

Sudit K. Parekh & Co. LLP
Chartered Accountants



**Segment Reporting: A Window
into Business Realities**



Introduction: Beyond a mere disclosure

An entity's consolidated financial statements through the Balance Sheet and Statement of Profit and Loss tell the story, but at the entity level. Dive a little deep, and you would agree that almost every earnings conference call demonstrates the fact that investors analyze the company's performance by breaking it down into various segments and analyzing for each segment various metrics such as revenue growth, EBIT margins, turnover ratios, and capital expenditure during the period.

Management makes key decisions regarding cash infusion, marketing efforts, and cost decisions not at an entity level but at a lower level, usually a business segment. CFOs generally like to discuss the revenue growth and PAT at the segment level before getting to the entity level numbers. Investors are always keen to hear about market share by product or geography, new customer signings, and new business divisions.

Together, these observations emphasize the significance of disclosing segment information. It also highlights that segment information serves a purpose beyond mere compliance or disclosure—it provides meaningful insight into a company's internal operations and strategic decision-making.

Use of 'Management Approach' for Segment Reporting

Under IFRS, the segment reporting disclosures are governed by IFRS 8; Under Ind AS, it is Ind AS 108. Segment reporting disclosures are to be based on the management approach, which was adopted for the first time under IFRS by the introduction of IFRS 8, which replaced IAS 14. This change in approach was inspired by the corresponding USGAAP, i.e. SFAS 131. Management approach requires that the reporting requirements be based on the way that management regards an entity, focusing on information about the business components used by the management for

making operating decisions. Erstwhile standard, IAS 14, on the other hand, required a mere disaggregation of the entity's financial statements into segments based on related products and services, and on geographical areas, which hardly added much value.

Management approach is used for segment identification as well as for measurement of segment information, including segment revenue, segment result, segment assets and segment liabilities. This approach is more effective since it ensures that the segments reported correspond to the internal reporting and hence the segment information is more consistent with other parts of the annual report, such as Management Discussion and Analysis (MD&A). Unlike MD&A, segment information needs to be reconciled to the consolidated financial information. It therefore acts as a bridge between the external and internal reporting. Segment reporting disclosures enable investors to see the entity from the eyes of management while also providing various measures of segment performance. Management's actions or reactions that significantly affect the entity's future cash prospects can be predicted/analyzed more efficiently due to the availability of segment information based on the structure of an entity's internal organization.

Ind AS 108 also requires the use of 'Management approach' since Ind AS 108 is based on IFRS 8.

Key Disclosure Components under Ind AS 108/IFRS 8

Broadly, the standard requires the following disclosures:

- Segment-wise disclosures for each reportable segment regarding Segment revenue, Segment results, Segment assets and Segment liabilities preceded by general disclosure about factors used to identify the reportable segments. These are based on

information provided to CODM and are reconciled to amounts between financial statements, functioning as a link between internal and external reporting.

- Entity-wide disclosures based on amounts reported in the financial statements.

Operating Segments

Segment reporting is fundamentally built on the identification of operating segments. It is the level within the entity (a component) at which the management makes decisions regarding resource allocation and evaluates performance.

Identifying the CODM

To identify its operating segments, the company needs to identify the Chief Operating Decision Maker (CODM). The term CODM identifies a function within the entity which is responsible for the resource allocation to and performance evaluation of the entity's segments. Depending on the organization, CODM may be an individual, such as a COO, but can also be a group, such as a committee of Directors. In identifying the CODM, the title is not relevant, and the identification needs to be based on the function performed. A typical situation may arise, whereby the results of a subsidiary company are reviewed directly at the parent company level, along with the review of the results of other subsidiaries. In these cases, judgement will be required to identify CODM at the subsidiary for segment reporting disclosures in the standalone financial statements of the subsidiary.

Identification of Operating Segments

IFRS 8 and Ind AS 108 define an operating segment as a component of an entity:

- That engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same entity);
- create material uncertainties about their ability to continue operations. If so, disclosures around mitigation plans and risks are mandatory.
- Whose operating results are regularly reviewed by the entity's chief operating decision maker (CODM) to assess performance and allocate resources; and
- For which discrete financial information is available.

Once the CODM is identified, identification of a component of the entity as an operating segment would therefore involve assessing the following:

- Nature of business activities undertaken by the component
- Determining whether discrete financial information is available for those business activities
- Determining whether the CODM reviews that information.

The ability of the business activities to generate revenue needs to be assessed. A component which is yet to generate revenue or which generates revenue only from transactions with other components would also satisfy criterion 1.

Judgment and care are, however, required in concluding whether an internally reported activity (Example: R&D activity) constitutes an Operating Segment. Similarly, a start-up

operation would also meet criterion 1 based on its ability to generate revenue without the need to examine whether revenue was generated during the period.

