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IMPROVING THE METHODOLOGY OF MANAGEMENT REPORTING BY SEGMENTS AND RESPONSIBILITY CENTERS

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Abstract

The thesis addresses the methodological mismatch between internal management segmentation and external segment reporting under IFRS 8. A two-tier segmentation methodology is proposed, linking internal management segments and responsibility centres with reportable operating segments through a documented reconciliation bridge.

Keywords: Operating segments, IFRS 8, responsibility centres, two-tier segmentation, controllability, transfer pricing, reconciliation.

Segmentation is the point at which management reporting and financial reporting meet most directly. Internally, an entity divides itself into products, services, customer groups and responsibility centres in order to assign accountability and measure performance. Externally, it discloses reportable operating segments in accordance with IFRS 8. In principle the two structures should coincide, since IFRS 8 applies the management approach. In practice they frequently diverge.

The divergence has practical consequences. If internal segments are defined by product while the chief operating decision maker reviews information by geography, the disclosed segments do not correspond to the way the business is actually managed, and the reconciliation required by the standard becomes a mechanical year-end exercise. Conversely, if internal reporting is forced into the



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external segment structure, it loses the granularity that managers need for operational decisions.

The proposed solution accepts that the two purposes legitimately differ, but requires that the connection between them be formalised. The methodology therefore separates segmentation into two tiers linked by a documented reconciliation bridge.

Tier one serves management purposes. Segments are formed by product, service and customer group, and each is linked to one or more responsibility centres. Measurement is governed by the controllability principle: only revenues and costs that the responsible manager can influence enter the evaluated result, while allocated non-controllable costs are presented separately below the controllable margin line.

Tier two serves reporting purposes. Tier-one segments are aggregated into reportable operating segments according to the review structure of the chief operating decision maker, the aggregation criteria and the quantitative thresholds of IFRS 8.

The reconciliation bridge consists of three documented elements: a mapping table linking every tier-one segment to a tier-two segment; elimination rules for internal turnover and transfer margins; and a reconciliation statement showing the transition from the sum of management segment results to the reported segment result.

The type of responsibility centre determines both the measure evaluated and the reporting form applied (Table 1).



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Table 1. Responsibility centres and evaluated measures

Responsibility centre	Manager controls	Evaluated measure
Cost centre	Level and structure of costs	Cost variance against budget
Revenue centre	Volume, mix and prices	Revenue and contribution margin
Profit centre	Revenues and controllable costs	Controllable operating profit
Investment centre	Profit and invested capital	Return on invested capital, residual income

Source: compiled by the author.

Where responsibility centres exchange goods or services internally, the transfer price becomes a determinant of the measured segment result. Three approaches are applicable: market-based prices where an external market exists; cost-based prices using standard rather than actual cost, so that inefficiency is not transferred between units; and negotiated prices where both parties have decision autonomy. The methodology requires that the chosen approach be fixed in an internal regulation and that transfer margins be eliminated in tier-two aggregation, since otherwise internal turnover inflates reported segment revenue.

Certain limitations should be acknowledged. The controllability principle is difficult to apply strictly, as few costs are entirely controllable or entirely uncontrollable. Transfer pricing remains sensitive to the relative negotiating position of internal units. Excessive granularity in tier one increases the maintenance burden without necessarily improving decisions.

Conclusion

Internal and external segmentation should not be maintained as parallel systems but connected through a documented reconciliation bridge. Practical recommendations: approve a mapping table linking each management segment to



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a reportable segment as part of the accounting policy; separate controllable and non-controllable items in every segment report; fix the transfer pricing approach in an internal regulation and eliminate internal turnover consistently; match the evaluated measure to the type of responsibility centre; and prepare the segment reconciliation regularly rather than only at the reporting date.

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