

TECHNICAL NOTE
FINANCIAL REPORTING BY SEGMENTS
IAS 14

I. BACKGROUND

As a result of the meeting of the Accounting and Budget Committee of the Central Bank held in July 2005 in the offices of the Brazilian Central Bank, with the participation of the constituent members corresponding to: Argentina, Brazil, Chile, Guatemala, Peru, Uruguay, in coordination with CEMLA and with the presence of the General Inspector of the Banco de España as a guest, an analysis was made of the application of the International Financial Reporting Standards in Central Banks, among other issues, and the identification of those standards that may be difficult to apply, given the particular characteristics of the Central Banks. This is the case of the Standards Nos. 2, 7, 14, 21, 32, 37 and 39, upon which it was agreed to make technical notes that would furnish legitimate accounting criteria aimed at improving the position of the central banks associated with CEMLA in the application of the IFRS.

Chile was chosen as the country to present the technical note referring to IAS 14.

II SUMMARY OF THE IFRS:

Goal

The purpose of this Standard is to establish policies for financial reporting by segments, that is, information on the different kinds of products and services carried out by the enterprise and the different geographical areas in which it operates, in order to help the users of financial statements to:

- a) better understand the returns of the company in the past;
- b) better assess the returns and risks of the company; and
- c) make a more informed judgment of the company as a whole.

Many enterprises offer products or services or operate in geographic areas that are subject to different kinds of returns, growth opportunities, future expectations and risks. The information concerning an enterprise's diverse products and services, and the information regarding different geographic areas, frequently called segment information, is relevant for the assessment of a diversified or multinational company's performance and risks; however, this cannot always be determined on the basis of aggregate data. Consequently, segment information is generally considered necessary to satisfy the needs of the users of financial statements.

Scope

This Standard is applicable to the complete sets of financial statements published that aim to comply with the International Accounting Standards (the balance sheet, profit and loss account, cash-flow statement, statement of changes in equity and explanatory notes).

This Standard should be applied to enterprises whose equity or debt certificates are publicly traded and to enterprises in the process of issuing securities to the public. It is advisable to also apply them to enterprises not publicly traded.

If a financial report contains both the consolidated statements of an enterprise whose securities are publicly traded and the individual financial statements of the parent or one or more of its

subsidiaries, it is only necessary to present the segment information corresponding to the consolidated data.

Definitions

Definitions from other International Accounting Standards

Business activities are the activities that make up the main source of an enterprise's ordinary income, as well as other activities that cannot be classified as investment or financing.

Accounting policies are the specific principles, bases, agreements, rules and procedures adopted by an entity in the preparation and presentation of financial statements.

Ordinary revenue is the gross income of economic benefits during the fiscal period that arise during the course of an enterprise's ordinary activities, provided that this income gives rise to increases in net equity other than that from contributions by the owners.

Definitions of the business segment and the geographic segment

A business segment is an identifiable component of an enterprise that provides a single product or service or a group of related products and services and that is characterized as being subject to risks and returns that are different from those of other business segments within the same enterprise.

A geographic segment is an identifiable component of an enterprise that provides products or services within a particular economic environment and that is characterized as being subject to risks and returns that are different from those of other business segments within the same enterprise. A segment that should be reported is a business or geographic segment, identified on the basis of the above definitions, for which it is obligatory to disclose information by segments, pursuant to the definitions of this Standard.

The way of organizing and managing an enterprise is affected by its inherent risks. Consequently, the organizational structure of an enterprise like the internal information system, is the base on which segments are identified. An enterprise's risks and returns are influenced both by *the location of its operations* and by *the location of its market*.

The determination of the composition of a segment, either business or geographic, implies the use of a certain degree of judgment. When the corresponding judgments are made, the management of the enterprise must bear in mind the purpose of furnishing the segment financial information established in this Standard, such as the qualitative characteristics of the financial statements identified in the Conceptual Framework for the Preparation and Presentation of financial Statements.

The qualitative characteristics include the relevance, reliability and temporal comparability of the financial information furnished on the different groups of products and services of the enterprise, or on its operations in particular geographic areas; this also includes the usefulness of such information for the assessment of the risks and returns of the enterprise taken as a whole.

Definitions of ordinary revenues, expenses, profit and loss, and assets and liabilities of a segment.

