Segment Reporting

Segment reporting is a crucial element of financial transparency, designed to provide stakeholders with a clearer, more disaggregated picture of a company's performance. It allows investors and other users of financial statements to "see the company through the eyes of management," understanding how value is created, resources are allocated, and risks are managed across different business activities. This disaggregated data provides insights into a company's risks, opportunities, and overall performance, aiding in better understanding of future net cash flows and more informed judgments about the entity as a whole.

Authoritative Guidance: FASB ASC 280

The primary authoritative guidance for segment reporting in the United States is **FASB Accounting Standards Codification (ASC) 280**, *Segment Reporting*. This guidance applies to **all public entities** that are required to report segment information. A business entity is considered a public entity under ASC 280 if:

- It has issued debt or equity securities or is a conduit bond obligor for conduit debt securities traded in a public market (e.g., a domestic or foreign stock exchange or over-the-counter market).
- It is required to file financial statements with the Securities and Exchange Commission (SEC).
- It provides financial statements for the purpose of issuing any class of securities in a public market.

While nonpublic and not-for-profit entities are not required to adopt ASC 280, they are encouraged to provide such disclosures. If they voluntarily provide segment disclosures, they must fully comply with Topic 280 and include the required disclosures for all periods presented.

A key principle of ASC 280 is the **"management approach,"** meaning that segment disclosures should reflect how management internally organizes segments for allocating resources and assessing performance. This approach ensures that the information provided to external users aligns with the internal view used by the company's chief operating decision maker (CODM).

Recent Updates (ASU 2023-07): The FASB issued Accounting Standards Update (ASU) 2023-07 in November 2023 to improve segment disclosures, particularly concerning significant segment expenses, in response to investor demand for more granular data. Key changes introduced by ASU 2023-07 include:

- **Disclosure of significant expenses** by reportable segment, required annually and on an interim basis.
- Requirement to report an amount for **"other segment items"** with a description of their composition.
- **All annual disclosures about a reportable segment's profit or loss and assets** are now required in interim periods.

- Permission for public entities to report **multiple measures of a segment's profit or loss** if used by the CODM, provided at least one measure aligns with GAAP principles used in consolidated financial statements.
- Mandatory disclosure of the **title and position of the CODM** and an explanation of how they use reported profit/loss measures to assess performance and allocate resources.
- Clarification that **entities with a single reportable segment** must provide all disclosures required by ASC 280, not just entity-wide disclosures.

Effective Dates: For public entities, ASU 2023-07 is effective for fiscal years beginning after December 15, 2023, and for interim periods within fiscal years beginning after December 15, 2024. Early adoption is permitted.

Core Concepts

Definition of an Operating Segment: An operating segment is a component of a public entity that meets three specific characteristics:

1. **Engages in business activities from which it may recognize revenues and incur expenses.** This includes activities with external customers as well as transactions with other operating segments of the same public entity. Even start-up operations or research and development (R&D) activities that primarily incur expenses but could recognize revenue can qualify. Vertically integrated operations can also consist of multiple operating segments if managed as such.
2. **Its operating results are regularly reviewed by the CODM to make decisions about resources to be allocated to the segment and assess its performance.** The CODM is a function, not necessarily an individual with a specific title; it can be an individual (e.g., CEO, COO) or a group (e.g., a committee). An entity cannot have more than one CODM. The CODM uses this information to assess the segment's performance and determine resource allocation. The term "regularly provided" casts a wider net for disclosure than "regularly reviewed," meaning information provided to the CODM through various means (hardcopy, electronic, meetings) should be considered.
3. **Its discrete financial information is available.** This means financial information for the component is separately identifiable. This information does not need to conform to U.S. GAAP. The existence of discrete financial information is not contingent on the allocation of all shared costs to a segment. Corporate headquarters or certain functional departments typically do not qualify as operating segments unless they recognize non-incidental revenues and meet the other criteria. Equity method investees can qualify as operating segments if they meet these criteria, and the CODM reviews their results for decisions like making additional investments.

Quantitative Thresholds for Reportable Segments: Once operating segments are identified, a company must determine which ones are "reportable segments" for separate disclosure. This is done by applying quantitative thresholds. An operating segment (or aggregated operating segment) is considered reportable if it meets any one of the following 10% tests:

- **Revenue Test**: Its reported revenue (including sales to external customers and intersegment sales/transfers) is **10% or more of the combined revenue** (internal and external) of all operating segments. Revenues from external customers must be consistent with ASC 606, *Revenue from Contracts with Customers*.
- **Profit or Loss Test**: The absolute amount of its reported profit or loss is **10% or more of the greater**, in absolute amount, of either:
    1. The combined reported profit of all operating segments that did not report a loss.
    2. The combined reported loss of all operating segments that did report a loss. When a CODM reviews different measures for different segments, a consistent measure (e.g., operating income or net income) should be selected for the test, often the one used for the majority of segments or most consistent with consolidated financials.
- **Asset Test**: Its assets are **10% or more of the combined assets** of all operating segments. Only assets included in the segment assets measure reported to the CODM are included in this test. If no asset information is provided to the CODM, the asset test is not required.

If an operating segment does not meet any of these quantitative thresholds, it can still be reported separately if management believes that information about the segment would be useful to financial statement users.

Aggregation of Operating Segments: Operating segments that do not meet the 10% quantitative thresholds may be combined into a single reportable segment if they meet specific aggregation criteria. This aggregation is permitted only if it is consistent with the objective and basic principles of ASC 280, the segments have similar economic characteristics, and they are similar in a majority of the following five areas:

- Nature of products and services.
- Nature of the production processes.
- Type or class of customer for their products and services.
- Methods used to distribute their products or provide their services.
- Nature of the regulatory environment (if one exists).

