Statement of Financial Accounting Standards No. 14

Note: This Statement has been completely superseded

FAS14 Status Page
FAS14 Summary

Financial Reporting for Segments of a Business Enterprise

December 1976

Financial Accounting Standards Board
of the Financial Accounting Foundation
401 MERRITT 7, P.O. BOX 5116, NORWALK, CONNECTICUT 06856-5116

Statement of Financial Accounting Standards No. 14

Financial Reporting for Segments of a Business Enterprise

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Paragraph Numbers

FAS 14: Financial Reporting for Segments of a Business Enterprise

INTRODUCTION

1. In recent years, many business enterprises have broadened the scope of their activities into different industries, foreign countries, and markets. This Statement requires that the financial statements of a business enterprise (hereinafter enterprise) include information about the enterprise's operations in different industries, its foreign operations and export sales, and its major customers. This Statement also requires that an enterprise operating predominantly or exclusively in a single industry identify that industry.

2. Appendix A contains background information. Appendix B sets forth the basis for the Board's conclusions, including alternatives considered and reasons for accepting some and rejecting others. Appendix C describes two systems that have been developed for classifying business activities, and Appendix D describes a number of factors to be considered in grouping products and services by industry lines. An illustration of applying paragraph 15(b) is presented in Appendix E, and illustrations of the disclosures required by this Statement are presented in Appendix F.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Inclusion in Financial Statements

3. When an enterprise issues a complete set of financial statements that present financial position at the end of the enterprise's fiscal year and results of operations and changes in financial position for that fiscal year in conformity with generally accepted accounting principles, those financial statements shall include certain information relating to:

a. The enterprise's operations in different industries—paragraphs 9-30.
b. Its foreign operations and export sales—paragraphs 31-38.

c. Its major customers—paragraph 39.

If such statements are presented for more than one fiscal year, the information required by this Statement shall be presented for each such year, except as provided in paragraph 41.

4. If an enterprise issues for interim period a complete set of financial statements that are expressly described as presenting financial position, results of operations, and changes in financial position in conformity with generally accepted accounting principles, this Statement requires that the information referred to in paragraph 3 be included in those interim financial statements. If an enterprise issues for an interim period financial statements that are not a complete set or are otherwise complete but not expressly described as presenting financial position, results of operations, and changes in financial position in conformity with generally accepted accounting principles, this Statement does not require that the information referred to in paragraph 3 be included in those interim financial statements.

Purpose of Segment Information

5. The purpose of the information required to be reported by this Statement is to assist financial statement users in analyzing and understanding the enterprise's financial statements by permitting better assessment of the enterprise's past performance and future prospects. As noted in paragraph 76, information prepared in conformity with this Statement may be of limited usefulness for comparing a segment of one enterprise with a similar segment of another enterprise.

Accounting Principles Used in Preparing Segment Information

6. The information required to be reported by this Statement is a disaggregation of the consolidated financial information [1] included in the enterprise's financial statements. The accounting principles underlying the disaggregated information should be the same accounting principles as those underlying the consolidated information, except that most intersegment transactions that are eliminated from consolidated financial information are included in segment information (see paragraph 8). For example, a segment for which information is required to be reported by this Statement may include a consolidated subsidiary that prepares separate financial statements. Amounts reported in the subsidiary's financial statements sometimes differ from amounts included in consolidation for reasons other than intersegment transactions, for instance, because the subsidiary was acquired in a business combination accounted for by the purchase method. In that event, the segment information required to be reported by this Statement with respect to the consolidated financial statements shall be based on the amounts included in consolidation, not on the amounts reported in the subsidiary's financial statements.

7. Enterprises are not required by this Statement to disaggregate financial information pertaining to unconsolidated subsidiaries or other unconsolidated investees. Unconsolidated subsidiaries and investments in corporate joint ventures and 50 percent or less owned companies

are normally accounted for by the equity method, and financial information about equity method investees is required to be disclosed in the investor's financial statements in accordance with paragraph 20 of *APB Opinion No. 18,* "The Equity Method of Accounting for Investments in Common Stock." In addition, *ARB No. 43,* Chapter 12, "Foreign Operations and Foreign Exchange," requires the disclosure of certain financial information about foreign subsidiaries of an enterprise. This Statement does not amend those disclosure requirements. However, in addition to those disclosures, identification shall be made of both the industries and the geographic areas in which the equity method investees operate. Also, paragraph 27(c) of this Statement requires special disclosures with respect to an equity method investee whose operations are vertically integrated with those of a reportable segment of the enterprise. Disaggregation of financial information pertaining to unconsolidated subsidiaries and other unconsolidated equity method investees is encouraged when that is considered to be desirable for an understanding of the enterprise's operations. When a complete set of financial statements that present financial position, results of operations, and changes in financial position in conformity with generally accepted accounting principles is presented for a subsidiary, corporate joint venture, or 50 percent or less owned investee, each such entity is considered to be an enterprise as that term is used in this Statement and thus is subject to its requirements whether those financial statements are issued separately or included in another enterprise's financial report.

8. Transactions between a parent and its subsidiaries or between two subsidiaries are eliminated in preparing consolidated financial statements (see paragraph 6 of *ARB No. 51,* "Consolidated Financial Statements"). In preparing the information required to be reported by this Statement, however, transactions between the segments of an enterprise shall be included in the segment information. Thus, for example, revenue reported for a segment includes both sales to unaffiliated customers (i.e., customers outside the enterprise) and intersegment sales or transfers. Similarly, expenses relating both to sales to unaffiliated customers and to intersegment sales or transfers are deducted in measuring a segment's profitability. Exceptions to the general rule that intersegment transactions are not eliminated from segment information are provided in paragraphs 10(c)-10(e) for certain intersegment advances and loans and related interest revenue and expense. Paragraphs 30 and 38 require reconciliation of segment information with amounts reported in consolidated financial statements.

Information about an Enterprise's Operations in Different Industries

9. The financial statements of an enterprise shall include certain information about the industry segments of the enterprise. Criteria for determining industry segments for which information shall be reported are in paragraphs 11-21. The type of information to be presented for each reportable industry segment is specified in paragraphs 22-27. Requirements for presenting that information in financial statements are in paragraphs 28-30.

Definitions

10. Certain terms are defined for purposes of this Statement as follows:

a. *Industry segment.*[2] A component of an enterprise engaged in providing a product or service or a group of related products and services primarily to unaffiliated customers (i.e., customers outside the enterprise) for a profit.[3] By defining an industry segment in terms of products and services that are sold primarily to unaffiliated customers, this Statement does not require the disaggregation of the vertically integrated operations of an enterprise.

b. *Reportable segment.* An industry segment (or, in certain cases, a group of two or more closely related industry segments—see paragraph 19) for which information is required to be reported by this Statement.

c. *Revenue.* The revenue of an industry segment includes revenue both from sales [4] to unaffiliated customers (i.e., revenue from customers outside the enterprise as reported in the enterprise's income statement) and from intersegment sales or transfers, if any, or products and services similar to those sold to unaffiliated customers.[5] Interest from sources outside the enterprise and interest earned on intersegment trade receivables is included in revenue if the asset on which the interest is earned is included among the industry segment's identifiable assets (see paragraph 10(e)), but interest earned on advances or loans or other industry segments is not included.[6] For purposes of this Statement, revenue from intersegment sales or transfers shall be accounted for on the basis used by the enterprise to price the intersegment sales or transfers.

d. *Operating profit or loss.* The operating profit or loss of an industry segment is its revenue as defined in paragraph 10(c) minus all operating expenses. As used herein, operating expenses include expenses that relate to both revenue from sales to unaffiliated customers and revenue from intersegment sales or transfers; those operating expenses incurred by an enterprise that are not directly traceable to an industry segment shall be allocated on a reasonable basis among those industry segments for whose benefit the expenses were incurred (see paragraph 24). For purposes of this Statement, intersegment purchases shall be accounted for on the same basis as intersegment sales or transfers (i.e., on the basis used by the enterprise to price the intersegment sales or transfers—see the last sentence of paragraph 10(c)). None of the following shall be added or deducted, as the case may be, in computing the operating profit or loss of an industry segment: revenue earned at the corporate level and not derived from the operations of any industry segment; general corporate expenses;[7] interest expense;[8] domestic and foreign income taxes; equity in income or loss from unconsolidated subsidiaries and other unconsolidated investees; gain or loss on discontinued operations (as defined in *APB Opinion No. 30,* "Reporting the Results of Operations"); extraordinary items; minority interest; and the cumulative effect of a change in accounting principles (see *APB Opinion No. 20,* "Accounting Changes").

e. *Identifiable assets.* The identifiable assets of an industry segment are those tangible and intangible enterprise assets that are used by the industry segment, including (i) assets that are used exclusively by that industry segment and (ii) an allocated portion of assets used jointly by two or more industry segments. Assets used jointly by two or more industry segments shall be allocated among the industry segments on a reasonable basis. Because the assets of an industry segment that transfers products or services to another industry segment are not used in the operations of the receiving segment, no amount of those assets shall be allocated to the receiving segment. Assets that represent part of an enterprise's investment in an industry segment, such as goodwill, shall be included in the industry segment's identifiable assets.[9] Assets maintained for general corporate purposes (i.e., those not used in the operations of any industry segment) shall not be allocated to industry segments. The identifiable assets of an industry segment shall not include advances or loans to or investments in another industry segment, except that advances or loans to other industry segments shall be included in the identifiable assets of a financial segment because the income therefrom is included in computing the financial segment's operating profit or loss (see footnote 6). Asset valuation allowances such as the following shall be taken into account in computing the amount of an industry segment's identifiable assets: allowance for doubtful accounts, accumulated depreciation, and marketable securities valuation allowance.

