Financial Accounting Standard No. (22)

Segment Reporting

Contents

Preface

The purpose of this Standard is to establish principles for reporting financial information by segments – information about the different types of products and services that an Islamic financial institution (IFI)[1] offers and the different geographical locations in which it operates – to help users of the financial statements:

a) Better understand the IFI's performance;
b) Identify the resources allocated to support the major activities of the institution;
c) Better assess the institution's risk and returns; and
d) Enhance the transparency of financial reporting prepared by the institution.

(1) Referred to hereafter as institution or institutions including Islamic banks.

Statement of the Standard

1. Scope of the Standard

This standard is applicable to a set of financial statements which includes, statement of financial position (the balance sheet) and income statement, prepared and published by Islamic financial institutions (IFIs), regardless of their legal form, country of incorporation or size.

Segment information is to be presented for each of the parent, subsidiary or associate's separate financial statements. However, if both consolidated financial statements of an IFI or its subsidiary or associate and the separate financial statements of the parent institution are presented together, segment information need only be presented on the basis of the consolidated financial statements.

This Standard should be applied by institutions irrespective of whether their securities are publicly traded or privately held, or are in the process of issuing securities in public securities market.

Should the requirements of this standard be in conflict with an institution's charter or the laws and regulations of the country in which it operates, a disclosure should be made to that effect. (para. 1)

2. Operating Segment

2/1 An operating segment is a distinguishable component within an IFI:

2/1/1 Which engages in business activities or a group of related activities, from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same institution);

2/1/2 Whose operating results are regularly reviewed by the institution's chief operating decision maker (board of directors or chief executive officer) to make decisions about the resources to be allocated to the segment and assess its performance; and

2/1/3 For which discrete financial information is available. (para. 2)

2/2 An operating segment may engage in business activities for which it has yet to earn revenues, for example, start-up operations may be operating segments before earning revenues. (para. 3)

2/3 An operating segment is divided into Business segments and Geographic segments. A business segment is a distinguishable component that is engaged in providing an individual product or service or a group of related products or services which may have risks and returns that may be different from those of other business segments. A geographic segment is a distinguishable component that is engaged in providing an individual product or service or a group of related products or services within a particular economic environment which may have risks and returns that may be different from the components operating in other economic environment. (para. 4)

2/4 Two or more business segments that are substantially similar may be combined as a single business segment if the segments are substantially similar in the majority of the following areas:

a) Their long term financial performance,
b) The nature of the products and services,
c) The type or class of customers for their products and services,
d) The method used to distribute their products or provide their services. (para. 5)

2/5 Two or more geographic segments that are substantially similar may be combined as a single geographic segment if the segments are substantially similar in the majority of the following areas:

a) Similarity of economic and political conditions,
b) Relationships between operations in different geographical areas,
c) Proximity of operations. (para. 6)

3. Reportable Segment

3/1 A reportable segment is a Business and Geographic segment identified in accordance with (para. 4) and that results from aggregating two or more of those segments in accordance with (para. 5) or (para. 6) and exceeds the quantitative thresholds described in (para. 8) below. (para. 7)

3/2 An IFI should disclose separate information about a reportable segment that meets any of the following quantitative thresholds:

a) Its reported revenue is 10% or more of the total revenue; or
b) Its segment result, whether profit or loss, is 10% or more of the combined result of all segments in profit or the combined result of all segments in loss, whichever is greater in absolute amount; or
c) Its assets are 10% or more of the total assets of all segments. (para. 8)

3/3 An IFI may combine information about reportable segments that do not meet the quantitative thresholds in (para. 8) above to produce a separate reportable segment only if the segments share a majority of the criteria listed in (para. 5 or 6). (para. 9)

3/4 Information about other segments that are not separately reportable shall be combined and disclosed in an “Other” category, separate from other reconciling items mentioned in (para. 7 and 8). (para. 10)

4. Disclosure Requirements

4/1 Specific disclosure

The disclosure requirements below should be applied to each reportable segment.

