Enhancing Audit Quality

Non-Compliance with Reporting Obligations observed by the FRRB

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 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:

Accounting Standards

AS 1, Disclosure of Accounting Policies

1. Some enterprises report significant amounts of income earned by way of interest, royalties, and dividend. However, they do not disclose their accounting policy adopted for reporting the same. This is not as per the requirement of paragraph 24 of Accounting Standard (AS) 1, *Disclosure of Accounting Policies,* which requires that 'All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed'.

AS 2, Valuation of Inventories

2. Paragraph 26 of the AS 2, *Valuation of Inventories,* dealing with disclosure requires that the financial statements should disclose:

- the accounting policies adopted in measuring inventories, including the cost formula used; and
- the total carrying amount of inventories and its classification appropriate to the enterprise.

In contravention to AS 2, some enterprises do not disclose the method of valuation of inventories i.e. whether FIFO/ LIFO or other method in their accounting policy on Inventories. Other enterprises simply state that the value of inventory is determined by using FIFO or Specific Identification method as applicable. The usage of term 'as applicable' is not correct. Such general statement on the method of valuation seems to be ambiguous. The enterprise should specifically state the method of valuation for each class of inventory viz. raw material and components, work in progress, finished goods, stores and spares, and loose tools.

AS 9, Revenue Recognition

3. 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 disclose sales (net of excise duty) on the face of the profit and loss account and 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.

AS 13, Accounting for Investments

4. The balance sheet of certain enterprises shows the Investments as part of their assets and classifies the same as per the requirements of Schedule VI of the Companies Act, 1956. However, they do not disclose any accounting policy regarding the Investments, which is not as per the requirements of AS 1 and AS 13. It may be mentioned that as per paragraph 24 of AS 1, *Disclosure of Accounting Policy,* 'All significant accounting policies adopted in the preparation and presentation of financial statements should be disclosed'. Further, as per clause (a) of paragraph 35 of *AS 13, Accounting for Investments,* along with other disclosure an enterprise is also required to state the accounting policy adopted for determination of carrying amount of both the long-term investments as well as current investments.

5. Some enterprises in their balance sheet classify the Investments as per the requirements of Schedule VI of the Companies Act, 1956 but do not classify these Investments as per the requirement of clause (b) and clause (e) of paragraph 35 of AS 13, *Accounting for Investments,* either in the Schedule 'Investments' or in the notes. It is not as per the requirement of AS 13. It may be noted that as per paragraph 35(b) and 35(e), an enterprise should disclose current investments and long term investments distinctly in its financial statements and the aggregate amount of quoted and unquoted investments, giving the aggregate market value of quoted investments, respectively.

AS 19, Leases

6. Some enterprises, while complying with the requirements of paragraph 22 of AS 19, Leases, disclose the information required by clause (a) to (e) of paragraph 22 of AS 19, however, they do not disclose general description of the lessee's significant arrangements as required by paragraph 22 (f) of AS 19. It may be mentioned that the disclosure requirement under clause (f) is also an important requirement and therefore the lessee should disclose, amongst the other disclosures of paragraph 22, a general descriptions of the lessee's significant arrangements including, but not limited to, the following:

a. the basis on which contingent rent payment are determined;
b. the existence and terms of renewal of purchase options and escalation clauses: and
c. restrictions imposed by lease arrangements, such as those concerning dividends, additional debts, and further leasing.

(to be continued...)