Determining Reportable Segments

11. The reportable segments of an enterprise shall be determined by (a) identifying the individual products and services from which the enterprise derives its revenue, (b) grouping those products and services by industry lines into industry segments (see paragraphs 12-14), and (c) selecting those industry segments that are significant with respect to the enterprise as a whole (see paragraphs 15-21).

Grouping Products and Services by Industry Lines

12. Several systems have been developed for classifying business activities, such as the Standard Industrial Classification (SIC) and the Enterprise Standard Industrial Classification (ESIC). (The SIC and ESIC systems are described in Appendix C to this Statement.) The Board has examined those systems and has judged that none is, by itself, suitable to determine industry segments for purposes of this Statement. Moreover, although certain characteristics can be identified that assist in differentiating among industries (such as those discussed in Appendix D to this Statement), no single set of characteristics is universally applicable in determining the industry segments of all enterprises, nor is any single characteristic determinative in all cases. Consequently, determination of an enterprise's industry segments must depend to a considerable extent on the judgment of the management of the enterprise.

13. Many enterprises presently accumulate information about revenue and profitability on a less-than-total-enterprise basis for internal planning and control purposes. Frequently, that type of information is maintained by profit centers for individual products and services or for groups of related products and services, particularly with respect to an enterprise's domestic operations. The term "profit center" is used in this Statement to refer only to those components of an enterprise t*hat sell primarily to outside markets and for which information about revenue and profitability is accumulated.* An enterprise's existing profit centers—the smallest units of activity for which revenue and expense information is accumulated for internal planning and control purposes—represent a logical starting point for determining the enterprise's industry segments. If an enterprise's existing profit centers cross industry lines, it will be necessary to

disaggregate its existing profit centers into smaller groups of related products and services (except as provided in paragraph 14). If an enterprise operates in more than one industry but does not presently accumulate any information on a less-than-total-enterprise basis (i.e., its only profit center is the enterprise as a whole), it shall disaggregate its operations along industry lines (except as provided in paragraph 14).

14. Industry segmentation on a worldwide basis is a desirable objective but it may be impracticable for some enterprises. To the extent that revenue and profitability information is accumulated along industry lines for an enterprise's foreign operations, as defined in paragraph 31, or that it would be practicable to do so, industry segments shall be determined on a worldwide basis. To the extent that it is impracticable to disaggregate part or all of its foreign operations along industry lines, the enterprise shall disaggregate along industry lines its domestic operations and its foreign operations for which disaggregation is practicable and shall treat the aggregate of its foreign operations for which disaggregation is not practicable as a single industry segment. When that segment qualifies as a reportable industry segment (see paragraphs 15-21), disclosure shall be made of the types of industry operations included in the foreign operations that have not been disaggregated.

Selecting Reportable Segments

15. Each industry segment that is significant to an enterprise as a whole shall be identified as a reportable segment. For purposes of this Statement, an industry segment shall be regarded as significant—and therefore identified as a reportable segment (see paragraph 16)—if it satisfies one or more of the following tests. The tests shall be applied separately for each fiscal year for which financial statements are presented, except as provided in paragraph 41.

a) Its revenue (including both sales to unaffiliated customers and intersegment sales or transfers) is 10 percent or more of the combined revenue (sales to unaffiliated customers and intersegment sales or transfers) of all of the enterprise's industry segments.
b) The absolute amount of its operating profit or operating loss is 10 percent or more of the greater, in absolute amount, of:
   (i) The combined operating profit of all industry segments that did not incur an operating loss, or
   (ii) The combined operating loss of all industry segments that did incur an operating loss. (Appendix E illustrates the application of paragraph 15(b).)
c) Its identifiable assets are 10 percent or more of the combined identifiable assets of all industry segments.

Revenue, operating profit or loss, and identifiable assets relating to those foreign operations that have not been disaggregated along industry lines on grounds of impracticability (see paragraph 14) shall be included in computing the combined revenue, combined operating profit or operating loss, and combined identifiable assets of the enterprise's industry segments.

16. The results of applying the percentage tests in paragraph 15 shall be evaluated from the

standpoint of interperiod comparability before final determination of an enterprise's reportable segments is made. For instance, interperiod comparability would most likely require that an industry segment that has been significant in the past and is expected to be significant in the future be regarded as a reportable segment even though it fails to satisfy the tests in paragraph 15 in the current year. Conversely, a relatively insignificant industry segment may happen to satisfy the tests in paragraph 15 in the current fiscal year because its revenue or operating profit or loss is abnormally high or the combined revenue or operating profit or loss of all industry segments is abnormally low. In that case, it may be inappropriate to regard it as a reportable segment. Appropriate explanation of such circumstances shall be included as a part of the enterprise's segment information.

17. The reportable segments of an enterprise shall represent a substantial portion of the enterprise's total operations. The following test shall be applied to determine whether a substantial portion of an enterprise's operations is explained by its segment information: The combined revenue from sales to unaffiliated customers of all reportable segments (that is, revenue not including intersegment sales or transfers) shall constitute at least 75 percent of the combined revenue from sales to unaffiliated customers of all industry segments. The test shall be applied separately for each fiscal year for which financial statements are presented, except as provided in paragraph 41. Revenue relating to those foreign operations that have not been disaggregated along industry lines on grounds of impracticability shall be included in the denominator of the computation required by this paragraph and will be included in the numerator if those operations have been identified (in accordance with paragraphs 14 and 15) as a reportable segment.

18. If the industry segments identified as reportable in accordance with paragraphs 15 and 16 do not satisfy the 75-percent test in paragraph 17, additional industry segments shall be identified as reportable segments (subject to the provisions of paragraph 19) until the 75-percent test is met.

19. The Board recognizes the need for a practical limit to the number of industry segments for which an enterprise reports information; beyond that limit, segment information may become overly detailed. Without attempting to define that limit precisely, the Board suggests that as the number of industry segments that would be identified as reportable segments in accordance with paragraphs 15-18 increases above 10, the question of whether a practical limit has been reached comes increasingly into consideration, and combining the most closely related industry segments into broader reportable segments may be appropriate. Combinations shall be made, however, only to the extent necessary to contain the number of reportable segments within practical limits while still meeting the 75-percent test.

20. An enterprise may operate exclusively in a single industry or a dominant portion of an enterprise's operations may be in a single industry segment with the remaining portion in one or more other industry segments. The Board has concluded that the disclosures required by paragraphs 22-30 of this Statement need not be applied to a dominant industry segment, except

that the financial statements of an enterprise that operates predominantly or exclusively in a single industry shall identify that industry. An industry segment may be regarded as dominant if its revenue, operating profit or loss, and identifiable assets (as defined in paragraphs 10(c)-(e)) each constitute more than 90 percent of related combined totals for all industry segments, and no other industry segment meets any of the 10-percent tests in paragraph 15.

21. Paragraphs 11-20 and the guidelines for grouping products and services into industry segments set forth in Appendix D are not intended to prohibit a more detailed disaggregation if that is considered to be desirable for an understanding of the enterprise's operations.

Information to Be Presented

22. The following shall be presented for each of an enterprise's reportable segments determined in accordance with paragraphs 11-21 (including those foreign operations that have not been disaggregated along industry lines on grounds of impracticability—see paragraph 14) and in the aggregate for the remainder of the enterprise's industry segments not deemed reportable segments:

a) Revenue information as set forth in paragraph 23.
b) Profitability information as set forth in paragraphs 24 and 25.
c) Identifiable assets information as set forth in paragraph 26.
d) Other related disclosures as set forth in paragraph 27.

In addition, the types of products and services from which the revenue of each reportable segment is derived shall be identified, and the accounting policies relevant to the information reported for industry segments shall be described to the extent not adequately explained by the disclosures of the enterprise's accounting policies required by APB *Opinion No. 22,* "Disclosure of Accounting Policies." Presentation of additional information for some or all of an enterprise's reportable segments beyond that specified in paragraphs 23-27 may be considered to be desirable, and this Statement does not preclude those additional disclosures.

