New Zealand Society of Accountants

STATEMENT OF STANDARD
ACCOUNTING PRACTICE NO. 23
1989

FINANCIAL REPORTING FOR SEGMENTS

Issued by the Council, New Zealand Society of Accountants

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This Statement should be read in the context of the Explanatory Foreword to Statements of Standard Accounting Practice.

1 INTRODUCTION

1.1 This Statement deals with the reporting of financial information concerning significant segments of a business entity.

1.2 The purpose of this Statement is to set standards requiring reporting entities to disclose in their financial statements information on industry and geographical segments whenever it is significant to an understanding of those statements. Where consolidated financial statements are presented, segmental information need be presented only in the consolidated financial statements and not in the parent entity's financial statements.

2 APPLICATION

2.1 The Standard in this Statement applies to the audited external financial statements of all entities other than wholly owned subsidiaries of entities reporting in

New Zealand. However, in the interest of more informative reporting, compliance with the Standard in this Statement is strongly recommended for all entities preparing external financial statements.

2.2 This Statement becomes operative for financial statements covering periods commencing on or after **1 April 1990.**

3 DEFINITIONS

The following terms are used in this Statement with the meanings specified.

3.1 *Geographical segment* means a distinguishable component of a reporting entity engaged in operations in individual countries or groups of countries.

3.2 *Foreign geographical segment* means a geographical segment, other than New Zealand, which serves a purpose beyond facilitating export sales from the reporting entity's domestic operations.

3.3 *Industry segment* means a distinguishable component of a reporting entity, where such component is engaged in providing product(s) and/or service(s) primarily to customers outside the reporting entity.

3.4 *Reportable segment* means a segment for which financial information is significant to an understanding of the financial statements.

3.5 *Segment assets* means all assets used exclusively by a segment and that portion of assets used jointly by two or more segments that can be allocated to individual segments on a reasonable basis.

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

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

3.8 *Segment result* means the difference between segment revenue and segment expenses.

4 DISCUSSION

Reasons for Segmental Reporting

4.1 The growth and product diversification of companies and the increasing number of export products and markets has resulted in the aggregation of non-homogeneous financial information. This has been exemplified in New Zealand by mergers and takeovers. With each combination there is a loss of information, since entities which previously reported separately now report only as a single entity.

4.2 In addition to mergers and takeovers, a number of entities have diversified their products, services and markets among industry and geographical segments.

4.3 Rates of profitability, opportunities for growth, future prospects, and risks to investments may vary greatly among industry and geographical segments. The operations and results of different industry and geographical segments may be subject to a variety of special risks such as the effects of technological change, the degree of government assistance, exchange rate fluctuations, international trade competition and political instability. Thus, users of financial statements need segment information to assess the prospects and risks of a diversified entity which may not be determinable from the aggregated data.

The objective of presenting information by segments is to provide users of financial statements with information on the relative size, profit contribution, and growth trend of the different industries and different geographical areas in which a diversified entity operates to enable those users to make more informed judgements about the entity as a whole.

4.4 Segmental information is not intended to convey the impression that such segments may be considered as independent businesses or that comparisons between similarly labelled segments of different enterprises would necessarily be valid. Where segments are not severable or operationally independent businesses, their results need to be interpreted within the context of the organisational structure of the reporting entity.

4.5 Concern is sometimes expressed that disclosing information about segments may weaken an entity's competitive position because more detailed information is made available to competitors, customers, suppliers and others. For this reason, some consider it appropriate to allow the withholding of certain segmental information where disclosure is deemed to be detrimental to the enterprise. However, the required disclosures about segments are no more detailed or specific than the disclosures typically provided by an entity that operates in a single activity. The information required to be reported is intended primarily to permit users of financial statements to make better assessments of the past performance and future prospects of an entity operating in more than one activity.

4.6 Reporting segmental information involves decisions that are based in part on judgement. Such decisions include the identification of segments and the allocation of revenues and expenses to those segments. Information about the bases used in the preparation of segmental reporting enhances the user's understanding of the resulting data.

4.7 Industry segments and geographical segments are the usual bases for presenting information on operations by segment. An entity would provide information on both bases if both are applicable to its operations.

Identification of Industry Segments

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

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

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

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

(d) markets and marketing methods.

4.9 Organisational groupings such as divisions, subsidiaries, or branches, are ordinarily created according to management requirements. Such groupings often correspond with the determinable segments of the enterprise, thus facilitating segment reporting. Where this is not the case, segment reporting may require reclassification of data.

4.10 There are a number of accepted industry classifications which may provide a reporting entity with information to assist in identifying industry segments. For example, industry classifications have been adopted by the Department of Statistics, the Reserve Bank of New Zealand and the New Zealand Stock Exchange.

