

International Financial Reporting Standard IFRS 8

Operating Segments

January 2022

BASIS FOR CONCLUSIONS

APPENDICES TO THE BASIS FOR CONCLUSIONS

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

B Amendments to the Basis for Conclusions on other IFRSs

DISSENTING OPINIONS

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Basis for Conclusions on IFRS 8 *Operating Segments*

This Basis for Conclusions and its appendices accompany, but are not part of, IFRS 8.

Introduction

- BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching the conclusions in IFRS 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 project is being conducted jointly with the United States standard-setter, the Financial Accounting Standards Board (FASB). The objective of the project is to reduce differences between 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.
- BC3 As part of the project, the Board identified differences between IAS 14 *Segment Reporting* and the US standard 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 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. In particular, both standards required the accounting policies underlying the disaggregated information 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 future cash flow prospects.

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:

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- (a) increased the number of reported segments and provided more information;
- (b) enabled users to see an entity through the eyes of management;
- (c) enabled an entity to provide timely segment information for external interim 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.
- BC8 Consequently the Board decided to adopt the US approach and published its proposals as an exposure draft in ED 8 *Operating Segments* in January 2006. The deadline for comments was 19 May 2006. The Board received 182 comment letters. After reviewing the responses, the Board issued IFRS 8 in November 2006.

Adoption of management approach

- BC9 In the Basis for Conclusions on ED 8, 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 more segments; and
 - (d) entities will report more segment information in interim financial reports.

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

- BC10 Most respondents to the Exposure Draft supported the adoption of the management approach. They considered the management approach appropriate, and superior to the approach of IAS 14. These respondents observed that the management approach for segment reporting allows users to review an entity's operations from the same perspective as management. They noted that although the IAS 14 approach would enhance comparability by requiring entities to report segment information that is consistent with

IFRSs, the disclosures will not necessarily correspond to segment information that is reported to management and is used for making decisions.

- BC11 Other respondents disagreed with the management approach. They argued that convergence should instead be achieved by changing SFAS 131 to IAS 14. In their view the latter approach is superior because it provides comparability of information across entities by defining measures of segment revenue, segment expense, segment result, segment assets and segment liabilities.
- BC12 Yet other respondents agreed with the management approach for the identification of segment assets, but disagreed with the management approach for the measurement of the various segment disclosures. In particular, they doubted whether the publication of internally reported amounts would generate significant benefit for investors if those amounts differ from IFRS amounts.
- BC13 The Board noted that if IFRS amounts could be prepared reliably and on a timely basis for segments identified using the management approach, that approach would provide the most useful information. However, the Board observed that IFRS amounts for segments cannot always be prepared on a sufficiently timely basis for interim reporting.
- BC14 The Board also noted the requirements in the IFRS 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. The Board was satisfied that users would be able to understand and judge appropriately the basis on which the segment amounts were determined.
- BC15 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.
- BC16 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 IFRS.
- BC17 The FASB's thinking behind the management approach of SFAS 131 is presented in its Background Information and Basis for Conclusions. Because the Board has adopted that approach, the FASB's Background Information and Basis for Conclusions are reproduced in Appendix A to this Basis for Conclusions. The few differences from SFAS 131 that the Board has included in the IFRS are noted in paragraph BC60 below.