23. *Revenue.* Sales to unaffiliated customers and sales or transfers to other industry segments of the enterprise shall be separately disclosed in presenting revenue of a reportable segment. As indicated in paragraph 10(c), for purposes of this Statement sales or transfers to other industry segments shall be accounted for on the basis used by the enterprise to price the intersegment sales or transfers. The basis of accounting for intersegment sales or transfers shall be disclosed. If the basis is changed, disclosure shall be made of the nature of the change and its effect on the reportable segments' operating profit or loss in the period of change.

24. *Profitability.* Operating profit or loss as defined in paragraph 10(d) shall be presented for each reportable segment. As part of its segment information, an enterprise shall explain the nature and amount of any unusual or infrequently occurring items (see paragraph 26 of *APB Opinion No. 30*) reported in its consolidated income statement that have been added or deducted in computing the operating profit or loss of a reportable segment in accordance with paragraph

10(d). Methods used to allocate operating expenses among industry segments in computing operating profit or loss should be consistently applied from period to period (but, if changed, disclosure shall be made of the nature of the change and its effect on the reportable segments' operating profit or loss in the period of change).

25. *Other profitability information.* In addition to presenting operating profit or loss as required by paragraph 24, an enterprise may choose to present some other measure of profitability for some or all of its segments. If the enterprise elects to present a measure of contribution to operating profit or loss, the enterprise shall describe the differences between contribution and operating profit or loss. If the enterprise elects to present net income or a measure of profitability between operating profit or loss and net income, the nature and amount of each category of revenue or expense that was added or deducted and the methods of allocation, if any, shall be disclosed. Those methods should be consistently applied from period to period (but, if changed, disclosure shall be made of the nature and effect of the change in the period of change).

26. *Identifiable assets.* The aggregate carrying amount of identifiable assets as defined in paragraph 10(e) shall be presented for each reportable segment.

27. *Other related disclosures.* Disclosures relating to the information for reportable segments shall be made as follows:

a) Disclosure shall be made of the aggregate amount of depreciation, depletion, and amortization expense for each reportable segment.
b) Disclosure shall be made of the amount of each reportable segment's capital expenditures, i.e., additions to its property, plant, and equipment.
c) For each reportable segment disclosure shall be made of the enterprise's equity in the net income from and investment in the net assets of unconsolidated subsidiaries and other equity method investees whose operations are vertically integrated with the operations of that segment. Disclosure shall also be made of the geographic areas in which those vertically integrated equity method investees operate.
d) Paragraph 17 of *APB Opinion No. 20* requires that the effect on income of a change in accounting principle be disclosed in the financial statements of an enterprise in the period in which the change is made. Disclosure shall also be made of the effect of the change in the operating profit of reportable segments in the period in which the change is made.[10]

Methods of Presentation

28. Information about the reportable segments of a business enterprise shall be included in the enterprise's financial statements in any of the following ways:

a) Within the body of the financial statements, with appropriate explanatory disclosures in the footnotes to the financial statements.

b) Entirely in the footnotes to the financial statements.
c) In a separate schedule that is included as an integral part of the financial statements. If, in a report to securityholders, that schedule is located on a page that is not clearly a part of the financial statements, the schedule shall be referenced in the financial statements as an integral part thereof.

29. Financial information such as revenue, operating profit or loss, and identifiable assets of reportable segments shall be presented as dollar amounts. Corresponding percentages may be shown in addition to dollar amounts.

30. The information required to be presented by paragraphs 22-27 for individual reportable segments and in the aggregate for industry segments not deemed reportable shall be reconciled to related amounts in the financial statements of the enterprise as a whole, as follows: Revenue shall be reconciled to revenue reported in the consolidated income statement, and operating profit or loss shall be reconciled to pretax income from continuing operations (before gain or loss on discontinued operations, extraordinary items, and cumulative effect of a change in accounting principle) in the consolidated income statement. Also, identifiable assets shall be reconciled to consolidated total assets, with assets maintained for general corporate purposes separately identified in the reconciliation. An illustration is presented in Appendix F to this Statement.

Information about Foreign Operations and Export Sales

31. The financial statements of an enterprise shall include information about its foreign operations. The features that identify an operation as foreign vary among enterprises. Thus, the identification of foreign operations will depend on the facts and circumstances of the particular enterprise. For purposes of this Statement, an enterprise's foreign operations include those revenue-producing operations (except for unconsolidated subsidiaries and other unconsolidated investees (see paragraph 7)) that (a) are located outside of the enterprise's home country (the United States for U.S. enterprises)[11] and (b) are generating revenue either from sales to unaffiliated customers or from intraenterprise sales or transfers between geographic areas.[12] Similarly, an enterprise's domestic operations include those revenue-producing operations of the enterprise located in the enterprise's home country that generate revenue either from sales to unaffiliated customers or from intraenterprise sales or transfers between geographic areas. Operations, either domestic or foreign, (and regardless of whether part of a branch or division of the enterprise or part of a consolidated subsidiary) should have identified with them the revenues generated by those operations, the assets employed in or associated with generating those revenues, and the costs and expenses incurred in generating those revenues or employing those assets.

32. The information specified in paragraph 35 shall be presented for (1) an enterprise's foreign operations, either in the aggregate or, if appropriate under paragraph 33, by geographic area, and (2) its domestic operations,[13] if either of the following conditions is met:

a) Revenue generated by the enterprise's foreign operations from sales to unaffiliated customers is 10 percent or more of consolidated revenue as reported in the enterprise's income statement.
b) Identifiable assets of the enterprise's foreign operations are 10 percent or more of consolidated total assets as reported in the enterprise's balance sheet.

33. If an enterprise's foreign operations are conducted in two or more geographic areas as defined in paragraph 34, the information specified in paragraph 35 shall be presented separately for each significant foreign geographic area, and in the aggregate for all other foreign geographic areas not deemed significant. A geographic area shall be regarded as *significant,* for the purpose of applying this paragraph, if its revenue from sales to unaffiliated customers or its identifiable assets are 10 percent or more of related consolidated amounts.

34. For purposes of this Statement, foreign *geographic* areas are individual countries or groups of countries as may be determined to be appropriate in an enterprise's particular circumstances. No single method of grouping the countries in which an enterprise operates into the geographic areas can reflect all of the differences among international business environments. Each enterprise shall group its foreign operations on the basis of the differences that are most important in its particular circumstances. Factors to be considered include proximity, economic affinity, similarities in business environments, and the nature, scale, and degree of interrelationship of the enterprise's operations in the various countries.

35. The following information shall be presented for an enterprise's foreign operations and for its domestic operations as appropriate in accordance with paragraphs 32-34:

a) Revenue as defined in paragraph 10(c), with sales to unaffiliated customers and sales or transfers between geographic areas shown separately. For purposes of this Statement, intraenterprise sales or transfers between geographic areas shall be accounted for on the basis used by the enterprise to price the intraenterprise sales or transfers. The basis of accounting for intraenterprise sales or transfers shall be disclosed. If the basis is changed, disclosure shall be made of the nature of the change and its effect in the period of change.
b) Operating profit or loss as defined in paragraph 10(d) or net income or some other measure of profitability between operating profit or loss and net income. A common level of profitability shall be reported for all geographic areas, although an enterprise may choose to report additional profitability information for some or all of its geographic areas of operations.
c) Identifiable assets as defined in paragraph 10(e).

36. With respect to an enterprise's *domestic* operations, sales to unaffiliated customers include both (a) sales to customers within the enterprise's home country and (b) sales to customers in foreign countries, i.e., export sales. If the amount of export sales from an enterprise's home country to unaffiliated customers in foreign countries is 10 percent or more of total revenue from

sales to unaffiliated customers as reported in the enterprise's consolidated income statement, that amount shall be separately reported, in the aggregate and by such geographic areas as are considered appropriate in the circumstances. The disclosure required by this paragraph shall be made even if the enterprise is not required by this Statement to report information about its operations in different industries or foreign operations.

37. Information about the foreign operations and export sales of a business enterprise may be included in the enterprise's financial statements in any of the ways identified in paragraph 28 of this Statement. Financial information shall be presented as U.S. dollar amounts; corresponding percentages may be shown in addition to dollar amounts. The geographic areas into which an enterprise's foreign operations have been disaggregated shall be identified.

38. The information about revenue, profitability, and identifiable assets required to be presented for foreign operations shall be reconciled to related amounts in the financial statements of the enterprise as a whole, in a manner similar to that described in paragraph 30. An illustration is presented in Appendix F to this Statement.

Information about Major Customers

39. If 10 percent or more of the revenue of an enterprise is derived from sales to any single customer, that fact and the amount of revenue from each such customer shall be disclosed. (For this purpose, a group of customers under common control shall be regarded as a single customer.) Similarly, if 10 percent or more of the revenue of an enterprise is derived from sales to domestic government agencies in the aggregate or to foreign governments in the aggregate, that fact and the amount of revenue shall be disclosed. The identity of the industry segment or segments making the sales shall be disclosed. The disclosures required by this paragraph shall be made even if the enterprise is not required by this Statement to report information about operations in different industries or foreign operations.

