Non-compliance with Reporting Obligations

Published below are some of the common non-compliances observed by the Financial Reporting Review Board (FRRB) of ICAI during review of general-purpose financial statements of certain enterprises and auditors' reports thereon:

(…Continued from December 2009 issue)

I Accounting Standards

AS 22, Accounting for Taxes on Income

1. Certain enterprises disclose advance income tax paid (current tax asset) and provision for income tax (current tax liability) separately in their balance sheets, i.e., they do not offset the amounts. This is contrary to AS 22, *Accounting for Taxes on Income*. Paragraph 27 of AS 22 requires that an enterprise should offset assets and liabilities representing current tax if the enterprise:
   a. has a legally enforceable right to set off the recognised amounts; and
   b. intends to settle the asset and the liability on a net basis.

   It may be noted that under the Income-tax Act, 1961, advance tax representing current tax is paid against provision for income tax representing current tax liability. Under the said Act, an enterprise has a legal right to set off the two amounts and normally, the enterprises settle these amounts on net basis only. Keeping this in view, the enterprise should offset advance income tax paid against provision for income tax and show only the net amount in the balance sheet. Disclosing two amounts separately is contrary to AS 22.
2. Paragraph 32 of AS 22, *Accounting for Taxes on Income*, requires that *"The nature of the evidence supporting the recognition of deferred tax assets should be disclosed, if an enterprise has unabsorbed depreciation or carry forward of losses under tax law"*.

   It has been observed in the case of few enterprises, that the balances of unabsorbed depreciation and/or losses are being carried forward under tax law due to which the deferred tax asset has been recognised in the financial statements. However, it omits to disclose the nature of evidence that supports the recognition of such deferred tax assets with virtual certainty.

ASI 7, Disclosure of deferred tax assets and deferred tax liabilities in the balance sheet of a company (Re. AS 22)

3. The deferred tax liability has been presented by way of deduction from 'Net Current Assets'. This is contrary to the Accounting Standards Interpretation (ASI) 7 on 'Disclosure of deferred tax assets and deferred tax liabilities in the balance sheet of a company' (Re. AS 22, Accounting for Taxes on Income). ASI 7 requires that deferred tax liabilities should be disclosed on the face of the balance sheet *separately after the head Unsecured Loans*.
4. Paragraph 31 of AS 22, Accounting for Taxes on Income, requires that *"The break-up of deferred tax assets and deferred tax liabilities in to major components of the respective balances should be disclosed in the notes to accounts"*.

   In case of the financial statement of few enterprises it is observed that, it has disclosed only the opening balance, addition during the year and the closing balance of the deferred tax assets and liabilities and there is no disclosure of the break-up of the deferred tax assets and liabilities into their major components which is not as per the requirement of AS 22.

AS 26, Intangible Assets

5. Product Development Expenditure is stated to be amortised over the estimated period of benefit. Such disclosure of accounting policy as adopted by the enterprise seems to be ambiguous. It may be noted that such expenditure is treated as expenditure incurred on intangible asset during 'development stage' provided it meets the criteria laid in paragraph 44 of AS 26, Intangible Assets. Further, paragraph 90 of AS 26, *inter alia* requires that the financial statements should disclose the useful lives or the amortisation rates used as well as the

amortisation method used by the enterprise.

AS 29, Provisions, Contingent Liabilities and Contingent Assets

6. There are financial statements of the enterprises that contain provisions of various natures that are often carried by them from period to period. However, they omit to comply with the disclosure requirements of AS 29, Provisions, Contingent Liabilities and Contingent Assets. As per paragraph 66 of AS 29, Provisions, Contingent Liabilities and Contingent Assets, *"For each class of provision, an enterprise should disclose:*
   a) the carrying amount at the beginning and end of the period;
   b) additional provisions made in the period, including increases to existing provisions;
   c) amounts used (i.e., incurred and charged against the provision) during the period; and
   d) unused amount reversed during the period.

   Further, Paragraph 67 of AS 29, requires that *"An enterprise should disclose the following for each class of provision:*
   a) a brief description of the nature of the obligation and the expected timing of any resulting outflow of economic benefits;
   b) an indication of uncertainties about those outflows. Where necessary to provide adequate information, an enterprise should disclose the major assumptions made concerning future events, as addressed in paragraph 41; and
   c) the amount of any expected reimbursement, stating the amount of any assets that has been recognised for that expected reimbursement.

   The enterprises often creaters and carry the provisions in the schedules to profit and loss account and balance sheet but they neither comply with the disclosure requirement as stated in Paragraphs 66 and 67 of AS 29 nor they disclose their accounting policy with regard to the same.

II Schedule VI to the Companies Act, 1956

7. In case of the Financial Statements of few enterprises, it was noted that the opening balance of certain specified reserves do not tally with their closing balance of the last year. Neither the notes to accounts nor the Schedules contain any information regarding the differences in such balances.

   It may be mentioned that pursuant to the instructions given in Part I of Schedule VI to the Companies Act, 1956, in accordance with which liabilities should be made out, the additions and deductions since last balance sheet to be shown under each of the specified heads. Therefore, such difference should not arise in the financial statements.
8. Paragraph (xi) of Part II of Schedule VI of the Companies Act, 1956 requires that the amount of income tax deducted from the gross income from investments and interest should be disclosed.

