THE NECESSITY OF INFORMATIONAL ADJUSTMENTS TO MANAGERIAL NEEDS ACCORDING TO OPERATING SEGMENTS

Josipa Mrša, *Ph.D, University of Rijeka, Faculty of Economics*
Marino Turčić, *Ph.D student, University of Rijeka, Faculty of Economics*
Davor Mance, *Ph.D student, University of Rijeka, Faculty of Economics*

1. INTRODUCTION

Financial Reporting, organized in two core areas as internal and external financial reporting, reached a very high scientific and professional level. These two areas of accounting flow from the same informational base. Financial reporting to internal and external users, and internal managerial accounting, developed into two separate directions, but along the way lost all common characteristics. An area important to both, where it is necessary and possible to set up a compliant accounting reporting system is the reporting by operating segments.

Global processes require harmonization of internal and external reporting systems in order to make the preparing, presenting and interpreting of the financial statements content more efficient. Based on identified informational needs of internal and external reporting by business segments and reached levels of standardization, this paper analyzes the characteristics and factors of further harmonization.

2. STANDARD FRAMEWORK OF INTERNAL AND EXTERNAL REPORTING BY OPERATING SEGMENTS

The provisions of IFRS 8 - Operating Segments, are accepted as a starting point in defining internal and external reporting systems. It is the basic framework to external users of financial statements by operating segments, which may also be accepted as a basic framework for internal reporting. Reporting segments are classified according to some basic features into business (functional) and geographic segments. Business segments do not have legal personality, and differ from other parts of the company according to the type of a product or group of products produced, customer orientation, distribution methods, production processes or by the type of recognizable operating environment. Geographical segments are allocated by same characteristics, but also by the characteristics of their economic environment.

Along business and geographical segments, information by business segments is increasingly approaching informational requirements of the management (FASB 131). According to the standard, operating segments that require presentation are: internally and externally generated revenues, profit or loss, interest payable and receivable, depreciation costs, the costs of research and development, and participation in profit-related companies, tax, exceptional items, and the total assets involved, the total liabilities, investments in subsidiaries and the cost of fixed assets. Data that requires reporting by business segments is contained in external financial statements, and the advantage of this system of reporting is that the internal and external reports are compiled using same basic principles, with same or similar comprehensive information and methods of valuation. The top-management is increasingly liable for the harmonisation of external and internal reporting. The reporting model that is the foundation on which to build the "accounting responsibility" with even greater importance given to a subjective approach of leading managers is defined by a category of "*Management Approach*". [1] The Managerial approach to designing a business segment emphasises internal managerial informational requirements. They are ultimately also accepted in the segmentation of financial statements in external reporting. That means then, that the starting point of external reporting by business segments is set by the internal system of reporting to whom the external reporting system is then adjusted. Shaping of business segments is based on the requirements of the internal organisational chart of the business system. The reporting by primary and secondary levels, which is present in the provisions of IAS 14 and IFRS 8, is then superfluous. Therefore, unique reporting segments are shaped, as a result of managerial information needs. This approach to the structuring of segment reporting facilitates informational linking of vertically integrated segments and provides better performance of managerial functions, and indicates a significant improvement in financial reporting. Information is provided for each business segment, its profitability, risk, capacity growth, future cash flows, etc. Without the adoption of the methodology set out in SFAS 131, on which the IAS 14 revision was based and on which the IFRS 8 was set out. Other data in the external reports would have been partially shown in the Notes to the basic financial statements, in which information is presented as a summary, for the company as a whole.

3. HARMONISATION OF INTERNAL AND EXTERNAL REPORTING BY SEGMENTS

The start of the harmonisation of internal and external reporting is defined by the signing of the "Memorandum of Understanding" between the IASB and the FASB's in Norwalk. During the harmonisation, best solutions from both committees were taken, which is especially true for the standard solution by reporting segments. IFRS 8 is undoubtedly a global standard that provides the conditions for external comparability of internal results on a national and international level. Operating segments are part of a business which necessitates separate financial information for the management responsible for business decision-making, but also for the evaluation of the success by business segments. [2]

