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FINANCIAL STATEMENTS OF COMPANIES

Unit – 1: Preparation of Financial Statements

Learning Objectives

After studying this unit, you will be able to:

- ♦ Know how to maintain books of account of a company.
- ♦ Learn about statutory books of a company.
- ♦ Prepare and present the final account of a company as per revised Schedule VI of the Companies Act, 1956.
- ♦ Calculate managerial remuneration of managers in a company.
- ♦ Appreciate the term divisible profit.

1.1 Meaning of Company

(a) The word 'company' derived from the Latin word '*com*' *i.e.* with or together and '*panis*' *i.e.* Bread. Originally the word referred to an association of persons or merchant men discussing matters and taking food together.

(b) In short it refers to a corporate body having perpetual succession and a common seal.

(c) As per section 3 of the Companies Act meaning of following expressions has been defined.

  (i) 'Company',

  (ii) 'Existing Company',

  (iii) 'Private company'

  (iv) 'Public company'.

(d) Apart from these categories, the different kinds of company are

  (i) Holding company,

  (ii) Subsidiary company,

  (iii) Foreign company and

(iv) Companies which are limited by guarantee

(v) Unlimited company.

All these have already been discussed in the Common Proficiency Test Study Material. For their understanding, students can refer it.

1.2 Maintenance of Books of Account

1.2.1 Maintenance at Registered Office

Section 209 of the Companies Act states that books of account shall be maintained at the company's registered office unless the Board of Directors decide to keep them at another place in India.

1.2.2 Maintenance at Place Other than Registered Office

It is a duty of the company to inform the Registrar of Companies within seven days of the decision in case the Board of Directors decides to maintain books at the place other than the registered office.

1.2.3 In Case of Branch Office

Where the company has a branch office, whether in or outside India the proper books of accounts relating to the transactions effected at the branch office are kept at that office and proper summarized returns made up to date at intervals of not more than three months are prepared and sent within reasonable time to head office

1.2.4 Requisites of Proper Books of Accounts

Every company is required to keep proper books of account showing

(i) Al monies received and spent and the details thereof,

(ii) Sales and purchases of goods, and

(iii) Assets and liabilities.

(iv) A company engaged in production, processing, manufacturing or mining activities has also to maintain, if required by the Central Government, cost accounting records *i.e.,* particulars relating to utilization of material, labour and other items of costs.

1.2.5 Proper Books not Deemed to be Kept

(a) If such books are not kept as are necessary to give a *true and fair view* of the state of affairs of the company or branch office, as the case may be, and to explain its transactions.

(b) Also if such books are not kept on *accrual basis* and according to system of double entry book keeping.

1.3 Statutory Books

The following statutory books are required to be maintained by a company under different sections of the Companies Act:

- Register of Investments of the company not held in its own name (Section 49).
- Register of Mortgages and Charges (Section 143).
- Register of Members and Index (Sections 150 & 151).
- Register of Debenture-holders and Index (Section 152).
- Foreign Register of Members and of Debenture-holders and their duplicates (Sections 157 and 158).
- Minute Books (Section 193).
- Register of Contracts, Companies, and firms in which directors are interested (Section 301).
- Register of directors, managing director, manager and secretary (Section 303).
- Register of Directors' share-holding (Section 307).
- Register of investments in securities of any other body corporate, loans made, guarantees given or securities provided to any body corporate.

  In addition, a company usually maintains a number of statistical books to keep a record of its transactions which have resulted either in the payment of money to it or constitute the basis on which certain payments have been made by it.
- Registers and documents relating to the issue of shares are:
  - (i) Share Application and Allotment Book;
  - (ii) Share Call Book; and
  - (iii) Certificate Book.
  - (iv) Register of Members
  - (v) Share Transfer Book
  - (vi) Dividend Register

1.4 Annual Return

(1) Section Applicable

Section 149 of the Companies Act,

(2) Applicability

Every company having a share capital,

(3) Number of Days

60 days from the day of which each of the annual general meeting is held

(4) Documents to be filed

Prepare and file with the Registrar the annual return containing the particulars specified in Part I of Schedule V.

(5) Form Applicable

The annual return shall be in the Form set out of Part II of Schedule V or near thereto as circumstances meet.

1.5 Final Accounts

(1) Company carrying on business for profit

Under Section 210 of the Companies Act, at the annual general meeting of a company, the Board of Directors of the company shall lay before the company:

(a) a balance sheet as at the end of the period;

(b) a profit & loss account for that period.

(2) Company not carrying on business for profit

Income and expenditure account shall be laid before the company at its annual general meeting instead of profit and loss account.

Requisites of Balance Sheet And Profit And Loss Account

It shall give a true and fair view of the state of affairs of the company as at the end of the financial year

Provisions Applicable

(1) Specific Act is Applicable

For instance any

(a) insurance company

(b) banking company or

(c) any company engaged in generation or supply of electricity* or

(d) any other class of company for which a Form of balance sheet or Profit and loss account has been prescribed under the Act governing such class of company

Respective Acts may be applicable

(2) No Specific Act is applicable

Balance Sheet as per Form set out in Part I of Schedule VI, or as near thereto as circumstances admit.

* The Electricity Act, 2003 does not specify any format for presentation of Financial Statements. Therefore, Schedule VI of the Companies Act, 1956 is followed by Electricity Companies in preparation of their financial statements.

Profit and Loss Account as per Part II of Schedule VI.

Points to be kept in mind while preparing final accounts:

- Requirements of Schedule VI (Revised in 2011);
- Other statutory requirements;
- Accounting Standards issued by the Institute of Chartered Accountants of India on different accounting matters and notified by the Central Government (AS 1 to AS 32);
- Statements and Guidance Notes issued by the Institute of Chartered Accountants of India; which are necessary for understanding the accounting treatment / valuation / disclosure suggested by the ICAI.

Compliance with Accounting Standards

As per the Companies Act, it is mandatory to comply with accounting standards as per Sub-sections 3A, 3B and 3C in Section 211.

These are :

‘(*3A*) Every profit and loss account and balance sheet of the company shall comply with the accounting standards.

(*3B*) Where the profit and loss account and the balance sheet of the company do not comply with the accounting standards, such companies shall disclose in its profit and loss account and balance sheet, the following, namely :

(a) the deviation from the accounting standards;

(b) the reasons for such deviation; and

(c) the financial effect, if any, arising due to such deviation.

(*3C*) For the purposes of this section, the expression “accounting standards” means the standards of accounting recommended by the Institute of Chartered Accountants of India constituted under the Chartered Accountants Act, 1949, as may be prescribed by the Central Government in consultation with the National Advisory Committee on Accounting Standards established under Sub-section (*1*) of Section 210A.

1.5.1 Revised Schedule VI

The Central Government, in exercise of the powers under section 641(1) of the Companies Act, 1956 has replaced the existing Schedule VI with the revised Schedule VI on the 28th February, 2011 pertaining to the preparation of Balance Sheet and Profit and Loss Account under the Companies Act, 1956. This revised Schedule VI has been framed as per the existing non-converged Indian Accounting Standards notified under the Companies (Accounting Standards), Rules, 2006. The Revised Schedule VI shall come into force for the Balance Sheet and Profit and Loss Account to be prepared for the financial year commencing on or after 1.4.2011. Given below is the revised Schedule VI as notified by the Central Government:

SCHEDULE VI

(See section 211)

General Instructions for preparation of Balance Sheet and Statement of Profit and Loss of A Company in addition to the Notes incorporated above the heading of Balance Sheet under

General Instructions

1. Where compliance with the requirements of the Act including Accounting Standards as applicable to the companies require any change in treatment or disclosure including addition, amendment, substitution or deletion in the head/sub-head or any changes *inter se*, in the financial statements or statements forming part thereof, the same shall be made and the requirements of the Schedule VI shall stand modified accordingly.

2. The disclosure requirements specified in Part I and Part II of this Schedule are in addition to and not in substitution of the disclosure requirements specified in the Accounting Standards prescribed under the Companies Act, 1956. Additional disclosures specified in the Accounting Standards shall be made in the notes to accounts or by way of additional statement unless required to be disclosed on the face of the Financial Statements. Similarly, all other disclosures as required by the Companies Act shall be made in the notes to accounts in addition to the requirements set out in this Schedule.

3. Notes to accounts shall contain information in addition to that presented in the Financial Statements and shall provide where required (a) narrative descriptions or disaggregations of items recognized in those statements and (b) information about items that do not qualify for recognition in those statements.

   Each item on the face of the Balance Sheet and Statement of Profit and Loss shall be cross-referenced to any related information in the notes to accounts. In preparing the Financial Statements including the notes to accounts, a balance shall be maintained between providing excessive detail that may not assist users of financial statements and not providing important information as a result of too much aggregation.

4. Depending upon the turnover of the company, the figures appearing in the Financial Statements may be rounded off as below:

Turnover	Rounding off
(i) less than one hundred crore rupees	to the nearest hundreds, thousands, lakhs or millions, or decimals thereof
(ii) one hundred crore rupees or more	to the nearest, lakhs, millions or crores, or decimals thereof.

   Once a unit of measurement is used, it should be used uniformly in the Financial Statements.

5. Except in the case of the first Financial Statements laid before the Company (after its incorporation) the corresponding amounts (comparatives) for the immediately preceding

reporting period for all items shown in the Financial Statements including notes shall also be given.