   Some enterprises in their financial statement do not disclose the amount of income tax deducted from the gross income from investment and interest, which is not in compliance with requirement of Schedule VI of the Companies Act, 1956.
9. As per Part I of the Schedule VI of the Companies Act, 1956, Sundry Creditors are required to be classified as below:
   a) total outstanding dues of micro enterprises and small enterprises; and
   b) total outstanding dues of creditors other than micro enterprises and small enterprises.

   Enterprises, often, do not classify Sundry Creditors as per the above mentioned classifications.

III Auditing and Assurance Standard (AAS) 28, *The Auditor's Report on Financial Statements*

10. In the auditor's report of some enterprises it has been observed that, the qualification given by the auditor is not clear and specific. If an auditor provides his opinion subject to the entire schedule containing the accounting policies adopted by the company for the preparation and presentation of the financial statements then it is regarded as an ambigu-ous qualification. Such qualification does not state clearly the schedule or the accounting policy that has been regarded as the subject matter of his qualification. Paragraph 4 of Auditing and Assurance Standard 28, *The Auditor's Report on Financial Statements*, require that "The auditor's report should contain a clear written expression of opinion on the financial statement taken as whole." Accordingly, if the auditor provides his opinion subject to any qualification, it should be clear and specific. Such ambiguous qualification may raise doubt in the mind of a reader regarding the accounting policies adopted by the

company in the preparation and presentation of the financial statements.

11. In contravention to AAS 28, *The Auditor's Report on Financial Statements*, in the auditors' report of some enterprises, the partner/ proprietor, who has signed the audit report, does not mention his membership number in the report. AAS 28 requires that the report should be signed by the auditor in his personal name. Where the firm is appointed as the auditor, the report should be signed in the personal name of the auditor and in the name of the audit firm. The partner/ proprietor signing the audit report should also mention the membership number assigned by the Institute of Chartered Accountants of India.

IV Companies (Auditor's Report) Order, 2003 (CARO 2003)

12. In case of a few enterprises, when certain clauses of Companies (Auditor Report) Order, 2003, are not applicable to them then the Auditors opt to directly report the clause number, as stated in CARO, 2003, which are not applicable to the company. For instance, the report states that "Matters specified in items x, xii, xviii, xix, xx of clause of paragraph 4 of Companies (Auditor's Report) Order, 2003 do not apply to the Company." Paragraph 80 of the Statement on the Companies (Auditor's Report) Order, 2003, as issued by the Institute of Chartered Accountants of India, states that there may be situation where one or more of the clauses are not applicable. In such situations, it would be appropriate for the auditor to make a suitable comment in his report bringing out the fact of non-applicability of a particular clause. To illustrate, where the maintenance of cost record has not been prescribed by the Central Government under section 209(1) (d) of the Act, the auditor may state:

    "The Central Government has not pre-scribed maintenance of cost records under section 209(1)(d) of the Companies Act, 1956 for any of the product of the company".

    Thus, the auditor should make a suitable comment in his report bringing out the fact of non-applicability of some of the clauses of CARO, 2003 rather than simply mentioning the concerned clause numbers.

13. In pursuance to the Statement on the Companies (Auditor's Report) Order, 2003 the auditor's report of few enterprises states that "…. We are informed that the fixed assets have been physically verified by the management….." It may be mentioned that such language creates an impression that no documentary evidence was available to the auditors to substantiate the physical verification of the fixed assets, and that the auditor has relied wholly on management representation. This practice of preparing report has potential of being misinterpreted and therefore, it should be avoided.

14. Paragraphs 4(iii)(a) and 4(iii)(e) of the Order requires that in case the company has granted or taken any loans, secured or unsecured to and/or from companies, firms or other parties covered in the register maintained under section 301 of the Companies Act, 1956, then the auditor is also required to disclose the "amount involved" in such transactions. In response to this clause, the auditors of few enterprises disclose only the year end balances.

    It may be noted that as per clause (f) of Paragraph 50 of Statement on the Companies (Auditor's Report) Order, 2003 issued by the ICAI, "Since the order does not clarify what constitutes "amount involved" it would be proper if the auditor discloses the maximum amount involved during the year in the transactions covered by this clause." Thus, while commenting on these clauses, the auditor should disclose both the amounts of maximum amount involved as well as the year end balance in his audit report.

15. Clause 4(ix)(b) of CARO, 2003 requires disclosure, *inter alia*, of the amount involved and the period to which disputed amount of Income Tax/Sales Tax/Service Tax/Customs Duty/Wealth Tax/Excise Duty/Cess relates. Ideally, as per the Statement on the Companies (Auditor's Report) Order, 2003 issued by the ICAI, the auditor should disclose the name of the statute, the nature of the dues, the amount, the period to which such amount relates as well as the forum where dispute is pending.

    In case of some enterprises it has been observed that the information about the disputed statutory dues reported in the auditor's report is not complete. They either omit to specify the period to which the amount of statutory dues are related or the forum where the dispute is pending.