Table 1

Basic differences between IAS 14 and IFRS 8

Criteria	IAS 14	IFRS 8
Applicants of the standard	Reporting segments whose securities are publicly traded or are in the process of issuing such securities.	Business entities whose securities are publicly traded, or are in the process of issuing such securities and the ones that hold assets in a fiduciary capacity.
Segment shaping	Business segments (segments of activities) or geographical segments.	The part of a business system that earns the most part of its revenue on an external market, as also parts of a business segment that earn their revenue by selling to other business segments within same business system.
Reporting segment	Primary segment Secondary segment	Top management monitors the operating segment's results and makes the decisions about the resource allocation and evaluates the results of the reporting segment.
Segment	Part of the business system that earns the majority of its revenue on external markets.	Part of the business system that earns the majority of its revenue on external markets as well as parts of a business system that earn their income only by selling to other operating segments within the same business system.
Information processing about the segment	According to accounting policies used in preparing and presenting the consolidated financial statements of the business.	According to specific managerial information requirements for the purpose of decision-making, and as an assumption for assets allocation and assessment of operational results.
Basic information about the segment	Revenues, costs, results, assets and segment liabilities are defined.	Revenues, costs, results, assets and liabilities of the segment are not defined. Instead, an explanation of the manner in which profit or loss and segment assets are measured is required.

Other information about the segment	Specific information about the primary segment	Types of products and services on the basis of which segment achieved revenue. Factors used to identify the operating segments within the business system, including the organizational preconditions for the preparation of specific information about each reporting segment. If they are included in the measurement of the financial results of a business segment, information on interest revenue and costs should be reported separately.
Business system having one reporting segment only	Does not require reporting on products and services, geographical areas and largest customers at the level of a business system.	Requires reporting on products and services, geographic areas and largest customers at the level of a business system, if such information is not included in the segment report.

Sources: [3, 4]

The results of research and public hearings have pointed to a higher acceptability of the provisions of SFAS-131 than the provisions of IAS 14, so the final text of IFRS 8 mostly kept the characteristics of the latter. The process of harmonization in the area of internal and external accounting moves away from the provisions of IAS 14, which underlines the need for future adjustments of IPSAS 8. The most significant differences in the design of business segments is that they are not shaped as geographical and business segments based on market opportunities and risks, any more. Now, the emphasis is placed on how the informational requirements of internal users are met. This is also influencing the area of external reporting in a following way:

- An increase of the number of reporting segments means also more information about the internal processes.
- Users of financial statements are allowed to view the statements with the eyes of the management. In this way the system of internal and external reporting is harmonised.
- Accounting information by segments is summarised and copied into financial statements for external users, which causes no additional reporting costs. The information is available directly from the database.
- The annual reports include preliminary internal and external information, individual management reports, the results of internal audits and other relevant information from the internal processes.
- The information base for the calculation of indicators on planned and actual business segment results is provided.

- Externally presented reports on the internal segment results become compatible with the internal managerial reports, and also integrated into the annual reports.

4. CONCLUSION

Successful implementation of the harmonization of internal and external reporting needs a serious consideration of significant differences between the German and Anglo-American approaches. [4, 5] The German approach emphasises the financial reporting, i.e. the reporting to the external users. The cost accounting can be distinguished as a separate unit and can be adjusted to the specific informational requirements of internal users. In respect to the technically oriented management, it comes to its merging with the controlling. Practical problems of harmonizing the internal and external systems of reporting will undoubtedly be imposed to the public sector accounting if it comes to the approaching of the provisions of IFRS 8 and IPSAS 18. The achieved level of development in connecting the internal and external reporting systems in the public sector is not satisfactory. Therefore it is necessary to take measures to introduce an integrated information system. The practical problems of internal and external reporting harmonisation are also going to rise in the public sector if IFRS 8 and IPSAS 18 regulations start to approach. The achieved developments in external and internal reporting in public sector are not satisfactory. An improvement of the integrated informational system is necessary. IFRS 8 is undoubtedly a global standard that ensures a global external comparability and compatibility of internally created information from worldwide business results. IFRS 8 will apply to all entities that have public accountability. This means that IFRS 8 would have to be applied whenever an entity has to apply full IFRS.

LITERATURE

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[3] IASB, IFRS 8 – Operating Segments, Basis for Conclusion on Exposure Draft, International Accounting Standards Board, p. 5, from: http://www.iasb.org.

[4] Peršić, M.; Janković, S., Menadžersko računovodstvo hotela, Hrvatska zajednica računovođa i financijskih djelatnika i fakultet za turistički i hotelski menadžment, Opatija, 2006, p. 327-361.

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