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CHANGES IN SEGMENT REPORTING IN THE AUSTRALIAN BANKING INDUSTRY

For a diversified company, segments may vary significantly in terms of profitability, risks and returns. It is difficult, if not impossible, for users of financial reports to identify those differences without supplementary information provided by segment disclosures (Herrmann and Thomas 1996). Information about the different products and services a firm provides and the different geographical areas in which it operates is known as a segment report.

This paper examines segment reporting in the Australian banking industry during the period 2000–03. The banking industry was chosen for this study mainly because of its general homogeneity and significance in the economy, both in Australia and worldwide. The period 2000–03 saw the withdrawal of the original AASB 1005 *Financial Reporting by Segments* and the introduction of the revised AASB 1005 *Segment Reporting* (reissued as AASB 114 *Segment Reporting* as part of Australian adoption of equivalents of IASB standards). The introduction of the revised standard has resulted in significant changes to segment reporting, specifically the manner in which entities disclose their segment data.

The paper evaluates the disclosure practices of seven Australian banks and determines whether their practices changed significantly after the introduction of the revised standard. It also evaluates the segment reports to determine whether there are implications for the qualitative characteristics outlined in the AASB Framework's *Qualitative Characteristics of Financial Reports*. We specifically examine the characteristics of understandability, relevance, reliability and comparability and determine whether these characteristics are more or less evident since the introduction of the revised standard.

We use the Connect 4 database of large Australian publicly listed firms to analyse segment reports during the four-year period. Our results indicate that compared with the previous

This paper examines changes in segment reporting in the Australian banking industry following the introduction of the revised AASB 1005 Segment Reporting. We find that the standard has implications for the qualitative characteristics of “understandability” and “comparability”. Feedback on the revised standard is timely, as both the AASB and the IASB have recently issued new segmental reporting standards that are based on US GAAP’s management approach of determining operating segments.

AASB 1005 there are major changes in reporting practices. For example, the requirement to identify primary and secondary segments, with substantially more data disclosed for primary segments, has dramatically increased the number of items contained in the segment report. We also find that for most of the banks the number of segments reported has increased.

Our evaluation finds that the revised standard has implications for the characteristic of understandability, as there is now additional descriptive information in the segment disclosures which should enhance the understanding of the more complex information disclosed in the report. There are issues concerning the characteristic of comparability, as there are inconsistencies in the reporting of segments between the different firms.

The findings of this paper have implications for standard-setters. By assessing the change in firms' segment disclosures after the adoption of the revised AASB 1005, this paper provides some insight to the effectiveness of the current Australian standard. The paper is timely as the AASB has recently issued AASB 8 *Operating Segments* which will ultimately result in further segment reporting changes for Australian firms.

BACKGROUND TO SEGMENT REPORTING

Segment information is fundamentally indispensable and integral to the investment analysis process (AIMR 1992, p. 39). Berg (1990) finds that market announcements result in more significant stock price changes when segments are identified. Hope *et al* (2004) suggest that the pricing of foreign earnings is associated with important aspects of the firm's information environment in terms of segment disclosure. Corporate collapses involving the loss of hundreds of millions of dollars in Australia (and elsewhere including the US) in the early years of the 21st century have highlighted the important role of disclosure and compliance. In the past decade, segment reporting standards have changed dramatically in the US, Australia and EU countries. Users of financial statements had long been expressing their concerns about the usefulness of segment reporting.

The revised Australian segment standard provides specific guidance to improving segment reporting's quality. The standard requires firms to adopt the management approach of defining segments, and to distinguish between primary and secondary segments, determined by the source and nature of the entities' risks and rewards. More information is to be disclosed for primary segments and significantly less information is disclosed for secondary segments.

