

## Segment Reporting for Sale of Power to the State Grid

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

### A. Facts of the Case

1. A listed company is engaged in the business of manufacturing paper for newsprint, printing and writing. The turnover from the sale of newsprint, printing and writing paper during 2004-05 was Rs. 671.29 crore.

2. The querist has stated that the company has installed four turbo generators. The entire power requirement is met through captive generation. Surplus power is sold to the State grid. In addition, the company is having a wind farm. The wind power is also sold to the State grid. The proceeds from sale of power during the financial year 2004-05 were Rs. 29.27 crore.

3. The querist has reproduced paragraph 27 of Accounting Standard (AS) 17, 'Segment Reporting', issued by the Institute of Chartered Accountants of India, which states as follows:

**"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 of all segments."**

4. According to the querist, sale from power works out to 4.36 % of the total turnover. The profit from sale of power is less than 10% of the combined result of the manufacturing activities and sale of power. The segment assets are also less than 10% of the total assets of the company.

5. The querist has stated that in the above circumstances, the company has considered that sale of power is not a reportable segment. However, during the audit, the statutory auditors have opined as below:

"Segment Reporting vis-à-vis, the company, after applying the above norms, we are of the opinion that the company has two business segments viz. 1) Paper and Paper products and 2) Wind farm or Power sector. Both are subject to different risks and returns and further have different organisational structure and internal reporting.

As far as reportable segment is concerned, paper and paper products individually meet the criteria laid down in AS 17 (paragraph 27) (i.e., more than 10%) and hence to be reported as a separate business segment.

As wind farm or power sector is regarded as a different undertaking for the purpose of claiming deduction u/s 80-IA of the Income-tax Act, for reckoning the threshold limits 'internal transfer/utilisation' (i.e., the transaction with other segments) shall also be taken into account as AS 17 (paragraph 27) is very clear in this regard.

Therefore, disclosing of the power sector as a reportable segment has to be arrived at by taking into consideration the transactions with other segments. In case the threshold limits are

lower than the percentage stipulated, it is the discretion of the management to consider it as a separate 'reportable segment' or as a 'residual segment' (as 'others')."

## B. Query

6. The querist has sought the opinion of the Expert Advisory Committee as to whether the sale of power to the State grid should be considered as a separate reportable segment even though the activity does not fall within the threshold limits stipulated under paragraph 27 of AS 17.

## C. Points considered by the Committee

7. The Committee notes from paragraph 6 above that the querist has raised the query only in the context of 'power' segment. In the absence of the relevant information, the Committee presumes that there is only one segment other than 'power', viz. 'paper'.

8. 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 have to first fall within the definitions of the term 'business segment' or 'geographical segment' before being considered as 'reportable segment'. In this context, the Committee notes the definitions of the terms 'business segment' and 'geographical segment' as per paragraph 5 of AS 17, which are reproduced below:

**"5. 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 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:**

**(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 current risks."**

9. The Committee further notes paragraphs 7 and 12 of AS 17 which provide as below:

"7. A single business segment does not include products and services with significantly differing risks and returns. While there may be dissimilarities with respect to one or several of the factors listed in the definition of business segment, the products and services included in a single business segment are expected to be similar with respect to a majority of the factors."

"12. The predominant sources of risks affect how most enterprises are organised and managed. Therefore, the organisational structure of an enterprise and its internal financial reporting system are normally the basis for identifying its segments."

10. The Committee notes from the above that to identify business and geographical segments, the undertaking needs to evaluate whether the risks and returns of various

components of an enterprise are different as per the factors stated in the definitions of the terms 'business segment' and 'geographical segment'. Where the organisational structure and internal financial reporting system of various components are different, it suggests that the risks and returns are different. The Committee presumes from the Facts of the Case that the company has two business segments, viz., paper and power, as the two have different risks and returns particularly, in view of the fact that they have different organisational structure and internal financial reporting systems.

11. The Committee also notes the requirements of paragraph 27 of AS 17 reproduced in paragraph 3 above with respect to identification of a reportable segment that for the purpose of determination of the threshold limit of 10% with regard to revenue, the revenue from sales to external customers and from transactions with other segments is to be taken into account. Accordingly, the Committee is of the view that for the purpose of determining whether paper and power qualify as reportable segments, the revenue from external sales as well as internal sales should be taken into account. In case the segment revenue so determined is equal to or exceeds 10% of the total revenue of the company, external and internal, that segment would qualify as a separate reportable segment. The Committee further notes that for the purpose of identification of reportable segments, not only the threshold limit with respect to segment revenue, but also with respect to segment result and segment assets

should be considered as stipulated in paragraph 27 of AS 17.

12. In the above context, the Committee notes paragraph 28 of AS 17, reproduced as below:

***"28. A business segment or a geographical segment which is not a reportable segment as per paragraph 27, may be designated as a reportable segment despite its size at the discretion of the management of the enterprise. If that segment is not designated as a reportable segment, it should be included as an unallocated reconciling item."***

Therefore, if the segment is not designated as a reportable segment either on the basis of the consideration of paragraph 27 of AS 17, or the management's discretion as per paragraph 28 of AS 17, it should be included as an unallocated reconciling item. In other words, in the context of the company under consideration even if one of the segments does not qualify as a reportable segment as per the threshold requirements of paragraph 27 of AS 17, the same would have to be reported separately as a residual segment.

#### D. Opinion

13. On the basis of the above, the Committee is of the opinion that the company needs to recalculate the threshold limits in accordance with paragraph 27 of AS 17 as stated in paragraph 11 above. In case the threshold limit is not met, it is the discretion of the management to consider power as a separate 'reportable segment'. However, in case the management does not do so, it has to be reported as a 'residual segment'.

#### Notes:

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 twenty four 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.