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Post-implementation of MFRS 8 “Operating Segment” among listed firms in Malaysia

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Abstract. This study examined the level of disclosure among Malaysian listed firms with respect to segment reporting under new accounting standard MFRS 8 (IFRS 8). It also aimed to determine how these firms defined the chief operating decision maker (CODM) during the disclosure of segment information. Study results showed that the way firms disclosed segment information tended to vary between companies, since disclosure was dependent on company management purposes and business activities. The results also showed that only a few Malaysian firms supply information about their CODM. In summary, this study provides a fairly up-to-date description of the status of segment disclosure post-implementation of MFRS 8.

1 Introduction

IFRS 8 *Operating Segments* was issued in November 2006 by the US Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) in a standard convergence project to supersede IAS 14R, which was previously issued by the IASB. The standard was eventually adopted by the Malaysian Accounting Standards Board (MASB) and is known as MFRS 8 in the Malaysian context. Although MFRS 8 became effective on 1 January 2009, its adoption is considered tardy compared with the US, which introduced SFAS 131 (similar to IFRS 8) to replace the old SFAS 14 (similar to FRS 114) in 1997. Although the IASB’s main intention in replacing IAS 14R with IFRS 8 was never to compel non-disclosing companies to eventually comply, the new standard could have an effect on Malaysian firms, as it was envisaged that no public listed firms would be able to avoid providing segment disclosures based on the requirements of the new standard. This is because IFRS 8 is precisely worded in its intention and it is unlikely that any company would be able to give creative excuses to justify not disclosing segment information.

The shift from a two-tier approach [2] to a management approach has created a few predicaments. These include an inconsistency and decline in the number of reportable segment items, and the overwhelming number of firms claiming to operate in just one segment. Thus, many firms continue to use broad and vague geographic groupings. During implementation of the previous International Accounting Standard (IAS), firms tended to not fully provide either the primary or secondary disclosures required under the industry

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approach. This was particularly true for disclosures related to capital expenditures and liabilities, and disclosures of expenses relating to transactions with other components of the same entity, whose operating results were regularly reviewed by the entity's chief operating decision maker (CODM) in order to decide about the allocation of resources to the segment, to assess its performance, and for which discrete financial information was available.

As under the parallel US GAAP accounting standard, SFAS 131 [4], the CODM designation does not necessarily refer to a single individual but to a function within the reporting entity. The new standard requires that the reported amount of each operating item (revenue, assets, etc.) be the same measure that is reported to the CODM for the purpose of allocating resources to the segment, and for assessing its performance. This "management approach" is less flexible, as firms must report segment data externally the same way they manage it internally [3]. In this regard, it can be imagined that any company big enough to be publicly listed would be unlikely to prepare statements and analyse their performance on only an aggregate level. All public listed firms would have some sort of reporting structure that divides the overall company or group into distinct cost centres or segments for meaningful analysis and measurement of performance. Therefore, it could be reasonable to expect that no firms would be able to avoid providing segment reporting based on the requirements of the new IFRS 8.

As the firms are required to disclose financial information by both line of business and geographical areas after having considered the internal information system of the CODM. In other words, the preparers of the financial statements, need to consider the internal organization of the firm when recognizing operating segments. If the operating segments identified do not correspond to the firm's business or geographic segments, then the company needs to reorganize its complex activities to identify products/services, groups of related products/services, or geographic areas that are subject to the same risk and returns and are different from those of other business segments or geographic areas. Using this method, the IASB promoted disaggregated information reporting based on the internal organization of firms. This could be concurrently compared with external information to define a set of criteria for segment items and their disclosure in reports.

The increase in managerial discretion to define operating segments and the extent of segment information disclosure. This is important for the users of financial information because defining segments consistent with corporate practice enables users to evaluate firms using the same information available to a firm's management. However, in increasing managerial discretion in this area, there is a risk that segment information could be subject to management manipulation or inconsistency due to management fads and vagaries [8].