Scope of the standard

- BC18 In ED 8, the Board proposed extending the scope of the IFRS to all entities that have public accountability rather than just entities whose securities are publicly traded. The Board noted that it was premature 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 concluded 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.
- BC19 Some respondents to ED 8 commented that the scope of the IFRS should not be extended until the Board has reached a conclusion on the definitions of 'fiduciary capacity' and 'public accountability' in the SMEs project. They argued that the terms needed clarification and definition.
- BC20 The Board accepted these concerns and decided that the IFRS should not apply to entities that hold assets in a fiduciary capacity. However, the Board decided that publicly accountable entities should be within the scope of the IFRS, and that a future amendment of the scope of the IFRS should be proposed to include publicly accountable entities once the definition has been properly developed in the SMEs project. The proposed amendment will therefore be exposed at the same time as the exposure draft of the proposed IFRS for SMEs.
- BC21 A number of respondents to ED 8 suggested that the scope exemption of paragraph 6 of IAS 14 should be included in the IFRS. This paragraph provided an exemption from segment reporting in the separate financial statements of the parent when a financial report contains both consolidated financial statements and the parent's separate financial statements. The Board agreed that on practical grounds such an exemption was appropriate.
- BC22 In ED 8 the Board proposed that if an entity not required to apply the IFRS chooses to disclose segment information in financial statements that comply with IFRSs, that entity would be required to comply with the requirements of the IFRS. Respondents commented that this was unnecessarily restrictive. For example, they observed that requiring full compliance with the IFRS would prevent an entity outside its scope from voluntarily disclosing sales information for segments without also disclosing segment profit or loss. The Board concluded that an entity should be able to provide segment information on a voluntary basis without triggering the need to comply fully with the IFRS, so long as the disclosure is not referred to as segment information.

- BC23 A respondent to ED 8 asked for clarification on whether the scope of the proposed IFRS included the consolidated financial statements of a group whose parent has no listed financial instruments, but includes a listed minority interest¹ or a subsidiary with listed debt. The Board decided that such consolidated financial statements should not be included in the scope and that the scope should be clarified accordingly. The Board also noted that the same clarification should be made to the scope of IAS 33 *Earnings per Share*.

Aspects of the management approach

Specific measurement requirements for some items

- BC24 In ED 8, the Board invited comments on whether the proposed IFRS should depart from the management approach in SFAS 131 by setting measurement requirements for specified items. Some respondents to ED 8 supported an approach that would define the measurement of the key terms such as segment revenues, segment expenses, segment results, segment assets and segment liabilities in order to enhance comparability between reporting entities. Other respondents disagreed with any departure from SFAS 131 on the grounds that defined measurements for specified items would eliminate the major benefits of the management approach.
- BC25 The IFRS requires the entity to explain the measurements of segment profit or loss and segment assets and liabilities and to provide reconciliations of the total segment amounts to the amounts recognised in the entity's financial statements. The Board believes that such reconciliations will enable users to understand and judge the basis on which the segment amounts were determined. The Board also noted that to define the measurement of such amounts would be a departure from the requirements of SFAS 131 that would involve additional time and cost for entities and would be inconsistent with the management perspective on segment information.
- BC26 Therefore, the Board decided not to require defined measures of segment revenues, segment expenses, segment result, segment assets and segment liabilities.

Matrix form of organisations

- BC27 In ED 8 the Board proposed that when more than one set of segments could be identified, for example when entities use a matrix form of organisation, the components based on products and services should be the basis for the operating segments. Some respondents noted that matrix organisational structures are commonly used for large complex organisations and that mandating the use of components based on products and services was inconsistent with the management approach. The Board agreed with this

¹ In January 2008 the IASB issued an amended IAS 27 *Consolidated and Separate Financial Statements*, which amended 'minority interest' to 'non-controlling interests'. The consolidation requirements in IAS 27 were superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011. The term 'non-controlling interests' and the requirements for non-controlling interests were not changed.

view. Accordingly, the IFRS requires the identification of operating segments to be made by reference to the core principle of the IFRS.

Quantitative thresholds

BC28 In ED 8 the Board proposed quantitative thresholds for identifying reportable segments. Some respondents argued that such requirements represent adoption of a rule-based, rather than a principle-based, approach. In addition, some respondents commented that the inclusion of a 10 per cent threshold could create a precedent for determining materiality in other areas.

BC29 The Board considered an approach whereby any material operating segment would be required to be disclosed separately. However, the Board was concerned that there might be uncertainty about the meaning of materiality in relation to disclosure. Furthermore, such a requirement would be a significant change from the wording of SFAS 131. Thus, the Board was concerned that the change would be from an easily understandable and familiar set of words that converges with SFAS 131 to a potentially confusing principle. Accordingly, the Board decided to retain the quantitative thresholds.