In July 2004, the AASB issued Australian equivalents of the IASB standards including AASB 114 *Segment Reporting*, which is a reproduction of IAS 14 *Segment Reporting*. There are no significant differences between AASB 114 and the revised AASB 1005 that it supersedes. As part of the process of issuing AASB equivalents to IASB standards, the AASB reviewed the Australian conceptual framework (Statements of Accounting Concepts) for consistency with the international framework. On 1 January 2005, SAC 3 was superseded by the AASB's Framework for the Preparation of Financial Statements based on the IASB Framework. The Framework identifies *relevance* and *reliability* as the primary qualitative characteristics which financial information should possess to satisfy the objectives of general purpose financial reporting. Financial reporting is *relevant* if it has the capacity to influence users' decision-making. The information should assist in predicting and confirming information for decision-makers. *Reliable* information is information that faithfully represents the effects of transactions and events it reflects. The information is reliable if it is free from material error and is complete (CPA Australia 2006).

Comparability and *understandability* are the two other qualitative characteristics recognised in the Framework. Users should be able to make within-firm comparisons and also between-firm comparisons based on the accounting information disclosed. This implies all firms need to measure and display transactions in a consistent manner. The reported information should be disclosed in a manner that is easy for users to understand (CPA Australia 2006). However, it is assumed that users have a reasonable knowledge of business and economic activities.

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RELEVANT LITERATURE

Tyson and Jacobs (1987) conducted a US study on segment reporting and the banking industry by analysing 10 large American banks to determine whether the original segment standard SFAS 14 achieved the objectives of the conceptual framework. The findings suggested that the discretion allowed to management resulted in a lack of consistency in segment disclosures between the sample banks which had consequences for the qualitative characteristics of reliability, understandability and decision-usefulness.

An Australian study by Gavens (1989) followed up the US study by investigating segment reporting in the Australian banking industry. This study examined whether the segment disclosures of six banks satisfied the qualitative characteristics contained in the proposed conceptual framework. The findings indicated that significant ambiguities in the wording of the standard resulted in a large degree of subjectivity by the preparers of the reports. The study recommended significant changes to ensure that future applications of the standard would satisfy the needs of the conceptual framework.

Several US papers examine the impact of the revised SFAS 131 to show whether the entities have responded to the change in regulatory requirements (Herrmann and Thomas 2000, Street *et al* 2000, Doupnik and Seese 2001). These studies compare segment reporting before and after the change in standard and find that entities comply with the additional reporting requirements and disclose more items for each operating segment under the new standard. Street *et al* report that the consistency of segment information has also improved.

RESEARCH QUESTIONS

The revised AASB 1005 *Segment Reporting* provides more guidance for preparers of financial statements in defining their reportable segments. The standard also requires additional explanatory information regarding the reportable segments and the reconciliation with the consolidated figures from the financial statements. These changes in requirements have implications for the number of segments reported, the number of items reported for each segment and the presentation of the segment information. The changes also have implications for the Framework's qualitative characteristics of financial information — relevance, reliability, understandability and comparability.

Number of segments

Under original segment standards, firms could avoid segment disclosures by exploiting the vagueness of the definition of reportable segments (Gavens 1989). Further, previous studies (Wines

1997, Birt 2002) show that under the original standard there was a tendency for firms to group together some geographical segments which did not exhibit similarities in terms of economic and political conditions, proximity in operations, special risks associated with operations in a particular area and underlying currency risks. This grouping of geographic segments into vague reportable segments could have led to an unfaithful representation of each entity's geographical activity, adversely affecting the qualitative characteristic of reliability.

There are also possible implications for the characteristic of understandability, as it may be difficult to interpret a segment which is a vague, ambiguous grouping of geographic regions. The revised AASB 1005 reduces the discretion left to firms by providing more guidance on identifying reportable segments. For example, the standard requires that business and geographical segments are defined according to the internal segmentation on which management decision-making is based. It also states that firms can combine two internally reported segments only if they are substantially similar (para. 4.7). These changes should result in an increase in the number of segments reported. The reporting of a new segment by a company should affect the assessment by users of the risks and opportunities facing the company, as the additional disclosure of segment data can assist users in making future predictions, thus enhancing the qualitative characteristic of relevance. The segment disclosures are also likely to be more reliable, as there is less scope for error and the disclosures are more complete.