A necessary condition for discrete financial information to qualify as available is that the CODM is provided with sufficient detail to meaningfully assess segment performance and make informed decisions on resource allocation across the entity's business activities. Thus, a review of only revenue information for the segment would not fulfil the criteria for discrete financial information being available. At the other extreme, it is also not necessary for a full set of financial statements to be available for the segment. Information reported to the CODM hence forms the basis for the identification as an operating segment. If CODM reviews revenue-only information for a particular business activity, then that activity may not qualify as an operating segment. However, even in these cases, if the costs are minimal, revenue-only data may be representative of the operating results. Review of segment assets and liabilities by CODM is not necessarily required to meet the definition of Operating Segment. Hence, discrete financial information will be considered as available even if the information available is, for example, gross profit for each product/class of product.

The discrete financial information needs to be reviewed by the CODM for the component to be identified as an Operating Segment. The information provided for review is commonly known as 'Management reporting package', or 'MIS reports', or 'Executive dashboards/performance pack'. This criterion would generally be easier to assess and demonstrate. However, the use of judgement is required in the determination of the operating segments, where the CODM reviews more than one set of information for resource allocation and performance evaluation. For example, a matrix form of organization, whereby information is provided for business components as well as geographical components. In these cases, identification of the operating segment is based on management's identification as to which set of operating results (products or geographical) has more prominence in internal reporting. This re-emphasizes the consistent use of the management approach throughout the standard.

Aggregation of Operating Segments

If two or more operating segments share essentially the same prospects, IFRS 8, as well as Ind AS 108, allow aggregation of such operating segments with similar economic characteristics, since separate reporting for them would add little to investors' understanding of the Company and its segments. For example, a retail chain may have 10 stores that individually meet the definition of an operating segment, but each store may be essentially the same as the others.

To ensure that the aggregation does not result in a loss of potentially valuable information, both IFRS 8 and Ind AS 108 prescribe tests to ensure that only those operating segments that exhibit similar long-term financial performance are aggregated. It is also referred to as the similar economic characteristics test and requires evaluation across five aspects, i.e. nature of products/services, nature of production processes, types/class of customer, methods of distribution and the nature of regulatory information.

Reportable Segments

Companies need to identify reportable segments from the Operating segments. A reportable segment is generally a single operating segment except in cases where aggregation of operating segments is permitted as noted above. However, not all operating segments will meet the criteria for a reportable segment. Information is required to be disclosed for each reportable segment.

Quantitative Thresholds

An operating segment is considered a reportable segment if it exceeds certain quantitative thresholds based on segment revenue, segment profit/loss, and segment assets. The criteria for the threshold are applied to a single segment or segments aggregated because they satisfy all five tests for the common economic characteristics.

An operating segment or segments aggregated should be considered as a reportable segment if it meets any of the following quantitative thresholds:

- Its reported revenue (External + Internal) is 10% or more of the Combined revenue (External + Internal) of all segments
- If all segments are in profit, then its reported profit is 10% or more of the Combined profit of all segments. However, if some segments are in profit and some are in loss, the quantitative threshold is based on the greater, in absolute amount, of (i) the combined reported profit of all operating segments that did not report a loss and (ii) the combined reported loss of all operating segments that reported a loss.

Segments in profit		Segments in loss	
Segment	Amount	Segment	Amount
A	100	D	-180
B	150	E	-90
C	20	F	-10
	270		-280

In absolute terms, 280 is greater than 270. 10% of 280 is 28. Hence, segments having a profit/loss (in absolute terms) which is greater than 28 will be considered as reportable, i.e. Segment A, B, D, and E in this example.

- Its assets are 10% or more of the combined assets of all operating segments.

Profit/loss for the above purpose would mean the measure of profit reviewed by the CODM and not necessarily the Net Profit before/after tax reported in the financial statements. This is again consistent with the management approach mandated by the standard.

The management may, at its discretion, identify an operating segment as reportable, even if it does not meet any of the quantitative thresholds.

Multiple operating segments that individually do not meet any of the 10% quantitative thresholds may do so when aggregated with other segments. In such cases, aggregation is permissible if the segments share the majority of the common economic characteristics noted above. It should also be noted that here the segments that may be aggregated are the ones which do not meet the quantitative threshold individually.

This aggregation is different from the aggregation applied and noted above before the 10% threshold.

Once the reportable segments are identified, a final check needs to be performed to assess if the external revenue of the reportable segments covers at least 75% of the entity's revenue. If that is not the case, then additional operating segments are identified as reportable till at least a 75% threshold is met.

Operating Segments Not Identified as Reportable Segments

Operating segments which do not meet the criteria for a reportable segment or are not identified as such by the management need to be clubbed together and presented as 'All Other Segments' in a separate column. For Indian entities, it is worthwhile to note that AS

17 requires the non-reportable segments to be presented as reconciling items, contrary to them being presented as a separate column 'Others' under Ind AS 108.

Components That are Not an Operating Segment

Components of the entity which do not meet the definition of an operating segment are not reported in 'All Other Segments', but are reported as part of the reconciliation of segment information to information reported in financial statements. This would include, for example, Head office costs or Head office assets. It will also include assets not attributed to any operating segment by the CODM for review by the CODM.