6. For the purpose of this Schedule, the terms used herein shall be as per the applicable Accounting Standards.

Notes

This part of Schedule sets out the minimum requirements for disclosure on the face of the Balance Sheet, and the Statement of Profit and Loss (hereinafter referred to as “Financial Statements” for the purpose of this Schedule) and Notes. Line items, sub-line items and sub-totals shall be presented as an addition or substitution on the face of the Financial Statements when such presentation is relevant to an understanding of the company’s financial position or performance or to cater to industry/sector-specific disclosure requirements or when required for compliance with the amendments to the Companies Act or under the Accounting Standards.

PART I – Form of BALANCE SHEET

Name of the Company……………………..
Balance Sheet as at ………………………

(Rupees in………..)

			Particulars	Notes No.	Figures as at the end of current reporting period	Figures as at the end of previous reporting period
			(1)	**(2)**	**(3)**	**(4)**
			EQUITY AND LIABILITIES			
1.			**Shareholders' funds**			
	a		Share capital	1		
	b		Reserves and Surplus	2		
	c		Money received against share warrants			
2.			**Share application money pending allotment**			
3.			**Non-current liabilities**			
	a		Long-term borrowings	3		
	b		Deferred tax liabilities (Net)			
	c		Other long term liabilities	4		
	d		Long-term provisions	5		
4.			**Current liabilities**			
	a		Short-term borrowings	6		

	b		Trade Payables				
	c		Other current liabilities	7			
	d		Short-term provisions	8			
			Total				
			ASSETS				
1			**Non-current assets**				
	a		Fixed assets				
		i	Tangible assets	9			
		ii	Intangible assets	10			
		iii	Capital Work-in-progress				
		iv	Intangible assets under development				
	b		Non-current investments	11			
	c		Deferred tax assets (Net)				
	d		Long-term loans and advances				
	e		Other non-current assets				
2			**Current assets**				
	a		Current investments				
	b		Inventories	12			
	c		Trade receivables	13			
	d		Cash and cash equivalents				
	e		Short-term loans and advances				
	f		Other current assets				
			Total				

Notes

GENERAL INSTRUCTIONS FOR PREPARATION OF BALANCE SHEET

1. An asset shall be classified as current when it satisfies any of the following criteria:

   (a) it is expected to be realized in, or is intended for sale or consumption in, the company's normal operating cycle;

   (b) it is held primarily for the purpose of being traded;

   (c) it is expected to be realized within twelve months after the reporting date; or

   (d) it is cash or cash equivalent unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date.

   All other assets shall be classified as non-current.

2. An operating cycle is the time between the acquisition of assets for processing and their realization in cash or cash equivalents. Where the normal operating cycle cannot be identified, it is assumed to have a duration of 12 months.

3. A liability shall be classified as current when it satisfies any of the following criteria:

   (a) it is expected to be settled in the company's normal operating cycle;

   (b) it is held primarily for the purpose of being traded;

   (c) it is due to be settled within twelve months after the reporting date; or

   (d) the company does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.

   All other liabilities shall be classified as non-current.

4. A receivable shall be classified as a 'trade receivable' if it is in respect of the amount due on account of goods sold or services rendered in the normal course of business.

5. A payable shall be classified as a 'trade payable' if it is in respect of the amount due on account of goods purchased or services received in the normal course of business.

6. A company shall disclose the following in the notes to accounts:

A. Share Capital

for each class of share capital (different classes of preference shares to be treated separately):

(a) the number and amount of shares authorized;

(b) the number of shares issued, subscribed and fully paid, and subscribed but not fully paid;

(c) par value per share;

(d) a reconciliation of the number of shares outstanding at the beginning and at the end of the reporting period;

(e) the rights, preferences and restrictions attaching to each class of shares including restrictions on the distribution of dividends and the repayment of capital;

(f) shares in respect of each class in the company held by its holding company or its ultimate holding company including shares held by or by subsidiaries or associates of the holding company or the ultimate holding company in aggregate;

(g) shares in the company held by each shareholder holding more than 5 percent shares specifying the number of shares held;

(h) shares reserved for issue under options and contracts/commitments for the sale of shares/disinvestment, including the terms and amounts;

(i) For the period of five years immediately preceding the date as at which the Balance Sheet is prepared:

- Aggregate number and class of shares allotted as fully paid up pursuant to contract(s) without payment being received in cash.
- Aggregate number and class of shares allotted as fully paid up by way of bonus shares.
- Aggregate number and class of shares bought back.

(i) Terms of any securities convertible into equity/preference shares issued along with the earliest date of conversion in descending order starting from the farthest such date.

(k) Calls unpaid (showing aggregate value of calls unpaid by directors and officers)

(l) Forfeited shares (amount originally paid up)

B. Reserves and Surplus

(i) Reserves and Surplus shall be classified as:

(a) Capital Reserves ;

(b) Capital Redemption Reserve;

(c) Securities Premium Reserve;

(d) Debenture Redemption Reserve;

(e) Revaluation Reserve;

(f) Share Options Outstanding Account;

(g) Other Reserves – (specify the nature and purpose of each reserve and the amount in respect thereof);

(h) Surplus i.e. balance in Statement of Profit & Loss disclosing allocations and appropriations such as dividend, bonus shares and transfer to/from reserves etc.

(Additions and deductions since last balance sheet to be shown under each of the specified heads)

(ii) A reserve specifically represented by earmarked investments shall be termed as a 'fund'.

(iii) Debit balance of statement of profit and loss shall be shown as a negative figure under the head 'Surplus'. Similarly, the balance of 'Reserves and Surplus', after adjusting negative balance of surplus, if any, shall be shown under the head 'Reserves and Surplus' even if the resulting figure is in the negative.

C. Long-Term Borrowings

(i) Long-term borrowings shall be classified as:

(a) Bonds/debentures.

(b) Term loans

- From banks.
- From other parties

(c) Deferred payment liabilities.

(d) Deposits.

(e) Loans and advances from related parties.

(f) Long term maturities of finance lease obligations

(g) Other loans and advances (specify nature).

(ii) Borrowings shall further be sub-classified as secured and unsecured. Nature of security shall be specified separately in each case.

(iii) Where loans have been guaranteed by directors or others, the aggregate amount of such loans under each head shall be disclosed.

(iv) Bonds/debentures (along with the rate of interest and particulars of redemption or conversion, as the case may be) shall be stated in descending order of maturity or conversion, starting from farthest redemption or conversion date, as the case may be. Where bonds/debentures are redeemable by installments, the date of maturity for this purpose must be reckoned as the date on which the first installment becomes due.

(v) Particulars of any redeemed bonds/ debentures which the company has power to reissue shall be disclosed.

(vi) Terms of repayment of term loans and other loans shall be stated.

(vii) Period and amount of continuing default as on the balance sheet date in repayment of loans and interest, shall be specified separately in each case.

D. Other Long Term Liabilities

Other Long term Liabilities shall be classified as:

(a) Trade payables

(b) Others

E. Long-term provisions

The amounts shall be classified as:

(a) Provision for employee benefits.

(b) Others (specify nature).

F. Short-term borrowings

(i) Short-term borrowings shall be classified as:

(a) Loans repayable on demand

- From banks
- From other parties

(b) Loans and advances from related parties.

(c) Deposits.

(d) Other loans and advances (specify nature).

(ii) Borrowings shall further be sub-classified as secured and unsecured. Nature of security shall be specified separately in each case.

(iii) Where loans have been guaranteed by directors or others, the aggregate amount of such loans under each head shall be disclosed.

(iv) Period and amount of default as on the balance sheet date in repayment of loans and interest shall be specified separately in each case.

G. Other current liabilities

The amounts shall be classified as:

(a) Current maturities of long-term debt;

(b) Current maturities of finance lease obligations;

(c) Interest accrued but not due on borrowings;

(d) Interest accrued and due on borrowings;

(e) Income received in advance;

(f) Unpaid dividends

(g) Application money received for allotment of securities and due for refund and interest accrued thereon. Share application money includes advances towards allotment of share capital. The terms and conditions including the number of shares proposed to be issued, the amount of premium ,if any, and the period before which shares shall be allotted shall be disclosed. It shall also be disclosed whether the company has sufficient authorized capital to cover the share capital amount resulting from allotment of shares out of such share application money. Further, the period for which the share application money has been pending beyond the period for allotment as mentioned in the document inviting application for shares along with the reason for such share application money being pending shall be disclosed. Share application money not exceeding the issued capital and to the extent not refundable shall be shown under the head Equity and share application money to the extent refundable i.e., the amount in excess of subscription or in case the requirements of minimum subscription are not met, shall be separately shown under 'Other current liabilities'

(h) Unpaid matured deposits and interest accrued thereon

(i) Unpaid matured debentures and interest accrued thereon

(j) Other payables (specify nature);

H. Short-term provisions

The amounts shall be classified as:

(a) Provision for employee benefits.

(b) Others (specify nature).

I. Tangible assets

(i) Classification shall be given as:

(a) Land.

(b) Buildings.

(c) Plant and Equipment.

(d) Furniture and Fixtures.

(e) Vehicles.

(f) Office equipment.

(g) Others (specify nature).

(ii) Assets under lease shall be separately specified under each class of asset.

(iii) A reconciliation of the gross and net carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations and other adjustments and the related depreciation and impairment losses/reversals shall be disclosed separately.

