Statement of Accounting Standards **AAS 16**
April 1987

Financial Reporting by Segments

Prepared by the
Accounting Standards Board of the
Australian Accounting Research Foundation

The National Councils of The Institute of Chartered Accountants in Australia and the Australian Society of Accountants issue the following Statement of Accounting Standards relating to "Financial Reporting by Segments". It supersedes the previous Statement issued in March 1984. Compliance with this Statement will ensure compliance with Approved Accounting Standard ASRB 1005: Financial Reporting by Segments.

Statements of Accounting Concepts and Statements of Accounting Standards are developed and maintained for the Councils by the Accounting Standards Board and the Public Sector Accounting Standards Board of the Australian Accounting Research Foundation, acting in concert. The processes applied by those Boards are outlined in "Foreword to Statements of Accounting Concepts and Statements of Accounting Standards".

This Statement applies to all companies in the private sector and all companies and other business entities in the public sector, and is operative from the date of reissue.

Issued by the
Australian Society of Accountants and
The Institute of Chartered Accountants in Australia

CONTENTS

INTRODUCTION

1 The purpose of this Statement is to set standards requiring companies in the private sector and companies and other business entities in the public sector to disclose in their financial statements information on industry and geographical segments whenever it is significant to an understanding of those statements. Where consolidated financial statements are presented, segment information would only need to be presented in the consolidated financial statements and not in the parent entity's financial statements.

DEFINITIONS

2 For the purposes of this Statement:

(a) **"Foreign geographical segment**" means a geographical segment, other than Australia, which serves a purpose beyond facilitating export sales from the reporting entity's domestic operations.

(b) **"Geographical segment"** means a distinguishable component of a reporting entity engaged in operations in individual countries or groups of countries.

(c) **"Industry segment"** means a distinguishable component of a reporting entity, where such component is engaged in providing a product or service, or a collection of related products or services, primarily to customers outside the reporting entity.

(d) **"Segment assets**" means all assets attributable to a segment, including the portion of those used jointly by two or more segments, that can be allocated to individual segments on a reasonable basis.

(e) **"Segment expense**" means an operating expense that is directly attributable to a segment, or the relevant portion of an operating expense that can be allocated on a reasonable basis to a segment for whose benefit the expense was incurred.

(f) **"Segment result**" means the difference between segment revenue and segment expenses.

(g) **"Segment revenue"** means operating revenue, directly attributable to a segment, including revenue from sales to customers outside the reporting entity and from intersegment sales and transfers of products and services, other than intersegment billings for the cost of shared facilities or other jointly incurred costs.

DISCUSSION

Reasons for Inclusion of Segment Information in Financial Statements

3 The principal objective in requiring the disclosure of segment information is to enable users of financial statements to make a better analysis of a reporting entity's past performance. Segmentation by industry and geographical areas is highly relevant to an analysis of a reporting entity's profit prospects and risk exposure when making investment and credit decisions. The operations and results of different industry and geographical segments may be subject to a variety of special risks such as the effects of technological change, the degree of government assistance, exchange rate fluctuations, international trade competition and political instability. By extending financial statements to include information about activities in different industries and foreign locations, improved assessments can be made regarding the reporting entity as a whole.

4 Segment data is not provided to enable users to make a direct comparison between the results of segments of different reporting entities. Where segments are not severable or operationally independent businesses, their results need to be interpreted within the context of the organisational structure of the reporting entity.

Identification of Industry Segments

5 It is considered impracticable to provide, in this Statement, detailed guidelines on the identification of segments within a reporting entity, because the level of segmentation adopted will depend upon the diversity of industry involvement of the reporting entity. In determining industry segments, factors such as the following would need to be considered by a reporting entity:

(a) existing profit centres (if these cross industry lines it would be necessary to break them down into smaller units);

(b) the nature of the product or service (similar purposes or end-uses);

(c) the nature of the production process (sharing common facilities, using the same raw materials, etc.); and,

(d) markets and marketing methods.

6 The Australian Standard Industry Classification, compiled by the Australian Bureau of Statistics, may provide a reporting entity with information to assist in identifying industry segments.