4/1/1 Disclosure should be made regarding segment revenue and segment expense for each reportable segment, classified according to the headings in the Income Statement. Segment revenue resulting from external customers and segment revenue from transactions with other segments should be separately reported. (para. 11)

4/1/2 Disclosure should be made regarding segment result for each reportable segment. (para. 12)

4/1/3 Disclosure should be made regarding the total amount of segment assets for each segment, classified according to the headings in the Statement of Financial Position. Disclosure should be made regarding the total amount of segment liabilities for each segment, classified according to the headings in the Statement of Financial Position. (para. 13)

4/1/4 Disclosure should also be made of the nature and amount of any extraordinary items of segment revenue and segment expense, that their disclosure is relevant to explain the performance of each segment. (para. 14)

4/1/5 An IFI should present reconciliation between information disclosed for reportable segments and aggregated information in the consolidated or institution financial statements. In presenting the reconciliation, segment revenue should be reconciled to institution revenue; segment expense should be reconciled to institution's expense; segment assets should be reconciled to institution's assets; and segment liabilities should be reconciled to institution's liabilities. (para. 15)

4/2 General disclosure

4/2/1 The IFI shall disclose the factors used to identify the reportable segments, including the basis of organisation (for example, whether management has chosen to organise the institution around differences in products and services, geographic areas, regulatory environments, or a combination of factors and whether reportable segments have been aggregated). If discrete financial information to distinguish components of an IFI is not available, then a statement to this effect shall be made. (para. 16)

4/2/2 The institution shall also disclose the types of products and services from which each reportable segment derives its revenues. (para. 17)

4/2/3 If not otherwise disclosed in the financial statements or elsewhere in the annual report, the institution is encouraged to disclose the broad operating objectives established for each segment at the commencement of the reporting period and to comment on the extent to which those objectives were achieved. (para. 18)

4/2/4 If a segment is identified as a segment for the first time in the current period, prior period segment data that is presented for comparative purposes should be reclassified to reflect the newly reported segment as a separate segment. (para. 19)

4/2/5 If the institution changes the identification of its segments in a manner that causes the composition of its reportable segments to change, the corresponding information for earlier periods shall be reclassified. (para. 20)

4/2/6 If an institution changes the identification of its segments and it does not reclassify prior period segment information on the new basis because it is impracticable to do so, then for the purpose of comparison, an institution should report segment data for both the old and the new bases of segmentation in the year in which it changes the identification of its segments. (para. 21)

4/2/7 Segment information should be prepared in conformity with the accounting policies adopted for preparing and presenting the financial statements of the consolidated group and/or institution. (para. 22)

4/2/8 Changes in accounting policies adopted that have a material effect on segment reporting should be disclosed, and prior period segment information presented for comparative purposes should be restated unless it is impracticable to do so. Such disclosure should include a description of the nature of change, the reasons for change, the fact that comparative information has been restated or that it is impracticable to do so, and the financial effect of change if it is reasonably determinable. (para. 23)

4/2/9 The disclosure requirements stated in Financial Accounting Standard No. (1): General Presentation and Disclosure in the Financial Statements of Islamic Financial Institutions should be observed. (para. 24)

5. Effective Date

This Standard shall be effective for financial periods beginning 1 Muharram 1426 A.H. or 1 January 2005 A.D. (para. 25)

Adoption of the Standard

The Standard on Segment Reporting was adopted by the Accounting and Auditing Standards Board in its meeting No. (27) held on 20-21 Jumada I, 1425 A.H., corresponding to 8-9 June 2004 A.D.

Members of the Board

1. Mr. Amer Sulaiman Al-Beireqdar	Chairman
2. Mr. Essa Abdullah Zainal	Deputy Chairman
3. Mr. Ebrahim Sidat	
4. Mr. David Vicary	
5. Mr. Salman Bin Essa Al Khalifa	
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7. Mr. Abdul-Hamid Abu Mousa	
8. Dr. Abdul-Hamid Mahmmod Al Bali	
9. Sheikh Essam Mohammed Ishaq	
10. Mr. Mohammed Al Hassan Al Shaikh	
11. Mr. Mohammed Alawi Thiban	
12. Mr. Mohammed Said Abdel-Wahab	
13. Dr. Nordin Mohammed Zain	
14. Dr. Mohamed Nedal Alchaar	Secretary General/ Rapporteur

Appendix (A)
Brief History of
the Preparation of the Standard

In its meeting No. (16) held in Jeddah in Saudi Arabia on 8-9 Ramadan 1419 A.H., corresponding to 26-27 December 1998 A.D., the Accounting and Auditing Standards Board decided to give priority to the preparation of a standard on Segment Reporting.