Interaction of aggregation criteria and quantitative thresholds

BC30 One respondent commented that the ranking of the aggregation criteria for operating segments and the quantitative thresholds for determining reportable segments was unclear in ED 8. However, the flow chart in paragraph IG7 of the implementation guidance indicates that the aggregation criteria take precedence over the quantitative thresholds. The Board also noted that the wording in SFAS 131 was clear because the paragraph on aggregation refers to aggregation into a 'single operating segment'. The quantitative thresholds then determine which operating segments are reportable segments. The term 'operating' has been inserted in paragraph 12 of the IFRS.

Aggregation of operating segments

BC30A The Board received a request to consider including a disclosure in paragraph 22 that would require a description of the operating segments that have been aggregated and the economic indicators that have been assessed to decide whether operating segments have 'similar economic characteristics' in accordance with paragraph 12. The Board observed that:

- (a) paragraph 12 does not elaborate upon the meaning of "similar economic characteristics" except to say that operating segments that share similar economic characteristics would be expected to exhibit a similar long term financial performance. In addition, determining whether operating segments have similar economic characteristics requires the use of judgement.

- (b) paragraph 22(a) currently contains a requirement to disclose the factors used to identify the entity's reportable segments, including the basis of organisation, and suggests, as an example, disclosing whether operating segments have been aggregated. However, there is no explicit, or indeed apparent, requirement in paragraph 22(a) to disclose the aggregation of operating segments.

BC30B The Board noted that the disclosure is complementary to the information required by paragraph 22(a). The Board thinks that including a disclosure requirement in paragraph 22 would provide users of financial statements with an understanding of the judgements made by management on how (and the reasons why) operating segments have been aggregated. The judgements made by management may relate to the application of any of the criteria in paragraph 12, which states that two or more operating segments may be aggregated into a single operating segment if aggregation is consistent with the core principle of IFRS 8, the segments have similar economic characteristics and the segments are similarly based on the factors listed in paragraph 12(a)–(e). Consequently, the Board added paragraph 22(aa) to complement the disclosure required in paragraph 22(a). The requirements in paragraph 22(b) remain the same and its wording has not been modified.

Inclusion of US guidance

BC31 The Board discussed the extent to which the IFRS should address the practical problems that have arisen from applying SFAS 131 in the US. The Board considered the FASB *Q&A 131 Segment Information: Guidance on Applying Statement 131* and Emerging Issues Task Force (EITF) 04-10 *Determining Whether to Aggregate Operating Segments that do not Meet the Quantitative Threshold*.

BC32 EITF 04-10 addresses the issue of whether to aggregate operating segments that do not meet the quantitative thresholds. It requires quantitative thresholds to be aggregated only if aggregation is consistent with the objective and core principles of SFAS 131, the segments have similar economic characteristics, and the segments share a majority of the aggregation criteria listed in paragraph 17(a)–(e) of SFAS 131. The Board agreed with the approach adopted in EITF 04-10 and concluded that the same requirement should be included in the IFRS.

BC33 FASB *Q&A 131 – Segment Information: Guidance on Applying Statement 131* is an implementation guide that provides the views of the FASB staff on certain questions on SFAS 131. Because it was not issued by the FASB itself, the Board decided not to include this material in the IFRS.

Information about segment assets

BC34 Several respondents noted that, whilst a measure of segment profit or loss can be expected in every entity's internal reporting, a measure of segment assets is not always available, particularly in service industries or other industries with low utilisation of physical assets. Respondents suggested that in such circumstances a measure of segment assets should be disclosed only if those amounts were regularly provided to the chief operating decision maker.

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BC35 ~~The Board noted that requiring disclosure of a measure of segment assets only when such a measure is reviewed by the chief operating decision maker would create divergence from SFAS 131. The Board also supported a minimum disclosure of segment profit or loss and segment assets. The Board therefore concluded that measures of segment profit or loss and total segment assets should be disclosed for all segments regardless of whether those measures are reviewed by the chief operating decision maker.²~~

BC35A After IFRS 8 was issued, the Board was informed that the reasons originally set out in paragraph BC35 contradict long-standing interpretations published in the US for the application of SFAS 131 and create an unintended difference from practice in the US under SFAS 131. After reconsideration and discussion of the interaction between the disclosure and measurement requirements in the IFRS (paragraphs 23 and 25), the Board concluded that those reasons no longer reflected its thinking. Therefore, the Board amended paragraph 23 by *Improvements to IFRSs* issued in April 2009 to clarify that a measure of segment assets should be disclosed only if that amount is regularly provided to the chief operating decision maker.