Additionally, the following terms are used in this Standard with the meanings specified below:

The ordinary segment revenue is formed by the ordinary revenues that, when included in the enterprise's profit and loss statement, are directly attributable to the segment, plus the relevant portion of the enterprise's general revenues that may be attributable to the segment by using a reasonable allocation base, with independence in both cases of whether the corresponding sales have been made to external clients or are due to transactions with other segments of the same enterprise.

The ordinary segment expense is formed by the expenses derived from operation activities that are directly attributable, plus the corresponding portion of the expenses that may be attributable to the segment by using a reasonable allocation base, and include both expenses relating to sales expenses to external clients and the expenses referring to transactions with other segments of the same enterprise. Segment expenses do not include:

a) interests, including advance payments or loans of other segments, unless the activities of the segment are of a fundamentally financial nature;

b) losses on the sale of investments or from rescue or debt payment operations, unless the activities of the segment are of a fundamentally financial nature;

c) participation of the enterprise in the losses of associate enterprises, joint business or other investments accounted for by the method of participation;

d) income tax expenses or,

e) general corporate expenses, head-office expenses or other expenses related to the financing of the enterprise as a whole. Nevertheless, on occasions the enterprise incurs expenses due to a segment. These expenses will be expenses of the segment if they are related to the business activities and may be directly attributable or allocable according to a reasonable allocating base.

In the segments of an essentially financial nature, positive and negative interests may be included in a single net item in the segment information, only if such items are also compensated in the enterprise's individual or consolidated financial statements.

The segment's profit and loss is the difference between the segment's ordinary revenues and its expenses. The segment's assets are those corresponding to the business activities used by the segment to carry out its activity, including those directly attributable to the segment in question and those that may be allocable to it, by using reasonable allocating bases.

If the segment's profit and loss include come from interests or dividends, its corresponding assets must include the accounts receivables, loans, investments or any revenue-producing assets.

Income tax assets may not be included in the segment's assets.

The investments that are accounted for by the equity method will only be included in the segment's assets if the profits and losses derived from such investments have been included as ordinary segment revenue. The segment's assets include the proportion of the participant in assets of any joint business activity that is accounted for by the proportional consolidation method, in accordance with IAS 31 Joint Ventures.

The segment's liabilities are those corresponding to the business activities used to carry out its activity and are directly attributable to the segment or that may be allocable to it, by using reasonable allocating bases.

If interest expenses have been included in the segment's profit and loss, the segment's liabilities will include the debts causing such interests.

The segment's liabilities include the proportion corresponding to the participant enterprise in the liabilities of any joint business activity that is accounted for by the proportional consolidation method, in accordance with IAS 31.

Income tax debts are not be included in the segment's liabilities.

The segment's accounting policies are those adopted to draw up and present the financial statements of the consolidated group or the enterprise, as well as all accounting policies that are specifically related to the segment's financial information.

The definitions of the ordinary revenue, expenses, assets and liabilities of the segment include both the amounts of the items directly attributable to it and those that may be allocable to it by using the reasonable allocation base. The enterprise should consider its internal financing system as the starting point for the identification of the above-mentioned items, which may be directly attributable or reasonably allocable among the segments. This means that it is assumed that items identified as belonging to segments, for internal information purposes, are also directly attributable and reasonably allocable to segments for the assessment in the external financial information, ordinary revenue, expenses, assets and liabilities of each segment for which information must be furnished.

The current assets used in carrying out the segment's business activity, the financial lease assets (see IAS 17 Leasing) and intangible assets are examples of a segment's assets. If a given amortization item of an asset is included in the segment's expenses, the corresponding asset will also be included in the segment's assets. The segment's assets do not include the assets used by the entity in its head-offices, or general overhead expenses. The segment's assets include the business activity assets shared by two or more segments, provided that there is a reasonable allocation criterion. A segment's assets will include the business fund that is directly attributable to the segment or which may be allocated to it by using reasonable criteria, in which case, the losses from the deterioration in value of this item will form part of the current expenses corresponding to the segment.

A segment's liabilities include business accounts payable and business activity debts, among others, as well as accrued liabilities, clients' advance payments, product warranty provisions and other debts related to the provisions derived from goods and services. IAS 11 includes some guidelines to distribute costs. These guidelines may be useful when attributing or allocating costs among the segments of an enterprise.

Although the accounting policies used in the preparation and presentation of an enterprise's financial statements jointly form the base of segment accounting policies, they will also include principles and policies specifically related to the segment information, such as how segments are identified, the methods used to set the transfer prices between them and the bases for the allocation of ordinary expenses and revenues to the segments.