Research question 1: Has the revised AASB 1005 resulted in an increase in the number of disclosed segments in the banking sector?

Number of disclosed items

The revised standard has led to more extensive mandatory disclosures for a firm's primary segment. Para. 6.1 requires additional disclosures relating to:

- segment liabilities;
- the total amount recognised during the reporting period for the acquisition of segment non-current assets;
- depreciation and amortisation expense;
- non-cash expenses other than depreciation and amortisation;
- the firm's share of the net profit or loss result and the carrying amount of the investment in an associate.

As a result, the revised AASB 1005 requires at least nine items to be disclosed for the primary segment, compared with the previous standard's mandatory three items of revenue, results and assets. If a segment report results in the user understanding more about the total company per-

formance compared with the consolidated data alone, then the information is seen as being relevant to the users (Emmanuel and Gray 2002).

Research question 2: Has the number of disclosed items increased under the revised AASB 1005?

Additional descriptive information

The revised AASB1005 (para. 6.11) requires the entity to disclose the types of products and services included in each reportable business segment and indicate the composition of each reported geographical segment, both primary and secondary. The additional descriptive information should assist users in understanding the segment reports as it provides greater explanation about the reportable segments.

Research question 3: Are the banks disclosing additional descriptive information?

Consistency of segment information

The revised standard (para. 6.9) requires that firms disclose changes in accounting policies that have a material effect on segment reporting and that prior-period segment information presented for comparative purposes is restated under the new standard. These disclosures should include a

description of the change and reason for the change. The more extensive requirements of the revised standard, combined with the explanations of any changes in disclosures, should lead to more consistent disclosures. It may also enable within-firm comparisons of segment disclosures. Users reportedly favour segments identified and reported consistently in respect to industry sectors or sub-sectors (Emmanuel and Gray 1977).

Research question 4: Is there consistency in segment disclosures within banks and between banks?

DATA AND RESULTS

Seven banks were selected on the basis that they disclosed segments during the period 2000–03 and are representative of a wide range of Australian banks. Connect 4 shows that in 2000 nine banks were listed on the Australian Stock Exchange; however, two (Bank of Queensland and Bank of Western Australia) did not disclose segment data. Their annual reports stated: “The consolidated Entity primarily operates in the banking and finance industry in Australia. Activity outside this industry and geographical segment is not material and has not been separately disclosed.” The sample banks used in this study represent 77%

TABLE 1: SAMPLE BANKS 2000-03					
Banks	Abbreviation	Segment disclosure			
		2000	2001	2002	2003
Adelaide Bank Limited	ADB	Yes	No	Yes	Yes
Australia and New Zealand	ANZ	Yes	Yes	Yes	Yes
Bendigo Bank Limited	BEN	Yes	Yes	Yes	Yes
Commonwealth Bank Of Australia	CBA	Yes	Yes	Yes	Yes
National Australia Bank Limited	NAB	Yes	Yes	Yes	Yes
St George Bank Limited	SGB	Yes	Yes	Yes	Yes
Westpac Banking Corporation	WBC	Yes	Yes	Yes	Yes
Banks that disclosed segment information		7	6	7	7

TABLE 2: NUMBER OF DISCLOSED SEGMENTS: LINE OF BUSINESS AND GEOGRAPHIC SEGMENTS								
	Line of business				Geographic			
	2000	2001	2002	2003	2000	2001	2002	2003
ADB	3	0	5	5	0	0	0	0
ANZ	3	3	8	10	5	3	3	3
BEN	3	3	3	3	0	0	0	0
CBA	2	3	3	3	3	3	3	3
NAB	6	6	6	6	6	6	6	6
SGB	3	3	5	5	0	0	0	0
WBC	4	4	5	5	6	3	3	3
Mean	3.43	3.14	5.00	5.29	2.86	2.14	2.14	2.14
Combined Mean	3.29		5.14		2.50		2.14	
P-value	0.009				0.690			

