

## IMPORTANCE OF SEGMENT REPORTING PRACTICES IN DIVERSIFIED COMPANIES

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### ABSTRACT

*Segment Reporting in India got a new impetus when the Institute of Chartered Accountants of India published its Accounting Standard, AS 17, on Segment Reporting and made it effective on and from April 1, 2001. The standard has been made mandatory for the companies whose shares or debts are listed, or going to be listed, on any of the stock exchange which is recognised in India. Moreover, this standard is also very much essential for those companies which make an annual turnover of Rs. 500 millions or more. This paper deals with various dimensions of segment reporting. India is a fast growing economy. This growth of economy is very much dependent on diversified companies. Diversified companies give a distinctive sort of hitch for making investment decision. The diversified company's performance can be evaluated from the performance of all numerous segments. The achievement of diversified company is dependent on accomplishment of its every segment. This is the particular reason why investors use segmental disclosures in company's annual reports.*

**KEYWORDS:** *Segment Reporting, ITC, Segment Revenue, Segment Expense.*

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### Introduction

Large, diversified companies can be viewed as a portfolio of assets operated as divisions or subsidiaries, often multinational in scope. The various components of a large company may have different profit rates, different degrees and types of risk, and different opportunities for growth. A major issue for accountants is how to develop and disclose the information necessary to reflect these essential differences. Segment reporting presents the accounting standards for reporting an entity's operating components, foreign operations, and major customers.

### Objective of Study

- To get an in-depth understanding of Segment reporting practices in India.
- To understand the need of segment reporting practices towards making transparent accounting practices
- To highlight the major hiccups for segment reporting practices

### Research Methodology

The nature of paper is exploratory and diagnostic. Research has considered analysis of secondary data about segment reporting practices in India, collected from various National and International research articles, official website of diversified companies, Government of India etc.

### Segment Reporting in India

AS 17 with the title of Segment Reporting has been issued by The Institute of Chartered Accountants of India in October 2000. AS 17 is compulsory for those companies who are or will be stock exchange listed or in the process of issuing equity or debt securities. Because of this, Segmental information in compliance with AS 17 is being given by Indian companies guidelines on identifying reportable segments are as follow:

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- Primary Segment reporting as well as Secondary Segment Reporting
- Business segment and Geographical Segment.

#### **Disclosure in segment reports as per the guideline of AS17**

- Revenue of segment
- Segment expense
- Liabilities
- Assets
- Segment profitability
- Policies of Accounting

#### **Need for Segment Reporting**

There is a specific problem of Diversified for decision-making regarding financial investments. The development and victory of a company which is diversified are accumulation of the progress and success of its many segments. Proponents of segment reporting compete that information about separate segments contributes to investor evaluations of diversified companies.

#### **Ñ Segment Disclosure and Decision**

Making regarding investment: An important fact in support of segmental reporting is that investors will be able to assess the earnings potential and the risk of the company in better way as a whole if they are given information about the risk and growth of the different segments of a company's operations, profitability. Investors will be capable to calculate firm's earning in coming future with more accuracy. Cash flows assumption can be done by using consolidated data alone. Investor uncertainty will be minimized about company prospects, more precise share prices will be set, allocation of resources will be done with more accuracy.

#### **Ñ Segments Disclosure and its Impact on Stakeholders**

Segmental reports are likely to be constructive to employees, trade unions and its members, general public, consumers, and government also Besides the investors,

It can also be used also for the purpose of promoting managerial efficiency.

- **Benefit for Employees and Trade Union:** Importance of segment disclosure can be understood from viewpoint of trade union and employees as well because it gives an idea about financial profit and future prospect of firm which can be used to calculate security of job along with wage negotiation
- **Benefit for Management:** Along with investors, trade union and employees, segment disclosure can be effectively utilized by organisation's management as well. It can be a useful tool for strategy management, policy development and understanding requirement of each segment separately. On the other hand if the information about each sector is not available, proper maintenance of individual segment may not be possible as a separate entity.
- **Benefit for Consumers:** Segment disclosure's benefit extend to promote the interest of public and consumers as well because it helps to support social responsibility of firms. It may encourage removal of discrimination of prices with the help of disclosure of profits segment wise. It also cause increase in competition between multinational companies at regional, national and international level and helps to maintain balance of payment.

