redeliberations: (a) modifying the aggregation criteria, (b) adding quantitative materiality thresholds for identifying reportable segments, (c) eliminating the requirements to disclose research and development expense and liabilities by segment, and (d) changing the second-level disclosure requirements about products and services and geography from a segment basis to an enterprise-wide basis.

Cost-Benefit Considerations

112. One of the precepts of the Board's mission is to promulgate standards only if the expected benefits of the resulting information exceed the perceived costs. The Board strives to determine that a proposed standard will fill a significant need and that the costs incurred to satisfy that need, as compared with other alternatives, are justified in relation to the overall benefits of the resulting information. The Board concluded that the benefits that will result from this Statement will exceed the related costs.

113. The Board believes that the primary benefits of this Statement are that enterprises will report segment information in interim financial reports, some enterprises will report a greater number of segments, most enterprises will report more items of information about each segment, enterprises will report segments that correspond to internal management reports, and enterprises will report segment information that will be more consistent with other parts of their annual reports.

114. This Statement will reduce the cost of providing disaggregated information for many enterprises. Statement 14 required that enterprises define segments by both industry and by geographical area, ways that often did not match the way that information was used internally. Even if the reported segments aligned with the internal organization, the information required was often created solely for external reporting because Statement 14 required certain allocations of costs, prohibited other cost allocations, and required allocations of assets to segments. This Statement requires that information about operating segments be provided on the same basis that it is used internally. The Board believes that most of the enterprise-wide disclosures in this Statement about products and services, geography, and major customers typically are provided in current financial statements or can be prepared with minimal incremental cost.

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Applicability to Nonpublic Enterprises and Not-for-Profit Organizations

115. The Board decided to continue to exempt nonpublic enterprises from the requirement to report segment information. Few users of nonpublic enterprises' financial statements have requested that the Board require that those enterprises provide segment information.

116. At the time the Board began considering improvements to disclosures about segment information, FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations*, had not been issued and there were no effective standards for consolidated financial statements of not-for-profit organizations. Most not-for-profit organizations provided financial information for each of their funds, which is a form of disaggregated information. The situation in Canada was similar. Thus, when the two boards agreed to pursue a joint project, they decided to limit the scope to public business enterprises.

117. The Board provided a limited form of disaggregated information in paragraph 26 of Statement 117, which requires disclosure of expense by functional classification. However, the Board acknowledges that the application of that Statement may increase the need for disaggregated information about not-for-profit organizations. A final Statement expected to result from the FASB Exposure Draft, *Consolidated Financial Statements: Policy and Procedures*, also may increase that need by requiring aggregation of information about more entities in the financial statements of not-for-profit organizations.

118. The general approach of providing information based on the structure of an enterprise's internal organization may be appropriate for not-for-profit organizations. However, the Board decided not to add not-for-profit organizations to the scope of this Statement. Users of financial statements of not-for-profit organizations have not urged the Board to include those organizations, perhaps because they have not yet seen the effects of Statement 117 and the Exposure Draft on consolidations. Furthermore, the term *not-for-profit organizations* applies to a wide variety of entities, some of which are similar to business enterprises and some of which are very different. There are likely to be unique characteristics of some of those entities or special user needs that require special provisions, which the Board has not studied. In addition, the AcSB has recently adopted standards for reporting by not-for-profit organizations that are different from Statement 117. In the interest of completing this joint project in a timely manner, the Board decided not to undertake the research and deliberations that would be necessary to adapt the requirements of this Statement to not-for-profit organizations at this time. Few respondents to the Exposure Draft disagreed with the Board's position.

Effective Date and Transition

119. The Board concluded that this Statement should be effective for financial statements issued for fiscal years beginning after December 15, 1997. In developing the Exposure Draft, the Board had decided on an effective date of December 15, 1996. The Board believed that that time frame was reasonable because almost all of the information that this Statement requires is generated by systems already in place within an enterprise and a final Statement was expected to be issued before the end of 1996. However, respondents said that some enterprises may need more time to comply with the requirements of this Statement than would have been provided under the Exposure Draft.

120. The Board also decided not to require that segment information be reported in financial statements for interim periods in the initial year of application. Some of the information that is required to be reported for interim periods is based on information that would have been reported in the most recent annual financial statements. Without a full set of segment information to use as a comparison and to provide an understanding of the basis on which it is provided, interim information would not be as meaningful.

Appendix B
Amendments to Basis for Conclusions on other IFRSs

This appendix contains [draft] amendments to the Basis for Conclusions on other IFRSs that are necessary in order to ensure consistency with IFRS [X].

BCA1 In the Basis for Conclusions on IFRS 1 *First-time Adoption of International Financial Reporting Standards*, paragraph BC4 is footnoted as follows:

> In [date] IAS 14 was replaced by IFRS [X] *Operating Segments*.

BCA2 In the Basis for Conclusions on IFRS 6 *Exploration for and Evaluation of Mineral Resources*, paragraph BC46 is footnoted as follows:

> In [date] IAS 14 was replaced by IFRS [X] *Operating Segments*, which does not require the identification of primary and secondary segments. See paragraph BC150A of the Basis for Conclusions on IAS 36.

BCA3 In the Basis for Conclusions on IFRS 7 *Financial Instruments: Disclosures*, paragraph BC47 is footnoted as follows:

> In [date] IAS 14 was replaced by IFRS [X] *Operating Segments*.

BCA4 In the Basis for Conclusions on IAS 27 *Consolidated and Separate Financial Statements*, paragraph BC21 is footnoted as follows:

> In [date] IAS 14 *Segment Reporting* was replaced by IFRS [X] *Operating Segments*.

BCA5 The Basis for Conclusions on IAS 36 *Impairment of Assets* is amended as described below.

Paragraph BC144 is footnoted as follows:

> In [date] IAS 14 was replaced by IFRS [X] *Operating Segments*. IFRS [X] does not require disclosure of primary and secondary segment information. See paragraph BC150A.

In the footnote to paragraph BC147, the following is added at the end:

> IAS 14 was replaced by IFRS [X] in [date]. See paragraph BC150A.

Paragraph BC150A is added after paragraph BC150, as follows:

BC150A In [date] IFRS [X] *Operating Segments* replaced IAS 14 and changed the basis for identifying segments. Under IAS 14, two sets of segments were identified—one based on related products and services, and the other on geographical areas. Under IFRS [X], operating segments are identified on the basis of internal reports that are regularly reviewed by the entity's chief operating decision maker in order to allocate resources to the segment and assess its performance. The objective of the change was to improve the disclosure of segment information, not to change the requirements of IAS 36 relating to the allocation of goodwill for impairment testing. The previous wording of the requirement in IAS 36 that each unit or group of units to which goodwill is allocated should 'not be larger than a segment based on either the entity's primary or the entity's secondary reporting format determined in accordance with IAS 14' has been amended by IFRS [X] to 'not be larger than an operating segment determined in accordance with IFRS [X]'. The arguments set out above in support of the original requirement based on segments determined in accordance with IAS 14 support the revised requirements based on segments determined in accordance with the requirements in IFRS [X].

The second sentence of BC166(b) is footnoted as follows:

In [date] IAS 14 was replaced by IFRS [X] *Operating Segments*, which does not require disclosure of primary and secondary segment information. See paragraph BC150A.

