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, published below are some of the common non-compliances observed by the Board during the review of general-purpose financial statements of certain enterprises and auditors' reports thereon:

Accounting Standards

AS 1, Disclosure of Accounting Policies

1. Certain enterprises merely states in its accounting policy relating to revenue recognition that the revenue has been recognised on the basis as stipulated under the AS 9, Revenue Recognition. Such disclosure can not be considered as adequate disclosure under the AS 1. The accounting policy as adopted by the enterprise with respect to timing of recognition of revenue arising from sales revenue, interest income, royalty income and dividend income should be considered as one of the most important accounting policies for any organisation and it should be disclosed separately.
2. Paragraph 10 (a) of the AS 1 provides that "the enterprise is normally viewed as a going concern, that is, as continuing in operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of the operations". Further, it may be noted that Paragraph 27 of the AS 1 provides that if the fundamental accounting assumptions, viz. going concern, consistency and accrual, are followed in financial statements, specific disclosure is not required. If a fundamental accounting assumption is not followed, the fact should be disclosed.

However, while reviewing the financial statement of an enterprise, it has been noted that it is continuously incurring losses and its net worth has become significantly negative. Further, certain relief measures are also being granted to it, so that the enterprise may be able to continue its operation, still, it fails to do so. It is also disclosed in the notes to accounts that even if the enterprise is able to continue some of its operations, it would be required to curtail its operations materially.

Despite all such facts, if the financial statements of such enterprise are prepared on a going concern basis, than, it is not as per the requirement of the AS 1. Also, it is not appropriate for such enterprise to simply prepare its financial statements on a going concern basis without disclosing this fact on the face of auditor's report.

3. Paragraph 24 of the AS 1 requires that all significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed. The financial statements of the enterprises provide a detailed note on accounting policies as adopted by them. However, they often omit to disclose accounting policies with regard to the borrowing costs, valuation of inventories, accounting for investments, impairment of assets, provisions, contingent liabilities and contingent assets. It was felt that enterprises normally, borrow funds, hold inventories as well as investments and also possess certain assets which may be subject to impairment. Further, there is always a need to carry certain provisions for meet their future liabilities. Accordingly, subject to circumstances, enterprises are expected to also disclose the accounting policies as adopted by them with regard to borrowing costs, valuation of inventories, accounting for investments, impairment of assets and provisions, contingent liabilities and contingent assets.

AS 2, Valuation of Inventories

4. Some enterprises recognise the custom duty on inventory as and when the goods are cleared from custom warehouse. As such, no provision for customs duty is made on the goods lying in the warehouse. It is contrary to the requirement of the AS 2. It may be noted that as per Paragraph 6 of the 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. Since the customs duty is a cost incurred in bringing the goods to its present location and condition, therefore, the liability to pay such duty should be recognised as and when the goods enter the territorial waters of the country.
5. Certain enterprises disclose the amount of the MODVAT credit receivables as well as Excise duty on finished goods as separate sub-heads under the head of 'Inventories'. It may be noted that the Guidance note on Accounting Treatment for Excise Duty provides that the excise duty should be considered as a manufacturing expense and like other manufacturing expenses, it should be considered as an element of cost for inventory valuation. Therefore, 'excise duty on finished goods' should be included in the value of finished goods instead of separately disclosing the same as a separate sub-head under the head of 'Inventory'. Further, as per Paragraph 16 of the Guidance note on Accounting Treatment for MODVAT/CENVAT provides that the debit balance in the MODVAT/CENVAT credit receivable (inputs) account should be shown on the asset side under the head of 'advances'.

(… to be continued)