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INVENTORY REPORTING AS PER INDIAN ACCOUNTING STANDARDS

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ABSTRACT The current study is an attempt to examine and summarize the requirements of various Indian accounting standards with regard to inventory reporting. There are three different accounting standards which deal with the inventory reporting in the annual reports. Inventory usually forms a high percentage of manufacturing firms current asset base, with the high magnitude of inventory in a firm's balance sheet and the associated advantage to a firm with its misstatement it is quite likely that at times a firm may deliberately misstate inventory. Thus as a reader of financial reports it is important to know what are the disclosure or reporting requirements of various Indian accounting standards.

KEYWORDS : Inventory reporting, Indian accounting standard, earnings management

INTRODUCTION

Misstatement of inventory and accounts receivables forms majority of the cases involving asset overstatement in the financial reports (COSO Report, March 19991). Misstating inventory usually involves overstating inventory in the firm's balance sheet, which improves reported liquidity position and in turn enhances its borrowing capacity. Overstated inventory in balance sheet usually leads to understating of the cost of goods sold in the firm's income statement, resulting into inflated reported net profit which may help a firm to meet or beat the market expectation.

Various Indian accounting standards have laid down requirements for the inventory reporting, the current paper has summarized the various requirement as follows:

1. As per para 26 of accounting standard-2, on valuation of inventories (here after AS-2) the financial statements should disclose:

a. The accounting policies adopted in measuring inventories, including the cost formula used.

b. The total carrying amount of inventories and its classification appropriate to the enterprise.

2. As per para 27 of AS-2, disclosure should be made on information about the carrying amounts held in different classifications of inventories and the extent of the changes in these assets. Common classifications of inventories are raw materials and components, work in progress, finished goods, stores and spares, and loose tools.

3. As per para 14 (a) of accounting standard – 5, on Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies (here after AS-5) the write-down of inventories to net realisable value as well as the reversal of such write-downs needs to be disclosed in the annual report.

4. As per para 20 of AS-5, estimates for inventory obsolescence needs to be disclosed

5. As per accounting standard-1 (here after AS-1) on Disclosure of Accounting Policies and para 32 of AS-5, any change in accounting policy needs to be disclosed. Preferably an explanation for the need to change the policy should be disclosed.

Inventory forms a considerable portion of firms asset base, both total asset and current asset, table-1, provides the data of average inventory held by selected Nifty-500, constituent firms as on March 31, 2015. On an average inventory formed approximately 14 percent and 33 percent of the total asset and current asset respectively, for textile industry in particular inventory formed as high as 22 percent of the total asset base while it constituted approximately 45 percent of the current asset base. With the given magnitude of inventory in a firm's balance sheet and the associated advantage to a firm with its misstatement it is quite likely that at times a firm may deliberately misstate inventory. Thus, the knowledge of reporting requirements may help user of financial reports to draw better inferences.

Table 1: Average inventory as per the annual reports of Nifty-500 constituent firms as on March 31, 2015

S.No.	Industry	Number of Firms	Average Inventory (Rs in Mn.)	Inventory as a Percentage of Total Asset	Inventory as a Percentage of Current Asset
1	Automobiles	30	2,82,542.80	9.93	27.11
2	Cement	15	2,09,730.50	10.79	37.83
3	Chemicals	10	52,622.90	13.68	30.48
4	Consumer Goods	68	5,42,458.70	18.54	33.76
5	Fertilisers and Pesticides	11	80,378.90	17.26	29.99
6	Industrial Manufacturing	49	3,51,219.80	13.25	22.32
7	Metals	18	6,47,643.00	9.08	30.29
8	Paper	3	9,282.00	10.28	40.88
9	Pharmaceuticals	36	2,10,143.00	10.73	27.87
10	Textiles	16	1,88,343.70	22.14	44.89

Source: CMIE PROWESS IQ

REFERENCES:

[1] The Committee of Sponsoring Organizations of the Treadway Commission's Report on Fraudulent Financial Reporting 1987 to 1997, (March 1999)
[2] Accounting Standard -1: Disclosure of Accounting Policies
[3] Accounting Standard -2: Valuation of Inventories
[4] Accounting Standard -5: Net Profit or Loss for the period, Prior Period Items and Changes in Accounting Policies