(iv) Where sums have been written off on a reduction of capital or revaluation of assets or where sums have been added on revaluation of assets, every balance sheet subsequent to date of such write-off, or addition shall show the reduced or increased figures as applicable and shall by way of a note also show the amount of the reduction or increase as applicable together with the date thereof for the first five years subsequent to the date of such reduction or increase.

J. Intangible assets

(i) Classification shall be given as:

(a) Goodwill.

(b) Brands /trademarks.

(c) Computer software.

(d) Mastheads and publishing titles.

(e) Mining rights.

(f) Copyrights, and patents and other intellectual property rights, services and operating rights.

(g) Recipes, formulae, models, designs and prototypes.

(h) Licenses and franchise.

(i) Others (specify nature).

(ii) A reconciliation of the gross and net carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations and other adjustments and the related amortization and impairment losses/reversals shall be disclosed separately.

(iii) Where sums have been written off on a reduction of capital or revaluation of assets or where sums have been added on revaluation of assets, every balance sheet subsequent to date of such write-off, or addition shall show the reduced or increased figures as applicable and shall by way of a note also show the amount of the reduction or increase as applicable together with the date thereof for the first five years subsequent to the date of such reduction or increase.

K. Non-current investments

(i) Non-current investments shall be classified as trade investments and other investments and further classified as:

(a) Investment property;

(b) Investments in Equity Instruments;

(c) Investments in preference shares

(d) Investments in Government or trust securities;

(e) Investments in debentures or bonds;

(f) Investments in Mutual Funds;

(g) Investments in partnership firms

(h) Other non-current investments (specify nature)

Under each classification, details shall be given of names of the bodies corporate (indicating separately whether such bodies are (i) subsidiaries, (ii) associates, (iii) joint ventures, or (iv) controlled special purpose entities) in whom investments have been made and the nature and extent of the investment so made in each such body corporate (showing separately investments which are partly-paid). In regard to investments in the capital of partnership firms, the names of the firms (with the names of all their partners, total capital and the shares of each partner) shall be given.

(ii) Investments carried at other than at cost should be separately stated specifying the basis for valuation thereof.

(iii) The following shall also be disclosed:

(a) Aggregate amount of quoted investments and market value thereof;

(b) Aggregate amount of unquoted investments;

(c) Aggregate provision for diminution in value of investments

L. Long-term loans and advances

(i) Long-term loans and advances shall be classified as:

(a) Capital Advances;

(b) Security Deposits;

(c) Loans and advances to related parties (giving details thereof);

(d) Other loans and advances (specify nature).

(ii) The above shall also be separately sub-classified as:

(a) Secured, considered good;

(b) Unsecured, considered good;

(c) Doubtful.

(iii) Allowance for bad and doubtful loans and advances shall be disclosed under the relevant heads separately.

(iv) Loans and advances due by directors or other officers of the company or any of them either severally or jointly with any other persons or amounts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

M. Other non-current assets

Other non-current assets shall be classified as:

(i) Long Term Trade Receivables (including trade receivables on deferred credit terms);

(ii) Others (specify nature)

(iii) Long term Trade Receivables, shall be sub-classified as:

(i) (a) Secured, considered good;

(b) Unsecured considered good;

(c) Doubtful

(ii) Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.

(iii) Debts due by directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

N. Current Investments

(i) Current investments shall be classified as:

(a) Investments in Equity Instruments;

(b) Investment in Preference Shares

(c) Investments in government or trust securities;

(d) Investments in debentures or bonds;

(e) Investments in Mutual Funds;

(f) Investments in partnership firms

(g) Other investments (specify nature).

Under each classification, details shall be given of names of the bodies corporate (indicating separately whether such bodies are (i) subsidiaries, (ii) associates, (iii) joint ventures, or (iv) controlled special purpose entities) in whom investments have been made and the nature and extent of the investment so made in each such body corporate (showing separately investments which are partly-paid). In regard to investments in the capital of partnership firms, the names of the firms (with the names of all their partners, total capital and the shares of each partner) shall be given.

(ii) The following shall also be disclosed:

(a) The basis of valuation of individual investments

(b) Aggregate amount of quoted investments and market value thereof;

(c) Aggregate amount of unquoted investments;

(d) Aggregate provision made for diminution in value of investments.

O. Inventories

(i) Inventories shall be classified as:

(a) Raw materials;

(b) Work-in-progress;

(c) Finished goods;

(d) Stock-in-trade (in respect of goods acquired for trading);

(e) Stores and spares;

(f) Loose tools;

(g) Others (specify nature).

(ii) Goods-in-transit shall be disclosed under the relevant sub-head of inventories.

(iii) Mode of valuation shall be stated.

P. Trade Receivables

(i) Aggregate amount of Trade Receivables outstanding for a period exceeding six months from the Date they are due for payment should be separately stated.

(ii) Trade receivables shall be sub-classified as:

(a) Secured, considered good;

(b) Unsecured considered good;

(c) Doubtful.

(iii) Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.

(iv) Debts due by directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

Q. Cash and cash equivalents

(i) Cash and cash equivalents shall be classified as:

(a) Balances with banks;

(b) Cheques, drafts on hand;

(c) Cash on hand;

(d) Others (specify nature).

(ii) Earmarked balances with banks (for example, for unpaid dividend) shall be separately stated.

(iii) Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments shall be disclosed separately.

(iv) Repatriation restrictions, if any, in respect of cash and bank balances shall be separately stated.

(v) Bank deposits with more than 12 months maturity shall be disclosed separately.

R. Short-term loans and advances

(i) Short-term loans and advances shall be classified as:

(a) Loans and advances to related parties (giving details thereof);

(b) Others (specify nature).

(ii) The above shall also be sub-classified as:

(a) Secured, considered good;

(b) Unsecured, considered good;

(c) Doubtful.

(iii) Allowance for bad and doubtful loans and advances shall be disclosed under the relevant heads separately.

(iv) Loans and advances due by directors or other officers of the company or any of them either severally or jointly with any other person or amounts due by firms or private companies respectively in which any director is a partner or a director or a member shall be separately stated.

S. Other current assets (specify nature).

This is an all-inclusive heading, which incorporates current assets that do not fit into any other asset categories.

T. Contingent liabilities and commitments

(to the extent not provided for)

(i) Contingent liabilities shall be classified as:

(a) Claims against the company not acknowledged as debt;

(b) Guarantees;

(c) Other money for which the company is contingently liable

(ii) Commitments shall be classified as:

(a) Estimated amount of contracts remaining to be executed on capital account and not provided for;

(b) Uncalled liability on shares and other investments partly paid

(c) Other commitments (specify nature).

U. The amount of dividends proposed to be distributed to equity and preference shareholders for the period and the related amount per share shall be disclosed separately. Arrears of fixed cumulative dividends on preference shares shall also be disclosed separately.

V. Where in respect of an issue of securities made for a specific purpose, the whole or part of the amount has not been used for the specific purpose at the balance sheet date, there shall be indicated by way of note how such unutilized amounts have been used or invested.

W. If, in the opinion of the Board, any of the assets other than fixed assets and non-current investments do not have a value on realization in the ordinary course of business at least equal to the amount at which they are stated, the fact that the Board is of that opinion, shall be stated.

PART II – Form of STATEMENT OF PROFIT AND LOSS

Name of the Company…………………….

Profit and loss statement for the year ended ………………………

(Rupees in………..)

Particulars		Note No.	Figures for the current reporting period		Figures for the previous reporting period	
I.	Revenue from operations			xxx		xxx
II.	Other income			xxx		xxx
III.	Total Revenue (I + II)			xxx		xxx
IV.	Expenses:			xxx		xxx
	Cost of materials consumed			xxx		xxx
	Purchases of Stock-in-Trade			xxx		xxx
	Changes in inventories of finished goods work-in-progress and Stock-in-Trade					
	Employee benefits expense					
	Finance costs					
	Depreciation and amortization expense					
	Other expenses					
	Total expenses			xxx		xxx
V.	Profit before exceptional and extraordinary items and tax (III-IV)			xxx		xxx
VI.	Exceptional items			xxx		xxx
VII.	Profit before extraordinary items and tax (V - VI)			xxx		xxx
VIII.	Extraordinary Items			xxx		xxx
IX.	Profit before tax (VII- VIII)			xxx		xxx
X	Tax expense:					
	(1) Current tax		xxx		xxx	
	(2) Deferred tax		xxx	xxx	xxx	xxx
XI	Profit (Loss) for the period from continuing operations (VII-VIII)			xxx		Xxx
XII	Profit/(loss) from discontinuing operations			xxx		Xxx
XIII	Tax expense of discontinuing operations			xxx		Xxx
XIV	Profit/(loss) from Discontinuing operations (after tax) (XII-XIII)			xxx		Xxx

XV	Profit (Loss) for the period (XI + XIV)		xxx	xxx
XVI	Earnings per equity share:			
	(1) Basic		xxx	xxx
	(2) Diluted		xxx	xxx

GENERAL INSTRUCTIONS FOR PREPARATION OF STATEMENT OF PROFIT AND LOSS

1. The provisions of this Part shall apply to the income and expenditure account referred to in sub-section (2) of Section 210 of the Act, in like manner as they apply to a statement of profit and loss.

2. (A) In respect of a company other than a finance company revenue from operations shall disclose separately in the notes revenue from

(a) sale of products;

(b) sale of services;

(c) other operating revenues;

Less:

(d) Excise duty.

(B) In respect of a finance company, revenue from operations shall include revenue from

(a) Interest; and

(b) Other financial services

Revenue under each of the above heads shall be disclosed separately by way of notes to accounts to the extent applicable.

