

Query No. 8

Subject: *Company's policy on transfer price for segment revenue and segment results under segment reporting.*¹

A. Facts of the Case

1. A company (hereinafter referred to as 'the company') is a public sector enterprise under the administrative control of Ministry of Mines, Government of India and is engaged in mining of bauxite, manufacturing of alumina and aluminium, generation of power at Captive Power Plant (CPP) for use in Smelter, and selling of alumina and aluminium both in domestic and international market. Besides, the company is also engaged in generation of wind power with setting up of wind power plants at distinct locations in the country.

2. The company has four production units, details of which are furnished below:

- (i) fully mechanised open cast bauxite mine having excavation capacity of 68,25,000 tonnes per annum
- (ii) Aluminium refinery having production capacity of 22,75,000 tonnes per annum
- (iii) Captive Power Plant having 10 units of 120 MW each to generate power and
- (iv) Smelter Plant of 460,000 tonnes per annum capacity. In addition, there are 4 wind power plants of about 50MW each located in the states of Andhra Pradesh, Rajasthan and Maharashtra.

3. Mines division, which is located on hills, serves feed-stock to the alumina refinery located 16 KM downhill. The Refinery provides alumina to the company's Smelter Plant which is about 600 KM away by a specially designed alumina wagon by rail transport. For production of 1 MT of aluminium at smelter, 13,600 KWH of power is required, which is met by generation of power at Captive Power Plant situated at 4 KM away from the Smelter. Calcined alumina and thermal power are two important inputs for producing aluminium metal at Smelter Plant. The production process starting from bauxite mines to alumina refinery to Aluminium Smelter and Captive power plant is fully integrated.

4. Bauxite produced at mines is only meant for captive consumption at alumina refinery and not open to sale. Surplus alumina produced over and above Smelter requirement is sold in the open market through competitive bids either as long term contracts or spot tenders. The company has been registered with London Metal Exchange (LME). Export and domestic price for sale of aluminium metal is dependent upon LME price of Aluminium.

5. At present, the company has two reportable operating segments for the purpose of segment reporting as mandated under Ind AS 108, 'Operating Segments'.

- a. Chemical segment
- b. Aluminium segment

6. The company has considered chemicals and aluminium as the two primary operating business segments. Chemicals include calcined alumina, alumina hydrate and other related

¹ Opinion finalised by the Committee on 13.6.2019.

products. Aluminium includes aluminium ingots, wire rods, billets, strips, rolled and other related products. Bauxite produced for captive consumption for production of alumina is included under chemicals and power generated for captive consumption for production of aluminium is included under aluminium segment. Wind Power Plants have been commissioned primarily to meet the Renewable Purchase Obligation (RPO) as a mandatory compliance and included in the unallocated common segment.

7. The company is working in an ERP-SAP environment. Transfer of alumina from refinery (chemical segment) to aluminium Smelter (aluminium segment) is recorded in the books of account at moving average price based on inventory valuation in compliance to Ind AS 2. Similarly, thermal power from CPP (Aluminium Segment) as transferred to refinery, is recognised at monthly average price as per Ind AS 2.

8. For the purpose of inter segment transfer pricing of alumina, the company considers average sales realization from export of calcined alumina less in-land freight from refinery to Port at Vizag plus export incentive and captive power transferred from aluminium segment to chemical segment at average purchase price of power from state grid as the transfer price for disclosure of inter-segment revenue and segment results under segment reporting.

9. The facts stated at paragraph 7 indicate the method of accounting of alumina for inventory valuation based on moving average price which is at cost price. Facts stated at paragraph 8 indicate disclosure of segment report based on average export realisation of Alumina. From the above, it is evidently clear that price considered for inter segment transfer for the purpose of segment report is not the same as considered in the Accounts.

10. The querist has stated that the notified Indian Accounting Standard (Ind AS) 108, 'Operating Segments' does not specifically prescribe the basis of determination of transfer price of inter-segment transfer for segment reporting. It may be mentioned that Accounting Standard (AS) 17, 'Segment Reporting', at paragraph 33 prescribes that "***Segment information should be prepared in conformity with the accounting policies adopted for preparing and presenting the financial statements of the enterprise as a whole.***"

11. According to the querist, as per the guidance provided in the Education Material on Indian Accounting Standard (Ind AS) 108, 'Operating Segments', issued by the erstwhile Ind AS Implementation Committee of the ICAI at page 54,

"... Diversified Company accounts for intersegment sales and transfers as if the sales or transfers were to third parties, i.e at current market prices."

