Segment Reporting

The following is the brief version of an opinion given by the Expert Advisory Committee of the Institute in response to query sent by a member. This is being published for the information of readers.

Facts of the Case

1 A multi-state co-operative society was incorporated in April 1980, as a national level co-operative society to manufacture and distribute a chemical fertiliser, i.e., urea. The society has two phases of ammonia plant of 1,350 MTPD capacity each and two phases of urea plant of 2,200 MTPD capacity each, each phase of urea plant consisting of two streams of 1,100 MTPD, with an annual capacity to produce 14.52 lakh MT of urea. The society commenced its commercial production from March 1986. The society manufactures urea at its only plant located at Hazira in Surat. The plant of the society is a continuous process plant.

2 The equity of the society is substantially owned by the Government of India and is under the administrative control of Department of Fertilisers, Ministry of Chemicals and Fertilisers. The rest of the equity of the society is held by other co-operative societies. The shares of the society are neither listed nor traded on any stock exchange and are not governed by any of the regulations of stock exchanges. Also, there is an express provision in the Multi-State Co-operative Societies Act, 1984, that the provisions of the Companies Act, 1956, shall not apply to multi-state co-operative societies. The Multi-State Co-operative Societies Act, 1984, does not provide any specific format for presenting the annual accounts of the society.

3 The Government of India, through the Essential Commodities Act, 1955, and the Fertiliser (Control) Order, 1985, as amended from time to time, regulates the movement of fertiliser and its price. The present pattern of regulation is enumerated as under:

(i) The Central Government allocates the quantity of urea to be sold by each manufacturing unit in the states indicated by the Central Government for every season, i.e., Khariff and Rabi season of the year. No manufacturer is allowed to sell beyond the limit prescribed by the Central Government. The allocation fixed by the Central Government for each manufacturer is based on the requirement of urea for every season by the respective state and total production of all the urea manufacturers available in the country. The individual allocation is done to cover the entire production.

(ii) Similarly, the price of urea is also controlled by the Central Government, i.e., the price at which various manufacturers can sell the urea in the country is fixed by the Central Government and this price is uniform throughout the country for all manufacturers. No variation is permitted by the Central Government.

(iii) The Central Government also reimburses a uniform amount as freight subsidy for each unit irrespective of the allocation given to various states. Even in this respect, uniformity is maintained by the Central Government.

(iv) The society distributes its product through state government agencies such as Apex Co-operative Marketing Federations, district and primary level co-operative societies, etc.

1. The Opinion is only that of the Expert Advisory Committee and does not necessarily represent the Opinion of the Council of the Institute.

2. The Compendium of Opinions containing the Opinions of Expert Advisory Committee has been published in 22nd volumes which are available for sale at the Institute's office at New Delhi and its regional council offices at Mumbai, Chennai, Kolkata and Kanpur.

4 The society does not sell its products beyond the shores of the country. The society has State Marketing Offices in various states and these offices supervise the work of receipt of material from the factory, delivery to various purchasers such as Apex Co-operative Marketing Federations, etc., arrange invoices on the customers, arrange storing/warehousing of the material, lifting of the material and collection of payment from the respective customers. The State Marketing Offices are not permitted to utilise the sale proceeds and the sale proceeds are directly transferred to Central Collection Accounts at Delhi/Noida. To meet the day-to-day expenditure for maintaining the office, salary, storage charges, transportation charges, handling charges, etc., the required funds are transferred from Delhi/Noida to the respective State Marketing Offices. The sales terms are uniform in all the States. The respective State Marketing Offices maintain accounts relating to stock transfer from plant to the State, invoice accounting, debtors accounting, expenses accounting, etc., and these are consolidated for preparation of final accounts of the society. These offices are treated as branches and operate for marketing of product of the society within the assigned territorial jurisdiction. The closing stock valuation is done centrally at the Central Marketing Office.