4.11 It is relevant to consider the interrelationships among an entity's activities. For example, it may be potentially misleading to report as separate industry segments, parts of an entity's activities that are significantly integrated or interdependent. The same considerations would not necessarily apply in determining geographical segments to be reported.

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

Identification of Geographical Segments

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

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

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

(a) physical location of the operations;

(b) proximity of operations in each country;

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

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

Determining Reportable Segments

4.16 After a reporting entity has been divided into industry and geographical segments, it is necessary to decide whether particular segments are significant and so warrant separate disclosure. The significance of a segment to the reporting entity as a whole can be measured in terms of revenue, profits or losses generated, or assets employed. In the absence of other factors a segment would be considered material if one or more of the following conditions applied:

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

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

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

  (ii) the total segment result of all segments that incurred a loss;

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

The 10 percent guideline in (b) is illustrated in Appendix 2 of this Statement.

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

4.18 The results from applying the guidelines in paragraph 4.16 are to be evaluated from the viewpoint of inter-period comparability. For instance, a segment that has been significant in the past, and is expected to be significant in the future, would be disclosed as a reportable segment despite failure in the current period to be identified by the guidelines as a significant segment. Conversely, it would be inappropriate to report on an immaterial segment that meets the guidelines only because of a temporary aberration in the results of other segments. When instances such as the above arise from strict application of the guidelines, the particular circumstances need to be explained.

4.19 A reporting entity that operates predominantly in one industry need only provide a description of the industry in which it operates. A reporting entity is considered, prima facie, to be operating predominantly in one industry when the dominant segment's revenue, segment result and segment assets (as defined respectively in paragraphs 3.6, 3.8 and 3.5) each constitute more than 90 percent of the related totals for all industry segments; in which case no other segment would meet any of the 10 percent guidelines given in paragraph 4.16.

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

4.21 There is a need for a practical limit to the number of industry segments and geographical segments for which an entity should report segmental information. It is suggested that, when the number of reportable industry and geographical segments exceeds 10 each, consideration should be given to whether or not a practical limit has been reached. Beyond that number of segments it may be appropriate to combine the most closely related industry and geographical segments into broader reportable segments. If this is done there should be disclosure of the circumstances and the action taken.

Segment Revenue and Expense

4.22 The basis for classifying items of revenue and expense as attributable to a particular segment will vary across reporting entities and may be influenced by the autonomy of each of the segments within the reporting entity.

4.23 Where revenue and expense are not directly attributable to a segment but a reasonable basis for allocation exists, they maybe allocated thereto on that basis. Where allocation of an item of revenue or expense cannot be made to segments on a reasonable basis no allocation is to be made and the unallocated amount is to be adjusted against the total result of all segments in disclosing operating profit for the reporting entity.

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

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

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

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

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

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

Segment Result

4.27 The only measure of profitability required in this Statement is the segment result for reportable industry and geographical segments. If segment result includes any abnormal items they should be disclosed separately in accordance with Statement of Standard Accounting Practice No. 7, *Extraordinary Items and Prior Period Adjustments.*

4.28 This Statement does not prohibit the disclosure of additional measures of segment profitability. However, if another measure is disclosed, the difference between segment result (as defined) and that other measure should be fully explained.

Segment Assets

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

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

General

4.31 This Statement does not require the disclosure of export sales from New Zealand except to the extent that they fall within industry or geographical segment revenue.

4.32 Industry and geographical segments should be identified and disclosed in a consistent manner. Any changes in the method of grouping should be disclosed and prior period data should be restated.

4.33 There should also be disclosed:

(a) the nature and effect of any change in the method of allocating revenue and expenses to segments or in the basis of accounting for intersegment transactions; and

(b) the effect on segment results of changes in the accounting policies of the entity as a whole.

4.34 This Statement does not require the disclosure of segmental information in interim reports. However, where segmental information is given in interim reports it should be given in accordance with this Statement.

4.35 When an interest in an investee is accounted for by the equity method, separate segmental information about the investee is not required by this Statement. However, it may be desirable to disclose the products and services of the investee and the geographical area in which it operates. In some circumstances it maybe appropriate to include financial information relating to the segments of the investee.

4.36 The following information for each reportable segment is generally considered necessary:

(a) a description of the activities of each reportable industry segment and an indication of the activities and location of each reportable geographical area;

(b) sales or other operating revenues, distinguishing between revenue derived from customers outside the enterprise and revenue derived from other segments;

(c) segment result;

(d) the carrying amount of segment assets;

(e) the basis or intersegment pricing;

(f) abnormal items.

In addition, it may be appropriate to disclose the following for each reportable segment:

(g) the aggregate amount of depreciation, depletion and amortisation expense, and

(h) the number of employees.