3. Finance Costs

Finance costs shall be classified as:

(a) Interest expense;

(b) Other borrowing costs;

(c) Applicable net gain/loss on foreign currency transactions and translation.

4. Other income

Other income shall be classified as:

(a) Interest Income (in case of a company other than a finance company);

(b) Dividend Income;

(c) Net gain/loss on sale of investments

(d) Other non-operating income (net of expenses directly attributable to such income).

5. Additional Information

A Company shall disclose by way of notes additional information regarding aggregate expenditure and income on the following items:-

(i) (a) Employee Benefits Expense [showing separately (i) salaries and wages, (ii) contribution to provident and other funds, (iii) expense on Employee Stock Option Scheme (ESOP) and Employee Stock Purchase Plan (ESPP), (iv) staff welfare expenses].

(b) Depreciation and amortization expense;

(c) Any item of income or expenditure which exceeds one per cent of the revenue from operations or Rs.1,00,000, whichever is higher;

(d) Interest Income;

(e) Interest Expense;

(f) Dividend Income;

(g) Net gain/ loss on sale of investments;

(h) Adjustments to the carrying amount of investments;

(i) Net gain or loss on foreign currency transaction and translation (other than considered as finance cost);

(j) Payments to the auditor as

(a) auditor,

(b) for taxation matters,

(c) for company law matters,

(d) for management services,

(e) for other services,

(f) for reimbursement of expenses;

(k) Details of items of exceptional and extraordinary nature;

(l) Prior period items;

(ii) (a) In the case of manufacturing companies,-

(1) Raw materials under broad heads.

(2) goods purchased under broad heads.

(b) In the case of trading companies, purchases in respect of goods traded in by the company under broad heads.

(c) In the case of companies rendering or supplying services, gross income derived from services rendered or supplied under broad heads.

(d) In the case of a company, which falls under more than one of the categories mentioned in (a), (b) and (c) above, it shall be sufficient compliance with the requirements herein if purchases, sales and consumption of raw material and the gross income from services rendered is shown under broad heads.

(e) In the case of other companies, gross income derived under broad heads.

(iii) In the case of all concerns having works in progress, works-in-progress under broad heads.

(iv) (a) The aggregate, if material, of any amounts set aside or proposed to be set aside, to reserve, but not including provisions made to meet any specific liability, contingency or commitment known to exist at the date as to which the balance-sheet is made up.

(b) The aggregate, if material, of any amounts withdrawn from such reserves.

(v) (a) The aggregate, if material, of the amounts set aside to provisions made for meeting specific liabilities, contingencies or commitments.

(b) The aggregate, if material, of the amounts withdrawn from such provisions, as no longer required.

(vi) Expenditure incurred on each of the following items, separately for each item:-

(a) Consumption of stores and spare parts.

(b) Power and fuel.

(c) Rent.

(d) Repairs to buildings.

(e) Repairs to machinery.

(g) Insurance .

(h) Rates and taxes, excluding, taxes on income.

(i) Miscellaneous expenses,

(vii) (a) Dividends from subsidiary companies.

(b) Provisions for losses of subsidiary companies.

(viii) The profit and loss account shall also contain by way of a note the following information, namely:-

(a) Value of imports calculated on C.I.F basis by the company during the financial year in respect of –

I. Raw materials;

II. Components and spare parts;

III. Capital goods;

(b) Expenditure in foreign currency during the financial year on account of royalty, know-how, professional and consultation fees, interest, and other matters;

(c) Total value if all imported raw materials, spare parts and components consumed during the financial year and the total value of all indigenous raw materials, spare parts and components similarly consumed and the percentage of each to the total consumption;

(d) The amount remitted during the year in foreign currencies on account of dividends with a specific mention of the total number of non-resident shareholders, the total number of shares held by them on which the dividends were due and the year to which the dividends related;

(e) Earnings in foreign exchange classified under the following heads, namely:-

I. Export of goods calculated on F.O.B. basis;

II. Royalty, know-how ,professional and consultation fees;

III. Interest and dividend;

IV. Other income, indicating the nature thereof

Note: Broad heads shall be decided taking into account the concept of materiality and presentation of true and fair view of financial statements,"

Illustration 1

You are required to prepare financial statements from the following trial balance of Haria Chemicals Ltd. for the year ended 31st March, 2012.

Haria Chemicals Ltd.
Trial Balance as at 31st March, 2012

Particulars	*₹*	*Particulars*	*₹*
Stock	*6,80,000*	*Equity Shares*	
Furniture	*2,00,000*	*Capital (Shares of ₹ 10 each)*	*25,00,000*
Discount	*40,000*	*11% Debentures*	*5,00,000*
Loan to Directors	*80,000*	*Bank loans*	*6,45,000*
Advertisement	*20,000*	*Bills payable*	*1,25,000*
Bad debts	*35,000*	*Creditors*	*1,56,000*
Commission	*1,20,000*	*Sales*	*42,68,000*
Purchases	*23,19,000*	*Rent received*	*46,000*
Plant and Machinery	*8,60,000*	*Transfer fees*	*10,000*
Rentals	*25,000*	*Profit & Loss*	
Current account	*45,000*	*account*	*1,39,000*
Cash	*8,000*	*Depreciation*	

Interest on bank loans	*1,16,000*	*provision :*	
Preliminary expenses	*10,000*	*Machinery*	*1,46,000*
Fixtures	*3,00,000*		
Wages	*9,00,000*		
Consumables	*84,000*		
Freehold land	*15,46,000*		
Tools & Equipments	*2,45,000*		
Goodwill	*2,65,000*		
Debtors	*2,87,000*		
Bills receivable	*1,53,000*		
Dealer aids	*21,000*		
Transit insurance	*30,000*		
Trade expenses	*72,000*		
Distribution freight	*54,000*		
Debenture interest	*20,000*		
	85,35,000		*85,35,000*

Additional information : Closing stock on 31-3-2012: ₹ 8,23,000.

Solution

Haria chemicals Ltd.

Balance Sheet as at 31st March, 2012

	Schedule No.	Rupees as at the end of 31st March 2012
(1)	(2)	(3)
Equity and Liabilities		
(1) Shareholders' funds :		
(*a*) Capital	1	25,00,000
(*b*) Reserves and Surplus	2	7,50,000
(2) Non Current Liabilities		
(a) Secured loans		
Long term borrowings	3	11,45,000

(3) Current Liabilities			
(a) Trade payables	4	2,81,000	
Total		46,76,000	
Assets			
(1) Non current assets			
Fixed Assets :			
(a) Tangible assets	5	32,70,000	
(2) Current assets			
(a) Inventories		8,23,000	
(b) Trade receivables		2,87,000	
(c) Cash and cash equivalents	6	53,000	
(d) Short term loans and advances	7	2,33,000	
(e) Other current assets		10,000	
Total		46,76,000	

Note: Other assets represent preliminary expenses not written off Rs. 10,000.

Haria Chemicals Ltd.

Profit and Loss Account for the year ended 31st March, 2012

	Schedule No.	*Figures as at the end of 31st March 2012*	
Revenue from operations		42,68,000	
Other income	8	56,000	
			43,24,000
Expenses			
Cost of materials consumed	9	21,76,000	
Manufacturing & other expenses	10	14,01,000	
Interest & other financial charges	11	1,36,000	
			37,13,000
Profit before tax			6,11,000
Provision for tax			—

Profit after tax	6,11,000
Balance of profit and loss	
account brought forward	1,39,000
Balance carried to balance sheet	7,50,000

Notes to Accounts

1. Share capital	*Rs.*
Authorised :	
Equity share capital of Rs. 10 each	25,00,000
Issued and Subscribed :	
Equity share capital of Rs. 10 each	25,00,000
2. Reserves and Surplus	
Balance as per last balance sheet	1,39,000
Balance in profit and loss account	6,11,000
	7,50,000
3. Long term Borrowings11% Debentures	5,00,000
Bank loans	6,45,000
	11,45,000
4 Trade payables	
Creditors	1,56,000
Bills payable	1,25,000
	2,81,000

5. Tangible Assets

	Gross block	*Depreciation*	*Net Block*
Goodwill	2,65,000		2,65,000
Freehold land	15,46,000		15,46,000
Furniture	2,00,000		2,00,000
Fixtures	3,00,000		3,00,000
Plant & Machinery	8,60,000	1,46,000	7,14,000
Tools & Equipment	2,45,000		2,45,000
Total	34,16,000	1,46,000	32,70,000

6. Cash and cash equivalents

Current account balance	45,000
Cash	8,000
	53,000

7. Short-term loans and Advances

Loan to directors	80,000
Bills receivable	1,53,000
	2,33,000

8. Other Income

Rent received	46,000
Transfer fees	10,000
	56,000

9. Cost of materials consumed

Opening stock	6,80,000
Add: purchases	23,19,000
Less: Closing stock	8,23,000
	21,76,000

10. Manufacturing and Other Expenses

Consumables	84,000
Wages	9,00,000
Bad debts	35,000
Discount	40,000
Rentals	25,000
Commission	1,20,000
Advertisement	20,000
Dealers' aids	21,000
Transit insurance	30,000
Trade expenses	72,000
Distribution freight	54,000
	14,01,000

11. Interest and Other Financial Charges

Interest on bank loans	1,16,000
Debenture interest	20,000
	1,36,000

1.6 Managerial Remuneration

I. Managerial remuneration is calculated as a percentage on profit. Managerial remuneration payable by a company is governed by various sections of the Companies Act, 1956 and also Schedule XIII of the Companies Act, 1956.