7 This Statement does not require the segmentation of vertically integrated operations where most or all of the output of one reporting entity, or one section of a reporting entity, is the input of another within the same reporting entity. Also, the Statement does not contemplate the segmentation of any other operations that are closely interrelated or interdependent because in such circumstances the artificiality of the created segments would render meaningless any reports on segment profitability.

Identification of Geographical Segments

8 In accordance with the definitions of "geographical segment" and "foreign geographical segment" a reporting entity's operations within Australia are to be considered a separate geographical segment.

9 Operations of a reporting entity will only be classified as operations in foreign geographical segments if they extend beyond facilitating export sales or services from the reporting entity's domestic operations. Thus, if the foreign activities of an Australian reporting entity were limited to selling and warehousing goods supplied from Australia and a small amount of connected servicing, the operations would usually be viewed as domestic operations. If the products were substantially manufactured, assembled or acquired in the overseas country, the activities would be classified as foreign.

10 In determining the appropriate boundaries of foreign geographical segments the following factors are to be considered:

(a) the physical location of the operations;

(b) proximity of operations in each country;

(c) similarities in business and political environment in each country; and,

(d) nature, scale and degree of interrelationship of operations in each country.

Determining Material Industry and Geographical Segments

11 After a reporting entity has been divided into industry and geographical segments, it is necessary to decide whether particular segments are material and so warrant separate disclosure. The materiality of a segment to the reporting entity as a whole can be

measured in terms of revenue, profits or losses generated, or assets employed. In the absence of other factors a segment would be considered material if one or more of the following conditions applied:

(a) its revenue is 10 percent or more of the total segment revenue of all segments (including intersegment sales and transfers);

(b) the absolute amount of its segment result is 10 percent or more of the greater, in absolute amount, of:

 (i) the total segment result of all segments that earned a profit; and,

 (ii) the total segment result of all segments that incurred a loss; and/or,

(c) its segment assets are 10 percent or more of the total segment assets of all segments.

The guideline in (b) is illustrated in Appendix 2 of this Statement.

12 To provide an adequate insight into the reporting entity's operations, it is necessary for the material segments to represent a substantial proportion of total operations. In this regard identification by a reporting entity of sufficient segments such that the total revenue from sales to customers outside the reporting entity of all material segments constitutes 75 percent or more of the reporting entity's revenue derived from customers outside the reporting entity, would, prima facie, ensure that the material segments constitute a substantial proportion of total operations.

13 The results from applying the guidelines in paragraph 11 are to be evaluated from the viewpoint of interperiod comparability. For instance, a segment that has been material in the past, and is expected to be material in the future, would be disclosed as a material segment despite failure in the current period to be identified by the guidelines as a material segment. Conversely, it would be inappropriate to report on an immaterial segment that meets the guidelines only because of a temporary aberration in the results of other segments. When instances such as the above arise from strict application of the guidelines, the particular circumstances need to be explained.

14 A reporting entity that operates predominantly in one industry need only provide a description of the industry in which it operates. A reporting entity is considered, prima facie, to be operating predominantly in one industry when the dominant segment's

revenue, segment result and segment assets (as defined respectively in paragraph 2(g), (f) and (d)) each constitute more than 90 percent of the related totals for all industry segments, in which case no other segment would meet any of the 10 percent guidelines given in paragraph 11.

15 Similarly, a reporting entity that operates predominantly in one geographical location need only disclose that circumstance. A reporting entity is, prima facie, considered to be operating predominantly in Australia when revenue, operating profit or loss and assets associated with operations within Australia each constitute more than 90 percent of the related totals for all geographical segments.

Revenue and Expenses

16 The basis for classifying items of revenue and expense as attributable to a particular segment will vary across reporting entities and may be influenced by the autonomy of each of the segments within the reporting entity. Where allocation of an item of revenue or expense cannot be made to segments on a reasonable basis no allocation is to be made and the unallocated amount is to be adjusted against the total result of all segments in determining operating profit for the reporting entity.

17 The following revenue items are not normally included in segment revenue:

- revenue earned at the head office or corporate level and not derived from operations of any segment;
- share of profits from investments accounted for by the equity method of accounting;
- interest and dividend revenue, other than that earned on an asset included in segment assets;
- interest earned on advances or loans to other segments, unless segment operations are primarily of a financial nature; and,
- extraordinary gains (net of income taxes).