Restatement of Previously Reported Segment Information

40. When prior period information about an enterprise's reportable industry segments, its foreign operations and export sales, and its major customers is being presented with corresponding information for the current period, the prior period information shall be retroactively restated (at least as far back as the effective date of this Statement—see paragraph 41) in the following circumstances, with appropriate disclosure of the nature and effect of the restatement:

a. When the financial statements of the enterprise as a whole have been retroactively restated, for example, for a change in accounting principle of the type described in paragraphs 27 and 29 of *APB Opinion No. 20* or for a business combination accounted for by the pooling-of-interests method.
b. When there has been a change in the way the enterprise's products and services are grouped

into industry segments or a change in the way the enterprise's foreign operations are grouped [14] into geographic areas and such changes affect the segment or geographic area information being reported.

Effective Date and Transition

41. The provisions of this Statement shall be effective for financial statements for fiscal years beginning after December 15, 1976 and for interim periods [15] within those fiscal years. Earlier application is encouraged in financial statements for periods beginning before December 16, 1976 that have not previously been issued. Information of the type required by this Statement need not be included in financial statements for periods beginning before the effective date of this Statement that are being presented for comparative purposes with financial statements for periods after the effective date, but if included, that information shall be prepared and presented in conformity with the provisions of this Statement to the extent practicable with appropriate explanation if the information for periods before the effective date is not comparable to that for periods after the effective date.

The provisions of this Statement need not be applied to immaterial items.

This Statement was adopted by the unanimous vote of the six members of the Financial Accounting Standards Board:

Marshall S. Armstrong, *Chairman*
Oscar S. Gellein
Donald J. Kirk
Arthur L. Litke
Robert E. Mays
Robert T. Sprouse

Appendix A: BACKGROUND INFORMATION

42. Although the authoritative accounting literature has heretofore dealt principally with financial statements prepared on a consolidated or total-enterprise basis, several pronouncements of the Accounting Principles Board and its predecessor, the Committee on Accounting Procedure, have required business enterprises to report information on a less-than-total-enterprise basis in a limited number of areas. For example, Chapter 12 of *ARB No. 43* requires certain disclosures related to an enterprise's foreign operations; *APB Opinion No. 18* requires disclosure of information about companies accounted for by the equity method; and *APB Opinion No. 30* requires information about the discontinued operations of a segment of a business.

43. Starting in the mid-1960s, a number of professional organizations, including the Financial Analysts Federation, the Financial Executives Research Foundation, and the National Association of Accountants, sponsored research studies to assess the desirability and feasibility of disclosing information for line-of-business segments in external financial reports. Several professional organizations have issued pronouncements that generally support segment reporting, including the APB (its Statement No. 2, "Disclosure of Supplemental Financial Information by Diversified Companies," issued in 1967, urged companies to report segment information voluntarily), the Financial Accounting Policy Committee of the Financial Analysts Federation, the Financial Executives Institute, the Committee on Management Accounting Practices of the National Association of Accountants, and the Accountants International Study Group.

44. In 1969, the Securities and Exchange Commission issued requirements for reporting line-of-business information in registration statements. In 1970, those requirements were extended to annual reports filed with the SEC on Form 10-K, and in October 1974 they were extended to the annual reports to securityholders of companies filing with the SEC.

45. In 1973, the New York Stock Exchange issued a "white paper" urging that line-of-business information at least as extensive as that required in SEC Form 10-K be included in annual reports to securityholders.

46. In 1974, the Federal Trade Commission initiated an annual line-of-business reporting program to enable it to publish aggregate data on corporations engaged in commerce in the United States. Under the FTC program, large manufacturing companies are required to report detailed financial information for each line of business as defined by the FTC.[16]

47. In recognition of the broadened scope of operations of many business enterprises, the need for disaggregation of enterprise-wide information expressed by many financial statement users, and the variety of present reporting practices in reports to securityholders, in April 1973 the FASB placed on its technical agenda a project on Financial Reporting for Segments of a Business Enterprise.

48. A task force of 16 persons from industry, government, public accounting, the financial community, and academe was appointed in May 1973 to counsel the Board in preparing a Discussion Memorandum analyzing issues related to the project.

49. A considerable number of research studies and articles on the subject were available to the Board, many of which were summarized or identified in the Discussion Memorandum. In addition, two research reports were prepared by the FASB staff. One was a survey of the existing reporting practices of 100 companies disclosing segment information in annual reports to shareholders. The other, involving field interviews of corporate executives of 30 companies, was directed primarily at identifying the decision criteria used by management for purposes of

internal and external segmentation. Those research reports were included as appendixes to the Discussion Memorandum.

50. The Board issued the Discussion Memorandum on May 22, 1974 and held a public hearing on the subject on August 1 and 2, 1974. The Board received 144 position papers, letters of comment, and outlines of oral presentations in response to the Discussion Memorandum. Twenty-one presentations were made at the public hearing.

51. An Exposure Draft of a proposed Statement on "Financial Reporting for Segments of a Business Enterprise" was issued on September 30, 1975. The Board received 233 letters of comment on the Exposure Draft.

52. In June 1976, the Organization for Economic Cooperation and Development (OECD) adopted a "Declaration on International Investment and Multinational Enterprises," recommending certain guidelines for a code of conduct for multinational corporations. Those guidelines include, but are not limited to, the following disclosures:

a. The geographical areas where operations are carried out and the principal activities carried on therein by the parent company and the main affiliates.
b. The operating results and sales by geographical area and the sales in the major lines of business for the enterprise as a whole.
c. Significant new capital investment by geographical area and, as far as practicable, by major lines of business for the enterprise as a whole.
d. The policies followed in respect of intergroup pricing.
e. The accounting policies, including those on consolidation, observed in compiling the published information.

The OECD is made up of representatives of the governments of 24 economically developed nations of Western Europe, North America, Asia, and the South Pacific.

Appendix B: BASIS FOR CONCLUSIONS

53. This Appendix discusses factors deemed significant by members of the Board in reaching the conclusions in this Statement, including alternatives considered and reasons for accepting some and rejecting others.

Inclusion in Financial Statements

54. The Board concluded that information relating to an enterprise's industry segments, foreign operations, export sales, and major customers is useful to analyze and understand the financial statements of the enterprise. Reasons for that conclusion are discussed in paragraphs

55-74.

55. The financial statements of an enterprise are usually prepared on a consolidated or total-enterprise basis, aggregating the financial data of the various activities of the enterprise. The principal exception to the rule of consolidation is that financial subsidiaries (such as banks, insurance companies, and finance companies) of a manufacturing company usually are not consolidated (see *ARB No. 51,* "Consolidated Financial Statements," especially paragraphs 1-5). Another exception to the rule of consolidation is that foreign subsidiaries sometimes are not consolidated (see *ARB No. 43,* Chapter 12, "Foreign Operations and Foreign Exchange," especially paragraphs 8 and 9).

56. Investors and lenders who acquire equity interests in or extend credit to an enterprise as a whole recognize the importance of consolidated financial statements for reporting the overall performance of the enterprise. At the same time, however, investors, credit grantors, and other financial statement users have indicated that disaggregation of total-enterprise financial data to provide information about the various segments of an enterprise, in addition to aggregate data for the enterprise, is useful to them.

57. Those financial statement users point out that the evaluation of risk and return is the central element of investment and lending decisions—the greater the perceived degree of risk associated with an investment or lending alternative, the greater is the required rate of return to the investor or lender. If return is defined as expected cash flows to the investor or creditor, the evaluation of risk involves assessment of the uncertainty surrounding both the timing and the amount of the expected cash flows to the enterprise, which in turn are indicative of potential cash flows to the investor or creditor. Users of financial statements indicate that uncertainty results, in part, from factors unique to the particular enterprise in which an investment may be made or to which credit may be extended. Uncertainty also results, in part, from factors related to the industries and geographic areas in which the enterprise operates and, in part, from national and international economic and political factors. Investors and lenders analyze factors at all of those levels to evaluate the risk and return associated with an investment or lending alternative.

58. Information contained in an enterprise's financial statements constitutes an important input to that analysis. Financial statements provide information about conditions, trends, and ratios that assist in predicting cash flows. In analyzing an enterprise, a financial statement user often compares information about the enterprise with information about other enterprises, with industry-wide information, and with national or international economic information in general. Those comparisons are helpful in determining whether a given enterprise's operations may be expected to move with, against, or independently of developments in its industry and in the economy within which it operates.

59. The broadening of an enterprise's activities into different industries or geographic areas complicates the analysis of conditions, trends, and ratios and, therefore, the ability to predict. The various industry segments or geographic areas of operations of an enterprise may have

different rates of profitability, degrees and types of risk, and opportunities for growth. There may be differences in the rates of return on the investment commitment in the various industry segments or geographic areas and in their future capital demands.