75% Reporting Sufficiency Test: Even after applying the 10% tests, the total external revenue reported by the identified reportable segments must constitute at least **75% of the entity's total consolidated external revenue**. If this threshold is not met, additional operating segments that did not meet the 10% criteria must be identified as reportable segments until the 75% threshold is satisfied. Companies have flexibility in choosing which additional segments to include, not necessarily the next largest ones.

Practical Limit: There is a practical limit to the number of reportable segments disclosed. If the number of reportable segments exceeds 10, a company should consider whether the information is becoming overly detailed and potentially less useful to users.

Required Segment Disclosures: ASC 280 requires public entities, including those with a single reportable segment, to provide extensive segment disclosures, both annually and, following ASU

2023-07, significantly expanded disclosures for interim periods. These disclosures fall into several categories:

1. **General Information**:
    - **Factors used to identify reportable segments**, including the basis of organization (e.g., products and services, geographic areas, regulatory environments, or a combination) and whether operating segments have been aggregated.
    - **Types of products and services** from which each reportable segment derives its revenues.
    - The **title and position of the individual or the name of the group** identified as the chief operating decision maker (CODM).
2. **Information about Profit or Loss and Assets**:
    - A **measure of profit or loss and total assets** for each reportable segment.
    - **Multiple profit or loss measures** may be reported if the CODM uses them to assess performance and allocate resources. At least one reported measure must be consistent with GAAP measurement principles used in the consolidated financial statements. Additional measures not calculated in accordance with GAAP may be considered non-GAAP financial measures by the SEC and are subject to specific rules and regulations.
    - **Significant expense categories and amounts** that are regularly provided to the CODM and included in the reported segment profit or loss. This includes expenses that are "easily computable" from information regularly provided to the CODM. Significance is assessed using both qualitative and quantitative factors, considering impact on an investor's understanding and decision-making.
    - An **amount and qualitative description of "other segment items"** included in each reported measure of segment profit or loss. This category captures the difference between reported segment revenues, disclosed significant expenses, and reported segment profit or loss.
    - **Specific income statement captions** if they are included in the measure of segment profit or loss or are otherwise regularly provided to the CODM, even if not included in that measure. These include: revenues from external customers and intersegment transactions, interest revenue, interest expense, depreciation, depletion, and amortization expense, unusual items, equity in net income of investees, income tax expense or benefit, and significant noncash items. Interest revenue and expense are typically reported separately unless a segment is primarily financial and the CODM relies on net interest revenue.
    - **Investments in equity method investees** and **expenditures for additions to long-lived assets** (with specific exceptions for certain financial instruments and deferred costs) if included in the determination of segment assets reviewed by the CODM or regularly provided. These disclosures help users estimate cash flow potential and requirements.
    - If **no asset information** is disclosed for a reportable segment, the fact and reason should be disclosed.
3. **Information about the Measurement of Segment Profit or Loss and Assets**:

- An explanation of the **measurements of segment profit or loss and segment assets** for each reportable segment.
- **Basis of accounting for any transactions between reportable segments**.
- **Nature of any differences** between segment measurements and consolidated amounts (e.g., accounting policies, allocation of centrally incurred costs, jointly used assets). Segment information can be reported on the same basis as internally, even if not conforming to US GAAP, but differences should be disclosed.
- **Nature of any changes from prior periods** in measurement methods used for segment profit or loss (including expenses or allocations) and their effect.
- **Nature and effect of any asymmetrical allocations** to segments (e.g., allocating depreciation expense without related assets).
- How the **CODM uses the reported measure(s)** of segment profit or loss in assessing performance and allocating resources.

4. **Reconciliations**:
    - **Total of reportable segments' revenues to consolidated revenues**.
    - **Total of reportable segments' amount for each measure of profit or loss to consolidated income before income taxes and discontinued operations** (or after these items if allocated to segments).
    - **Total of reportable segments' assets to consolidated assets**.
    - **Total of reportable segments' amounts for every other significant item of information disclosed to the corresponding consolidated amount** (excluding significant segment expenses and other segment items, which are not required to be reconciled to consolidated totals).
    - **All significant reconciling items** must be separately identified and described.
5. **Entity-Wide Information**:
    - Required **only for annual financial statements**.
    - Information about **products and services**: revenues from external customers for each product/service or group of similar products/services, unless impracticable. Should align with GAAP financial statements, not necessarily CODM-reviewed data. A 10% of consolidated revenue guideline is useful for materiality.
    - Information about **geographic areas**: revenues from external customers attributed to the entity's country of domicile and all foreign countries (separately for material individual foreign countries), and long-lived assets located in these areas. The basis for attributing revenues must be disclosed.
    - Information about **major customers**: if revenues from a single external customer amount to 10% or more of the entity's revenues, disclose that fact, the total revenue from that customer, and the segment(s) reporting the revenues. The identity of the customer is not required. Groups of entities under common control and governments are considered single customers.

Recasting of Prior Period Information: If a company changes its internal organizational structure, leading to a change in reportable segments or the identification of significant segment expenses, **corresponding information for earlier periods, including interim periods, must be recast** to conform to the current period's presentation, unless it is impracticable. When recasting is impracticable, the current period's segment information must be disclosed under both the old and new bases. While not required, it is preferable to recast prior periods for changes in the measurement methods of segment profit or loss to maintain comparability. If not recast, the nature and effect of such changes must be disclosed.

In conclusion, segment reporting under ASC 280, significantly enhanced by ASU 2023-07, aims to provide comprehensive and transparent financial insights into a company's diverse operations "through the eyes of management." This detailed breakdown, covering identified operating segments, quantitative thresholds, and specific disclosure requirements (including revenues, profit/loss, assets, and expenses), is vital for investors to make informed decisions about an entity's performance and future prospects.