The findings of segment disclosure gives a crystal clear picture of performance of each segment separately, it becomes easier to understand the weakness and strength of each segment with overlapping influence of other segment. As a result better planning for growth of each segment can take place with better efficiency and more reliable policies can be designed both by government as well as the business owners. Decisions related with expansion, closure, merger, acquisition can be taken with proper understanding of all aspects of business

#### **Major Problems related with Segment Reporting**

The hick ups associated with reporting of segments comes at the point of realization of segment reporting instead of to its conception and theory. Few major problems may be discussed as follows:

### Ñ **Pricing Inter-segment Transactions**

A diversified organisation self-possessed of different parts, each of which goes its own way, might have very few inter-company transactions. On the flip side, there might be few diversified business enterprises which may have very extensive dealings among and between the segments. There are various ways for inter-segment transfers such as market price, cost plus, cost, and negotiated price. The fundamental reason (in selecting a method of transfer pricing) is to stimulate employees, and to essentially calculate the victory of the number of segments as precisely as potential. Dissimilar schemes results in diverse operating results for the segments. For a significant segment reporting, there is a requirement for opting a reasoned process for inter-segment transmits.

### Ñ **Allocation of Common Costs**

In a business enterprise producing more than one product or engaged in different activities, there are possibly costs which are common to two or more of the products. Examples of common costs are general administrative and selling expenses, legal expenses, general advertising etc. Because these costs are common to more than one segment, they cannot be connected in completely with a single segment. The difficulty of putting common costs will be higher for few objects than for rest. It is mainly immense for assets, liabilities, and equity so that reporting for company segments is suggested less often for information from the balance sheet, statement of shareholders equity, and funds statements than for information from the income statement. Due to the variety of techniques used, cross-company evaluation of comparable segments may be deceptive and the dependability of segment operating outcome varies on the bases of how intimately the basis of allocation approximates results that would have been produced by market transactions.

### Ñ **Ground of Segmentation**

One of the biggest concern starts with the question that what will be the base to fractionalize a diversified company for the purpose of reporting. A division of diversified business can be done for segment reporting intention in provisions of industry, division of organization, marketplace, purchaser merchandise, etc. Every ground of segmentation may generate segments that vary considerably in productivity, development and risk and each implies a different basis for identifying segments. Moreover, more than one form of diversification may be present in the same. Until and Unless ground selected actually represent the business and the way it functions, unless they reveal the disparity within the corporation regarding rate of revenue, intensity of threat, and possibility for growth, reports-of operating data by segments are unlikely to be of any real use.

### Ñ **Costs of Segment Disclosure**

Additional influence against segmental reporting are related with the costs of disclosure. The prerequisite of additional information wills, undeniably, boost a firm's operating costs in terms of the costs of compilation, processing, audit and distribution. One more imperative cost argument is connected to the enlarged competition that may effect from segmental disclosures. It is argued that the disclosure of profitable segments will be a magnet for competitors, at the same time as loss-making segments may become the topic of take-over bids or put weight on administration to sell them off, with the reason of improving earnings in the short- term and to take on a smaller amount of risky projects. A aggressive drawback may also take place where overseas organisations are not asked to make available segmental reports.

### **Management Conservatism**

Adding with this, one more argument is that, where there is no authoritarian condition to reveal segmental reports, intentional disclosures are likely to be perceived by managements to be profitable only in specific examples

### **Basis of Segmentation of Diversified Companies**

A diversified company can be dissected as per to one or more of the following bases:

#### Ñ **Base # 1. Market Structure**

Market configuration is measured by a few as a probable explanation to the trouble of defining segments of diversified corporations on the limit that varios markets have various degrees of threat attributed to them, e.g., both earnings and threat can be affected by whether the firm supplies makers, middlemen or clients and whether there is a high share of sales to administration bodies, to particular industries, or to particular company groups. Information for different markets is valuable to users in determining the future growth and stability of the company.