As a result, the present study was concerned with examining whether the changes to the standard have affected segment reporting disclosures by Malaysia's public listed firms under MFRS 8. In addition, this study was also concerned with reported segment disclosures and whether firm management is using certain discretion in managing the extent to which segment information is reported under MFRS 8. Thus, the purpose of this study was to examine segment reporting disclosures under MFRS 8 in 2012, the year of its implementation, and whether the changes in the standard have had an impact on the information published by Malaysian public listed firms.

2 Methodology

An empirical analysis of the application of MFRS 8 was conducted on a sample of Malaysian listed firms with Bursa Malaysia. This study examined only listed firms because these firms are required to prepare their financial statements and disclosure notes in accordance with IFRS [6]. The sample of firms is those that published financial statements

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in year 2012, after the mandatory implementation of MFRS 8 in Malaysia. This study also looked at the accounting items represented in the segment reports and whether were changes in the number and typology of items voluntarily published. For this study, a customized checklist of potentially disclosed items after considering all the items required under IFRS 8 was created. These items were then grouped into the main balance sheet categories common to all types of companies. A sample of 250 firms listed with Bursa Malaysia around the time of the introduction of MFRS 8 was identified using stratified random sampling. Data were collected based on MFRS 8 requirements.

3 Results

The results obtained from the descriptive analysis of the firms that were examined regarding the implementation of MFRS 8 is being discussed in detail in this sections. The result based on the research objective to examine segment reporting disclosures under MFRS 8 and whether its implementation of new accounting standard had an impact on the information published by Malaysian public listed firms. Thus the result discussed upon the segment reporting disclosure based on operating segment disclosure and entity wide disclosure, the selection of CODM and the analysis by sector group. The result upon the primary/operating segment disclosures and secondary/entity-wide disclosures is in three panel as stated in Table 1.

Table 1. Disclosures made by firms based on the segment items required under MFRS 8.

Panel A: Primary/operating disclosures		**Panel B: Secondary/entity-wide disclosures**		**Panel C: Companies entity-wide disclosures**	
Item	**%**	**Item**	**%**	**Item**	**%**
Segment revenue to external customers	85	Segment revenue from external customers based their location	53	Segment revenue from external customers by products and services	79
Segment revenue – inter-segment transactions	79	Capital expenditure	12	Revenue from external customers by geographic area	56
Segment results – continuing operations	95	Total carrying amount of segment assets based on their location	44	Non-current assets by geographic area	45

Table 1 results indicate a low disclosure of information regarding geographic areas and major customers, as firms alleged that disclosures of this type of information were commercially sensitive and could provide competitors with information that might damage their future business prospects. Companies in the sample were only willing to disclose information about major customers that contributed not more than 10% of revenue, which is the threshold stipulated in MFRS 8 (para 34). Table 2 shows the number of firms reporting by business and geographic segment. Some 90% of companies (224) disclosed

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financial information according to business segment, while 53% (132) and 45% (112) of companies disclosed information based on the location of their customers and the location of their assets, respectively.

Table 2. Number of companies reporting by business and geographic segment.

Disclosure by:	No. of firms
Business segment	224
Geographic by location of customers	132
Geographic by location of asset	112

One of the key element of segment reporting under MFRS 8 distinct from the old standard is that an operating segment is a component of an operating results are regularly reviewed by an entity's chief operating decision maker (CODM) to make a decision about the segment (IASB, 2006a). Even though the standard highlights the importance of the review of segment activities by a CODM, the standard does not specify the identity of the CODM. The standard simply states that the CODM "is not necessarily a manager with a specific title. Table 3 reports the results for firm disclosures made in segment notes, including disclosures about the CODM.

Table 3. Disclosures in segment notes.