Required Disclosures for Reportable Segments

Aligning with the core principles, the disclosure requirement aims at providing the readers of the financial statements with information necessary to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates.

Broadly, the disclosure requirements are as detailed below:

General Information

- **Basis of segmentation**

Companies must disclose the factors used to identify reportable segments, such as organization by products, services, geography, regulatory environment, or a combination.

- **Aggregation judgments**

Management must explain any judgments made in aggregating operating segments, including which segments were combined and the economic indicators used to assess similarity.

- **Revenue sources**

Companies must specify the types of products and services that generate revenue for each reportable segment.

Disclosures regarding segment revenue, segment results, segment assets and segment liabilities.

- **Measurement**

The amounts reported should be based on the reporting to the CODM. Hence, for example, if the CODM reviews EBIT for purposes of resource allocation and performance evaluation, then EBIT (which is a non-GAAP measure) is used to measure and report segment results. Similarly, if the segment assets reported to CODM include only current assets, then these are used as a measure of segment assets. Segment revenue to be disclosed will include external revenue and revenue from transactions with other segments, both of which need to be disclosed separately. Thus, disclosures should reflect information provided to CODM, even if accounting policies differ from those used in the financial statements.

Measurement policies and the basis of inter-segment pricing must be disclosed.

- **Other Amounts**

Specific income and expense items (e.g., depreciation, interest, income tax, material non-cash items) must be disclosed if reviewed by the CODM.

- **Reconciliations**

Since the amounts of segment revenue, segment result, segment assets and segment liabilities are based on the reporting made to CODM, reconciliations are required to the corresponding amounts in the financial statements to provide a link between internal and external reporting. For example, the Segment result is to be reconciled to the Net Profit as per the Statement of Profit & Loss. Tax expense for each segment is reported only if the amount is reported to the CODM.

Other material segment items should also be reconciled to the corresponding items in the financial statements.

Entity-wide Disclosures

This requirement applies even to a single-segment company and is sometimes missed out as part of financial statements, as evidenced by the observations by the regulators and the ICAI board.

Contrary to the requirements for the reportable segment, this information is not based on a management approach but is a simple disaggregation of the amounts reported in the financial statements. Disclosures are broadly required for:

- **Products/Services**

External revenues disclosed by product or service (or groups of similar products/services).

- **Geography**

External revenues and non-current assets disclosed separately for the country of domicile and foreign locations (with material countries shown individually).

- **Major Customers**

Revenues from customers contributing $\geq 10\%$ of total revenue disclosed, along with the segment(s) involved (customer names not required). Two or more customers who the company is aware of belonging to the same group are treated as a single customer for the purpose of applying the 10% threshold.

Lessons from Practice: Missed Disclosures



Companies sometimes omit important details when complying with IFRS 8/Ind AS 108; a few common oversights, as observed by the Financial Reporting Review Board of ICAI, are listed below:

- Some entities incorrectly claimed that Ind AS 108 was not applicable in cases of a single reportable segment, overlooking the requirement to provide entity-wide disclosures
- In several cases, segment reporting disclosures were inappropriately included under “Significant Accounting Policies” instead of being presented separately in the Notes to Accounts.
- General disclosures were either missing or inappropriate, including relating to:
 - Identification or designation of the CODM, and
 - Criteria and judgments applied in segment identification and aggregation
- Information about major customers contributing 10% or more of revenue was not provided in some cases.

Final Thoughts

The management approach to segment reporting offers a significant advantage by allowing investors to view the enterprise “through the eyes of management,” thereby enhancing their ability to anticipate managerial actions that could influence future cash flows. At the same time, since the information is already prepared for internal decision-making, the incremental cost of extending it for external reporting remains relatively low. Importantly, segment reporting should not be perceived merely as a compliance exercise but rather as a meaningful tool for transparency and value creation. Finally, entities must exercise caution to ensure that entity-wide disclosures, which are often overlooked in practice, are given due attention to present a complete and reliable picture to stakeholders.

Sudit K. Parekh & Co. LLP

Chartered Accountants



GET OUR INSIGHTS IN YOUR MAILBOX

Subscribe to our newsletter today for more insights, thought leadership publications, and success stories to help you better navigate complex business challenges.

communication@skparekh.com

Mumbai
Pune
Hyderabad
Gurugram
Bengaluru

www.suditkparekh.com

skpco.info@skparekh.com

Disclaimer

The contents of this document are intended for general marketing and informative purposes only and should not be construed to be complete. This document may contain information other than our services and credentials. Such information should neither be considered as an opinion or advice nor be relied upon as being comprehensive and accurate. We accept no liability or responsibility to any person for any loss or damage incurred by relying on such information. This document may contain proprietary, confidential or legally privileged information and any unauthorised reproduction, misuse or disclosure of its contents is strictly prohibited and will be unlawful.