5 In addition to urea, the society sometimes also deals in other products such as bio-fertilisers, seeds, chemicals, imported and other fertilisers which are not predominant products and the total revenue from these products constitutes a miniscule percentage of total revenue of the society as detailed below:

S. No.	Name of the product	Percentage of revenue earned from these products to the total revenue of the society
1	Seeds, chemicals and agricultural implements	0.79%
2	Imported and other fertilisers	0.97%
3	Ammonia, liquid nitrogen and syn gas	2.61%

As per the querist, since the revenue from sales of these products is less than 10% of the total revenue, these products by themselves do not constitute a reportable segment as per paragraph 27 of Accounting Standard (AS) 17, 'Segment Reporting', issued by the Institute of Chartered Accountants of India.

6 The querist has referred to the 'Objective' paragraph of AS 17, which, inter alia, provides as follows:

> ".... Many enterprises provide groups of products and services or operate in geographical areas that are subject to differing rates of profitability, opportunities for growth, future prospects, and risks. ...."

7 The querist has also referred to the definition of the term 'geographical segment' contained in paragraph 5 of AS 17 which provides as below:

> "A geographical segment is a distinguishable component of an enterprise that is engaged in providing products or services within a particular economic environment and that is subject to risks and returns that are different from those of components operating in other economic environments. Factors that should be considered in identifying geographical segments include:
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> (a) similarity of economic and political conditions;
> (b) relationships between operations in different geographical areas;
> (c) proximity of operations;
> (d) special risks associated with operations in a particular area;
> (e) exchange control regulations; and
> (f) the underlying currency risks."

8 According to the querist, the society is of the view that it is providing products or services within the same economic environment of the country. Its products, production, distribution and pricing are controlled by the Central Government. The risks and returns in respect of operations in each state are the same. The geographical location of its State Marketing Offices does not affect the risks and returns of the society. The society is not operating in different countries; no spe-

cial risks are associated with operations in a particular area. The society is not governed by exchange control regulations and there are no currency risks. The officials incharge of respective State Marketing Offices are not allowed to vary the sales terms, product distribution or allocation of material to that state. Sales terms, product distribution, and allocation of material to the states are duly controlled by the Central Government and are uniform throughout the country. The society has only one plant-factory located at Hazira, Surat. Freight subsidy paid to the society by the Central Government is uniform for all states.

9 According to the querist, in view of the above uniqueness of operations of the society and factual position stated above, wherein total operations are in the same economic environment and risks and returns are same, it is felt that segment reporting under geographical segments is not applicable in the case of the society.

A. Query

10 The querist has sought the opinion of the Expert Advisory Committee as to whether, in the light of the circumstances explained above, the society needs to comply with AS 17 while presenting its general purpose financial statements, i.e., balance sheet and profit and loss account.

C. Points considered by the Committee

11 The Committee notes that as per the provisions of Accounting Standard (AS) 17, 'Segment Reporting', issued by the Institute of Chartered Accountants of India, the components of an enterprise that are required to be reported separately have to first fall within the definitions of the terms 'business segment' or 'geographical segment'. In this context, the Committee notes the definition of the term 'geographical segment' as per AS 17, as reproduced at paragraph 7 above, and the definitions of the terms 'business segment' and 'reportable segment' as per paragraph 5 of AS 17, and the criteria for identification as reportable segment as per paragraph 27 of AS 17, reproduced below:

"A business segment is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products or services and that is subject to risks and returns that are different from those of other business segments. Factors that should be considered in determining whether products or services are related include:

(a) the nature of the products or services;
(b) the nature of the production processes;
(c) the type or class of customers for the products or services;
(d) the methods used to distribute the products or provide the services; and
(e) if applicable, the nature of the regulatory environment, for example, banking, insurance, or public utilities."

"A reportable segment is a business segment or a geographical segment identified on the basis of foregoing definitions for which segment information is required to be disclosed by this Statement."

