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August 2022

# On the Radar
## Segment Reporting

ASC 280-10-10-1 states that the objective of segment reporting "is to provide information about the different types of business activities in which a public entity engages and the different economic environments in which it operates to help users of financial statements do all of the following:

a. Better understand the public entity's performance

b. Better assess its prospects for future net cash flows

c. Make more informed judgments about the public entity as a whole."

In paragraph 60 of the Background Information and Basis for Conclusions of FASB Statement 131, the Board describes certain advantages of basing segments on the structure of an entity's internal organization, including the following:

- "[A]n ability to see an enterprise 'through the eyes of management' enhances a user's ability to predict actions or reactions of management that can significantly affect the enterprise's prospects for future cash flows."
- "[B]ecause information about those segments is generated for management's use, the incremental cost of providing information for external reporting should be relatively low."

The segment determinations reached by a public entity that files with the SEC form the framework for certain other disclosures within the periodic filing, including those in the business and MD&A sections. Segment disclosures have been and are expected to remain an area of focus of the SEC staff because of their importance to investors.

## Identification of Operating Segments

An entity's first step in applying ASC 280 is to identify its operating segments. It performs such identification by using the management approach described in ASC 280-10-05-3, which is "based on the way that management organizes the segments within the public entity for making operating decisions and assessing performance." As indicated in ASC 280-10-50-1, "[a]n operating segment is a component of a public entity that has all of the following characteristics:

a. It engages in business activities from which it may recognize revenues and incur expenses . . .

b. Its operating results are regularly reviewed by the public entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance.

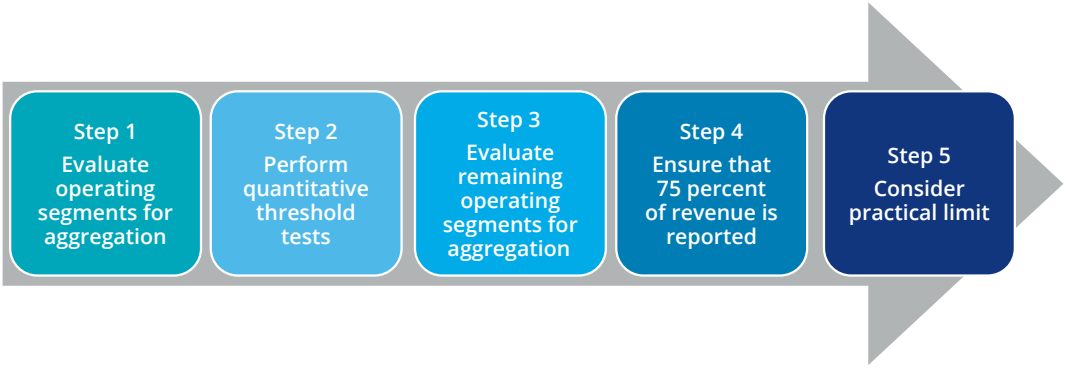
c. Its discrete financial information is available."

An entity may need to use judgment when evaluating whether a component has all the characteristics of an operating segment.

## Reportable Segments

Once an entity has identified its operating segments, it determines which of them to report (i.e., its "reportable segments"). As described in paragraph 72 of the Background Information and Basis for Conclusions of FASB Statement 131, to meet the objectives of segment reporting without providing overly detailed information, an entity applies a "modified management approach," which takes into account aggregation criteria and quantitative thresholds.

The following steps should be considered in the identification of reportable segments:



Under ASC 280-10-50-11, two or more operating segments may be aggregated into a single operating segment if the following three criteria are met:

- Aggregation is consistent with the objectives and basic principles of ASC 280.
- The segments have similar economic characteristics.
- The segments are similar with respect to the following five qualitative characteristics:
  - "The nature of the products and services."
  - "The nature of the production processes."
  - "The type or class of customer for their products and services."
  - "The methods used to distribute their products or provide their services."
  - "If applicable, the nature of the regulatory environment, for example, banking, insurance, or public utilities."