60. Consequently, many financial statement users have said that consolidated financial information, while important, would be more useful if supplemented with disaggregated information to assist them in analyzing the uncertainties surrounding the timing and amount of expected cash flows—and, therefore, the risks—related to an investment in or a loan to an enterprise that operates in different industries or areas of the world. Since the progress and prospects of a diversified enterprise are composites of the progress and prospects of its several parts, financial statement users regard financial information on a less-than-total-enterprise basis as also important.

61. Although many business enterprises presently include disaggregated financial information in reports to securityholders, in filings with the Securities and Exchange Commission and in other types of reports, the nature and extent of the information disclosed and the methods of presentation vary, and that information generally is not included in the financial statements.

62. A few respondents to the Discussion Memorandum and the Exposure Draft contended that information on a less-than-total-enterprise basis is not useful to investors and creditors. They generally argued that investors and lenders who acquire equity interests in or extend credit to an enterprise as a whole should be concerned only with overall enterprise results as reported in its consolidated financial statements. For the reasons expressed in paragraphs 55-61, however, the Board concluded that investors and creditors find segment information to be useful in analyzing and understanding consolidated statements and therefore in analyzing overall enterprise results.

63. Although most respondents agreed that information on a less-than-total-enterprise basis is useful for investment and credit decisions, some said that the information should not be included in the financial statements of an enterprise, principally on two grounds:

a. Some said that while segment information may indeed be useful to investors and credit grantors, it is too analytical or interpretive to be classified as accounting information and, thus, does not belong in financial statements.
b. Others said that disaggregated information is not susceptible to the same degree of verifiability as consolidated information.

64. The Board has given careful consideration to those points of view because inclusion of segment information in financial statements is an important question to be resolved in this project. The Board does not agree that segment information of the type required to be reported by this Statement is too analytical or interpretive to be properly classified as accounting information. The information called for by this Statement is a rearrangement (that is, a disaggregation) of information included in an enterprise's consolidated financial statements, as is the information required in the statement of changes in financial position a rearrangement of

information reported in or underlying the balance sheet and income statement. Thus, in the Board's judgment, this Statement does not go beyond or enlarge the boundaries of accounting, as some have contended.

65. As to the question of verifiability, the Board recognizes that disaggregated information is subject to certain limitations and that some of it may not be susceptible to the *same degree* of verifiability as some of the consolidated information. The Board believes, however, that the more critical question to be addressed is whether the disaggregated information is *sufficiently* verifiable to warrant its inclusion in an enterprise's financial statements.

66. Verifiability is identified in *APB Statement No. 4,* "Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises," as one of the qualitative objectives of financial accounting. Paragraph 90 of that Statement says:

> Verifiable financial accounting information provides results that would be substantially duplicated by independent measures using the same measurement methods.

That paragraph further states:

> Measurements cannot be completely free from subjective opinions and judgments. The process of measuring and presenting information must use human agents and human reasoning and therefore is not founded solely on an "objective reality." Nevertheless, the usefulness of information is enhanced if it is verifiable, that is, if the attribute or attributes selected for measurement and the measurement methods used provide results that can be corroborated by independent measures.

67. Other qualitative objectives set forth in paragraphs 87-93 of *APB Statement No. 4* are relevance (described as "the primary qualitative objective"), understandability, neutrality, timeliness, and comparability. Paragraph 94 sets forth a final qualitative objective, completeness: "Complete financial accounting information includes all financial accounting data that reasonably fulfill the requirements of the other qualitative objectives." Paragraph 94 goes on to say that the qualitative objectives are not absolute but, rather, must be met "in reasonable degree." That is, an appropriate balance must be maintained among the objectives. For example, some degree of verifiability might have to be sacrificed to improve the relevance of information included in financial statements. In the Board's judgment, the information required to be reported by this Statement meets the objective of verifiability in reasonable degree and is useful for analyzing and understanding an enterprise's financial statements. Moreover, consistency from period to period in the methods by which an enterprise's segment information is prepared and presented is as important as consistency in the application of the accounting principles used in preparing the enterprise's consolidated financial statements. Consistency is a quality that is comprehended by the objective of comparability and is an important aspect of segment reporting

that does lend itself to objective verification. For those reasons, the Board concluded that the information required to be reported by this Statement shall be included as an integral part of an enterprise's financial statements.

68. Some respondents contended that the costs of compiling and processing the type of information called for by this Statement would be overly burdensome to many enterprises, particularly those that are relatively small or whose securities are not publicly traded. Many enterprises, however, already accumulate information similar to the type required to be reported by this Statement for various purposes, such as inclusion in filings with the SEC or internal planning and control. Those enterprises will be able to provide the information required to be reported by this Statement by using existing records.

69. To lessen the information processing costs to enterprises, the Board has modified the proposal in the Exposure Draft that an enterprise's industry segments be determined by grouping its products and services by industry lines on a *worldwide* basis. Some respondents to the Exposure Draft felt that disaggregation of *foreign* operations was an especially burdensome requirement. Accordingly, this Statement does not require an enterprise to disaggregate its foreign operations to the extent that it is impracticable to do so (see paragraph 14).

70. In the Exposure Draft, the Board proposed that any requirement to include segment information in financial statements be applicable to all enterprises regardless of their size or whether their securities are publicly traded. The Board continues to believe that there are no fundamental differences in the types of decisions and the decision-making processes of those who use the financial statements of smaller or privately held enterprises. Many small or privately held enterprises operate in more than one industry or country or rely significantly on a single or a few major customers or export sales. Information of the type required to be disclosed by this Statement is as important to users of the financial statements of those enterprises as it is to users of the financial statements of larger or publicly held enterprises. Accordingly, this Statement applies to all enterprises, regardless of their size or whether their securities are publicly traded. In reaching that conclusion, the Board neither rejects nor accepts the recommendations of the AICPA Committee on Generally Accepted Accounting Principles for Smaller and/or Closely Held Businesses, in its August 1976 report.

71. Several respondents cited harm to an enterprise's competitive position as a basis for opposing disclosures about industry segments such as this Statement requires. However, the required disclosures about an industry segment are no more detailed or specific than the disclosures typically provided by an enterprise that operates in a single industry. The information required to be reported is intended primarily to permit users to make a better assessment of the past performance and future prospects of an enterprise operating in more than one industry. In the Board's judgment, the information specified by this Statement is useful in making that assessment and, therefore, the information should be required.

72. Some respondents recommended that the disclosure requirement of this Statement should

apply only to annual financial statements and not to any interim financial statements. They said that an interim reporting requirement would be unnecessarily burdensome for many enterprises, particularly those enterprises not heretofore reporting any information of the type required by this Statement. Also, some said that for many enterprises, seasonal fluctuations could cause significant changes from quarter to quarter in the composition of an enterprise's significant industry segments, diminishing the interperiod comparability of segment information. On the other hand, some respondents took the position that segment information should be included in all interim reports, including those that present only condensed financial statements or selected financial data and that do not purport to present financial position, results of operations, and changes in financial position in conformity with generally accepted accounting principles. Those respondents contended that segment information is needed on a more timely basis than annually and that the difficulties of preparing it on an interim basis can be overcome.

73. After considering both views, the Board has concluded that segment information should not be required in interim financial statements or interim financial reports unless they are e*xpressly described* as presenting financial position, results of operations, and changes in financial position in conformity with generally accepted accounting principles. When an enterprise issues for an interim period a complete set of financial statements that are *expressly described* as presenting financial position, results of operations, and changes in financial position in conformity with generally accepted accounting principles, those financial statements should include all of the disclosures required by this Statement in similar financial statements for an entire fiscal year. Users have the right to expect that financial statements so described, even though for an interim period, would contain all of the disclosures required in similarly described financial statements for an entire fiscal year.

74. A number of respondents to both the Discussion Memorandum and the Exposure Draft said that 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, they pointed out that 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. The Board agrees, in general, with those views. In the Board's judgment, the standards set forth in this Statement are sufficiently broad that when they are applied in the context of the objective stated in paragraph 5 they will result in reporting information that is useful in analyzing and understanding the financial statements of an enterprise that operates in different industries or geographic areas or that derives significant revenue from export sales or from a single or a few major customers.

Purpose of Segment Information

75. As stated in paragraph 5, the purpose of the information required to be disclosed by this Statement about an enterprise's operations in different industries and different areas of the world

and about the extent of its reliance on export sales or major customers is to assist financial statement users in analyzing and understanding the enterprise's financial statements by permitting better assessment of the enterprise's past performance and future prospects. The standards of financial accounting and reporting set forth in paragraphs 3-40 derive from that purpose.

76. Information prepared in conformity with those standards 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. As explained in paragraph 74, the Board concluded that it is not appropriate to specify rules and procedures in that degree of detail. Moreover, differences in the bases of accounting for intersegment sales or transfers may also militate against comparison of a segment of an enterprise with extensive intersegment transactions with a similar but autonomous segment of another enterprise or with a unitary enterprise in the same industry.