II. The scope of the relevant sections are as below :

Section 198 prescribes the overall maximum managerial remuneration payable and also managerial remuneration in case of absence or inadequacy of profits.

Section 309 prescribes the remuneration payable to whole-time directors and part-time directors.

Section 310 states that if there is an increase in managerial remuneration within the scope of Schedule XIII and within the overall ceiling, permission of Central Government is not required for such increase. In other words sanction of Central Government will be required only if the increase in managerial remuneration has the effect of exceeding the overall ceiling as given in Section 198.

Section 349 lays down how the net profit of the company will be ascertained for the purpose of calculating managerial remuneration.

Section 387 deals with remuneration of manager. Remuneration to manager cannot exceed in the aggregate five per cent of the net profits. However, a manager is included within the scope of the term 'managerial person'.

Schedule XIII consists of three parts. Part I lays down conditions to be fulfilled for the appointment of a managing or wholetime director or a manager without the approval of the Central Government. Part II deals with remuneration payable to managerial person by companies having profits and also by companies having no profits or inadequate profits. Part III specifies the provisions applicable to earlier parts of the schedule.

III. It may be noted that the Central Government had amended Schedule XIII to the Companies Act, 1956 on 14th July, 1993 introducing sweeping changes in provisions governing managerial appointment and remuneration.

IV. As a result of such amendment, the ceiling on commission on net profit was withdrawn. With a view to give still greater freedom to companies in regard to managerial appointment and remuneration, Central Government have once again amended Schedule XIII to the Companies Act, 1956 effective from 1st February, 1994.

V. Managerial Remuneration : Maximum limits :

(A) For companies having profits:

(i)	Overall (excluding fees for attending meetings)	11% of net profit
(ii)	If there is one managerial person	5% of net profit
(iii)	If there are more than one managerial person	10% of net profit
(iv)	Remuneration of part-time directors :	

(a) If there is no managing or whole-time director 3% of net profit

(b) If there is a managing or whole-time director 1% of net profit

(B) For companies having no profits or inadequate profits :

VI. In the event of absence or inadequacy of net profits in any financial year, managerial remuneration will have to be limited to amounts (varying from ₹ 40,000 per month to ₹ 87,500 per month, depending on the effective capital of the company) specified in Section II of Part II of Schedule XIII.

VII. Such remuneration may be paid as 'minimum remuneration' without the approval of the Central Government.

However, approval of the Central Government will be required if such 'minimum remuneration' is sought to be exceeded.

Loss making companies or companies with inadequate net profits have the freedom to work out suitable remuneration packages for their managerial personnel within the limits specified in Section II of Part II of Schedule XIII.

VIII. The remuneration of managerial person in case of absence or inadequacy of profits shall be calculated on the following scale [vide circular CL-V dated 2nd March, 2000, issued by Department of Company Affairs]

Where the effective capital of company is :		*Monthly remuneration payable shall not exceed :*
(i)	Less than ₹ 1 crore	₹ 75,000
(ii)	₹ 1 crore or more but less than ₹ 5 crores	₹ 1,00,000
(iii)	₹ 5 crores or more but less than ₹ 25 crores	₹ 1,25,000
(ix)	₹ 25 crores or more but less than ₹ 100 crores	₹ 2,00,000

IX. Subject to the provisions of Section I and II, a managerial person shall draw remuneration from one or both companies, provided that the total remuneration drawn from the companies does not exceed the higher maximum limit admissible from any one of the companies of which he is a managerial person

IX Explanation :

1. Managerial persons include managing or whole-time director and manager.

2. Effective capital means the aggregate of the paid-up share capital (excluding share application money or advances against shares), amount, if any, for the time being standing to the credit of share premium account, reserves and surplus (excluding revaluation reserves), long-term loans and deposits repayable after one year (excluding working capital loans, overdrafts, interest due on loans unless funded, bank guarantee etc. and other short-term arrangements) as reduced by the aggregate of any investments (except in the case of investment by an investment company), accumulated losses and preliminary expenses not written off.

Ascertainment of profit for managerial remuneration

I As we have seen above that in case of a company having profits, managerial remuneration is calculated as a percentage on net profit.

II Such net profit is to be arrived in accordance with the provisions of Section 349 of the Companies Act, 1956.

III The following credits or incomes in addition to the gross profit should be taken into account:

Bounties and subsidies received from any Government, or any public authority constituted or authorised in this behalf, by the Government unless and except in so far as the Central Government otherwise directs.

IV The following "incomes" or credits should not be taken into account :

(a) premium on shares or debentures issued or sold by the company;

(b) profit on sale by the company of forfeited shares;

(c) profits of a capital nature including profit from the sale of the undertaking or any of the undertakings of the company, or any part thereof; and

(d) profits from the sale of any immovable property of fixed assets of capital nature comprised in the undertaking or any of the undertakings of the company, unless the business of the company consists, whether wholly or partly, of buying and selling such property or assets.

V But where the amount for which any fixed asset is sold exceeds its written down value (calculated according to Section 350) credit should be given for such of the excess as is not higher than the difference between the original cost of that fixed asset and its written down value:

Suppose a machine purchased for ₹ 30,000, written down to ₹ 18,000 by writing off depreciation, is sold for ₹ 35,000.

The managerial personnel are entitled to remuneration on profit including ₹ 12,000 *i.e.,* excluding the profit over and above the original cost of ₹ 5,000.

VI From the incomes of the company, the following have to be deducted :

(a) all the usual working charges;

(b) bonus or commission paid or payable to any member of the company's staff or any engineer, technician or person employed or engaged by the company whether on a wholetime or on a part-time basis;

(c) any tax notified by the Central Government as being in the nature of a tax on excess or abnormal profit;

(d) any tax on business profit imposed for special reasons or in special circumstances notified by the Central Government in this behalf;

(e) interest on debentures issued by the company;

(f) interest on mortgages executed by the company and on loans and advances secured by a charge on its fixed or floating assets.

(g) interest on unsecured loans and advances;

(h) expenses on repairs, whether to immovable property or to movable property, provided the repairs are not of a capital nature;

(i) outgoings, inclusive of contributions made under clause (of sub-section) of Section 293. This relates to donations to charitable funds;

(j) depreciation calculated according to Section 350. Under Section 350 the depreciation (for the purpose of calculating remuneration to managerial personnel) is to be calculated according to the rates specified in Schedule XIV. Depreciation includes only normal depreciation including extra and multiple shift allowance but excluding any special, initial or other depreciation or any development rebate.

VII If an asset is sold, discarded, demolished or destroyed before it is completely written off, the excess of the written down value over its sale proceeds or its scrap value has to be written off in the financial year in which the assets is sold, discarded, demolished or destroyed;

(k) the excess of expenditure over income which arises in computing the net profit in accordance with this section in any year (after the commencement of the Act) in so far as its excess has not been deducted in any subsequent year preceding the year in respect of which the net profit have to be ascertained;

(l) any compensation or damage to be paid in by virtue of any legal liability including a liability arising from a breach of contract;

(m) any sum paid by way of insurance against the risk of meeting any liability such as is referred to in (m); and

(n) debts considered bad and written off or adjusted during the year of account.

VIII Profit on which remuneration has to be allowed should be ascertained without deducting the following :

(a) income-tax and super tax payable by the company under the Income-tax Act or any other tax on the income of the company not covered by (d) and (e) above;

(b) any compensation, damages or payment made voluntarily, that is to say, otherwise than by virtue of a liability such as is referred to in (m) above; and

(c) loss of a capital nature including loss or sale of the undertaking or any of the undertakings of the company or of any part thereof not including in any excess of written down value over its sale proceeds of scrap value of any asset sold. The excess has to be written off to the Profit and Loss A/c.

IX It should be noted that the Profit and Loss Account should have a statement attached showing how profit has been ascertained for the purpose of remuneration due to directors, managing director or manager as per the requirements of paras 4 and 4A of Part II, Schedule VI.

Illustration 2

The following is the Profit & Loss A/c of Mudra Ltd., the year ended 31st March, 2011

		₹			₹
To	Administrative, Selling and distribution expenses	8,22,542	By Balance b/d		5,72,350
”	Donation to charitable funds	25,500	“ Balance from Trading A/c		40,25,365
”	Directors fees	66,750	“ Subsidies received from Govt.		2,32,560
”	Interest on debentures	31,240	“ Interest on Investments		15,643
”	Compensation for breach of contract	42,530	“ Transfer fees		722
”	Managerial remuneration	2,85,350	“ Profit on sale of Machinery:		
”	Depreciation on fixed assets	5,22,543	Amount realised	55,000	
”	Provision for Taxation	12,42,500	Written down value	30,000	25,000
”	General Reserve	4,00,000			
”	Investment Revaluation Reserve	12,500			
”	Balance c/d	14,20,185			
		48,71,640			48,71,640

Additional Information:

(1) Original Cost of the machinery sold was ₹ 40,000

(2) Depreciation on fixed assets as per Schedule XIV of the Companies Act, 1956 was ₹ 5,75,345.

You are required to comment on the managerial remuneration in the following situations:

(a) there is only one whole time director;

(b) there are two whole time directors;

(c) there are two whole time directors, a part time director and a manager.

