ED/AS108/2022/20

Exposure Draft

Accounting Standard (AS) 108

Segment Reporting

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Accounting Standards Board

The Institute of Chartered Accountants of India

Objective

After clause '(c)': To add-

(d) better assess company's prospects for future cash flows

It may further add at the end-

Diversified companies present a unique type of problem for investment decision making. The performance of a diversified company can be judged from the performance of all several segments. The success of diversified company depends on success of all segments that is why segmental disclosures in company's annual reports are more useful to investors and other user groups.

The key objective of segment reporting is transparency. Analysts, potential investors and other stakeholders need complete information to evaluate the sustainability and growth of a company and to monitor the performance of its management. Segment reporting aims to allow financial statement users to get a better sense of the fluctuations that might affect overall numbers for each segment.

Scope

This part may add-

5. The AS will enable the governing board to discharge their managerial responsibilities and to evaluate the performance of the entity in achieving its objectives in the past, and to make decisions about the allocation of resources by the entity in the future.

Definitions

It may begin with-

'Segment' means a distinguishable activity or group of activities of an entity for which it is appropriate to separately report financial information for the purpose of evaluating the entity's past performance in achieving its objectives and for making decisions about the future allocation of resources.

This part may further add-

'Segment of business' means "a Component of an entity whose activities represent a separate major line of business or class of customer. A segment may be in the form of a subsidiary or division or a department, and in some cases a joint venture or other non-subsidiary investee, provided that its assets, results of operations and activities can be clearly distinguished, physically and operationally and for financial reporting purposes from the other assets, results of operations and activities of the entity."

'Accounting policies' are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.

‘Financing activities’ are activities that result in changes in the size and composition of the contributed capital and borrowings of the entity. Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

‘Operating activities’ are the activities of the entity that are not investing or financing activities.

‘Revenue’ is the gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets/equity, other than increases relating to contributions from owners.

Other terms defined in other IndAS are also used in this Standard with the same meaning as in those other IndAS.

‘Segment expense’ to add-

(e) an entity’s share of losses of associates, joint ventures, or other investments accounted for under the equity method;

Identifying Reportable Segments

Primary and Secondary Segment Reporting Formats

Primary Reporting format:

To create a new separate category in the profit or loss statement for ‘investing’ income and expenses, as it will provide useful information to users of financial statements about the returns from investments that are not part of the entity’s main business activities.

The format may provide for a subtotal to determine "profit or loss before financing and income tax". This subtotal would serve the purpose of allowing users of financial statements to analyse on a consistent and comparable basis an entity's performance independently of how that entity is financed.

The statement of financial performance and the statement of cash flows would have three different categories with similar labelling (operating, investing, and financing) even though they would not be aligned.

The ED may make clear whether operating expenses are to be reported by function or by nature or mixed. An entity may present additional line items when such presentation is relevant to an understanding of its financial performance, regardless of the analysis of operating expenses retained. In this case, the statement of profit or loss would mix by-function and by-nature methods. As a result, the main users’ information needs could be met by requiring an entity to disclose only some expense amounts such as the employee benefits expenses, depreciation and amortisation expenses and impairment losses.

The Illustrative Segment Disclosures contain formats for Revenue & Expense and Assets & liabilities and has no illustration for Cash Flow statement. The ED to require the ‘operating profit or loss' as a starting point for the indirect reconciliation of cash flows from operating activities in the statement of cash flows. While incorporating Illustrative segment disclosure for Cash flow, the statement of cash flows to be fundamentally reviewed as it has to providing relevant information for the financial sector.

It is highlighted that the 'Operating profit or loss' subtotal would only be relevant for entities that have a significant part of income and expenses in other categories (i.e. financing and investing). For banks and financial conglomerates, most of the income and expenses would be, in accordance with the IndAS ED proposals, presented within operating profit or loss. Thus, this subtotal would be artificial and would formally improve comparability without contributing to the relevance of the information.

Insurers report on a fair value through profit and loss basis for their financial assets and insurance liabilities and consider that operating profit or loss would replace a well understood measures of financial performance and in reduce comparability with insurers which report using other comprehensive income. The proposal would result in short-term volatility being reported in operating profit in a way which both does not help the management's reporting on their stewardship of the entity's resources and has limited predictive value from the user's perspective. This would reinforce, rather than reduce, the need for extra management performance measure reporting. All non-insurance related operating expenses of the financial conglomerate are presented as 'operating expenses' and as such the total operating expenses of the bank insurer group are split over different lines in the income statement Reconciliation between income statement and disclosure on analysis of operating expenses as required by the ED becomes more difficult.

Any standard should indicate whether the income and expenses from each activity and the related subtotals should be presented excluding or including inter-activities transactions: if one holds the view that they should be presented excluding inter-activities transactions— because consolidated financial statements always exclude all intercompany transactions— there is a risk that the subtotals presented might be irrelevant and/or misleading as well as potentially confusing with segment information. Therefore, the ED should discuss explicitly this matter and develop adequate presentation requirements.

The ED to clarify whether organizations should present for interim periods the same structure of primary financial statements as for year-end periods as this would significantly improve comparability and allow better monitoring of the performance by investors between different periods. SIRC of ICAI strongly recommends that the requirement to present expenses by nature either on the face or in the notes of the financial statements should be expanded to interim financial statements given its purported value to users.

A practical problem in is that governmental organizations often cannot – at all or often only with huge efforts – allocate assets and liabilities to segments. Also the allocation of revenues can be problematic as generally by definition they might be "general purpose". In the public sector, governments are also often pooling some assets and the allocation of them to segments might be cumbersome. Even more problematic in practice is the allocation of liabilities to specific activities. Furthermore, it has to be mentioned that the

Classification of functions of government does not require to allocate assets and liabilities to functions. To sum up, it can be said that the performance-oriented approach of ED 108 in which not only expenditures but also revenues, assets and liabilities need to be allocated to segments causes additional efforts. Therefore, the ED may address the issues of Public sector companies and public sector enterprises.

General Comments

An entity should start from its internal financial reporting system to identify those items that can be directly attributed, or reasonably allocated, to segments. However, it should be considered that – even though being very well understood by the entity's own management – the internal allocation to segments but could be deemed subjective, arbitrary or difficult to understand by external users of financial statements.

SIRC of ICAI see a clear relationship between budgeting and financial reporting for segment reporting purposes. The standards relating to segment and budgeting reporting do not address this relationship so far.

Further challenges are the technical difficulties, i.e. to have the appropriate IT systems and organizational structure in place that are able to account for segment information.

Approach does only cover the financial performance of segments but not their financial position. - Problem of allocating revenues to segments still persists.

As the basis for measuring segment results (i.e. the surplus or deficit for each segment) reported may differ from the one prescribed by financial reporting standards, reconciliations are required where information which is presented to management by using internal accounting policies differs from IndAS-based information in the primary financial statements.

Finally, The ED-108 is identical to IAS 14 with few minor changes. Though these standards are optional to Small and Medium Sized Companies and Micro, Small and Medium sized enterprises, none of these organizations would be in a position to follow the ED, since the accounting system may not permit to follow these segment reporting.