Once an entity considers the aggregation criteria in ASC 280, it must apply the quantitative threshold guidance (i.e., the 10 percent tests based on revenue, profit or loss, and assets) in ASC 280 to determine which segments to report separately. An operating segment needs to meet only one of the 10 percent tests in ASC 280 to be a reportable segment, although it may meet more than one.

After identifying which operating segments meet the quantitative threshold requirements or are otherwise qualitatively material and must be reported separately, the entity can apply the guidance in ASC 280-10-50-13, which permits the combination of any remaining segments to produce a reportable segment if all of the following criteria are met:

- Aggregation is consistent with the objectives and principles of ASC 280.
- The segments have similar economic characteristics.
- The segments share a majority of qualitative aggregation criteria outlined in ASC 280.

Under ASC 280, "if total of external revenue reported by operating segments constitutes less than 75 percent of total consolidated revenue, additional operating segments shall be identified as reportable segments . . . until at least 75 percent of total consolidated revenue is included in reportable segments."

In addition, an entity's identified reportable segments should "facilitate consistent descriptions" of the entity in its annual report and other published information, such as its earnings release, its investor presentations, and the financial information on its Web site.

While the steps provide a helpful guide, an entity is not required to aggregate operating segments and is encouraged to consider whether to separately report information on them irrespective of whether the segments meet the quantitative requirements for separate disclosure. We believe that such an approach is consistent with the objectives and principles of ASC 280, which aim to help users of financial statements understand an entity's performance, assess its prospects for future cash flows, and make more informed judgments about the entity as a whole. As the FASB acknowledges in ASC 280-10-50-18, "[t]here may be a practical limit to the number of reportable segments that a public entity separately discloses beyond which segment information may become overly detailed. Although no precise limit has been determined, as the number of segments that are reportable . . . increases above 10, the public entity should consider whether a practical limit has been reached."

## Disclosure Requirements

Under ASC 280, an entity that has identified reportable segments must provide the following types of quantitative and qualitative disclosures for each of them, generally for each period presented:

- General information.
- Information about profit or loss and assets.
- Reconciliations.

An entity must also provide certain entity-wide disclosures about products and services and geographical operations regardless of how the entity is organized. The FASB has determined that while the information gathered may not be used for making operating decisions or assessing performance, it would provide some comparability between public entities and would not be unduly burdensome to obtain.

## SEC Reporting Considerations

An SEC registrant's reportable segment determination provides the basis for its required disclosures in the business and MD&A sections of its filing. For example, Regulation S-K, Item 101(c), states that the registrant should provide a narrative description of the business, "focusing upon the registrant's dominant segment or each reportable segment about which financial information is presented in the financial statements." In addition, SEC Regulation S-K, Item 303, provides guidance on MD&A of financial condition and results of operations. It states, in part:

> Where in the registrant's judgment a discussion of segment information and/or of other subdivisions (e.g., geographic areas, product lines) of the registrant's business would be necessary to an understanding of such business, the discussion must focus on each relevant reportable segment and/or other subdivision of the business and on the registrant as a whole.

To comply with this guidance, a registrant will often provide disclosures that are consistent with those of its reportable segments.

A registrant should also be mindful of the SEC's guidance on non-GAAP measures that apply to the financial information presented in its filing and of the SEC reporting implications of retrospective changes in reportable segments.

## On the Horizon

In September 2017, the FASB added a project on segment reporting to its technical agenda. More recently, the Board has focused on segment disclosures, specifically "disclosures to provide users with more decision-useful information about the reportable segments of a public entity." In late 2020, the FASB considered whether to add guidance to ASC 280 on the disclosure of certain expenses by reportable segment and tentatively agreed "to pursue a disclosure principle based on the significant segment expense categories that are:

1. Regularly provided to the chief operating decision maker (CODM)
2. Included in the reported measure of segment profit or loss."

In 2022, the FASB has continued to deliberate the significant expense principle and related issues. Practitioners should monitor the status of the project for developments.

For a comprehensive discussion of the requirements in ASC 280 related to identifying and disclosing operating segments, see Deloitte's Roadmap *Segment Reporting*.

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