Segment Reporting in India and Abroad
A Comparative Study

Y.V. Reddy and R. Satish

Segment reporting is very popular in developed countries since the last 15 to 40 years. On the other hand, for the first time in India, Indian Accounting Standard on segment reporting came into effect only from 1st April 2001. This paper investigates the effectiveness of the Indian Accounting Standard on segment reporting in comparison with the existing accounting standard, regulations, and stock exchange pronouncements abroad.

In the liberalised, competitive and borderless world economy, the survival and growth of any corporate sector has been mainly through diversification of the companies in the new product lines and in other geographical areas. The major objectives of diversification is to reduce risk and uncertainty in earnings by spreading investment over several businesses. The present study reveals that, out of 125 companies studied in India, 103 companies have diversified operations in new product lines and 67 companies have their operations in foreign countries.

Segment reporting is the dis-aggregation of financial information such as turnover profits, assets, etc, about the business entity and reporting the same segment-wise. The main purpose is to provide users of financial statements an information on relative size, profit contribution and growth trend of various industries and different geographical areas in which a diversified enterprise operates to enable them to make more informed judgements about the enterprise as a whole.

In the USA., segment reporting requirements are contained in SFAS 14, which states its goal as “to assist financial statements users in analyzing and understanding the enterprise’s financial statements by permitting better assessment of the enterprises past performance and future prospects.”

Most diversifications in business emerge from activities in different industries, different markets, and different geographical areas. The merger which combines companies engaged in different activities is probably the most effective contributor to diversification. Internal growth and expansion are also an important factor in generating diversification in business.

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Diversification is sometimes adopted to reduce undue concentration in a single activity or industry. Large companies and diversified companies are not one and the same thing, either in concept or in practice. Size and diversification are separate characteristics. Many large companies are engaged in a single industry, although they may have a substantial number of plants and marketing outlets, likewise a fairly good number of small companies operate in different industries and activities.

**Approach to the Problem**

Diversified companies present a peculiar and special problem for investment decision making. Successful evaluation of a diversified company requires information on its separate segments. Accordingly, diversified companies should report segmental information that allows investors to determine profitability, risk, growth opportunities, and relative importance of different segments as well as to make proper evaluation of the total performance of a diversified company.

Segment reporting is very popular in developed countries for the last 15 to 40 years. They have well tested rules, regulations, legislation, accounting and stock exchange pronouncements regarding segment reporting. On the other hand, in India for the first time, Indian Accounting Standards on segment reporting is proposed to be mandatory for all companies accounting periods commencing on or after 1-4-2001. In India, at present only the Companies Act, 1956 contains certain provisions regarding segment reporting.

**Objectives of the Study**

The objectives of the study are as follows:

- To analyse the segment reporting practices in India and abroad.
- To compare various rules, regulations, accounting standards and stock exchange pronouncements regarding segment reporting in India and abroad.
- To study the problems in segment reporting.

**Methodology**

A sample of 125 Public Limited Companies from various industries have been selected in India, and 50 from USA. Further, for the purpose of analysis annual reports have also been examined for the last five years, i.e. for Indian companies 1995-96 to 1999-00, and for foreign companies (USA) 1995 to 1999. Mostly, the information from the USA and the UK, companies has been considered as foreign company information. References to other European countries have also been made in order to support our arguments. Whereever companies information in the USA is not available, the analysis has been supported by giving companies information in the UK and vice versa.

**Segment Reporting in India**

In practice, at present there is no Indian accounting standard on segment reporting. The Institute of Chartered Accountants of India has issued Account-
ing Standard 17, on “Segment reporting”. This standard came into effect in respect of accounting periods commencing on or after 1-4-2001, and is mandatory in nature from that date, in respect of the following:

- Enterprises whose equity or debt securities are listed on a recognized stock exchange in India, and enterprises that are in the process of issuing equity or debt securities that will be listed on a recognized stock exchange in India as evidenced by the board of director's resolution.
- All other commercial, industrial and business reporting enterprises, whose annual turnover is more than Rs. 50 crores.

So far, only the Companies Act 1956, part (ii) of schedule (iv) contains certain provisions regarding segment reporting. It requires that if a company is engaged in the production and selling of more than one class of goods, it should indicate by way of notes to the profit and loss account the information regarding production, sales, opening and closing stock for each class of goods.

Section 212 of the companies Act 1956, also requires that published accounts of holding company must contain the balance sheet, profit and loss account, director's report and the auditors report for each of its subsidiaries. The Act doesn't require the disclosure of detailed information like revenues, profitability, identifiable assets etc., for each of the industry or geographical segments.