Information Required to Be Presented

77. This Statement requires that sales to outsiders be reported separately from sales or transfers to other segments because different types of uncertainties and measurement bases affect those two sources of a reportable segment's revenue. The Exposure Draft proposed that intersegment sales or transfers be accounted for at amounts that are consistent with the objective of determining segment profitability "as realistically as practicable." A number of respondents to the Exposure Draft asked the Board whether, under the draft, intersegment sales or transfers could be accounted for at other than market price, for example, at cost. The Board has concluded that for purposes of this Statement revenue from intersegment sales or transfers shall be accounted for on whatever basis is used by the enterprise to price the intersegment sales or transfers. No single basis is prescribed or proscribed, but disclosure of the basis of accounting for intersegment sales or transfers is required.

78. The Exposure Draft proposed that two specified levels of profitability—profit or loss contribution and operating profit or loss—be presented for each reportable segment. The former was defined as revenue less only those operating expenses that were directly traceable to the segment, and the latter was defined (as it is in paragraph 10(d) of this Statement) as revenue less all operating expenses including those allocated to segments on a reasonable basis as well as those that are directly traceable. This Statement, however, requires presentation of only operating profit or loss for reportable segments. In the Exposure Draft, the Board stated that "presenting profitability both before and after allocation of common costs and expenses highlights the extent to which the computation of operating profit or loss is affected by allocations." Although most respondents to the Exposure Draft did not disagree with the requirement that operating profit or loss be disclosed for individual reportable segments, many

made the point that it is not practicable to distinguish between those operating expenses that may be said to be *directly traceable* to a segment and those that may be said only to be *allocable.* Some respondents pointed out that traceability often depends on the sophistication of an enterprise's internal recordkeeping system. They noted that traceability depends on the degree to which management of an enterprise's operations is decentralized. Some said that location of incurrence should not govern the attribution of a cost to a particular segment. In view of the problems cited by those who responded to the Exposure Draft, the Board has judged that disclosure of profit or loss contribution should not be required, although this Statement does not proscribe that disclosure if an enterprise wishes to include it.

79. The Board continues to believe that certain items of revenue and expense either do not relate to segments or cannot *always* be allocated to segments on the basis of objective evidence, and for that reason this Statement does not require that net income be disclosed for reportable segments. Those items are revenue earned at the corporate level and not derived from operations of any industry segment, general corporate expenses, interest expense, domestic and foreign income taxes, and equity in income or loss from unconsolidated subsidiaries and other unconsolidated investees. The Board also has not required that the following (which are normally reported net of income taxes) be allocated: extraordinary items, gain or loss on discontinued operations, minority interest, and the cumulative effect of a change in accounting principle. However, paragraph 25 permits additional disclosure of some other measure of profitability for some or all of an enterprise's reportable segments in addition to operating profit or loss, with appropriate disclosure of the nature and amount of each type of item allocated to segments and the method of allocation.

80. Disclosure of identifiable assets is required, as proposed in the Exposure Draft, to allow financial statement users to assess the relative investment commitment in an enterprise's various segments and to assess the results obtained by the various segments in relation to the investment committed. Some respondents to the Exposure Draft stated that the definition of a segment's identifiable assets as proposed in the Exposure Draft was inconsistent with the proposed definition of a segment's operating profit or loss. They indicated that although allocation of all operating expenses common to two or more segments was required to compute operating profit or loss, allocation of all assets used jointly by two or more segments was not required. In response to that view, the definition of identifiable assets in paragraph 10(e) of this Statement requires that a portion of assets used jointly by two or more industry segments be allocated among the industry segments on a reasonable basis.

81. To provide information useful in understanding the operating profit or loss and the identifiable assets of an industry segment, paragraph 27 requires disclosure of the aggregate amount of each reportable segment's depreciation, depletion, and amortization and of each reportable segment's capital expenditures. The Exposure Draft had identified certain additional disclosures that "may be important" in certain circumstances, including property, plant, and equipment and related accumulated depreciation, receivables and inventories, loans, deposits, or other monetary amounts, and research and development costs. A number of respondents to the

Exposure Draft recommended that the final Statement not identify those disclosures as possibly "important" unless the circumstances were clearly specified. Some said the disclosures were overly detailed and would be of questionable benefit in many cases. The Board found those arguments persuasive and decided to delete them in the final Statement. As stated in paragraph 22, presentation of additional information beyond that required to be reported by this Statement may be considered to be desirable, and this Statement does not preclude those additional disclosures.

82. The Exposure Draft proposed that operating profit or loss and identifiable assets of an industry segment or geographic area of consolidated operations include, respectively, the income from and the investment in unconsolidated investees operating in the same industry or the same geographic area. Some respondents stated that, due to the complexity of many enterprises' unconsolidated operations, information called for by the Exposure Draft (i.e., operating profit or loss and identifiable assets) may not be available for some of those investees, especially for those investees in which the enterprise has less than a 50 percent ownership. Other respondents considered it inappropriate to combine the after-tax net income from the unconsolidated investees with operating profit of the consolidated operations. They also considered it inappropriate to combine the investment in the net assets of unconsolidated investees with identifiable assets of the consolidated operations. Such combinations, in their view, would distort the operating results and financial ratios for the industry segments and geographic areas and thereby make the reported information less useful in some cases and misleading in others. The Board found merit in those arguments and accordingly eliminated the requirement. The Board continues to believe, however, that if the operations of an unconsolidated investee are closely related with those of a reportable segment, information about the segment would be incomplete and therefore subject to possible misinterpretation without information about the relationship. For that reason, the Board concluded that disclosure should be made for each reportable segment of the enterprise's equity in the net income from and investment in the net assets of unconsolidated subsidiaries and other equity method investees whose operations are vertically integrated with the operations of that segment.[17] The Board further concluded that disclosure should also be made of the geographic areas in which those vertically integrated equity method investees operate.

Information about Foreign Operations and Export Sales

83. Several respondents to the Exposure Draft indicated that for their particular industries the distinction between domestic and foreign operations was very difficult to make and requested that the Board develop guidelines and allow judgment in determining the distinction between the two. The Board's intention had been to allow judgment and that intention is made explicit and guidelines are furnished in paragraph 31 and footnote 12 of this Statement.

84. With respect to reporting information about an enterprise's operations in different geographic areas, some respondents to the Exposure Draft requested that the Board clarify or elaborate on a number of matters, including (a) whether the Statement would require disclosure

of information on an individual country-by-country basis and (b) how should significance be determined for an enterprise's foreign operations in the aggregate or in any geographic area. The Board's conclusion on each of those matters is clarified or elaborated on in paragraphs 32 and 33 of this Statement.

85. The Board recognized in the Exposure Draft and in this Statement that the variety of ways in which foreign operations are conducted made it impossible to define appropriate geographic areas for all enterprises. Therefore, only general guidelines for that determination are set forth in paragraph 34 of this Statement. For those enterprises conducting foreign operations in two or more geographic areas, the Board considered several methods of associating foreign revenue, a measure of profitability, and identifiable assets with a particular geographic area. Those methods include associating this information with geographic areas in terms of the location of the accounting records, the location of the assets, the location of the risks associated with the assets and liabilities, and the location of the customers. However, the Board concluded that none of those methods would necessarily correlate the profitability and identifiable assets of a geographic area in a manner consistent with the objective expressed in paragraph 31. The Board believes that the description of geographic areas of foreign operations in paragraph 34 is sufficiently broad to permit management to accomplish that objective by determining the scope of its operations in each area and then identifying (i) the revenue generated from those operations, (ii) the assets employed in or associated with generating those revenues, and (iii) the costs and expenses related to those revenues and assets. The Board believes that disclosing a measure of assets or assets and liabilities that can be related to a measure of profitability for each significant geographic area will provide users of financial statements with useful financial information about an enterprise's foreign operations consistent with the purpose set forth in paragraph 5.

86. Some respondents to the Exposure Draft recommended that the Statement not require disclosure of operating profit or loss for each geographic area of an enterprise's operations if it is determined instead to present a level of profitability below operating profit or loss. They said that in many cases an after-tax profitability measure is more informative than a pretax measure and that because of significant differences in income tax rates among different geographic areas a pretax measure could at times be misinterpreted. They also said that many enterprises can more easily determine net income or another measure of profitability below operating profit or loss by geographic area than by industry segment. The Board found those arguments convincing, and paragraph 35(b) requires presentation of operating profit or loss, or net income, or some other measure of profitability between operating profit or loss and net income.

87. The Board considered whether this Statement should supersede any part of *ARB No. 43,* Chapter 12, "Foreign Operations and Foreign Exchange," especially paragraph 9 thereof. Since paragraph 9 of Chapter 12 deals with consolidation of foreign subsidiaries which is a subject beyond the scope of this Statement, the Board concluded that it should not be superseded. However, this Statement provides definitions and guidelines that may also be useful in applying that Bulletin.

