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Proposed FASB Staff Position No. FAS 131-a, “Determining Whether Operating Segments Have ‘Similar Economic Characteristics’ under Paragraph 17 of FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*”

Dear Mr. Smith:

We appreciate the opportunity to comment on the proposed FASB Staff Position No. FAS 131-a, “Determining Whether Operating Segments Have ‘Similar Economic Characteristics’ under Paragraph 17 of FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*.” We agree with the proposed guidance that, for purposes of determining whether the economic characteristics of two or more operating segments are similar, (1) both quantitative and qualitative factors should be considered and (2) those factors should be based on factors used by the Chief Operating Decision Maker (CODM) in allocating resources to individual segments. As discussed below, we recommend certain clarifications to the proposed FSP and additional guidance that may reduce diversity in practice.

Evaluating Whether Economic Characteristics Are Similar

Paragraph 7 of the proposed FSP states “evaluating whether economic characteristics are similar is a matter of judgment that depends on the specific facts and circumstances.” As currently drafted, the proposed FSP provides guidance for identifying factors to be considered in evaluating whether two or more operating segments are similar; however, it does not provide guidance on how such factors should be evaluated after they have been identified. An entity’s method of evaluating the relevant factors is a critical aspect of this issue and we believe that the final FSP should provide further guidance in this regard. For example, when an entity is evaluating two or more operating segments in the same



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industry with similar operations and similar qualitative factors, how should the entity evaluate a quantitative metric that differs between those operating segments but for which changes in that metric are expected to be highly correlated in response to the same external factors? In contrast, how should that entity evaluate a quantitative metric that is presently consistent between two or more operating segments but for which changes are not expected to be highly correlated in response to the same external factors? Additionally, we would expect the valuation of quantitative metrics to consider the nature of the industry in which the segments operate and the range of variability in those metrics for that industry.

We also believe paragraph 7 of the proposed FSP should specify that qualitative and quantitative factors should be appropriately weighted based on the facts and circumstances (i.e., all factors are not necessarily of equal weight in evaluating whether two or more operating segments are similar). Additionally, the determination of whether two or more operating segments are similar should entail consideration of the objectives and basic principles of Statement 131. For example, the purpose of providing disaggregated financial information to the CODM should be considered when evaluating whether operating segments are similar (i.e., the entity should consider whether the CODM requires separate information because of economic dissimilarity among the operating segments or whether the information is required for other informational purposes).

Other Matters

Paragraph 5 of the proposed FSP provides examples of quantitative factors to be considered in the analysis of whether two or more operating segments are similar. We believe certain other measures of performance such as earnings before interest, taxes, depreciation, and amortization (EBITDA) and similar metrics that would be non-GAAP measures absent the segment reporting requirements should be considered if they are among the primary quantitative factors that the CODM uses in evaluating performance of and allocating resources to individual segments. Other measures that may be relevant in determining whether two or more operating segments are similar include: industry-specific sales metrics (e.g., sales per square foot, same store sales, professional services revenue per employee), cost metrics, and levels of capital investment. To reinforce the notion that the factors to be considered when determining whether operating segments



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have similar economic characteristics are company-specific and are based on the factors considered by the CODM, we recommend including an illustrative example that does not include gross margin as one of the key quantitative factors.

Paragraph 7 of the proposed FSP provides an example in which “sales volume” is identified as a quantitative factor in the evaluation of whether two or more operating segments are similar. It is unclear why sales volume would be evaluated as a quantitative measure in determining whether economic characteristics are similar (i.e., sales volume may be a measure of size, rather than economic similarity).

Paragraph 5 of the proposed FSP provides examples of qualitative factors to be considered in the analysis of whether two or more operating segments are similar. We believe interest rate risks and the “capital intensiveness” of the segments should be considered if they are among the primary qualitative factors that the CODM uses in assessing performance of and allocating resources to individual segments.

In many cases, we believe expected long-term trends may be more relevant indicators of similar economic characteristics than indicators based on current results. Accordingly, we suggest that paragraph 5 of the proposed FSP be modified to clarify that expected future trends in the quantitative and qualitative factors should be considered and the evaluation would not be limited to a review based on the current status of the indicators. For example, assume two production plants are determined to be operating segments under Statement 131 and have historically exhibited similar economic characteristics based on the quantitative and qualitative factors considered by the CODM in assessing performance of and allocating resources to the individual segments. The plants have been in operation for an extended period of time and many of their production assets are fully depreciated. If one of the plants incurs significant capital expenditures to upgrade its equipment, the relevant quantitative measures for the two plants may no longer be similar due to the additional depreciation expense and higher recorded fixed asset amounts. Would the two plants no longer be deemed to have similar economic characteristics under Statement 131 until the other plant has incurred similar capital expenditures to upgrade its equipment? In this example, we believe that the differences in quantitative measures are temporary and the operating segments continue to have similar economic characteristics. Likewise, if operating segments historically did *not* have similar economic characteristics, but in the current period they do and such similar economic characteristics are not expected to continue in subsequent periods, we believe the operating segments should not be aggregated in the current period.

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If you have any questions about our comments or wish to discuss any of the matters addressed herein, please contact Mark Bielstein at (212) 909-5419, Paul Munter at (212) 909-5567, or Melanie Dolan at (202) 533-4934.

Sincerely,

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