For the purpose of studying whether the selected companies disclose segmental information, three major items of segmental information were considered, viz., segment production, segment sales, and segment earnings. The present study has shown that the companies to which these items are applicable, segment production, and segment sales have been disclosed by them during all the five years of the study. However the segment earnings has been disclosed by only two of these companies during the period of study. Whereas the selected companies in USA, discloses all the major items of segmental information. Table 1 clearly summarises the above fact.

<table>
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<th>USA</th>
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<td>Segment sales</td>
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<td>Segment revenues</td>
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The proposed Indian accounting standard 17 on segment reporting is more or less the same as that of the SIAS 14 of USA.

The study of Banerjee (1999) reveals that almost all of the respondents are in favour of segment reporting. Of them a large number are of the opinion that
20% of the turnover of a firm should be taken as a threshold for segment reporting.

**Disclosure in Annual Reports in India**

Generally, segment information, given in company annual reports may be:

- within the body of the financial statements;
- in the supplementary statement that is included as an integral part of the financial statements;
- entirely in the footnotes to the financial statements;
- in the director's report;
- elsewhere in the company annual report.

The present study reveals the following:

(i) All 125 companies have disclosed segment production and segment sales in the footnotes to the financial statements.

(ii) 86 companies have disclosed segment information in the director's report. Some are product-wise segmentation and the others are area-wise segmentation. For example, Gujarat Ambuja Cements Ltd. in its 1999-00 annual report provides segment information on the basis of area. On the other hand, Zuari Agro Chemicals Ltd. in its annual report for the year 1999-00 has disclosed segment information on product basis.

(iii) 18 companies have disclosed segment information in the management discussion and analysis. For example, The ACC Ltd, annual report for the year 1999-00, carries a section called Management Discussion and Analysis in which figures a separate sub-section called Segmental Review and Analysis. It discloses different segments information like segment production, sales, capacity utilization, profit before-depreciation, interest and tax, operating margin and return on capital employed.

(iv) Only six companies have disclosed segment information in the form of tables and charts by giving product-wise information. For example, Hindustan Lever Ltd. presented segment information as a percentage of segment sales over total sales in the form of tables and charts.

(v) Only two companies have disclosed segment information in the form of product and area-wise statistics separately. For example, Goodricke Group Ltd. annual report.

(vi) Three companies have disclosed segment information separately in the annual reports by giving its market share for each segment separately. For example, the annual report of Linc Pen and Plastics Ltd.

(vii) 38 companies have disclosed segment information for two years.

(viii) Only one company i.e., Cyber Tech Systems and Software Ltd. in its annual report disclosed segment information in the form of an interview (question and answer).

(ix) Few years back, the number of pages of annual reports in India were between 25 to 40. But now a days, many companies' annual reports are more than 100 pages. This is mainly due to reporting on subsidiaries.
Out of 125 companies studied, almost all the companies have disclosed information about their subsidiary companies (Table 2).

Table 2: Disclosure of segment information in annual reports

<table>
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<th>India No. of companies disclosed</th>
<th>USA No. of companies studied</th>
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<td>Director’s report</td>
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Segment Reporting Abroad

The standard of corporate reporting has significantly improved in developed countries, after the implementation of segment reporting. The Indian accounting standard on segment reporting will be mandatory only from on or after 1-4-2001. But it was being practiced in USA as early as four decades ago. In the early 1960s, most of the developed countries have introduced segment reporting requirements to varying degrees by legislation, accounting standards, and stock exchange pronouncements. For the first time the need for segmented reporting was felt around 40 years ago, when the senate sub-committee in the USA on Antitrust in American Industry could not make out any sense from the aggregation of financial information submitted by large conglomerate firms. Since then the need for the reporting has been felt.

In the UK by schedule 4 of the Companies Act, 1985, segment reporting was made mandatory to all companies and by the accounting standards SSAP 25, it was made mandatory to private companies and other entities, which met any two of the criteria fixed on that behalf for turnover, total assets and average number of employees. Canadian Institute of Chartered Accountants handbook section 1700 on “segmented information” effective for financial statements for fiscal years commencing on or after June 1, 1979, requires publicly traded companies to disclose segmented information in their annual financial statements. In 1981, the International Accounting Standard Committee issued IAS-14 on “Reporting financial information by segment”, which, too, requires the disclosure of the details about the revenue, profitability, and assets for each of the industry and geographical segments separately. In Pakistan, the segment reporting is required if turnover of segment exceeds 20% of the turnover of the company. From the study of 50 companies abroad, the following interpretations have been drawn:

(i) Disclosure of segment information is mandatory abroad. Therefore, all the companies are disclosing segment data.
(ii) Segment reporting is being practiced abroad for a long time, therefore, the manner of presentation is more appealing and more informative.

