CHAPTER ONE: INTRODUCTION

1.1 INTRODUCTION

In the 1960s and 1970s, there was criticism of the accounting practices in developed countries such as the United Kingdom and the United States for not keeping abreast with business activities, which have moved from one business and one geographical segment operations producing single products for local consumption to multinational operations with more than one business segment. Aggregate information in consolidated financial statements could no longer satisfy the information needs of some users especially with regards to the evaluation of different rates of risks, returns and growth in a diversified multinational corporation.

Empirical studies subsequently seem to suggest that segment information do have some benefits especially with regard to the analysis of user decision making (Nobes and Parker, 2000; Baldwin, 1984; Nichols, Tunnell and Seipal, 1995; Emmanuel, Garrod and Frost, 1989), comparisons with the predictive ability of different types of forecasts (Nobes and Parker, 2000; Kinney, 1971; Collins, 1976; Silhan, 1983; Emmanuel and Pick, 1980) and stock market reaction test (Nobes and Parker,2000; Simmonds and Collins, 1978; Mohr, 1983, 1985; Prodhan and Harris, 1989) as compared with consolidated information.

The Financial Accounting Standards Board of the United States, the Accounting Standards Committee (now replaced by the Accounting Standards Board) of the United Kingdom and the International Accounting Standards Committee (IASC) responded to this need by requiring the disclosure of segmental information in their regulations and standards. The original International Accounting Standard (IAS) 14 was issued in Malaysia in 1985. However that standard was criticized for several reasons including the following:

- It provided only general guidance for identifying industry segments and geographical segments;
- Too many companies claimed to operate in only one business segment;

- Companies used broad, vague geographic groupings;
- Lack of consistency of primary segment information with other parts of the annual report;
- Too few items of information disclosed for each segment.

To better satisfy the information needs of users of financial statements, the Malaysian Accounting Standards Board (MASB) issued MASB 22 *Segmental Reporting*. MASB 22 has replaced IAS 14 *Reporting Financial Information by Segment* (hereafter referred to as 'the original IAS 14) and becomes operative for financial statements covering periods beginning on or after 1 January 2002.

The objective of MASB 22 is to establish principles for reporting financial information by segment – information about different types of products and services an enterprise produces and the different geographical areas in which it operates – to help users of financial statements:

- Better understand the enterprise's past performance;
- Better assess the enterprise's risks and returns; and
- Make more informed judgements about the enterprise as a whole.

An enterprise's primary segment disclosure format shall be the one that dominates the source and nature of an enterprise's risks and returns, and shall be either its business segments or geographical segments. Secondary disclosure information shall be reported for the business segments or geographical segments not selected for primary segment disclosure.

Some of the changes brought about by MASB 22 in comparison with the original IAS 14 in order to achieve the above objectives are as follows:

- MASB 22 requires that if total revenue from external customers for all reportable segments combined is less than 75% of total enterprise revenue, then additional reportable segments should be identified until the 75% level is reached (hereafter referred to as '**the 75% ruling**'). The original IAS 14 did not have such a requirement. (A reportable segment is a business or geographical segment that is specifically identified for segment disclosure)

- The original IAS 14 required 4 principal items of information for both industry and geographical segments i.e. sales or other operating revenue, segment result, segment assets employed and the basis of inter-segment pricing. For an enterprise's primary basis of segment reporting, MASB 22 requires the above 4 items of information plus another 5 items of information i.e. segment liabilities, additions of property, plant and equipment and intangible assets, depreciation and amortisation expense, other non-cash expenses and share of net profit or loss of associate or joint venture (hereafter referred to as '**primary segment disclosure**')

1.2 OBJECTIVES AND SCOPE OF THE STUDY

This research examines the compliance of segment disclosures of Main Board public listed companies in Malaysia. The reason this category has been selected is because this category has recorded higher compliance rate (81.7%) than the Second Board (63.9%) (Chow 2001) and also because of the limitation of time. This paper seeks to obtain empirical evidence on the extent of compliance of MASB 22 by such companies. It should be interesting to find out whether Main Board companies would still have such a high compliance rate given the fact that the changes brought about by MASB 22, especially the two noted above, could result in a greater amount of information disclosed.

Section 166A of the Companies Act 1965 requires accounts to be prepared in accordance with the applicable approved accounting standards. This makes the compliance of MASB 22 legally mandatory..

There were 570 Main Board companies listed in the Bursa Malaysia at the time of this current study. However some companies have to be discarded due to the following reasons:

- Some annual report files could not be opened from the Bursa Malaysia website, probably due to some technical reasons;
- Some annual reports were not audited for the period selected for this study;
- Quite a number of companies were only listed recently i.e. their first annual reports after being listed in the Bursa Malaysia were subsequent to the period selected for this study;
- One company had a notice of book closure;
- Non-diversified companies i.e. those companies that operated mainly in only one business segment and one geographical segment were excluded from the sample to be analyzed.

Therefore, after exclusion of the above companies, a final sample size of 391 companies was selected.

It should be noted that there are 85 paragraphs in MASB 22 and it would not be practical to examine whether the Main Board companies have followed every provision in the Standard. As such I have, using my own discretion selected two provisions of the Standard to be examined. These two provisions concern the compliance of the 75% ruling and the 9 items to be disclosed for the primary segment as referred to above. These are new provisions under MASB 22 (compared with the original IAS 14) which I believe were included to bring about more disclosure of segment information among the Main Board companies.

There have been numerous studies on segmental information disclosure, some of which will be discussed and are referred to in chapter 2 of this study. A summary of some of these studies can be seen in Table 1. Table 1 highlights some of the many determinants that can significantly influence the disclosure of segment information. Due to cost and time constraints, I have mainly selected three determinants that in previous studies had resulted in apparently conflicting findings i.e. firm size, financial leverage and industry membership.

Two Malaysian studies had completely different findings with regards to support for firm size. Tan and Ngan (1991) found that firm size is not a significant determinant of segment disclosure whereas Chow (2001) discovered that there is a significant relationship between firm size and segment disclosure.

There have also been dissimilar findings with respect to support for financial leverage as a significant determinant of segment disclosure. Bradbury (1992), Mitchell et al. (1995) and Chow (2001) found support for leverage but Chow and Wong-Boren (1987), McKinnon and Dalimunthe (1993) and Aitken et al. (1997) found no such support.

Findings for industry membership have been contrasting. McKinnon and Dalimunthe (1992) found that politically sensitive industries are likely to volunteer to disclose segment information whereas Belkaoui and Karpik (1989) found that firms try to avoid the attention of government regulators (Birt et al. 2003)

Therefore, it should be interesting to ascertain from this study whether support can be found for these three determinants, and its relationship with the two provisions of MASB 22 referred to above.

1.3 ORGANIZATION OF THE STUDY

The study will be organized in 5 chapters as follows:

Chapter 1: introduction

Chapter 2: literature review

Chapter 3: research methodology

Chapter 4: research findings

Chapter 5: conclusion and recommendations