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

4.38 The accounting principles applied in determining segmental information should be the same as those underlying the preparation of the financial statements of the entity as a whole. However, intersegment transactions that are eliminated from consolidated financial statements should be reinstated on a basis that corresponds with that used in recording inter-entity transactions for internal accounting purposes.

4.39 Segmental information should be disclosed as part of the financial statements.

5 STANDARD ACCOUNTING PRACTICE

Financial Reporting for Segments

The Standard set out in the following paragraphs should be read in the context of the foregoing paragraphs of this Statement and the Explanatory Foreword to Statements of Standard Accounting Practice issued by the Council of the New Zealand Society of Accountants.

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

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

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

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

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

5.6 For each industry and geographical segment, the following information should be disclosed:

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

(b) segment result;

(c) the carrying amount of segment assets;

(d) the basis of intersegment pricing;

(e) abnormal items.

5.7 The information provided on segment revenue, segment result and segment assets should be aggregated and reconciled to agree with the related information in the financial statements.

5.8 When preparing segmental information, inter-segment transactions that have been eliminated in the preparation of consolidated financial statements should be reinstated.

5.9 The segmental information required by this Statement should be disclosed in and form part of the financial statements.

5.10 Changes in the identification of segments and changes in accounting practices used in reporting segmental information should be disclosed. Such disclosure should include a description of the nature of the change, an explanation of the reasons for the change, and, where the information is reasonably determinable the effect of the change.

5.11 Comparative amounts for the prior period should be disclosed.

Note: Compliance with this Standard will ensure compliance with the International Accounting Standard IAS-14 "Reporting Financial Information by Segment".

APPENDICES

The following appendices do not form part of the Statement of Standard Accounting Practice. The methods of presentation are illustrative only.

(The figures have been adapted from the appendix to ASRB 1005: Financial Reporting by Segments.)

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APPENDIX 1

Example Statement of Operations of Industry and Geographical Segments for year ended 30 June 19x2

INDUSTRY SEGMENTS	Industry A		Industry B		Other Industries		Elimination		Consolidated	
	19x2	19x1	19x2	19x1	19x2	19x1	19x2	19x1	19x2	19x1
	$000		$000		$000		$000		$000	
Operating revenue										
Sales to customers outside the group	9,000	10,000	13,000	9,700	4,000	3,000	–	–	26,000	22,700
Intersegment sales	1,100	1,250	2,200	2,300	–	–	(3,300)	(3,550)	–	–
Unallocated revenue	–	–	–	–	–	–	–	–	2,000	1,000
Total revenue[1]	10,100	11,250	15,200	12,000	4,000	3,000	(3,300)	(3,550)	28,000	23,700
Segment result	1,900	2,500	3,500	2,400	305	400	(5)	(300)	5,700	5,000
Unallocated expenses									(3,800)	(3,040)
Group operating profit (before equity accounting)									1,900	1,960
Segment assets	25,000	24,000	30,000	25,000	13,930	13,035	(30)	(25)	68,900	62,010
Unallocated assets									10,000	8,150
Total assets									78,900	70,160

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

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

GEOGRAPHICAL SEGMENTS	N.Z.		Australia		Other		Eliminations		Consolidated	
	19x2	19x1	19x2	19x1	19x2	19x1	19x2	19x1	19x2	19x1
	$000		$000		$000		$000		$000	
Operating revenue										
Sales to customers outside the group	20,000	18,000	5,000	3,800	1,000	900	–	–	26,000	22,700
Intersegment sales	2,000	1,400	1,600	900	–	–	(3,600)	(2,300)	–	–
Unallocated revenue	–	–	–	–	–	–	–	–	2,000	1,000
Total revenue[1]	22,000	19,400	6,600	4,700	1,000	900	(3,600)	(2,300)	28,000	23,700
Segment result	3,800	3,400	1,800	1,400	200	300	(500)	(300)	5,300	4,800
Unallocated expenses									(3,400)	(2,840)
Group operating profit (before equity accounting)									1,900	1,960
Segment assets	32,000	30,000	24,000	18,000	14,850	12,700	(1,250)	1,880	69,600	62,580
Unallocated assets									9,300	7,580
Total assets									78,900	70,160

Notes: The company operates predominantly in two geographical segments—New Zealand and Australia. The basis of intersegment pricing is (description).

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

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APPENDIX 2

This example of five industry segments illustrates the guideline contained in paragraph 4.16(b) for determining materiality in the event of a segment incurring losses.

Determining Material Segments

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

Segments A, B and D are material under the guideline because the amount of segment result for each of these segments is greater than 10 percent of $440,000 which in turn is the greater, in absolute amount, of the total segment result of all segments that earned a profit and the total segment result of all segments that incurred a loss. Those segments which are not material under paragraph 4.16(b) may be material under paragraph 4.16(a) or 4.16(c).