88. The Board has determined that disclosure of working capital and property, plant, and equipment and related accumulated depreciation should not be required by geographic area. Those disclosures had been proposed in the Exposure Draft, but a number of respondents said, and the Board agreed, that the volume of detail that would be required would be excessive. However, as noted in paragraph 87, this Statement does not supersede the requirements of paragraph 9, Chapter 12, *ARB No. 43,* for certain disclosures with respect to the assets and liabilities of foreign subsidiaries.

89. A number of respondents to the Exposure Draft requested that the Board provide guidance as to when export sales should be considered significant, and paragraph 36 of this Statement provides a test of significance. The Board also was asked to clarify certain matters with respect to the disclosures about major customers, including a guideline as to significance and an elaboration on the type of information required to be presented. Paragraph 39 of this Statement reflects the appropriate revisions. Because many respondents argued that identification of the major customer could be competitively harmful to either the enterprise or the customer, the proposal for disclosure of the name of the customer has been dropped.

Effective Date and Transition

90. On considering all circumstances, the Board determined that prospective application of the standards set forth in this Statement effective for periods beginning after December 15, 1976 as stated in paragraph 41, is appropriate because enterprises may not have accumulated in prior years all of the information required to be disclosed by this Statement; the Board also determined that the effective date is advisable in the circumstances.

Appendix C: STANDARD INDUSTRIAL CLASSIFICATIONS

91. As indicated in paragraph 12, the Board has examined several systems that have been developed for classifying business activities, such as the Standard Industrial Classification and the Enterprise Standard Industrial Classification systems and has judged that none is, by itself, suitable to determine industry segments as that term is used in this Statement. Nonetheless, those systems may provide guidance for the exercise of the judgment required to group an enterprise's products and services by industry lines.

92. As set forth in the *Standard Industrial Classification Manual* prepared by the Statistical Policy Division of the U.S. Office of Management and Budget, SIC is a system for classifying business establishments (generally, individual plants, stores, banks, etc.) by the type of economic activity in which they are engaged. An establishment is not necessarily identical with a business enterprise, which may consist of one or more establishments.

93. The 649-page manual contains one-digit, two-digit, three-digit, and four-digit SIC industry codes, each of which is described in detail. At the one-digit level, the SIC classifies business activities into 11 divisions:

- A Agriculture, forestry, and fishing.
- B Mining.
- C Construction.
- D Manufacturing.
- E Transportation, communications, electric, gas, and sanitary services.
- F Wholesale trade.
- G Retail trade.
- H Finance, insurance, and real estate.
- I Services.
- J Public administration.
- K Nonclassifiable establishments.

94. Each of those divisions is subdivided into two-digit major groups. There is a total of 84 two-digit groups. For example, the 20 major groups in manufacturing are:

1. Food and kindred products.
2. Tobacco manufacturers.
3. Textile mill products.
4. Apparel and other finished products made from fabrics and similar materials.
5. Lumber and wood products, except furniture.
6. Furniture and fixtures.
7. Paper and allied products.
8. Printing, publishing, and allied products.
9. Chemicals and allied products.
10. Petroleum refining and related industries.
11. Rubber and miscellaneous plastics products.
12. Leather and leather products.
13. Stone, clay, glass, and concrete products.
14. Primary metal industries.
15. Fabricated metal products, except machinery and transportation equipment.
16. Machinery, except electrical.
17. Electrical and electronic machinery, equipment, and supplies.
18. Transportation equipment.
19. Measuring, analyzing, and controlling instruments; photographic, medical, and optical goods; watches and clocks.
20. Miscellaneous manufacturing industries.

95. Each of the two-digit SIC major groups, in turn, is further subdivided into three-digit industry groups. There are 421 three-digit industry groups. For example, the "machinery,

except electrical" group includes the following industry groups:

1. Engines and turbines.
2. Farm and garden machinery and equipment.
3. Construction, mining, and materials handling machinery and equipment.
4. Metalworking machinery and equipment.
5. Special industry machinery, except metalworking machinery.
6. General industry machinery and equipment.
7. Office, computing, and accounting machines.
8. Refrigeration and service industry machinery.
9. Miscellaneous machinery, except electrical.

96. The three-digit SIC industry groups are still further subdivided by product lines into over 1,000 narrower four-digit industry groups. Metalworking machinery and equipment (a three-digit industry group), for example, is divided into metal cutting machine tools, metal forming machine tools, power driven hand tools, rolling mill machinery and equipment, and so on.

97. The *Standard Industrial Classification Manual* is revised periodically, most recently in 1972. It is available for sale by the Superintendent of Documents, U.S. Government Printing Office.

98. The *Enterprise Standard Industrial Classification Manual,* like the *SIC Manual,* is prepared by the Statistical Policy Division of the U.S. Office of Management and Budget. It classifies enterprises (companies, firms, partnerships, etc.) rather than establishments (plants, stores, banks, etc.). The structure of ESIC follows closely the structure of the SIC codes. It includes eight classes of enterprises at the one-digit level, 67 at the two-digit level, 216 at the three-digit level, and 252 at the four-digit level.

Appendix D: FACTORS TO BE CONSIDERED IN DETERMINING INDUSTRY SEGMENTS

99. This Appendix identifies a number of factors to be considered in grouping products and services by industry lines into industry segments. As indicated in paragraph 12, although certain characteristics can be identified that assist in differentiating among industries, no single set of characteristics is universally applicable to determine the industry segments of all business enterprises. Nor is any single characteristic determinative in all cases.

100. Among the factors that should be considered in determining whether products and services are related (and, therefore, should be grouped into a single industry segment) or unrelated (and, therefore, should be separated into two or more industry segments) are the following:

a. *The nature of the product.* Related products or services have similar purposes or end uses. Thus, they may be expected to have similar rates of profitability, similar degrees of risk, and similar opportunities for growth.
b. *The nature of the production process.* Sharing of common or interchangeable production or sales facilities, equipment, labor force, or service group or use of the same or similar basic raw materials may suggest that products or services are related. Likewise, similar degrees of labor intensiveness or similar degrees of capital intensiveness may indicate a relationship among products or services.
c. *Markets and marketing methods.* Similarity of geographic marketing areas, types of customers, or marketing methods may indicate a relationship among products or services. For instance, the use of a common or interchangeable sales force may suggest a relationship among products or services. The sensitivity of the market to price changes and to changes in general economic conditions may also indicate whether products or services are related or unrelated.

101. Broad categories such as *manufacturing, wholesaling, retailing, and consumer products* are not per se indicative of the industries in which an enterprise operates, and those terms should not be used without identification of a product or service to describe an enterprise's industry segments.

Appendix E: ILLUSTRATION OF APPLYING PARAGRAPH 15(b)

102. Under paragraph 15(b), an industry segment is to be regarded as significant if the absolute amount of its operating profit or operating loss is 10 percent or more of the greater, in absolute amount, of:

(i) The combined operating profit of all industry segments that did not incur an operating loss, or
(ii) The combined operating loss of all industry segments that did incur an operating loss.

103. To illustrate how that paragraph is applied, assume that an enterprise has seven industry segments some of which incurred operating losses, as follows:

Industry Segment	Operating Profit or (Operating Loss)	
A	$ 100	
B	500	$ 1,000
C	400	
D	(295)	
E	(600)	
F	(100)	(1,100)
G	(105)	
	$(100)	

104. The combined operating profit of all industry segments that did not incur a loss (A, B, and C) is $1,000. The absolute amount of the combined operating loss of those segments that did incur a loss (D, E, F, and G) is $1,100. Under paragraph 15(b), therefore, Industry Segments B, C, D, and E are significant because the absolute amount of their individual operating profit or operating loss equals or exceeds $110 (10 percent of $1,100). Additional industry segments might, of course, also be deemed significant under the revenue and identifiable assets tests in paragraphs 15(a) and 15(c).

Appendix F: ILLUSTRATIONS OF FINANCIAL STATEMENT DISCLOSURES

105. This Appendix contains examples of disclosures of the type that this Statement requires to be included in the financial statements of an enterprise. The illustrations do not encompass all possible circumstances, nor do the formats used indicate a particular preference of the Board.

106. Exhibit A presents the consolidated income statement of a hypothetical company for the year ended December 31, 1977. Exhibit B illustrates how the company might present information about its operations in different industries and its reliance on major customers. Exhibit C illustrates how the company might present information about its foreign operations in different geographic areas and its export sales.