On Sha'ban 1423 A.H., corresponding to 9 November 2002 A.D., a consultant was commissioned to prepare a preliminary study on the accounting aspects of the standard.

The Accounting Standards Committee discussed in its meeting No. (36) held in the Kingdom of Bahrain on 22 Rabi' I, 1424 A.H., corresponding to 22 June 2003 A.D., the preliminary study and made the necessary amendments. The Committee also discussed the revised accounting study and the exposure draft of the standard in its meeting No. (37) held in the Kingdom of Bahrain on 22 Jumada I, 1424 A.H., corresponding to 23 July 2003 A.D., and requested the consultant to make the necessary amendments in light of the comments made by the members.

The revised exposure draft of the standard was discussed by the Accounting Standards Committee meeting No. (38) held in Kingdom of Bahrain on 10 Rajab 1424 A.H., corresponding to 7 September 2003 A.D., and the necessary amendments were made. The Accounting Standards Committee also discussed the revised exposure draft in its meeting No. (39) held in the Kingdom of Bahrain on 2 Sha'ban 1424 A.H., corresponding to 28 September 2003 A.D., and requested the consultant to make the necessary amendments in light of the comments made by the members.

The exposure draft of the standard was discussed by the Shari'a Committee for Standards in its meeting No. (8) held in the Kingdom of Bahrain on

10 Sha'ban 1424 A.H., corresponding to 6 October 2003 A.D., and some additional amendments were made.

The amended exposure draft was discussed in the Accounting and Auditing Standards Board meeting No. (26) held in the Kingdom of Bahrain on 15-16 Shawwal 1424 A.H., corresponding to 9-10 December 2003 A.D. The Accounting and Auditing Standards Board made some amendments to the exposure draft and decided that it should be distributed to specialists and interested parties to obtain their comments on the exposure draft in order to discuss them in a listening session.

The Accounting Standards Committee held its meeting No. (40) on 28 Shawwal 1424 A.H., corresponding to 22 December 2003 A.D., and it meeting No. (41) on 19 Dhul-Hajjah 1424 A.H., corresponding to 10 February 2004 A.D., in Bahrain to discuss the comments made on the exposure draft. The Committee made the necessary amendments, which it deemed necessary in light of the discussions took place in the listening session and the Accounting Standard Board meeting.

The Accounting and Auditing Standards Board adopted the proposed standard in its meeting No. (27) held in Bahrain on 20 and 21 Jumada I, 1425 A.H., corresponding to 8 and 9 June 2004 A.D.

Appendix (B) Juristic Rules for Segment Reporting

The principle of preparing reports by the institutions on their various activities in order to meet the objectives stated in the preface of this standard is based on the need to a mechanism for users of financial statements that are prepared by the institutions. These statements would enable the users to have cognizance of the directions of such activities. This is a fundamental requirement due to the nature of the institutions' contractual relationships that differ from conventional banks' contractual relationships. The latter's contractual relationship is manifested in a borrower-lender relationship without given much consideration to the outcome of use and investment of money. The operations of the institutions depend on the following relationships:

- If the relationship is based on Mudaraba, then the financier (rabb al-mal) is entitled to assess and supervise activities of the mudarib and ensure that the contractual limitations, if any, are observed. This is not contrary to the principle of non-interference in the work of the mudarib.
- If the relationship is based on agency, the principal is absolutely entitled to observe investment operations that are conducted based on appointment as agent, especially in view of the fact that the agent's remuneration would not be affected by the outcome of investment. There is thus a need for the principal to be aware of various products and services and circumstances surrounding these products and services. All these issues concern the stakeholders in order to assist them to know the performance of the management.

As for the content of the reports, the requirements stated in the Standard must be reflected in the reports. The objective of separation or consolidation of reports is to present sound reports and this is based on the principle that any person given an admission must do so in a manner that others may benefit from his admission. The reports have similarity with the principle of admission in addition to the fact that these reports are conveying realities and activities. This is because the issuing entity of the report is conveying its liabilities and rights to others for which the reports must be adequate and truthful.