III. ANALYSIS OF IAS 14

The purpose of the IAS 14 is to establish policies for financial reporting by segments about an enterprise's products or the geographic area in which it sells its products, in order to furnish the users of financial statements with information by segments, which make it possible to determine the performance of the enterprise in the past, assess its returns and risks and help establish better informed opinions about the entity as a whole.

The Standard obliges the entities to issue publicly-traded debt or capital certificates, which may be applicable to Central Banks when they issue debt instruments that are traded on the local market.

The determination of a business or geographic segment involves acknowledging that it is a question of furnishing financial information that complies with characteristics like Relevance, Reliability and Comparability.

Based on segments and their respective returns, the Standard proposes acknowledging the most important results of the entity and also the expenses that support the activities of the business or geographic segment, in which case some form of allocation of such expenses should be used.

Furthermore, it proposes minimum percentage parameters to acknowledge segments at 10% or the revenues on external sales or total assets. It also acknowledges that the total of the segments on which the entity shall report must exceed 75% of the consolidated revenues.

The risks and profitability of an enterprise are directly affected by the geographic location in which it carries out its business activities and the location of its markets. Consequently, the determination of a segment ...

The segment's profit and losses are determined by the difference between its revenues and expenses.

The segment's balance sheet is determined by showing the assets and liabilities directly used in carrying out its business activities.

The standard proposes a conciliation of the Expenses, Assets and Liabilities associated with the segment and the financial statement information.

Analysis of the problem posed by applying the standard in Central Banks

Central Banks, like any other business enterprise, keep assets and liabilities that are subject to returns and also to different risk levels. Furthermore, as a result of the role played, they have operations of a business nature with the local or international financial system, for example, the issuance of documents and investment in reserve assets, respectively. On the other hand, there are operations that are only carried out with fiscal sector enterprises, according to the guidelines defined in the respective organic laws.

Consequently, the organic laws of Central Banks become more relevant when applying accounting policies, because in certain cases, they establish, for example, specific accounting criteria to be followed and the destination of the results, among others. The above implies that changes in accounting policies require the review and approval of not only the administration,

but they could also require the corresponding change at a legislative level, and in other cases, the approval of the body that regulates the national banking activity.

Indeed, there are cases in which there is a higher degree of interference in accounting policy, for example, when certain specific accounting practices are established in the organic law that do not necessarily agree with international accounting standards. In this respect, we have Central Banks with a higher or lower degree of accounting policy definition, which has a direct impact on the degree of difficulty in adopting international accounting standards.

On the other hand, we must consider the existence of specific laws, other than organic laws, that may also affect the presentation of Central Banks' financial statements.

Consequently, given the special characteristics of Central Banks, because, as it is known, such organizations are largely entrusted with overseeing the stability of the currency and the normal functioning of the internal and external payment systems, for which they apply monetary, credit, financial and international exchange policies by regulating the amount of money and granting loans to diverse institutions, it could be said that even if it is possible to segregate financial information, mostly by business segment, through Notes to the Financial Statement, which refer to some principal operations, as in the case of international reserves and the issuance of documents for monetary purposes, this is not an easy task, and the accounting information furnished by the Central banks may not be of interest for the users.

Furthermore, the application of IAS 14 implies a degree of difficulty in the establishment of an accounts plan that makes it possible to furnish information on segment returns, an aspect that necessarily involves adapting the accounting information system, in order to comply with the requirement of more information to be disclosed together with the financial statements.

IV. PROPOSAL OF AN ALTERNATIVE GENERAL FRAMEWORK OR ACCOUNTING CRITERIA

Even though there are clear difficulties in integrally applying the IAS 14, progress could be made in its application in order to provide a vision by business or geographic segment of the Central Banks' operations, by considering some of the following elements:

- International reserve assets
- Internal credits
- Operations with the government , and
- Issuance of documents for monetary regulation.

This is provided that such segments represent a significant amount in the returns that could be generated by a Central Bank.

The financial information to be classified by segment is data of a complementary nature to the financial statements that should be included in the Notes to the Annual Financial Statements.

V. CONCLUSION

The application of IAS 14 in Central Banks is possible, in terms of following the objective of providing information that would make it possible to reveal each Central Bank's actions concerning certain important operations that may be subject to segmentation. Nevertheless, the implementation, in the case of some operations could imply new requirements in the re-adaptation of information systems at an accounting level, which in many cases would take time to start up.

The application would help reveal the origin of the most important results obtained by a Central Bank and the assets and liabilities that gave rise to such.