The querist has mentioned that the company having, an integrated project of bauxite mining, alumina refinery and aluminium smelter is continuing its business model since inception without any diversification. In view of the above, the decision of the company to adopt a cost based intersegment transfer pricing for segment reporting confirms the provisions of the Accounting Standards in compliance to Ind AS 108.

12. With above backdrop, the company has decided to change its existing policy of inter-segment transfer price as below:

Existing Policy	Proposed Policy
<p>Inter-segment transfer of calcined alumina is considered at average sales realization from export sales during the period less freight from refinery to Port at Vizag plus export incentive. Transfer of power from aluminium segment to chemical segment is considered at the annual / periodic average purchase price of power from State Grid at alumina refinery.</p>	<p>Inter-segment transfer of calcined alumina from chemical segment to aluminium segment and captive power from aluminium segment to chemical segment is considered at their respective cost price used for recording such transactions.</p>

B. Query

13. On the basis of the above, the querist has sought the opinion of the Expert Advisory Committee as to whether inter-segment transfer price of alumina from chemical segment to aluminium segment and captive power from aluminium segment to chemical segment at cost price, as recorded in the books for determination of cost of production and inventory valuation, will be appropriate for segment reporting, in the absence of specific stipulation regarding transfer pricing for inter-segment transfer in the notified Indian Accounting Standard (Ind AS) 108, ‘Operating Segments’.

C. Points considered by the Committee

14. The Committee notes that the basic issue raised in the query relates to measurement principles to be adopted for inter-segment transfer for presenting segment information as per Indian Accounting Standard (Ind AS) 108, ‘Operating Segments’, notified under the Companies (Indian Accounting Standards) Rules, 2015 (hereinafter referred to as ‘the Rules, 2015’). The Committee has, therefore, considered only this issue and has not considered any other issue that may arise from the Facts of the Case, such as, identification and aggregation of reportable segments, appropriateness of accounting policies and principles followed for preparing and presenting the financial statements including valuation of inventories and determining cost of production, etc.

15. The Committee notes the following paragraphs of Ind AS 108, notified under the Rules, 2015:

“23 An entity shall report a measure of profit or loss for each reportable segment. An entity shall report a measure of total assets and liabilities for each reportable segment if such amounts are regularly provided to the chief operating decision maker. An entity shall also disclose the following about each reportable segment if the specified amounts are included in the measure of segment profit or loss reviewed by the chief operating decision maker, or are otherwise regularly provided to the chief operating decision maker, even if not included in that measure of segment profit or loss:

- (a) revenues from external customers;
- (b) *revenues from transactions with other operating segments of the same entity;*
- (c) interest revenue;

...”

“25 *The amount of each segment item reported shall be the measure reported to the chief operating decision maker for the purposes of making decisions about allocating resources to the segment and assessing its performance. ...*

26 If the chief operating decision maker uses only one measure of an operating segment’s profit or loss, the segment’s assets or the segment’s liabilities in assessing segment performance and deciding how to allocate resources, segment profit or loss, assets and liabilities shall be reported at those measures. If the chief operating decision maker uses more than one measure of an operating segment’s profit or loss, the segment’s assets or the segment’s liabilities, the reported measures shall be those that management believes are determined in accordance with the measurement principles most consistent with those used in measuring the corresponding amounts in the entity’s financial statements.

27 An entity shall provide an explanation of the measurements of segment profit or loss, segment assets and segment liabilities for each reportable segment. At a minimum, an entity shall disclose the following:

(a) *the basis of accounting for any transactions between reportable segments.*

(b) *the nature of any differences between the measurements of the reportable segments’ profits or losses and the entity’s profit or loss before income tax expense or income and discontinued operations (if not apparent from the reconciliations described in paragraph 28). Those differences could include accounting policies and policies for allocation of centrally incurred costs that are necessary for an understanding of the reported segment information.*

(c) the nature of any differences between the measurements of the reportable segments’ assets and the entity’s assets (if not apparent from the reconciliations described in paragraph 28). Those differences could include accounting policies and policies for allocation of jointly used assets that are necessary for an understanding of the reported segment information.

