Non-Compliance with Reporting Obligations

With a view to apprise the members of the Institute and others concerned about the major non-compliances observed during the review, the Financial Reporting Review Board (FRRB) compiles such non-compliances from time to time and publishes the same in the Journal of the Institute. Continuing the same practice, following are the some of the common non-compliances observed by the Board during review of general-purpose financial statements of certain enterprises and auditors' reports thereon:

I Accounting Standards (ASs)

AS 2, Valuation of Inventories

1. Inventories of raw materials, work-in-progress, stores and spares parts, goods-in-progress and by-products have been valued at cost. The policy indicates that apparently the enterprise is not considering the net realisable value (NRV) in the valuation of raw materials and work-in-progress. This is not as per AS 2. Paragraph 5 of AS 2 requires all inventories, including raw materials, and work-in-progress to be valued at the lower of cost and net realisable value. As per paragraph 24 of AS 2, net realisable value of raw materials and work-in-progress is taken into consideration in the following manner:

   "Materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realisable value, the materials are written down to net realisable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realisable value."
2. Paragraph 26(a) of AS 2, Valuation of Inventories, *inter alia*, requires disclosure of cost formula used for valuation of inventories but many enterprises fail to disclose the cost formula.
3. Some of the enterprises are not creating provision for excise duty on finished stock lying in the stock. This treatment results in understatement of liabilities as well as value of inventories. It is contrary to AS 2 as well as the *Guidance Note on Accounting Treatment for Excise Duty*.

   As per paragraph 6, Valuation of Inventories, of AS 2 "the cost of inventories should comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition." Further, as per Guidance *Note on Accounting Treatment for Excise Duty*, which is based on AS 2, excise duty is a cost incurred in bringing the inventories to their present location and condition.

AS 6, Depreciation Accounting

4. It was observed that some of the enterprises adopt depreciation rates, for certain assets that are different from the rates as specified in Schedule XIV to the Companies Act, 1956. Further, the enterprises also do not disclose the useful lives or the depreciation rates that have been adopted for such assets. It is a non compliance of the Companies Act, 1956 as well as AS 6. It may be mentioned that Note No.5 of Schedule XIV to the Companies Act, 1956 provides as follows:

   5. The following information should be disclosed in the accounts:

   (i) depreciation methods used; and

   (ii depreciation rates or the useful lives of the assets, if they are different from the principal rates specified in the Schedule XIV.

   Further, paragraph 17 of AS 6, Depreciation Accounting also states that

   "…The depreciation rates or the useful lives of the assets are disclosed only if they are different from the principle rates specified in the statute governing the enterprises."

   Thus, if on the basis of bona fide technological evaluation, higher rates of depreciation are justified, they may be provided with proper disclosure of the same in the notes forming part of financial statements.

AS 9, Revenue Recognition

5. Accounting Standards Interpretation (ASI) 14, *Disclosure of Revenue from Sales Transactions* (Re. AS 9, Revenue Recognition), requires that the amount of turnover should be disclosed in the following manner on the face of the statement of profit and loss:

Turnover (Gross)	xx
Less: Excise Duty	xx
Turnover (Net)	xx

Some enterprises neither disclose sales (net of excise duty) on the face of the profit and loss account nor the amount of excise duty is shown as deduction from sales in the Schedule to the profit and loss account, which is contrary to the Accounting Standards Interpretation (ASI) 14.

6. Some enterprises include two amounts of excise duty, relating to both opening stock as well as closing stock, in the statement of profit and loss but fail to give any explanatory note in note to accounts to explain their nature. It may be mentioned that as per paragraph 3 of ASI 14 of Accounting Standard 9, *Revenue Recognition*, requires that "The excise duty related to the difference between the closing stock and opening stocks should be recognised separately in the statement of profit and loss, with an explanatory note in the notes to accounts to explain the nature of two amounts of excise duty".

AS 10, Accounting for Fixed Assets

7. Some enterprises include in the Schedule of Inventory those items of fixed assets which have been retired from active use and are held for disposal as an inventory item. It is not in line with Accounting Standard (AS) 10, *Accounting for Fixed Assets* and Accounting Standard (AS) 2, *Inventory Valuation*. Paragraph 14.2 of AS 10, *Accounting for Fixed Assets*, requires that the "Items of fixed assets that have been retired from active use and are held for disposal are stated at the lower of their net book value and net realisable value and are shown separately in the financial statement". Further, paragraph 3 of AS 2 defines 'Inventories' as assets "held for sale in the ordinary course of business". However, the sale of fixed assets cannot be treated as sale arising from the ordinary course of business. Accordingly, such items should be included in the Schedule of fixed assets as per the principle suggested in AS 10.

AS 13, Accounting for Investments

8. Accounting Standard (AS) 13, *Accounting for Investments*, require provision to be created to recognise a decline, other than temporary, in the value of long-term investments. Some enterprises use the term permanent diminution instead of other than temporary, which is contrary to the requirement of AS 13. It may be noted that there is a difference between 'permanent diminution in the value of investments' and 'other than temporary diminution in value of investments' and normally, no diminution in value of investments may be termed as permanent.

AS 15, Accounting for Retirement Benefits in the Financial Statements of Employers

9. In the financial statement of certain enterprises it has been observed that the deferred expenditure on retirement benefit is carried forward beyond the maximum period specified in Paragraph 146 of Accounting Standard 15, i.e. 1st April 2010, which is contrary to the provisions of paragraph 146 of Accounting Standard 15, *Employee Benefit*. It states that "This Statement requires immediate expensing of expenditure on termination benefits (including expenditure incurred on voluntary retirement scheme (VRS)). However, where an enterprise incurs expenditure on termination benefits on or before 31st March, 2009, the enterprise may choose to follow the accounting policy of deferring such expenditure over its pay-back period. However, the expenditure so deferred cannot be carried forward to accounting periods commencing on or after 1st April 2010".

AS 20, Earnings Per Share

10. Paragraph 48 of AS 20, Earnings per Share, *inter alia* also requires that an enterprise should disclose "*the nominal value of shares alongwith the earning per share figures.*" However, certain enterprises do not comply with this requirement of AS 20. They disclose the earning per share figures on the face of the profit and loss statement as well as in the notes to accounts but omit to state the nominal value of share alongwith it.

(to be continued...)