EXHIBIT A

X Company
Consolidated Income Statement
Year ended December 31, 1977

Sales		$4,700
Cost of sales	$3,000	
Selling, general, and administrative expense	700	
Interest expense	200	3,900
		800
Equity in net income of Z Co. (25% owned)		100
Income from continuing operations before income taxes		900
Income taxes		400
Income from continuing operations		500
Discontinued operations:		
Loss from operations of discontinued West Coast division (net of income tax effect of $50)	70	
Loss on disposal of West Coast division (net of income tax effect of $100)	130	200
Income before extraordinary gain and before cumulative effect of change in accounting principle		300
Extraordinary gain (net of income tax effect of $80)		90
Cumulative effect on prior years of change from straight-line to accelerated depreciation (net of income tax effect of $60)		(60)
Net income		$ 330

Exhibit B

X Company
Information about the Company's Operations in Different Industries
Year Ended December 31, 1977

	Industry A	Industry B	Industry C	Other Industries	Adjustments and Eliminations	Consolidated
Sales to unaffiliated customers	$1,000	$2,000	$1,500	$ 200		$ 4,700
Intersegment sales	200		500		$ (700)	
Total revenue	$1,200	$2,000	$2,000	$ 200	$ (700)	$ 4,700
Operating profit	$ 200	$ 290	$ 600	$ 50	$ (40)	$ 1,100
Equity in net income of Z Co.						100
General corporate expenses						(100)
Interest expense						(200)
Income from continuing operations before income taxes						900
Identifiable assets at 12/31/1977	$2,000	$4,050	$6,000	$1,000	$ (50)	$13,000
Investment in net assets of Z Co.						400
Corporate assets						1,600
Total assets at 12/31/1977						$15,000

Refer to accompanying note.

Note

The Company operates principally in three industries, A, B, and C. Operations in Industry A involve production and sale of (describe types of products and services). Operations in Industry B involve production and sale of (describe types of products and services). Operations in Industry C involve production and sale of (describe types of products and services). Total revenue by industry includes both sales to unaffiliated customers, as reported in the Company's consolidated income statement, and intersegment sales, which are accounted for by (describe the basis of accounting for intersegment sales).

Operating profit is total revenue less operating expenses. In computing operating profit, none of the following items has been added or deducted: general corporate expenses, interest expense, income taxes, equity in income from an unconsolidated investee, loss from discontinued operations of the West Coast division (which was a part of the Company's operations in Industry B), extraordinary gain (which relates to the Company's operations in Industry A), and the cumulative effect of the change from straight-line to accelerated depreciation (of which $30 relates to the Company's operations in Industry A, $10 to Industry B, and $20 to Industry C). Depreciation for Industries A, B, and C, respectively, was $80, $100, and $150. Capital expenditures for the 3 industries were $100, $200, and $400, respectively.

The effect of the change from straight-line to accelerated depreciation was to reduce the 1977 operating profit of Industries A, B, and C, respectively, by $40, $30, and $20

Identifiable assets by industry are those assets that are used in the Company's operations in each industry. Corporate assets are principally cash and marketable securities.

The Company has a 25-percent interest in Z Co., whose operations are in the United States and are vertically integrated with the Company's operations in Industry A. Equity in net income of Z Co. was $100; investment in net assets of Z Co. was $400.

To reconcile industry information with consolidated amounts, the following eliminations have been made: $700 of intersegment sales; $40 relating to the net change in intersegment operating profit in beginning and ending inventories; and $50 intersegment operating profit in inventory at December 31, 1977.

Contracts with a U.S. government agency account for $1,100 of the sales to unaffiliated customers of Industry B.

Exhibit C
X Company
Information about the Company's Operations in Different Geographic Areas
Year Ended December 31, 1977

	United States	Geographic Area A	Geographic Area B	Adjustments and Eliminations	Consolidated
Sales to unaffiliated customers	$3,000	$1,000	$ 700		$ 4,700
Transfers between geographic areas	1,000			$(1,000)	
Total revenue	$4,000	$1,000	$ 700	$(1,000)	$ 4,700
Operating profit	$ 800	$ 400	$ 100	$ (200)	$ 1,100
Equity in net income of Z Co.					100
General corporate expenses					(100)
Interest expense					(200)
Income from continuing operations before income taxes					900
Identifiable assets at December 31, 1977	$7,300	$3,400	$2,450	$ (150)	$13,000
Investment in net assets of Z Co.					400
Corporate assets					1,600
Total assets at December 31, 1977					$15,000

Refer to accompanying note.

Note

Transfers between geographic areas are accounted for by (describe the basis of accounting for such transfers). Operating profit is total revenue less operating expenses. In computing operating profit, none of the following items has been added or deducted: general corporate expenses, interest expense, income taxes, equity in income from unconsolidated investee, loss from discontinued operations of West Coast division (which was part of the Company's U.S. operations), extraordinary gain (which relates to the Company's operations in Geographic Area B), and the cumulative effect of the change from straight-line to accelerated depreciation (which relates entirely to the Company's operations in the United States).

Identifiable assets are those assets of the Company that are identified with the operations in each geographic area. Corporate assets are principally cash and marketable securities.

Of the $3,000 U.S. sales to unaffiliated customers, $1,200 were export sales, principally to Geographic Area C.

Footnotes

FAS14, Footnote 1--The term "consolidated financial information" is used herein to refer to aggregate information relating to an enterprise as a whole whether or not the enterprise has consolidated subsidiaries.

FAS14, Footnote 2--The meaning of the term "industry segment" as it is used in this Statement is different from the use of the term "segment" in pronouncements of the Cost Accounting Standards Board.

FAS14, Footnote 3--In some industries, it is normal practice for an enterprise to purchase and sell substantially identical commodities to minimize transportation or other costs. In those situations, sales and purchases of substantially identical commodities shall be netted for the purpose of determining whether a product or service or a group of related products and services is sold primarily to unaffiliated customers. Although those sales and purchases are netted for the purpose of identifying an industry segment, it is not intended that this rule change an enterprise's accounting practice with respect to determining the revenue of the enterprise or any of its industry segments.

FAS14, Footnote 4--For convenience, the term "sales" is used in this Statement to include the sale of a product, the rendering of a service, and other types of transactions by which revenue is earned.

FAS14, Footnote 5--Intersegment billings for the cost of shared facilities or other jointly incurred costs do not represent intersegment sales or transfers as that term is used in this Statement.

FAS14, Footnote 6--Interest earned on advances or loans to other industry segments is included in computing the operating profit or loss of an industry segment whose operations are principally of a financial nature (e.g., banking, insurance, leasing, or financing).

FAS14, Footnote 7--Some of the expenses incurred at an enterprise's central administrative office may not be general corporate expenses, but rather may be operating expenses of industry segments that should therefore be allocated to those industry segments. The nature of an expense rather than the location of its incurrence shall determine whether it is an operating expense. Only those expenses identified by their nature as operating expenses shall be allocated as operating expenses in computing an industry segment's operating profit or loss.

FAS14, Footnote 8--Interest expense is deducted in computing the operating profit or loss of an industry segment whose operations are principally of a financial nature (e.g., banking, insurance, leasing, or financing).

FAS14, Footnote 9--Any related depreciation or amortization expense is deducted in determining the operating profit of the industry segment.

FAS14, Footnote 10--The pro forma effects of retroactive application, which are required to be disclosed on a consolidated basis by paragraph 21 of *APB Opinion No. 20,* need not be disclosed for individual reportable segments. Also, the pro forma supplemental information relating to a business combination accounted for by the purchase method required to be presented by paragraph 96 of *APB Opinion No. 16,* "Business Combinations," need not be presented for individual reportable segments.

FAS14, Footnote 11--An enterprise whose home country is other than the United States but that prepares financial statements in conformity with U.S. generally accepted accounting principles shall classify operations outside of its home country as foreign operations.

FAS14, Footnote 12--Difficulties may arise in classifying the activities of certain types of enterprises. The following examples may provide useful guidelines: (1) Determination of whether the employment of an enterprise's mobile assets, such as off-shore drilling rigs or ocean-going vessels, constitutes foreign operations should depend on whether such assets are normally identified with operations located and generating revenue from outside the home country. If they are normally identified with the enterprise's foreign operations, revenue generated from abroad would be considered foreign revenue. If they are normally identified with the enterprise's domestic operations, revenue generated from abroad would be considered export sales; (2) Services rendered by the foreign offices of a service enterprise, such as a consulting firm, having offices or facilities located both in the home country and in foreign countries would be considered foreign operations, and the revenue should be considered foreign revenue. Revenue generated abroad from services provided by domestic offices should be considered export sales.

FAS14, Footnote 13--Separate information about domestic operations need not be presented if domestic operations' revenue from sales to unaffiliated customers and domestic operations' identifiable assets are less than 10 percent of related consolidated amounts.

FAS14, Footnote 14--Restatement is not required when an enterprise's reportable segments change as a result of a change in the nature of an enterprise's operations or as a result of applying the tests in paragraphs 15-20.

FAS14, Footnote 15--See paragraph 4.

FAS14, Appendix A, Footnote 16--A number of companies are challenging the FTC's line-of-business reporting program through legal proceedings.

FAS14, Appendix B, Footnote 17--If the operations of two or more equity method investees are vertically integrated with a reportable segment, the amounts required to be disclosed may be combined respectively.