TABLE 3: ITEMS DISCLOSED FOR PRIMARY SEGMENT AND NUMBER OF BANKS				
	2000	2001	2002	2003
Items	No of items	No of items	No of items	No of items
Revenue (external)	7	6	7	7
Revenue (internal)	4	4	4	4
Segment result	7	6	7	7
Segment assets	7	6	7	7
Segment liabilities	2	4	7	7
Acquisition of non-current asset	0	3	5	5
Depreciation and amortisation	3	3	6	6
Non-cash expenses other than depreciation	0	2	4	4
Share of profit and investment in associates	0	2	4	4

of Australia's major banks and their segment disclosures for the period 2000–03 are illustrated in Table 1.

The sample banks' annual reports were obtained from the online annual report database Data Analysis, the Connect 4 database, or through the company's website. The methodology is similar to the key study on segment reporting in the US banking industry, Tyson and Jacobs (1987), which enables comparisons with that study. In both studies segment reports were extracted and form the basis of the information used in the study. Both also investigate what can be described as a homogeneous group of banks from their respective countries, thus facilitating the desired comparisons.

RQ 1: *Has the revised AASB 1005 resulted in an increase in the number of disclosed segments in the banking sector?* Table 2 illustrates the number of segments during the period 2000–03 for the seven banks. During the application of the old standard the mean number of business segments decreased from 3.43 to 3.14. This is mainly due to the non-disclosure of segment information by Adelaide Bank in 2001. The bank's 2001 annual report stated: "Operations and assets are in the banking and finance industry in Australia. Activity outside this industry is not material and has not been separately disclosed." It did however disclose industry data in 2000.

With the introduction of the revised standard in 2002, the mean number of business segments increased to 5.00 and it increased further to 5.29 in 2003. We conducted a paired sample *t*-test which compared the average number of segments reported before (in 2000 and 2001) and after (in 2002 and 2003) the implementation of the revised standard and the respective means were significantly different ($p = 0.009$). The effect of the revised AASB 1005 on the number of business segments is notable in the case of ANZ Banking Group and St George Bank. Bendigo Bank and National Australia Bank reported the same number of segments in the four years and the

other five banks increased the number of segments.

Table 2 also illustrates the changes in the number of geographic segments. In 2000, the mean number of geographic segments was 2.86 and this decreased to 2.14 in 2001. After the introduction of the revised standard, the mean number of geographic segments remained the same at 2.14 for both 2002 and 2003. We conducted a paired sample *t*-test and the respective means were not significantly different ($p = 0.69$).

RQ 2: *Has the number of disclosed items increased under the revised AASB 1005?* Table 3 illustrates the number of primary-segment disclosures made by the sample banks during the period of the study. Under the old standard in 2000, all seven of the sample banks disclosed the three mandatory items of revenue, result and assets. In 2001, due to the early adoption of the revised AASB 1005, several banks reported the additional items of liabilities, acquisition of non-current assets, depreciation and amortisation, other non-cash items and equity-accounted investments. In 2002 and 2003, all of the sample banks disclosed revenue, result, assets and liabilities and all but one disclosed depreciation. Thus the number of disclosed items has increased under the revised AASB 1005 in line with its reporting requirements.

In general, the data reveal that the revised AASB 1005 was effective in increasing the number of disclosed items for primary segments among the sample banks. An increase in disclosure should improve the users' understanding of the resources committed by the banks and the risks and returns of those segments, thereby providing more help in decisions about the allocation of resources. The information relating to asset levels can be used to form predictions about future cashflows in order to determine appropriate measurements for the assets. For example, liability and non-current assets can be assessed for recoverability. By assisting users in forming better predictions about the asset structure of the

banks, the qualitative characteristic of relevance is improved. Further, more relevant segment information increases the users' ability to understand the banks' activities and comprehend the meaning of its financial statements.