Solution :

Calculation of net profit u/s 349 of the Companies Act, 1956

	₹	₹
Balance from Trading A/c		40,25,365
Add : Subsidies received from Government	2,32,560	
Interest on investment	15,643	
Transfer fees	722	
Profit on sale of machinery (40,000 – 30,000)	10,000	2,58,925
		42,84,290
Less : Administrative, selling and distribution expenses	8,22,542	
Donation to charitable funds	25,500	
Director's fees	66,750	
Interest on debentures	31,240	
Compensation for breach of contract	42,530	
Depreciation on fixed assets as per Schedule XIV	5,75,345	15,63,907
Profit u/s 349		27,20,383

Situation:

(a) When there is only one whole time director:

Managerial remuneration = 5% of ₹ 27,20,383 = ₹ 1,36,019

(b) When there are two whole time directors :

Managerial remuneration =10% of ₹ 27,20,383 = ₹ 2,72,038

(c) When there are two whole time directors, a part time director and a manager:

Managerial remuneration = 11% of ₹ 27,20,383 = ₹ 2,99,242

Comment : In situations (*a*) and (*b*) since managerial remuneration as per Profit and Loss account ₹ 2,85,350 exceeds the maximum amount payable, the company should obtain permission under Section 309(3) for such excess payment.

Illustration 3

The following extract of Balance Sheet of X Ltd. was obtained:

Balance Sheet (Extract) as on 31st March, 2011

Liabilities	₹
Authorised capital:	
20,000, 14% preference shares of ₹ 100	20,00,000
2,00,000 Equity shares of ₹ 100 each	2,00,00,000
	2,20,00,000

Issued and subscribed capital:	
15,000, 14% preference shares of ₹ 100 each fully paid	15,00,000
1,20,000 Equity shares of ₹ 100 each, ₹ 80 paid-up	96,00,000
Share suspense account	20,00,000
Reserves and surplus	
Capital reserves (60% is revaluation reserve)	2,50,000
Securities premium	50,000
Secured loans:	
15% Debentures	65,00,000
Unsecured loans:	
Public deposits	3,70,000
Cash credit loan from SBI	4,65,000
Current Liabilities:	
Sundry creditors	3,45,000
Assets:	
Investment in shares, debentures, etc.	75,00,000
Profit and Loss account	15,25,000
Preliminary expenses not written off	55,000

Share suspense account represents application money received on shares, the allotment of which is not yet made.

X Ltd. has been sustaining loss for the last few years. X Ltd. has only one whole-time director. Find out how much remuneration X Ltd. can pay to its managerial person as per the provisions of Part II of Schedule XIII. Would your answer differ if X Ltd. is an investment company?

Solution :

Computation of effective capital :

	Where X Ltd. is a non-investment company ₹	*Where X Ltd. is an investment company* ₹
Paid-up share capital —		
15,000, 14% Preference shares	15,00,000	15,00,000
1,20,000 Equity shares	96,00,000	96,00,000
Capital reserves	1,00,000	1,00,000
Securities premium	50,000	50,000
15% Debentures	65,00,000	65,00,000
Public Deposits	3,70,000	3,70,000
(A)	1,81,20,000	1,81,20,000

Investments	75,00,000	—
Profit and Loss account (Dr. balance)	15,25,000	15,25,000
Preliminary expenses not written off	55,000	55,000
(B)	90,80,000	15,80,000
Effective capital (A–B)	90,40,000	1,65,40,000
Monthly remuneration shall not exceed	75,000	1,00,000

1.7 Divisible Profit

One of the important functions of company accounting is to determine the amount of profits which is available for distribution. This is necessary since the amount of profits disclosed by the Profit & Loss Account, in every case, is not available for distribution. The availability of profits for distribution depends on a number of factors, *e.g.*, their composition, the amount of provisions and appropriations that must be made out of them in priority, etc.

Dividends cannot be declared except out of profits

Declaration of a dividend presupposes that there is a trading profit or a surplus available for distribution, arrived at after providing for depreciation on assets, not only for the year in which the profits were earned but also for any arrears of depreciation of the past years, calculated in the manner prescribed by sub-section (2) of Section 205 (*see* below).

The balance of undistributed profits of the past years, provided the same has been arrived at in a like manner, is also available for distribution.

Any money provided by the Central or State Government for any payment of dividend in pursuance of a guarantee given by the Government also is available for distribution as a dividend.

Capital cannot be returned to the shareholders by way of dividend

Under the Companies Act it is not obligatory for a company to maintain its capital intact. But the Act has prescribed the procedure for reduction of capital. It must be followed in every case if the paid-up capital is to be reduced. Therefore, no part of the capital can be paid unless there is profit. But interest may be paid under Section 208.

Provision for Depreciation —

I. Section 205(2) provides that depreciation must be provided either —

(*a*) to the extent specified in Section 350.

(*b*) equal to an amount arrived at by dividing 95% of the cost of the asset by the number of years at the end of which the asset would cease to be serviceable; or

(*c*) on any other basis approved by the Central Government by which 95% of the cost of each depreciable assets will be written off on the expiry of its serviceable life; or

(*d*) As regards any other depreciable asset for which no rate of depreciation has been laid down by the Companies Act, 1956 or any rules made thereunder, on such basis as may be approved by the Central Government by any general order published in the Official Gazette or by any special order in any particular case.

II Section 350 provides that depreciation should be written off at the rates specified for different assets in Schedule XIV to the Companies Act, 1956.

III Provision is required only for the normal depreciation (including extra and multiple shift allowance) and not for any initial depreciation or any development rebate.

IV Further, when the assets are sold, discarded, demolished or destroyed in any financial year, the excess of the written down value over its sale proceeds as scrap, if any should be written off in the same financial year.

V Section 350 contemplates that depreciation on assets shall be computed with reference to the written down value of the assets as shown by the books of the company at the end of the financial year.

VI The Amendment Act, 2000 has replaced the words "the amount calculated with reference to the written down value of the assets" with "the amount of depreciation on assets".

Thus any other method of depreciation is also allowed. Earlier only written down value of method could be used for the purpose of calculation of depreciation under this section.

VII It should be noted that depreciation has to be written off or provided for if dividends are to be declared; a company need not provide for depreciation if it does not want to declare dividends.

In such a case, the fact that depreciation has not been provided for or written off, together with the quantum of arrears of depreciation [computed as per Section 205(2)], must be stated in the Profit and Loss Account.

VIII If provision for depreciation is not made by means of a depreciation charge but by some other method, the method adopted should be disclosed.

N.B. For purpose of ascertaining profit on which remuneration is to be paid to managerial personnel, depreciation according to Section 350 is to be considered.

IX Loss suffered in the past may not be made good –

(a) Where a company has incurred any loss in any previous financial year or years, Sub-section (2) of Section 205 prescribes that it must set off either the loss or an amount which is equal to the amount provided for as depreciation in that year or those years whichever is less, against the profit of the company for the year, out of which the dividend is proposed to be declared or paid.

(b) Thus, the losses suffered in the past or at least amount of depreciation on assets comprised therein, must first be made good out of the profits of a year before any part thereof is distributed as a dividend.

(c) This is illustrated below :

		Year ended 31st December (in ₹ lakhs)			
		2008	*2009*	*2010*	*Total*
1.	Depreciation as provided in the books	3	2	8	13
2.	Depreciation chargeable under section 205	13	10	8	31
3.	Profit before charging depreciation	–15	–7	37	15
4.	Profit after charging depreciation as in (1)	–18	–9	29	2
5.	Profit after charging depreciation as in (2)	–28	–17	29	-16

The amount available for dividend in 2010 is ₹ 6,00,000 as shown below :

A.	Past Losses [4]		27
B.	Depreciation previously provided [1]		5
C.	Depreciation in arrear [2–1]		
	2008	10	
	2009	8	
	2010	Nil	18

Profit for 2010 (as per books)	29
Less: Arrears of Depreciation not provided for as per (C) above, which must be now provided	18
	11
Less: Amount of depreciation provided (B) or the loss (A), whichever is less	5
Distributable Profit	6

This amount of ₹ 6,00,000 may also be arrived at as follows :

Profit for 2010 (before charging depreciation)	37
Less: Total depreciation for 3 years u/s 205	31
Distributable Profit	6

(d) However, one should note that before the amendment of the Companies Act in 1960 the legal position was according to the decisions in various cases in England. Therefore, it was not necessary to provide for depreciation on fixed assets or past losses for declaring a dividend (*Ammonia Soda Co.* v. *Chamberlain and Stapley* v. *Read Bros Ltd.*).

(e) It is still not necessary to provide arrears of depreciation and losses relating to the financial year falling before 28th December 1961.

Distribution of Capital Profit

Any capital profit or any appreciation in the value of fixed asset in the case of a company may be distributed as dividend provided *(i)* the revaluation of all the assets discloses a surplus;

(ii) the profit has been realised in cash;

(iii) the article of the company permit such a distribution, (*Lubbok* v. *British Bank of South America and Foster* v. *The New Trinidod Lake Asphalte Co. Ltd.*).

Writing off losses against capital profits

1. It is permissible for a company to revalue its assets but the revaluation must be in a *bona fide* manner.
2. Depending upon the results disclosed by such a revaluation, with the approval of the shareholders, the assets, which may have been over depreciated in the past may be written up and the surplus, if any, resulting therefrom utilised for writing down value of other assets, so that the value of each asset is brought closer to its current value (*Ammonia Soda Co.* v. *Chamberlain*).
3. Where any expenditure of a capital nature has been charged to revenue the company can subsequently reimburse an equal amount of revenue, out of capital.
4. Similarly, when losses on capital account have been charged off to revenue and later the value of the capital assets appreciates, the amount so realised would be a revenue profit (*Mills* v. *Northern Railway of Buenos Aires Co.*).