Appendix (C)
Reasons for the Standard

Islamic Financial Institutions (IFIs) have been established to assist investors to utilise their funds in a beneficial manner that is consistent with the principles of Shari'a. In making the choice of investing or depositing funds in or dealing with one IFI versus the other, is dependent on the users analysis and evaluation of the financial statement, having confidence in the bank's ability to maintain its capital at a level sufficient to provide safety for depositors funds, and its ability to realize rates of returns for both the equity and the investment accountholders, commensurate with the assumed level of risk.

Segment reporting provides this indispensable tool in the evaluation and analysis of the IFIs. This is because users of financial statements will be able to understand and analyse the various ingredients that is contributing towards the banks returns and the risks are being assumed. This is because disaggregated information highlights the relative strengths and weaknesses of the different areas of an Islamic financial institution's (IFI) operations, increases transparency, and therefore aids the users of financial statements to compare the performance of Islamic financial institutions (IFIs), and be able to make informed economic decisions.

The reasons for preparing this standard emanate from the following observations, concluded from a survey conducted on Islamic financial institutions:

- The structure of an IFI is regarded more akin to that of a universal bank, practicing a combination of investment and retail banking operation. The IFI is therefore exposed to different types of risks, rates of returns and capital needs, as compared to conventional financial institutions. Currently, there are not many yardsticks that are available to assist users to make comparisons, and as a result, this lack of comparability often puts the IFI at a disadvantage, for example in terms of higher cost of capital, as external institutions such as rating agencies are unable to make informed judgement or comparison. The provision of disaggregated data may be able to overcome this apparent disadvantage of IFIs.

- Improved segment disclosure also helps ensure that the capital is allocated more efficiently and effectively, and can result in lowering the cost of capital for less risky firms.
- The prevailing standards on segment reporting applies predominantly to entities whose equity or debt securities are publicly traded. As many IFIs do not fall within this category, users are unable to make reasonable comparisons of the performance of the IFIs.
- In addition, these standards allow differences in the approach adopted to identifying reportable segments, which result in heavy reliance on judgement. Consequently, some IFIs have produced information that is relevant but not comparable and vice versa. The relevance over comparability debate is not trivial. Those responsible for raising and allocating capital need to earn maximum total return, and tend to require data that are more aggregated (i.e., relevant), while those responsible for managing the resources of the banks need concrete and heterogeneous data (i.e., comparable).

Appendix (D)
Basis for Conclusions

The Accounting Standards Committee discussed in its meetings the alternative accounting treatments for segment reporting that were stated in the initial study. The Committee recommended the adoption of the alternatives which was found to be in compliance with the provisions of the previous Financial Accounting Statement No. (1): Objectives of Accounting for Islamic Banks and Financial Institutions and previous Financial Accounting Statement No. (2): Concepts of Accounting for Islamic Banks and Islamic Financial Institutions (Statement of Concepts).

Operating Segment

The method chosen for determining what information to report is referred to as the ‘management’ approach, which is based on the way that the management organises the segments within the institution for making operating decisions and assessing performance. Consequently, the segments are evident from the structure of the institution’s internal organization, and the financial statement preparers should be able to provide the required information in a cost-effective and timely manner. The management approach facilitates consistent descriptions of an institution in its annual report and various other published information. Segment information will be most reliable where the basis for determining segments for external and internal reporting purposes is the same.

Reportable Segment

The Committee also decided that equal reporting should be provided for both format of reporting - business and geography segment. This is to enhance the comparability of IFIs. There is a presumption in this standard that the internal financial reports for products and services based on both business and geography will be available, and it is this information that should be the basis of determining segments for financial reporting purposes

Quantitative Threshold

A ‘pure’ management approach to segment reporting might require the IFI to report all of the information that is reviewed by the chief operating decision maker (board of directors or chief executive officer) when making decisions about resource allocations and assessing the performance of the enterprise. However, that may involve disclosing an excessive amount of detail. The Committee decided that the addition of quantitative thresholds would be a practical way to address this concern, while at the same time ensuring that a minimum number of segments are presented.

Appendix (E)
Definitions

Extraordinary Items

Revenues or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the institution and therefore are not expected to recur frequently or regularly.

Revenue from External Customers

Revenue that arise other than as a result of inter or intra company transactions.