RQ 3: *Are the banks disclosing additional descriptive information?* Five of the banks, ANZ, BEN, NAB, CBA and WBC, provided additional segment descriptions before and after the revised standard. The amount of additional segment information for these banks did not change during the 2000–03 period apart from ANZ, which provided substantially more additional information after the implementation of the revised standard. In 2003 ANZ provided a description of its nine major business segments and reported that the institutional financial services segment provides “institutional banking, transaction services, foreign exchange, capital markets, structured finance, corporate finance and advisory services”. Of the remaining two banks, SGB provided additional descriptive information from 2002 and described its business segments as consisting of “personal customers, institutional and business banking, BankSA and wealth management”. It reported that its personal customers segment is responsible for “residential and consumer lending, provision of personal financial services, etc”. The remaining bank, ADB, reduced the amount of additional information.

In summary, the revised standard has resulted in a slight increase in the additional information reported. This finding has implications for the qualitative characteristic of understandability. The disclosure of additional segment description may enhance users' understanding of the entity's background and activities, and consequently improve their understanding of the entity's financial report overall.

RQ 4: *Is there consistency in segment disclosures within banks and between banks?* With the implementation of the revised standard, the segment reporting format changed dramatically for the sample banks. Under the old standard, because of the lack of guidance, banks tended to report their segment results in an incoherent fashion; some reports were several pages long, others were the equivalent of a quarter-page. The ANZ bank adopted the revised standard early and consequently its segment disclosure was more detailed and comprehensive. Several of the banks reported voluntary segment information above the mandatory items. The inconsistency of the segment reports has implications for the qualitative characteristic of comparability. It is difficult to compare segments between firms because of the differences in presentation.

The revised AASB 1005 states that the basis of segment reporting should be classified into primary and secondary segments with considera-

bly more information to be disclosed for the primary segment. In 2000, under the old standard, there was no requirement for the identification of the primary and secondary segments. While all our sample banks have complied with the revised AASB 1005, and are now reporting primary and secondary segments, there is still inconsistency in the reporting. Some banks provide the additional descriptive information as an introduction to the segment report while others provide the information at the conclusion of the segment report. Some banks report voluntary segment data such as segment profit after tax, a breakdown of different types of segment revenue, significant items and bad and doubtful debts. All firms provide segment data for two years, although in some cases there were inconsistencies in the two years.

Our analysis shows that disclosure practices of the sample banks are inconsistent in areas including length of segment report, amount of voluntary segment data, provision of additional descriptive information and the general format of the report. This has implications for the qualitative characteristic of comparability. The introduction of the revised standard has not resulted in firms measuring and displaying transactions in a consistent manner.

CONCLUSION

This research provides some feedback to standard-setters on the implementation of the revised standard AASB 1005. This is timely, as the AASB recently issued new a new segment reporting standard, AASB 8 *Operating Segments*, which will have consequences for Australian segment reporting.

Our findings suggest that the number of segments and the number of disclosed items for primary segments has increased under the revised standard, which has possible implications for the qualitative characteristics of relevance and understandability. The disclosure of additional information should assist users in understanding banks' activities. Further, the application of the revised standard has resulted in the disclosure of additional segment descriptive information which again has implications for the qualitative characteristics of relevance and understandability. However, it appears that disclosure practice by the sample banks is still inconsistent in several areas including provision of additional descriptive information and the general format of the report. This has implications for the qualitative characteristic of comparability.

This paper has limitations. First, the investigation of a single industry makes it difficult to generalise the findings to the wider population of listed companies. Seven listed banks cannot be

said to be representative of the Australian capital market; however, they are representative of the Australian banking sector. Second, focusing solely on the banking industry has advantages and disadvantages. General homogeneity makes comparability between banks more relevant; however, since they are not representative of a wide range of entities, the study has limited value in evaluating the new standard regarding general compliance.

Finally, the research could be expanded beyond the 2003 time period to increase its value in providing feedback to standard-setting bodies. Future research could also investigate the recently issued AASB 8 *Operating Segments* and determine whether there are any early-adopters of this new standard and what are the implications of adoption for the banking industry and the wider Australian capital market.

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