Transfer to Reserves

I The Board of Directors, unless prohibited by the Articles, can appropriate a part of the profits to the credit of a reserve or reserves.

II Appropriation of a part of profit is sometimes made under law.

(a) For example, under the Banking Regulation Act, 25% of the profit of a banking company must first be transferred to the General Reserve before any dividend can be distributed.

(b) Similarly, when profit of a licence under the Electricity Supply Act, 1984 exceeds the amount of reasonable return, a part (about 1/3 of the excess) has to be transferred to the Tariffs and Dividend Control Reserve.

(c) Transfer of a part of profit to a reserve is also necessary where the company has undertaken, at the time of raising of loan, that before any part of its profit is distributed, a specified percentage of the profit every year shall be credited to a reserve for the repayment of the loan and until the time for repayment arrives, the amount shall remain invested in a specified manner.

III Apart from appropriations aforementioned, it may also be necessary to provide for losses and arrears of depreciation and to exclude capital profit, as mentioned earlier, to arrive at the amount of divisible profit.

IV The changes made in the company law (effective 1st February, 1975) now authorises Government to compel companies to transfer a part of their after tax profits to reserve. The Government has promulgated the following rules in this regard:

(1) No dividend shall be declared or paid by the company for any financial year out of the profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of Sub-section (2) of Section 205 of the Act, except after the transfer to the reserve of the company of a percentage of its profit for that year as specified below :

(*i*) Where the proposed dividend exceeds 10 per cent but does not exceed 12.5 per cent of the paid-up capital, the amount to be transferred to the reserve shall not be less than 2.5 per cent of the current profits;

(*ii*) Where the proposed dividend exceeds 12.5 per cent but does not exceed 15 per cent of the paid up capital, the amount to be transferred to the reserve shall not be less than 5 per cent of the current profits;

(*iii*) Where the proposed dividend exceeds 15 per cent, but does not exceed 20 per cent of the paid up capital, the amount to be transferred to the reserves shall not be less than 7.5 per cent of the current profit; and

(*iv*) Where the dividend proposed exceeds 20 per cent of the paid-up capital the amount to be transferred to reserve shall not be less than 10 per cent of the current profits.

Proposed dividend as % of paid up capital	*Amount to be transferredto reserves as % of current profits*
>10%<=12.5%	>=2.5%
>12.5%<=15%	>=5%
>15% <=20%	>=7.5%
>20%	>=10%

(2) Nothing in rule (1) shall be deemed to prohibit the voluntary transfer by a company of a percentage higher than 10 per cent of its profit to its reserves for any financial year, so however that :

(*i*) Where a dividend is declared:

(*a*) a minimum distribution sufficient for the maintenance of dividends to shareholders at a rate equal to the average of the rates at which dividends declared by it over the three years immediately preceding the financial year; or

(*b*) in a case where bonus shares have been issued in the financial year in which the dividend is declared or in the three years immediately preceding the financial year, a minimum distribution sufficient for the maintenance of dividend to shareholders at an amount equal to the average amount (quantum) of dividend declared over the three years immediately preceding the financial year is ensured; Provided that in a case where the net profits after tax are lower by 20% or more than the average net profit after tax of the two financial years immediately preceding, it shall not be necessary to ensure such minimum distribution.

(*ii*) Where no dividend is declared, the amount proposed to be transferred to its reserves from the current profit shall be lower than the average amount of the dividends to the shareholders declared by it over the three years immediately preceding the financial year.

Declaration of dividend out of reserves

Government has promulgated rules regarding utilisation of reserves for payment of dividend. In the event of inadequacy or absence of profit in any year, dividend may be declared by a company for that year out of the accumulated profit earned by it in previous years and transferred by it to the reserves, subject to the condition that:

(*i*) the rate of the dividend declared shall not exceed the average of the rates at which dividend was declared by it in five years immediately preceding that year or ten per cent of its paid-up capital, whichever is less;

(*ii*) the total amount to be drawn from the accumulated profits earned in previous years and transferred to the reserves shall not exceed an amount equal to one-tenth of the sum of its paid up capital and free reserves and the amount so drawn shall first be utilised to set off the losses incurred in the financial year before any dividend in respect of preference or equity shares is declared; and

(*iii*) the balance of reserves after such drawl shall not fall below fifteen per cent of its paid up share capital.

Interest on Capital

As has been pointed out above, dividends cannot be paid except out of profits or, in other words, dividends cannot be paid out of capital. In certain cases, however, the Central Government has the power to permit payment of interest to shareholders even when there is no profit.

A company which has to wait rather a long period before it can commence production because construction of works may take long may find the shareholders restive if nothing is given to them by way of yield. Moreover, if construction is carried on by borrowed funds interest will have to be paid; hence there is some theoretical justification for payment of interest to the shareholders. Section 208 governs payment of interest in such cases. The company is allowed to pay interest on such shares as are issued for the purpose of defraying the expenses of the construction of any works of building or providing any plant which cannot be made profitable for a lengthy period, subject to the following conditions:

(*a*) The payment is authorised by Articles or by a special resolution.

(*b*) Prior sanction of the Central Government is obtained.

(*c*) Interest is paid only for such period as may be determined by the Central Government.

But the period cannot extend beyond the close of the half year next after the half year in which the works, buildings, etc., have been actually completed. For example, if the construction is over on 10th October, 2005, interest cannot be paid after 30th June 2006.

(*d*) The rate of interest does not exceed four per cent *per annum* or such other rates as the Central Government may, by notification in the Official Gazette, direct.

The Central Government can order an enquiry at the company's cost before according its sanction, the company can treat the interest so paid as part of the cost of construction.

Profit and Loss (Appropriation) Account

1. The provisions contained in Part II of Schedule VI of the Companies Act require that the under mentioned appropriations made out of profit should be disclosed in the Profit and Loss Account of the year:

   (*a*) Amounts provided for:

   - (i) repayment of share capital; and
   - (ii) repayment of loans [clause (*vii*)].

   (*b*) (*i*) The aggregate, if material,

   - ➢ of any amount set aside or proposed to be set aside to reserves, but not including provisions made to meet any specific liability, contingency or commitment known to exist at the date as at which the balance sheet is made up.
   - ➢ of the amounts withdrawn from such reserves [clause (viii)].
   - ➢ of the amount set aside to provisions made for meeting specific liabilities, contigencies or commitments.
   - ➢ of the amounts withdrawn from such provisions as no longer required [clause (*ix*)].
   - ➢ the aggregate amount of dividend paid and proposed and stating whether such amounts are subjects to deduction of income-tax or not [clause (XIV)]

2. It is evident therefore that it is necessary to disclose in the Profit & Loss Account amount withdrawn from reserves, excess provisions written back and appropriation proposed by the directors out of profits.

3. One should note that provisions for income-tax relating to the current year is no longer treated as an appropriation of profits - at one time it was.

4. With a view to distinguish the appropriation of profits from expenses chargeable against profits, the Research Department of the Institute has made the following recommendations:

5. "The Profit & Loss Account should be prepared in two parts:

   (*i*) The Profit and Loss Account, proper, include all income and expenditure properly attributable to the year's working and show the figure of profit or loss for the year; and

   (*ii*) The second part of the account should include all appropriations for dividends, transfers to and from reserves."

When appropriations are shown in a separate section in the Profit & Loss account, an imaginary line is supposed to separate them from income and expenses of the year. The account, therefore, refers to amount being shown above or below the 'line' depending on whether the amount is chargeable in the Profit and Loss section or the Appropriation section.

It is pertinent to mention here that clause (3) of Part II of Schedule VI states that the Profit & Loss account shall set out items relating to income and expenditure of the company, arranged under the most convenient heads in respect of the period covered by the account.

6. It would, therefore appear that when an addition to or a deduction from a reserve has no impact on the profit and loss of the period of account, such an addition or deduction need not be passed through the Profit & Loss Account.

Capital reserve

I Meaning

   (a) It is the reserve which does not include any amount regarded as free for distribution through the Profit and Loss account.

   (b) Share Premium and Capital Redemption Reserve Account should not be credited to capital reserve; these accounts have to be kept separate.

   (c) Only profits or a surplus of a capital nature can be credited to such a reserve.

II The following are instances of profit or surpluses which can be so created:

   1. Profit prior to incorporation.

   2. Capital profit on sale of fixed assets when these are not available for distribution as dividends in the circumstances mentioned below :

      (*i*) Where the profit on sale of a fixed asset has not been realised; or

      (*ii*) Where the profit on sale of fixed assets though realised is likely to be wiped out by the deficiency on revaluation of other assets; or

      (*iii*) Where the Articles of Association do not permit distribution of such profit as a dividend.

3. The excess of the value of net assets over the price paid for the acquisition of a business.
4. Profit on re-issue of forfeited shares. (Premiums received on issue of shares according to the provisions contained under Section 78 are to be credited to Shares Premium Account.)
5. The credit balance in the Capital Reduction Account, where there has been a reduction of capital with the consent of the Court.
6. Premiums received on issue of debentures or profits on redemption of debentures where the distribution of such profits is not permitted by the Articles.