"27. A business segment or geographical segment should be identified as a reportable segment if:

(a) its revenue from sales to external customers and from transactions with other segments is 10 per cent or more of the total revenue, external and internal, of all segments; or
(b) its segment result, whether profit or loss, is 10 per cent or more of -
(i) the combined result of all segments in profit, or
(ii) the combined result of all segments in loss,

whichever is greater in absolute amount; or

(c) its segment assets are 10 per cent or more of the total assets o f all segments."

12 The Committee also notes from the facts of the case that the society manufactures urea at its only plant located at Hazira at Surat and it does not sell its products beyond the shores of the country. The Committee further notes from the facts of the case that according to the querist, total operations of the society are in the same economic environment and, therefore, the concerned risks and returns are the same. Accordingly, the Committee is of the view that the society does not have

components that would constitute different geographical segments as per AS 17.

13 The Committee notes from the facts of the case that the society primarily deals in urea. It also sometimes deals in other products such as bio-fertilisers, seeds, chemicals, imported and other fertilisers which are not predominant products. The Committee also notes that the querist has not supplied information as to whether or not the risks and returns associated with the various products in which the society sometimes deals in, are different. In this context, the Committee notes that according to the definition of the term 'business segment' as per AS 17 reproduced in paragraph 11 above, if the various products of the society are subject to different risks and returns, these would constitute different business segments. However, if the products are not subject to different risks and returns, they would not constitute different business segments.

14 The Committee notes from paragraph 27 of AS 17 reproduced above that a business segment or a geographical segment would be reportable only if it meets the thresholds provided in that paragraph. Accordingly, the Committee is of the view that in case the products in which the society deals are subject to different risks and returns and, therefore, constitute business segments, these would be reportable only if they also meet the thresholds provided in paragraph 27 of AS 17.

15 The Committee notes from the facts of the case that the society primarily earns revenue from the sale of urea. The total revenue from other products constitutes a small percentage of total revenue of the society. The Committee is of the view that these products, i.e., bio-fertilisers, seeds, etc., will not constitute reportable business segments provided that none of the criterion mentioned in paragraph 27 of AS 17, viz., revenue, segment result, and segment assets, meet the respective thresholds provided in that paragraph. The Committee notes the contention of the querist that since the revenue from sales of products other than urea, i.e., bio-fertilisers, seeds, etc., is less than 10% of the total revenue, these products do not constitute a reportable segment as per paragraph 27 of the Standard. The Committee is of the view that paragraph 27 of AS 17 lays down the criteria for identification of 'a reportable segment', which is a 'business segment' or a 'geographical segment'. These criteria, therefore, do not apply to identification of residual business or geographical segments which individually fail to meet the said criteria. Accordingly, it cannot be concluded that if the residual segments, in aggregate, do not meet the threshold criteria, AS 17 does not apply because there is only one reportable segment. In this context, the Committee notes that it can be argued that since the residual head comprising the segments that do not meet the criteria specified in paragraph 27 of AS 17, is not material, AS 17 should not apply to the society on the consideration of materiality. The Committee does not agree with this argument in view of paragraph 30 of AS 17, which states as below:

> "30. The 10 per cent thresholds in this Statement are not intended to be a guide for determining materiality for any aspect of financial reporting other than identifying reportable business and geographical segments."

The Committee is of the view that once the materiality criteria as specified in paragraph 27 of AS 17 are applied and on that basis a reportable segment is identified and there are other business/geographical segments which do not individually meet the criteria, AS 17 becomes applicable. The enterprise should, in such a case, present segment information, as per AS 17, for the reportable segment so identified and the residual head. The Committee is of the view that such a reporting would be in consonance with the consideration of materiality since the users of the financial statements would get a very useful information that the risks and returns of the enterprise are dependent on only one dominant segment and if business conditions related to that segment change, the profitability/financial condition of the whole enterprise would change.

D. Opinion

16 On the basis of the above, the Committee is of the opinion that in the circumstances of the case, the society should present segment information in its financial statements as per AS 17.