Such information indicates the degree of dependence: (i) On a single major customer, (ii) On a group of customers, (iii) On a particular industry as the major purchaser of its products and (iv) On business with government. Base # 4. Geographical Segments: AS17 Segment Reporting describe geographical sector as follows: A geographical division is a distinguishable part of a venture that is engaged in providing goods or services within a particular financial situation and that is subject to threat and profits that are dissimilar from those of machinery operating in other fiscal background. Factors that should be measured in recognizing geographical segments contains: (a) associations between functions in different geographical region; (b) closeness of various; (c) resemblance of political and monetary and circumstances; (d) swap control policy; (e) unique menace linked with function in a specific district; and (f) The fundamental legal tender threat.

#### Ñ **Base # 2. Basis of Activities of Business**

Segmentation on the basis of Activities of business can be done mainly in terms of (i) Broad Industries Groupings, (ii) Lines-of-business or product lines and (iii) Individual Products and Services. (i) Broad Industry Groupings: According to International Accounting Standard No. 14, industry segments (industry groupings) "are the distinguishable components of an enterprise engaged in providing a different product or service, or a different group of related products or services, primarily to customers outside the enterprise".

Financial Accounting Standards Board (USA), Statement No. 14, gives a parallel definition. An industry is typically considered as a extensive group of related services or goods. This segmentation base uses wide groupings of alike products and services as reporting units. ASB's (India) AS17 Segment Reporting defines business segment as follows: A business segment is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products or services and that is subject to risks and returns that are different from those of other business segments.

Factors that should be considered in determining whether services or goods are connected comprise: (a) The character of the services or product; (b) The character of the processes of Production; (c) The set of consumers for the services or products; (d) The technique used to dispense the products or supply the services; and (e) If applicable, the nature of the controlling factors, for example, banking, insurance, or public utilities. (ii) Product line or Line-of - business: product line or a line of business can be described on the basis of the final-products manufactured. A product line is that core business lines or operating activity in which a company is engaged. It is usually measured to be a relatively thin section of related products, whereas an industry constitutes a broader grouping. (iii) Individual Products and Services: Segmentation foundation may imply particular service and products with the use of specifically defined categories of products constructed or vended and services rendered as reporting units. Segmentation on the grounds of individual products would prove useful in making predictions and analysis of a company's profit prospects and risk element. Product-wise data produce a comparable data which could be compared with data of other firms, competitors, customers, suppliers.

#### Ñ **Base # 3. Organisational Division**

The term 'division' has different meanings in different companies. Most generally, the word 'division' means to the use of company operating structure or association charts as a ground for segmenting functions into reporting entity.

A division can be considered to be an individual unit having liability of making profit. In that case, division has right to control sale and cost both. On the other side, some activities like research and development, marketing etc may still remain under control of central authority. For such organizations, method for accounting systems generally focus on costs incurred and profit generated by managerial responsibilities represented by divisions and their sub-units.

In some manufacturing organizations division also describe the range of industries, product lines or geographical areas in which the organization does its functions. However, the products manufactured in divisions are not always homogeneous. Various goods, i.e., products which have dissimilar characteristics, are assigned to a given division for a range of causes such as physical contiguity of the operations, capability of management, profits generate out of integrating or combining production or marketing operations, etc. In some companies, division may be market-oriented and each division handles a variety of products in a given market. Under all circumstances, divisions are, at best, only approximations to those segments which are to be selected for reporting to the external users. Thus,

segmentation on the grounds of division indicates responsibilities of management that is planning, operating and controlling in a company where with the help of delegation of authority, decentralisation of management takes place. It is done for a reasonably broad range of functions which is divided among each division head.

### Conclusion

It can be understood that segment reporting is an essential activity for multidisciplinary organization to have a crystal clear outlook of functions and outcomes but it requires much understanding about various functions related to particular business where segment reporting is being applied. One can not use a universal principle of segment reporting on all organizations and businesses. A keen study has to be conducted and careful segment reporting practice has to be followed to get the useful result which can benefit management, employees, customers, society and the government.

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