Disclosures in segment notes	%
Reference to the introduction of MFRS 8	14
Reference to the management approach	37
Reference to the CODM	44
Identification of the CODM	33
- Chief Executive Officer (CEO)	23
- Managing Director	19

Only 14% of companies in the sample made reference to the introduction of MFRS 8 in the segment notes, while 37% made reference to the use of the management approach in disclosing financial information. The results also show that 44% of firms made reference to their CODM, while only 33% actually identified their CODM. Given that the MFRS requires segment disclosures to be regularly reviewed by the CODM, these results are somewhat surprising as they tend to suggest that the users of most companies' financial statements do not know who is reviewing segment information. Although the disclosure of information about the CODM is not a mandatory requirement under the standard, its absence appears to be a lost opportunity for firms to provide useful information to their stakeholders. From the 33% of firms (82) that identified a CODM, a majority described their CODM as a managing director, chief executive director, or a member of their company's board of directors.

4 Discussion of the results

Under MFRS 8, a firm is required to disclose segment information that is consistent with how management views the entity based on its internal reports. However, the findings of this study show that, post-MFRS 8 implementation in 2012, most Malaysian public listed firms disclosed segment information based on business products and services rather than by geographic segments. Moreover, MFRS 8 has had a significant impact on how entities

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disclose segment information. For example, new items such as interest revenue, interest expense, and income tax expense are disclosed if recognized by the CODM. In addition, the geographic locations were finer for individual country disclosures and broader to continents under MFRS 8. The entity-wide geographic disclosures seemed to improve the flexibility to disclose more geographic segment information with a finer and broader disaggregation of geographic locations.

Segment reporting has often been analysed from the perspective of voluntary disclosure. Voluntary disclosure, in general, refers to the issuer's interest in signalling good news to the users of its financial information. However, some firms tend to limit the information they disclose to avoid drawing new competitors into profitable segments [7]. The choice of segments to disclose depends on a company's determination to protect certain highly profitable segments. As a result, some companies prefer to aggregate them with less profitable segments to ward off the arrival of new competitors [5].

One of the principles underpinning MFRS 8 is enabling users to interpret a firm's position and performance based on internal reports that are regularly reviewed by the CODM. According to this study's findings, many Malaysian listed firms do not identify their CODM or the internal function to which the position was related. While there were variations in the identity of the CODM in some firms, the function was predominantly associated with the entity's Chief Executive Officer (CEO). This provides some interesting insight, as interpretation of firm performance "through the eyes of management" must depend on a user's appreciation of who or what the CODM is and, therefore, the management perspective that is being presented.

The segment reporting disclosure practices of Malaysian listed firms need further improvement, as continuous non-disclosure by these firms will have serious negative consequences with respect to the quality of the overall reporting practices of Malaysian listed firms, compared to those of other countries. Malaysian listed firms that do not fully comply with segment reporting requirements will inevitably find themselves the subject of criticism from related stakeholders and the authorities. The eventual outcome of the effectiveness of MFRS 8 in solving the problem mentioned above would be of great interest to the financial analyst community and general users of financial information and could set the direction of future research in this domain. More importantly, the adoption of the suggestions recommended by this study may solve this reporting problem to a certain extent, if not fully.

5 Conclusion

In summary, this study is to examine the post - implementation segment reporting disclosures under MFRS 8 in the year 2012. Despite, the old standard showing firms tend not to disclose fully, the changes in the standard have had an impact on the information published by Malaysian public listed firms. The result of the study shows that the way Malaysian-listed firms report on segments under MFRS 8 varies between firms, since reporting is dependent on company management purposes and business activities. From the results, it appears that Malaysian-listed firms still have not fully put MFRS 8 into practice and that improvements are needed to ensure that firms really comply with the standard. Moreover, the identity of CODMs was not provided by a sizeable number of firms in the study sample. The disclosure of this information is important to stakeholders, as the identity of CODMs may help them to assess how firms are organized and where key decisions regarding operations are being made.

The point of interest to be discussed based on the result is that to examine any possibility of enforcement mechanisms that could increase the level of segment disclosure.

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As the result of the study showing that the firms have failed in playing their role and putting their effort to increase the level of transparency. The role of the firms to ensure that they fully comply with the standard are fall short and in consequences the level of disclosure are not in line with what being portrayed in the new standard. As a result the future study upon this matter must be considered by introducing what is mediating and moderating factor that might enhance the level segment disclosure in Malaysia.

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