(iii) Accounting standards or legislation relating to segment reporting abroad has been present for a long time. Therefore, there is uniformity in segment reporting.

(iv) Some companies are preparing segment-wise fund flow statement. This is very helpful in knowing which segments are generating resources and which segments are not. The disclosure of application of funds indicates to the shareholders the management’s commitment to future prospect of various segments.

(v) Some companies have prepared a statement showing reconciliation of segment data to the consolidated financial data.

(vi) Very few companies have presented budgetary data on various segments.

Comparative Analysis

In general, the proposed Indian accounting standard on segment reporting is more or less in line with the requirements prescribed by SFAS 14 in the USA, with some exception.

Segments: Firms in the U.K provide sales and pre tax profit by location and by industry. Better discloser has been available in the UK primarily due to listing requirements of the International Stock Exchange in London. A recent Accounting Standard Board (UK) exposure draft has proposed disclosure of sales, pre tax profits and capital employed. The SEC and the FASB of the USA has made it mandatory to all companies to disclose segment information by industry segments and geographical segment. Geographical statistics should be provided for each significant geographical area and for all other geographical area in the aggregate. In India, as per the proposed standard, segment data can be provided in two main ways—by class of business and geographical statistics. France, Germany, and the Netherlands require segments data by sector and market.

Exempted: In UK, schedule 4 to the Companies Act, 1985, and the accounting standard SSAP-25 has made mandatory to all companies, private companies and other entities, to disclose segment information. However, it provided for an exemption where in the opinion of the directors, the disclosure of any information which would be seriously prejudicial to the interest of the company, that information need not be disclosed, but although in the USA SFAS 14 are essentially the same as those of SSAP 25, it doesn’t allow the companies to disclose segmental information on the grounds that the disclosure would be seriously prejudicial to the interest of the company. However the proposed Indian accounting standard and international accounting standard 14 do not exempt any company from disclosing segment information on the grounds that such disclosure will be seriously prejudicial to the interest of the company.
Scope: In the UK, the scope of segment reporting has been extended to all Public Limited Companies, Private Companies and other entities. In the USA, it applies to all enterprise, whose debts or equity securities traded in a stock exchange or which are required to file financial statements with SEC. In India, the accounting standard is proposed to be mandatory to all enterprises whose equity or debt securities are listed on a recognized stock exchange, and also to those enterprises that are in the process of issuing equity or debt securities that will be listed on a recognized stock exchange in India.

Number of years: In the USA, segment information is to be provided for the last three fiscal years. But in India, the proposed accounting standard on segment reporting proposes to provide information for the last two years.

Reportable segments: As per the proposed Indian accounting standard and in the USA, for a segment to be reportable, it must account for at least 10% of any one of the following:

- total revenues
- combined operating profit or its operating loss must exceed 10% of any one of the combined operating loss of segments with losses
- combined identifiable assets of all segments.

In UK, for a segment to be reportable, the following criteria are adopted:

- Its third party turnover is 10% or more of the total third party turnover of the entity, or
- Its segment result, whether profit or loss is 10% or more of the combined results of all segments in profit or of all segments in loss, whichever combined result is greater, or
- Its net assets are 10% or more of the total net assets of the entity.

From the above, it will be noted that the criteria (b) is the same in the UK and USA standard as well as in the proposed Indian standard. But the criteria (a) and (c) in UK is different from the other two countries, on the following two aspects:

(a) The term 'revenue' has a wider connotation and therefore may include non operating incomes like interests, dividends, saledtax refund, etc. On the other hand, the term 'turnover' is well understood and not subject to any misunderstanding. Further in the USA, and in the proposed standard in India, the test is 'revenue' from external customer and from transactions with other segments. Thus, the inter-segment transactions will have to be priced. Such a pricing may differ from segment to segment, and from company to company. This may result in misinterpretations.

(b) The proposed Indian accounting standard, similarly, IAS-14, and also the USA, SFAS 14, requires the aggregate carrying amount of identifiable assets to be presented for each reportable segment and not net assets. But in the UK, SSAP- 25 requires segment analysis of net assets, i.e. operating assets less operating liabilities.
**Segment pricing:** In UK in SSAP 25, segment pricing disclosure of the basis is not necessary. This is because though the exposure draft in the UK proposed the disclosure of the basis of transfer price, e.g. market value, full cost, marginal cost, hence, many felt the disclosure would be prejudicial. In the USA and in India, unlike SSAP 25 and SFAS 14, the proposed Indian accounting standard requires the basis of inter segment pricing to be disclosed. Where there is a change in the basis, disclosure is required of the nature of the change and its effects on financial disclosures.