Intersegment billings for the cost of shared facilities or other jointly incurred costs do not represent intersegment sales or transfers but represent a cost recovery that needs to be offset against segment expenses.

18 The following expense items are not normally included in segment expense:

- general head office or corporate expenses;
- share of losses from investments accounted for by the equity method of accounting;
- interest expense when segment operations are not primarily of a financial nature;
- income tax expense applicable to operating profit; and,
- extraordinary losses (net of income taxes).

19 Since intersegment sales and transfers occur within the reporting entity and as a result can be made at prices substantially higher or lower than regular market prices, it is important that the basis used in pricing the intersegment sales and transfers is disclosed in the segment reports.

Profitability

20 The only measure of profitability required in this Statement to be disclosed is segment result for material industry and geographical segments. The Statement does not prohibit the disclosure of additional measures of segment profitability.

Investment

21 The relative profitability of different segments is difficult to evaluate without knowledge of the investment in each segment. In identifying assets with segments, the procedures used in allocating jointly used assets to segments parallels the procedures used in allocating common operating expenses. General corporate assets that are not used in the operations of any particular segment are not to be allocated.

22 While provisions for doubtful debts and depreciation are deducted in obtaining the amounts for segment assets, a segmentation of liabilities to facilitate the computation of "net" investment is not required. For instance, equity capital and debt normally issued by the reporting entity as a whole and the attribution of particular sources of capital to particular segments could often be arbitrary and misleading. Similarly, advances or loans to another segment are not included in segment assets unless segment operations are of a financial nature or segments are individually responsible for raising finance.

ACCOUNTING STANDARDS

Discussion and Definitions

23 The following standards shall be interpreted in the context of paragraphs 1 to 22 of this Statement.

24 Paragraph 2 (definitions) shall be read as forming part of the accounting standards set out in this Statement.

Materiality

25 The accounting standards contained in paragraphs 26 to 34 shall, in accordance with the guidance contained in paragraphs 11 to 15 of this Statement and with the provisions of Statement of Accounting Standards AAS 5 "Materiality in Financial Statements", apply to Financial Statements where such application is of material consequence.

Financial Statements to include Segment Information

26 All reporting entities, to which this Statement applies, that have industry or geographical segments shall report segment information in accordance with paragraphs 27 to 34, except that where the reporting entity presents consolidated financial statements, segment information need only be presented in the consolidated financial statements and not in the parent entity's financial statements.

Industry and Geographical Segments

27 Where a reporting entity operates predominantly in one industry, that circumstance shall be disclosed together with a general description of the products and services from which revenue is derived.

28 Where there are operations in more than one industry, industry segments shall be identified. A general description of the products and services from which each industry segment derives its revenue shall be disclosed.

29 Where a reporting entity operates predominantly in one geographical segment, that circumstance and the geographical location shall be disclosed.

30 Where there are operations in more than one geographical segment, such segments shall be disclosed, showing separately the country, or groups of countries, comprising each.

31 for each industry and geographical segment, the following information shall be disclosed:

(a) segment revenue, distinguishing between revenue derived from customers outside the reporting entity and revenue derived from other segments;

(b) segment result;

(c) the carrying amount of segment assets; and,

(d) the basis of inter-segment pricing.

32 The information provided on segment revenue, segment result and segment assets shall each be aggregated and reconciled to agree with the related information in the consolidated or other main financial statements.

33 When preparing segment information, intersegment transactions that have been eliminated in the preparation of consolidated financial statements shall be reinstated.

Disclosure of Accounting Policies

34 Changes in the accounting policies used in preparing segment data, including changes in the method of identifying industry and geographical segments, shall be disclosed in accordance with paragraphs 16 to 18 of Statement of Accounting Standards AAS 6 "Accounting Policies: Determination, Application and Disclosure", except that the financial effect of any change shall be reported in relation to segment revenue, segment result and segment assets where appropriate.

Applicability and Operative Date

35 This Statement applies to all companies in the private sector and all companies and other business entities in the public sector, and is operative from the date of reissue.