Reconciliation of segment assets

BC35B The Board received a request to clarify in paragraph 28(c) that a reconciliation of the total of the reportable segments' assets to the entity's assets should only be disclosed if that amount is regularly provided to the chief operating decision maker. This clarification would make this paragraph consistent with paragraphs 23 and 28(d). The Board agreed with the request and decided to modify paragraph 28(c) to achieve this.

Information about segment liabilities

BC36 ED 8 did not propose disclosure of segment liabilities because there is no such requirement in SFAS 131. The reasons for this are set out in paragraph 96 of the Basis for Conclusions on SFAS 131, included as Appendix A to this Basis for Conclusions.

BC37 Some respondents proposed adding a requirement for each entity to disclose information about segment liabilities, if such information is regularly provided to the chief operating decision maker. They argued that information about segment liabilities would be helpful to users. Other respondents favoured information about net segment assets rather than gross segment assets.

BC38 The Board noted that if segment liabilities are considered in assessing the performance of, and allocating resources to, the segments of an entity, such disclosure would be consistent with the management approach. The Board also noted support for this disclosure from some commentators, particularly users of financial statements. Accordingly the Board decided to require disclosure of a measure of segment liabilities if those amounts are regularly

² Paragraph BC35 was deleted and paragraph BC35A added as a consequence of *Improvements to IFRSs* issued in April 2009.

provided to the chief operating decision maker notwithstanding that such a requirement would create divergence from SFAS 131.

Level of reconciliations

- BC39 ED 8 proposed that an entity should provide reconciliations of total reportable segment amounts for specified items to amounts the entity recognised in accordance with IFRSs. It did not propose such reconciliations for individual reportable segments.
- BC40 Several respondents expressed concern about the level of detail provided by the proposed reconciliations. They argued that if the IFRS allows segment information to be measured on the basis of management information, it should require reconciliations for individual reportable segments between the segment amounts and the equivalent amounts measured in accordance with an entity's IFRS accounting policies. They added that reconciling only total reportable segment amounts to amounts presented in the financial statements does not provide useful information.
- BC41 Other respondents supported the proposed reconciliations on the grounds that more detailed reconciliations would not be more understandable to users and might be confusing. They believed that the additional costs to reporting entities were not justified.
- BC42 The Board noted that a requirement to provide reconciliations at the individual reportable segment level would effectively lead to two complete segment reports – one according to internal measures and the other according to IFRSs. The Board concluded that the cost of providing two sets of segment information would outweigh the benefits.

Lack of a competitive harm exemption

- BC43 The Board discussed whether entities should be exempt from aspects of the IFRS if disclosure could cause competitive damage or erosion of shareholder value. The Board considered an alternative approach whereby entities could be required to provide reasons for non-disclosure on a 'comply or explain' basis.
- BC44 The Board concluded that a 'competitive harm' exemption would be inappropriate because it would provide a means for broad non-compliance with the IFRS. The Board noted that entities would be unlikely to suffer competitive harm from the required disclosures since most competitors have sources of detailed information about an entity other than its financial statements.
- BC45 Respondents also commented that the requirements of the IFRS would place small listed companies at a disadvantage to non-listed companies, which are outside the scope of the IFRS. The Board noted that the relative advantage/disadvantage of an entity being publicly listed is not a matter for the Board to consider.

Adoption of the term ‘impracticable’

- BC46 Some respondents to ED 8 expressed concern that entities were to be allowed not to give entity-wide disclosures about products and services and geographical areas if ‘... the necessary information is not available and the cost to develop it would be excessive.’ They argued that the test to be applied for non-disclosure should be that of impracticability as defined in IAS 1 *Presentation of Financial Statements*.
- BC47 The Board noted that the wording in ED 8 ensures convergence with SFAS 131. Using the term ‘impracticable’ as defined in IAS 1 would change the requirement and create divergence from SFAS 131. Therefore, the Board decided to retain the wording of ED 8.