**Detail disclosure:** SEC of the USA requires detail disclosure on description of segment business like sources and availability of raw materials, seasonality business of the segment, status of a product or segment, main customers, dollar amount of backlog orders, principal product produced, services rendered, principal market, method of distribution of the segment's product and services, a description of any material portion of the business that may be subject to renegotiation of profit or termination of contracts or subcontracts at the election of government, and the method of competition the segment is facing (price, service, or quality). In Canada, when an enterprise has a dominant industry segment, this fact should be disclosed.

**Prior period information:** In Canada, when there has been a change in the method of grouping the industry segments or foreign geographic segments, prior period information concerning the enterprise's various segments should be restated.

**Problems in Segment Reporting**

**Competitive damage:** Presenting the results of segment operations could lead to competitive damage. Competitors may learn valuable information about profit margins and new product lines, and thus competitors may invade the company's most lucrative market. In this regard, The International Accounting Standards Committee observes; “that disclosing information about segments may weaken an enterprise’s competitive position because more detailed information is made available to competitors, customers, suppliers and others.” But in contrary, a study done by The Institute of Chartered Accountants in England and Wales (UK) concludes, “we accept that the disclosure may add somewhat to the information that competitors and customers already have, although we believe that this difficulty is overstated.” Similarly, Duff and Phelps state; “we have rarely, if ever, encountered any real loss of competitive advantage as a result of segment reporting.”

**Unreliable:** Another drawback of segment data are that they cannot be prepared with sufficient reliability and it is beyond the scope of external financial reporting to provide such analytical or interpretive data. There are definite reliability problems with segment data due to some difficulties, such as defining the segment, allotting common costs, and pricing intra-segment transfers.

**Expensive:** Developing, preparing, and providing segment-data for external users by the reporting company may be a costly one.
Misunderstanding: Misunderstanding is likely to be found among investors about segment information. Many may find it difficult to analyse or interpret or to understand or to use it.

Irrelevant: Investment by investors and creditors are made in a company and not in its individual segments.

Misleading results: Sometimes, external users of segment reporting may have difficulty in understanding them, and using them in investment decisions. A segment whose products are still in the developing stage may compare unfavourably with another segment whose products are well developed. The products in the developing stage may be as essential to the company as the developed product and sometimes the developing products need to be pushed at the cost of the more developed products. However, accounting is unable to communicate such information clearly. Consequently, investors may arrive at wrong conclusions.

Classification of segments: Various classification systems have been advocated as a consistent method of grouping products and services. However, no system has been found to be suitable universally to determine the segments. Classification of segment is left to the management of the reporting entity.

Reportable Segments: As in the case of the UK, if the identification of reportable segment is only on third party turnover, then the problem of pricing for internal customer will not arise.

Apportionment of common cost: There are a wide range of categories of common costs. The proposed Indian Accounting Standard on segment reporting allows common costs to be allocated to different segments on what the company’s management believes is a reasonable basis. Where apportionment of common costs would be misleading, the standard requires they shouldn’t be apportioned. What the company’s management believes as a reasonable basis may change from company to company.

Conclusions

In India, disclosing segment information is very popular in the form of footnotes to the financial statements, followed by director's report and in management discussion and analysis. Segment reporting practices of some Indian companies like ACC, Hindustan Lever Ltd, Bajaj Auto Ltd, Satyam Computer Service Ltd., etc., are on par with any other company in the developed countries. In India, segment information is not disclosed uniformly in a particular place of the annual report. In India, the form of disclosing segment information varies from company to company, because there is no accepted standard for segment reporting. The companies like Line Pen and Plastic Ltd gives segment report on its product by giving its market share. Some companies segment reporting practices are quite innovative like Cyber Tech System and Software Ltd., which has presented segment report in the form of interview (question-answer). In Australia, an auditor is bound to give a qualified report, when the companies financial statements are not reflecting the segment. In the USA, seg-
ments information are being provided in ratios also. In India or abroad most of the companies disclose only the statutory points on segment reporting. Very few companies go beyond the statutory requirements.

REFERENCES

Banerjee, B. 1999. Regulation of corporate reporting in India : perceptions of users a case study, Indian Journal of Accounting (December).