(d) the nature of any differences between the measurements of the reportable segments’ liabilities and the entity’s liabilities (if not apparent from the reconciliations described in paragraph 28). Those differences could include accounting policies and policies for allocation of jointly utilised liabilities that are necessary for an understanding of the reported segment information.

(e) *the nature of any changes from prior periods in the measurement methods used to determine reported segment profit or loss and the effect, if any, of those changes on the measure of segment profit or loss.*

- (f) the nature and effect of any asymmetrical allocations to reportable segments. For example, an entity might allocate depreciation expense to a segment without allocating the related depreciable assets to that segment.”

(Emphasis supplied by the Committee.)

16. From the above, the Committee notes that as per paragraph 25 of Ind AS 108, the amount of each segment item reported should be the measure reported to the chief operating decision maker (CODM) for the purposes of making decisions about allocating resources to the segment and assessing its performance. Thus, the Standard uses the ‘management approach’, under which, the information to be reported about each segment should be measured on the same basis as the information used by CODM for purposes of allocating resources to segments and assessing segments’ performance rather than to be provided in accordance with the same generally accepted accounting principles (GAAP) used to prepare the financial statements. Thus, the measurement principles to be followed for presenting segment information could be different from the accounting principles and policies followed for preparing the general purpose financial statements.

17. The Committee also notes that the Standard is not specific as to how this measure should be calculated, nor does it require that the same accounting policies should be used as those used in preparing the financial statements. The measurement principles are also not required to be in accordance or consistent with those used in an Ind AS. In this context, the Committee notes that paragraph 27(b) of Ind AS 108 requires to disclose the nature of any differences between the measurements of the reportable segments’ profits or losses and the entity’s profit or loss before income tax expense or income. This, itself indicates that the Standard allows the company to have a non-GAAP presentation as long as the presentation is clear what constitutes the non-GAAP measure and there is a clear and detailed reconciliation of the disclosed measure to the respective GAAP amount.

18. The Committee also notes that Ind AS 108 does not define segment revenue, segment expense, segment results, segment assets and segment liabilities. It requires an explanation of how segment profit or loss, segment assets and liabilities are measured at each reportable segment as used by the CODM for decision-making purposes. The Standard also specifically requires to disclose as minimum, the basis of accounting for any transactions between reportable segments. Thus, the Standard only requires to disclose the basis of accounting for any inter-segment transactions and does not prescribe any specific accounting/measure to be adopted for presenting segment information. Accordingly, the Committee is of the view that in the extant case, inter-segment transfer price of alumina from chemical segment to aluminium segment and captive power from aluminium segment to chemical segment should be at the measure reported to the chief operating decision maker for the purposes of making decisions about allocating resources to the segment and assessing its performance. However, in case CODM uses more than one measure of an operating segment’s results/assets/liabilities, the reported measures should be those that the management believes are determined in accordance with the measurement principles most consistent with those used in the entity’s financial statements as per the requirements of paragraph 26 of Ind AS 108.

19. Incidentally, the Committee wishes to point out that the extract of Educational Material on Ind AS 108 referred to by the querist in the Facts of the Case is an extract of only an example from the Guidance on Implementing Ind AS 108, that illustrates the disclosure to be made by a company regarding measurement of operating segment profit or loss, assets and liabilities as required under paragraph 27 of Ind AS 108 for the facts provided in the Example given thereunder. Therefore, it does not establish measurement principles.

D. Opinion

20. On the basis of above, the Committee is of the view that in the extant case, inter-segment transfer price of alumina from chemical segment to aluminium segment and captive power from aluminium segment to chemical segment should be at the measure reported to the chief operating decision maker for the purposes of making decisions about allocating resources to the segment and assessing its performance. However, in case CODM uses more than one measure of an operating segment's results/assets/liabilities, the reported measures should be those that the management believes are determined in accordance with the measurement principles most consistent with those used in the entity's financial statements as per the requirements of paragraph 26 of Ind AS 108.