Entity-wide disclosures

Geographical information

- BC48 The IFRS requires an entity to disclose geographical information about non-current assets, excluding specified items. The Board considered comments made by some respondents who advocated country-by-country disclosure, others who requested specific items of geographical information to be disclosed, and some who expressed reservations with the proposed requirement relating to disclosure of country of domicile.
- BC49 A coalition of over 300 organisations from more than 50 countries known as the Publish What You Pay campaign requested that the scope of the IFRS should be extended to require additional disclosure on a country-by-country basis. The objective of such additional disclosure would be to promote greater transparency in the management of amounts paid by the oil, gas and mining industries to governments in developing or transitional countries that are resource-rich. The view of these campaigners was that publication of specific payments made by those companies to governments is in the interest of all users of financial statements.
- BC50 Because the IFRS is being developed in a short-term convergence project to converge with SFAS 131, the Board decided that issues raised by the Publish What You Pay campaign relating to country-by-country disclosures should not be addressed in the IFRS. The Board was of the view that such issues merit further discussion with bodies that are currently engaged in similar issues, for example the United Nations, International Public Sector Accounting Standards Board, International Monetary Fund, World Bank, regional development banks and Financial Stability Forum.

Exemption from entity-wide disclosures

- BC51 Several respondents suggested different geographical disclosures from those proposed in ED 8. For example, some preferred disclosures by geographical areas rather than by individual country. Others favoured geographical disclosure of profit or loss as well as non-current assets. Several respondents expressed the view that disclosure of total assets would be more relevant than

non-current assets. Some took the view that disclosures should be made of both current and non-current assets. Other respondents recommended that financial assets should be disclosed as well as non-current assets. Some respondents expressed the view that disclosure of non-current assets should not be required if those amounts are not reviewed by the chief operating decision maker.

- BC52 In developing ED 8, the Board decided to adopt the requirements in SFAS 131. Paragraphs 104–107 of the Basis for Conclusions on SFAS 131 provide the rationale for the geographical disclosures required.
- BC53 None of the suggested alternative disclosures was broadly supported by the user responses. The Board noted that entities that wish to give additional information are free to do so. The Board therefore concluded that the disclosure requirement taken from SFAS 131 should not be changed.

Country of domicile

- BC54 Some respondents asserted that disclosures relating to the country of domicile were inappropriate for many entities. They expressed the view that such information would be relevant when a large proportion of an entity's business is carried out in its country of domicile. They noted, however, that in many circumstances the country of domicile represents a small proportion of the entity's business and in these cases the information required would not be relevant. In addition, they argued that SFAS 131 had been designed for entities in the US, for whom the 'country of domicile' is in itself a significant geographical area. These respondents suggested that disclosures should instead be required about the country of principal activities.
- BC55 The IFRS requires disclosures for any country that is individually material. The Board noted that identifying the country of principal activities may be difficult and subjective. Accordingly, the Board decided not to require entities to identify the country of principal activities.

Subtotal for tangible non-current assets

- BC56 Paragraphs 14 and 15 of the Basis for Conclusions on ED 8 highlighted a potential difference from SFAS 131. SFAS 131 requires disclosure of 'long-lived assets' excluding intangible assets, whereas ED 8 proposed disclosure of 'non-current assets' including intangible assets. The Board reconsidered whether, in the interest of convergence, the IFRS should require disclosure of the subtotal of tangible non-current assets.
- BC57 The Board concluded that a separate disclosure of a subtotal of tangible non-current assets was unnecessary on the grounds that the incremental benefit does not justify such disclosure. However, the Board noted that entities that wish to provide that information are free to do so.

