

Segmental Reporting under IFRS in the UK Retail sector

A review of the requirements under IAS14



From 2005, retailers whose equity or debt securities are publicly traded, and those in the process of issuing securities in the public markets, and any entities that choose to present segmental information, will have to report financial information by segment, together with comparative information for the prior period, in accordance with the rules detailed in IAS 14 - 'Segment reporting.'

The identification of segments is giving rise to some debate in the retail sector, particularly regarding the extent to which IAS14 may require the disclosure of more segments than have previously been disclosed under UK GAAP.

The purpose of this paper is to help inform this debate by reviewing the requirements of IAS14 and by surveying the segmental disclosures made by retailers:

- in the UK reporting under current UK GAAP
- in Europe
- in the US reporting under the requirements of the similar US standard, FAS131.

Reference is also made to retailers who have publicly commented on their proposed disclosures under IAS14.

The issue

IAS 14 distinguishes two classes of reportable segments, business and geographical, with entities having to provide information about both of these classes.

Determination of primary segments is dependent on the dominant source of an entity's risks and returns. If the impact on the retailer's risks and returns is determined predominantly by the fact it operates in different countries or geographical areas, then the primary segment should be based on geography. Conversely, if the impact on risks and returns is predominantly determined by differences in the products the retailer sells, then the primary segment should be business.

More information is required to be disclosed for the primary segment format. For example, the disclosure of the segment result is required for the primary segment analysis but not for the secondary.

The information that is required to be disclosed is substantial and includes segment result, assets and liabilities, and capital expenditure. There are rules for determining whether a sub-segment is sufficiently material for separate disclosure.

The key initial judgements are deciding which of 1 or 2 below, is primary by identifying which comprises the entity's dominant risks and returns:

1. Identifying the business segments
2. Identifying the geographical segments

Of these decisions the identification of business segments is giving rise to the most discussion. This debate arises from the fact that retailers usually have a significant amount of management information on product sales and outlets. For products the question arises as to whether retailers need to treat different products or categories of product as separate segments.

By way of example:

- Should a supermarket treat food and general merchandise as separate segments?
- In a department store chain, should different product categories be treated as separate segments?
- In an electrical chain are white and brown goods separate segments?

For each type of retail outlet information will often be available by departments within stores, by store, by region, by country, by type of

European Retailers		
Retailer	Year end	Segments
Carrefour Group (i)	31/12	The Carrefour Group will apply: - its geographic regions (France, Europe excluding France, Latin America, Asia) as the primary level. - its activities (hypermarkets, supermarkets, hard discount, other) as the secondary level.
Metro AG (ii)	31/12	Business 1. Cash & Carry 2. Food retail 3. Non-food specialty stores 4. Department stores 5. Other Geographical regions

Notes

- (i) Currently reports under French GAAP. Above segments are noted in the 2003 Annual Report as the expected reporting segments under IFRS
- (ii) Currently reports under IFRS.

outlet (hypermarket, supermarket, local, convenience, specialised,) and by fascia or brand.

The identification of geographical segments has caused less debate, perhaps because the globalisation of retail enterprises is in its infancy (with notable exceptions) and because retailers are accustomed to disclosing such information.

The requirements of IAS14

IAS14 approaches segmentation from two directions by distinguishing two reporting categories – business and geographical. Segmentation of both these categories is based on risk and return. Separate segments will be subject to risks and returns that are different from those of other segments.

On the basis that the predominant sources of risks affect how most entities are organised, the standard provides that the entity's organisational structure and its internal financial reporting system should be used as the basis for identifying its segments.

Therefore an entity's business and geographical segments for external reporting purposes shall be those organisational units for which information is reported to the board of directors and to the chief executive officer for the purpose of evaluating the unit's past performance and for making future allocations of resources. This is similar to the requirement of FAS 131 under US GAAP, in which a segment is defined as any component of an enterprise whose operating results are regularly reviewed by the enterprise's chief

operating decision maker in order to make decisions about resources to be allocated to the segment and to assess its performance.

IAS 14 further requires that segments identified in this manner also be based on individual products, or groups of related products or on geography. If this is not the case, then the primary segments should be based on either business or geographical segments that, in the judgement of management, reflect the primary sources of the entity's

risks and returns. They should be determined having regard to the definitions of business and geographical segments.

Thus, in essence, one should identify those segments that are reported to top management, and then decide whether those segments are based on groups of related products or groups of related geographies.

Retailers reporting under US GAAP		
Retailer	Year end	Segments
Wal-Mart	31/1	Business 1. Wal-Mart Stores 2. SAMS CLUB 3. International No further geographical analysis
The Home Depot	31/1	Single segment in one country
Target Corporation	31/1	Business 1. Target 2. Mervyns 3. Marshall Fields No further geographical analysis
Costco Companies	31/8	Business Single segment Geographical 1. US 2. Canada 3. Other International
Sears, Roebuck & Co	31/12	Business 1. Retail & Related Services 2. Credit & Financial Products 3. Corporate & Other 4. Sears Canada No further geographical analysis
Gap	31/12	Single segment in one country

Existing practices

PricewaterhouseCoopers has recently performed a global survey which reviewed the current reporting practices of top listed retailers globally, UK FTSE100 retailers and selected European retailers. The results must be treated with some caution since only one of the survey participants (Metro) currently reports under IFRS and one (Carrefour) has indicated its expected IFRS segments. On the other hand the US standard, FAS131, is similar to IAS14 in identifying the nature of the information reported to top management as a key determinant of segments. Accordingly, the practices of US retailers are relevant.

Segmentation in practice

- In the survey not a single retailer identifies a merchandise category or group of merchandise categories as a segment of the business. However, financial services are separately segmented relatively frequently.
- Internet functions appear to rarely be material.
- A number of specialist retailers in the US consider that they operate in a single segment and consequently give no further information as the financial statements as a whole give the segment information. It should be noted, however, that the SEC has announced that it intends to review segmental disclosure for compliance with US GAAP and this may result in changes in US practice.
- The most frequent forms of segmentation are by fascia (separate chains and organisational units) and by geography.

Conclusions

The application of IFRS14 to a particular enterprise must, of course, depend on the particular circumstances of that organisation and it is impossible to draw hard and fast rules for the judgemental aspects of accounting standards.

The observations drawn from this note are:

Requirements of IAS14

- The actual organisational structure of the enterprise is highly relevant which may lead to different decisions for retailers operating a number of fascias compared to those operating a single chain.

- It will only be in rare cases that segment information is presented differently from the information presented to top management.
- Top management is the CEO, the board and particularly the non-executive directors.
- The judgements involved in determining the enterpriser's segments should take account of the relevance, reliability and comparability over time of the segment financial information and its usefulness for assessing the risks and returns of the entity as a whole. The requirement for reliability may be significant for retailers because whilst there is often much information on sales and gross margin, retailers very rarely have reliable systems that can allocate assets, liabilities and capital expenditure on the same basis.

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