

**PROPOSED FASB STAFF POSITION**

**No. FAS 131-a**

**Title:** 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*

**Comment Deadline:** April 18, 2005

1. Questions have arisen on how to determine whether two or more operating segments have “similar economic characteristics” for purposes of applying paragraph 17 of FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*. The Board directed the FASB staff to issue this FASB Staff Position (FSP) to address these questions.
2. An enterprise is permitted to aggregate two or more operating segments into a single operating segment only if the operating segments meet all of the criteria in paragraph 17 of Statement 131, which states:

Operating segments often exhibit similar long-term financial performance if they have similar economic characteristics. For example, similar long-term average gross margins for two operating segments would be expected if their economic characteristics were similar. Two or more operating segments may be aggregated into a single operating segment [a] if aggregation is consistent with the objective and basic principles of this Statement, [b] if the segments have similar economic characteristics, and [c] if the segments are similar in each of the following areas:

- a. The nature of the products and services
- b. The nature of the production processes
- c. The type or class of customer for their products and services
- d. The methods used to distribute their products or provide their services
- e. If applicable, the nature of the regulatory environment, for example, banking, insurance, or public utilities.

[Bracketed letters have been added to emphasize that there are three criteria.]

3. In reaching its decision to permit aggregation of operating segments, the Board believed that separate reporting of segment information would not add significantly to

an investor's understanding of an enterprise if the enterprise's operating segments have characteristics so similar that they can be expected to have essentially the same future prospects. In those circumstances, the Board concluded that although information about each segment may be available, the benefit would be insufficient to justify its disclosure.

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4. *Q1*—Should both quantitative and qualitative factors be considered for purposes of determining whether the economic characteristics of two or more operating segments are similar?
5. *A1*—The FASB staff believes both quantitative and qualitative factors<sup>1</sup> should be considered for purposes of determining whether the economic characteristics of two or more operating segments are similar. Even if the qualitative factors (including those listed in paragraph 17 of Statement 131) are virtually identical, the FASB staff believes it is still necessary to evaluate the quantitative factors to determine whether the segments have similar economic characteristics. Quantitative factors could include performance measures such as gross margins, trends in sales growth, returns on assets employed, and operating cash flows. Qualitative factors could include nonperformance measures such as competitive and operating risks, currency risks, and economic and political conditions associated with each segment.
6. *Q2*—How should an enterprise identify the factors to consider for purposes of determining whether two or more operating segments have similar economic characteristics?
7. *A2*—The FASB staff believes that the factors that should be considered for purposes of determining whether operating segments have similar economic characteristics

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<sup>1</sup> These factors will be different from those listed in Statement 131 paragraph 17 (a)-(e) and, therefore, should be evaluated separately.

should be based on the primary factors that the Chief Operating Decision Maker (CODM)<sup>2</sup> uses in allocating resources to individual segments. For example, if the CODM primarily uses gross margin, sales volume, and expected future sales growth to allocate resources to individual operating segments, those are the quantitative factors that should be considered for purposes of determining whether the operating segments have similar economic characteristics. The FASB staff would expect the quantitative and qualitative factors to be similar in order to conclude that the operating segments have similar economic characteristics; however, evaluating whether economic characteristics are similar is a matter of judgment that depends on specific facts and circumstances.

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<sup>2</sup> Paragraph 12 of Statement 131 states that “the term *chief operating decision maker* identifies a function, not necessarily a manager with a specific title. That function is to allocate resources to and assess the performance of the segments of an enterprise. Often the chief operating decision maker of an enterprise is its chief executive officer or chief operating officer, but it may be a group consisting of, for example, the enterprise's president, executive vice presidents, and others.”