Information about major customers

- BC58 ED 8 proposed that, in respect of the disclosures about major customers, a group of entities known to be under common control should be treated as a single customer. Some respondents noted that this could be difficult when entities are state-controlled. The Board noted that it was considering proposals to amend IAS 24 *Related Party Disclosures* with regard to state-controlled entities, and a consequential amendment to the IFRS on reporting segments might result from those proposals. In the meantime, the Board decided to require in the IFRS that a government (whether national, state, provincial, territorial, local or foreign) and entities known to the reporting entity to be controlled by that government should be treated as a single customer. This makes the requirements relating to government-controlled entities the same as those relating to privately controlled entities.

Interim financial information

- BC59 The Board decided that the changes to IAS 34 *Interim Financial Reporting* proposed in ED 8 should be amended to clarify that interim disclosure of information on segment profit or loss items is required only if the specified amounts are included in the measure of segment profit or loss reviewed by the chief operating decision maker. The Board reached this conclusion because it noted that such disclosure is consistent with the management approach.

Differences from SFAS 131

- BC60 In developing the IFRS, the Board included the following differences from SFAS 131:
- (a) 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. Non-current assets in the IFRS include intangibles (see paragraphs BC56 and BC57).
 - (b) SFAS 131 does not require disclosure of a measure of segment liabilities. The IFRS requires disclosure of segment liabilities if such a measure is regularly provided to the chief operating decision maker (see paragraphs BC36–BC38).
 - (c) SFAS 131 requires an entity with a matrix form of organisation to determine operating segments based on products and services. The IFRS requires such an entity to determine operating segments by reference to the core principle of the IFRS (see paragraph BC27).

Transitional provisions

- BC61 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.
- BC62 The Board did not agree with the transitional provision for interim financial statements in SFAS 131. The Board noted that the IFRS is not effective until 2009, giving entities adequate time to prepare. Furthermore, the Board was aware that some entities adopting IFRSs for the first time may wish to present comparative information in accordance with the IFRS rather than IAS 14.

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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]

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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,³ 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 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

³ 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.

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 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.

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 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 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.

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.

IFRS 8 BC

Appendix B **Amendments to Basis for Conclusions on other IFRSs**

This appendix contains amendments to the Basis for Conclusions on other IFRSs that are necessary in order to note the replacement of IAS 14 by IFRS 8.

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The amendments contained in this appendix when IFRS 8 was issued in 2006 have been incorporated into the text of the Basis for Conclusions on IFRSs 1, 6 and 7 and IASs 27 and 36 as issued at 30 November 2006.

Dissenting opinions

Dissent of Gilbert Gélard and James J Leisenring

- DO1 Messrs Gélard and Leisenring dissent from the issue of the 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.
- DO2 By not defining segment profit or loss, the 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. Messrs Gélard and Leisenring believe that the 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.
- DO3 Messrs Gélard and Leisenring 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 that the 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.
- DO4 Messrs Gélard and Leisenring support the management approach for defining reportable segments and support requiring disclosure of selected segment information in interim financial reports. They 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 IFRS and applied to segments identified by the management approach. They believe that proper external reporting of segment information should not permit the use of non-GAAP measures because they might mislead users.
- DO5 Messrs Gélard and Leisenring also believe that the changes from IAS 14 are not justified by the need for convergence with US GAAP. IAS 14 is a disclosure standard and therefore does not affect the reconciliation of IFRS amounts to US GAAP, though additional disclosure from what is required now by IAS 14 might be needed to comply with US GAAP.

Dissent of Stephen Cooper from the amendment issued in April 2009

- DO1 Mr Cooper dissents from the amendment to IFRS 8 *Operating Segments* made by *Improvements to IFRSs* issued in April 2009.
- DO2 In his view the changes are unnecessary considering that the provisions in the *Framework*⁴ regarding materiality already enable a reporting entity not to disclose segment assets when those assets are small relative to segment profit and not relevant to the understanding of the business. Mr Cooper believes that allowing a reporting entity not to disclose segment assets merely because this is not reported to the chief operating decision maker weakens IFRS 8, and may result in segment assets not being disclosed even when they are important to understanding the performance and financial position of that business.

⁴ The reference to the *Framework* is to the IASC's *Framework for the Preparation and Presentation of Financial Statements*, adopted by the Board in 2001 and in effect when the Standard was amended.