COMPATIBILITY WITH INTERNATIONAL ACCOUNTING STANDARD IAS 14

The standards set out in this Statement are consistent with those set out in IAS 14 "Reporting Financial Information by Segment" issued by the International Accounting Standards Committee, except to the extent that this Statement applies to all companies in the private sector and all companies and other business entities in the public sector, while IAS 14 applies to "enterprises whose securities are publicly traded and other economically significant entities".

APPENDIX 1

This appendix does not form part of the Statement of Accounting Standards. The method of presentation used is illustrative only. Other methods of presentation may equally comply with the accounting standards set out in the Statement.

Example Statement of Operations of Industry and Geographical Segments for year ended 30 June 19X2

INDUSTRY SEGMENTS	Industry A		Industry B		Other Industries		Eliminations		Consolidated	
	19X2	19X1	19X2	19X1	19X2	19X1	19X2	19X1	19X2	19X1
Operating Revenue	$000		$000		$000		$000		$000	
Sales to customers outside the group	9,000	10,000	13,000	9,700	4,000	3,000	–	–	26,000	22,700
Intersegment sales	1,100	1,250	2,200	2,300	–	–	(3,300)	(3,550)	–	–
Unallocated Revenue	–	–	–	–	–	–	–	–	2,000	1,000
Total revenue[1]	10,100	11,250	15,200	12,000	4,000	3,000	(3,300)	(3,550)	28,000	23,700
Segment result	1,900	2,500	3,500	2,400	305	400	(5)	(300)	5,700	5,000
Unallocated expenses									(3,800)	(3,040)
Group operating profit (before equity accounting)									1,900	1,960
Segment assets	25,000	24,000	30,000	25,000	13,930	13,035	(30)	(25)	68,900	62,010
Unallocated assets									10,000	8,150
Total assets									78,900	70,160

Notes: The company operates predominantly in two industries – A and B. Industry A's operations comprise the production and sale of (describe types of products and services). Industry B's operations comprise the production and sale of (describe types of products and services). The basis of intersegment pricing is (description).

[1] Where other operating revenue exists (that is, in addition to sales), and it relates to individual segments, it would need to be allocated to those segments on a reasonable basis.

GEOGRAPHICAL SEGMENTS	Australia		S/E Asia		Other		Eliminations		Consolidated	
	19X2	19X1	19X2	19X1	19X2	19X1	19X2	19X1	19X2	19X1
Operating Revenue	$000		$000		$000		$000		$000	
Sales to customers outside the group	20,000	18,000	5,000	3,800	1,000	900	–	–	26,000	22,700
Intersegment sales	2,000	1,400	1,600	900	–	–	(3,600)	(2,300)	–	–
Unallocated Revenue	–	–	–	–	–	–	–	–	2,000	1,000
Total revenue[1]	22,000	19,400	6,600	4,700	1,000	900	(3,600)	(2,300)	28,000	23,700
Segment result	3,800	3,400	1,800	1,400	200	300	(500)	(300)	5,300	4,800
Unallocated expenses									(3,400)	(2,840)
Group operating profit (before equity accounting)									1,900	1,960
Segment assets	32,000	30,000	24,000	18,000	14,850	12,700	(1,250)	1,880	69,600	62,580
Unallocated assets									9,300	7,580
Total assets									78,900	70,160

Notes: The company operates predominantly in two geographical segments – Australia and South-East Asia. The basis of intersegment pricing is (description).

1 Where other operating revenue exists (that is, in addition to sales), and it relates to individual segments, it would need to be allocated to those segments on a reasonable basis.

APPENDIX 2

This example illustrates the guideline contained in paragraph 11(b) for determining materiality in the event of a segment incurring losses.

Determining Material Segments

Industry Segment	*Segment Result*	*Material*
A	200,000	YES
B	150,000	YES
C	30,000	NO
Absolute amount of segment result (profits)	380,000	
D	(400,000)	YES
E	(40,000)	NO
Absolute amount of segment result (losses)	(440,000)	
Net segment result	$ (60,000)	

Segments A, B and D are material under the guideline because the amount of segment result for each of these segments is greater than 10 percent of $440,000. Those segments which are not material under paragraph 11(b) may be material under paragraph 11(a) or 11(c).