Dividends

1. Meaning

(a) A dividend is a distribution of divisible profit of a company among the members according to the number of shares held by each of them in the capital of the company and the rights attaching thereto.

(b) Such a distribution may or may not entail a release of assets; it would be where a distribution involves payment of cash.

(c) But when profits are capitalised and the amount distributed is applied towards payment of bonus shares, issued free to the share holders, no part of the assets of the company can be said to have been released since, in such a case, profits are only capitalised, thereby increasing the paid up capital of the company. The company does not give up any asset.

2. Declaration

(a) A dividend is declared in the annual general meeting on the basis of the recommendation of the Board of Directors.

(b) Though the shareholders may declare a dividend smaller than recommended by the Board, they cannot declare a larger dividend or any dividend when none has been recommended (Clause 85 of Table A of Schedule I of the Companies Act).

(c) It is thus apparent that the Board of Directors determines the amount of profit which is to be distributed as a dividend as well as the time at which the distribution shall be made.

3. Interim Dividend

(a) The Board of Directors may, from time to time, pay to the members an interim dividend at a rate which may appear to be justified by the amounts of profit earned by the company (Clause 86 of table A of Schedule I to the Companies Act).

(b) The interim dividend is not adjusted when the final dividend is declared (that is the final dividend is in addition to the interim dividend) unless the resolution declaring the dividend states otherwise.

(c) The Companies (Amendment) Act, 2000 has inserted new sub-section (14 A) in Section 2 of the Companies Act which includes 'interim dividend' in the definition of the term 'dividend'.

4. Dividend on preference shares

(a) Holders of preference shares are entitled to receive a dividend at a fixed rate before any dividend is declared on equity shares.

(b) But such a right can be exercised subject to there being profits and the Directors recommending payment of the dividend.

(c) In the case of cumulative preference shares

- The holders are entitled to receive all the dividends which are in arrear before any dividend is paid on equity shares. For instance, suppose a company has not paid a dividend say, for five years and in the sixth year it earns a handsome profit. If Directors decide to declare a dividend on equity shares, it would be necessary to make a provision first for the payment of one year's dividend to holders of preference shares, if they are non-cumulative.
- If on the other hand, the right is cumulative, a provision for payment of dividends due to the preference shares for all the six years shall first have to be made before any dividend is declared on equity shares.

(d) In respect of preference shares issued before 1st April, 1960, the dividend payable is to be increased by 30% if the dividend payable was stipulated to be tax free and by 11% in the other case [Preference Shares (Regulation & Dividend) Act, 1960].

5. Dividend on partly paid shares:

(a) Provision in Articles

- In the case of partly paid-up shares, the dividend is payable either on the nominal, called up or the paid-up amount of shares, depending on the provision in this regard that there may be in the Articles.
- A company may if so authorised by its Article, pay a dividend in proportion to the amount paid on each share, where a larger amount is paid on some share than on other (Section 93).

(b) No Such Provision

- In the absence of any such provision, Table A would be applicable.
- In such a case the amount of dividend payable will be calculated on the amount paid up on shares, and while doing so, the dates on which the amounts were paid must be taken into account.

- But where the Articles are silent and Table A has been excluded, the amount of dividend payment will have to be calculated on nominal amount of shares.
- According to the Clause 88 of Table A, dividends are to be declared and paid according to the amounts paid or credited as paid on the shares in respect whereof the dividend, is paid but, if and so long as nothing is paid upon any of the shares in the company, dividends may be declared and paid according to the nominal amounts of the shares.
- In the case of fresh issue of capital, the holders thereof, unless precluded by the terms of issue, are entitled to receive dividend *pari passu* with the shares already issued.

6. Calls in Advance

Calls paid in advance do not rank for payment of dividend. Instead, interest may be paid on such calls; the rate of interest is 6% p.a. according to Table A; Articles of a company may prescribe a different rate.

7. Payment :

7.1 Mode of payment

All dividends must be paid in cash [Section 205(3)]; dividend warrants, made payable at a bank are treated as cash.

7.2 Timing

Dividend must be paid within 30 days of declaration.

7.3 The following provisions of law [after the introduction of the Companies (Amendment) Act, 1999 and Companies (Amendment) Act, 2000] should be noted :

(*i*) Where a dividend has been declared by a company but has not been paid, or claimed, within thirty days from the date of the declaration, to any shareholder entitled to the payment of the dividend, the company shall within seven days from the date of expiry of the said period of thirty days, transfer the total amount of dividend which remains unpaid or unclaimed within the said period of thirty days to a special account to be opened by the company in that behalf in any scheduled bank to be called "Unpaid Dividend Account of _ _ _ _ _ Company Limited/Company (Private) Limited.

(*ii*) Any money transferred to the unpaid dividend account of a company in pursuance of this section which remains unpaid or unclaimed for a period of seven years from the date of such transfer shall be transferred by the company to the Fund established under Sub-section (*1*) of Section 205C.".

(*iii*) In Section 205 of the Principal Act after sub-section (1), the following sub-sections have been inserted by the Companies Amendment Act, 2000 namely :

(1A) The Board of Directors may declare interim dividend and the amount of dividend including interim dividend shall be deposited in a separate bank account within five days from the date of declaration of such dividend.

(1B) The amount of dividend including interim dividend so deposited under sub-section (1A) shall be used for payment of interim dividend

(1C) The provisions contained in sections 205, 205A, 205C, 206, 206A and 207 shall, as far as may be, also apply to any interim dividend.

(*iv*) Section 55A (inserted by Companies Amendment Act, 2000) grants power to Securities and Exchange Board of India in respect of the listed companies for the matters relating to issue and transfer of securities and non-payment of dividend.

(*v*) Substitution of new section for 207. – For section 207 of the principal Act, the following section shall be substituted, namely :

7.4 Penalty for failure to distribute dividends within thirty days. –

- Where a dividend has been declared by a company but has not been paid, or the warrant in respect thereof has not been posted, within thirty days from the date of declaration, to any shareholder entitled to the payment of the dividend,
- every director of the company shall, if he is knowingly a party to the default, be punishable with simple imprisonment for a term which may extend to three years and shall also be liable to a fine of one thousand rupees for every day during which such default continues and
- the company shall be liable to pay simple interest at the rate of eighteen per cent per annum during the period for which such default continues :
- Exceptions

Provided that no offence shall be deemed to have been committed within the meaning of the foregoing provisions in the following cases, namely:

(a) where the dividend could not be paid by reason of the operation of any law;

(b) where a shareholder has give directions to the company regarding the payment of the dividend and those directions cannot be complied with;

(c) where there is a dispute regarding the right to receive the dividend;

(d) where the dividend has been lawfully adjusted by the company against any sum due to it from the shareholder; or

(e) where, for any other reason, the failure to pay the dividend or to post the warrant within the period aforesaid was not due to any default on the part of the company.

7.5 Establishment of fund

Under Section 205C (*1*), the Central Government shall establish a fund to be called the Investor Education and Protection Fund (hereafter in this section referred to as the "Fund"). There shall be credited to the Fund the following amounts, namely :

(*a*) amounts in the paid dividend account of companies;

(*b*) the application moneys received by companies for allotment of any securities and due for refund;

(*c*) matured deposits with companies;

(*d*) matured debentures with companies;

(*e*) the interest accrued on the amount referred to in clauses (*a*) to (*d*);

(*f*) grants and donations given to the Fund by the Central Government, State Governments, companies or any other institutions for the purpose of the Fund; and

(*g*) the interest or other income received out of the investments made from the Fund:

- Exception

  Provided that no such amounts referred to in clauses (*a*) to (*d*) shall form part of the Fund unless such amounts have remained unclaimed and unpaid for a period of seven years from the date they became due for payment.

- Maximum period of fund

  For the removal of doubts, it is hereby declared that no claims shall lie against the Fund or the company in respect of individual amounts which were unclaimed and unpaid for a period of seven years from the dates that they first became due for payment and no payment shall be made in respect of any such claims.

- Utilization

  The Fund shall be utilised for promotion of investor awareness and protection of the interests of investors in accordance with such rules as may be prescribed.

Dividend Distribution Tax

1. Meaning

(a) The Finance Act, 1997, has introduced Chapter XIID (Sections 115O and 115Q) on "Special Provisions Relating to Tax on Distributed profits of Domestic Companies"

[Hereinafter referred to as 'DDT' (Dividend Distribution tax)]. The ICAI has issued Guidance Note on Accounting for Dividend Distribution tax.

(b) The salient features of DDT are as below:

(i) DDT is in addition to the income-tax chargeable in respect of the total income of a domestic company.

(ii) DDT is chargeable on any amount declared, distributed or paid by such company by way of dividends (whether interim or otherwise).

(iii) The dividends chargeable to DDT may be out of the current profits or accumulated profits.

(iv) The rate of DDT is fifteen per cent (excluding surcharge plus education Cess).

(v) DDT shall be payable even if no income-tax is payable by the domestic company on its total income.

(vi) DDT is payable to the credit of the Central Government within 14 days of

(a) declaration of any dividend,

(b) distribution of any dividend, or

(c) payment of any dividend.

whichever is the earliest.

(vii) DDT paid shall be treated as the final payment of tax on the dividends and no further credit therefore shall be claimed by the company or by any person in respect of the tax so paid.

(vii) The expression 'dividend' shall have the same meaning as is given to 'dividend' in clause (22) of Section 2 but shall not include sub-clause (e) thereof.

2. Accounting for DDT

- According to generally accepted accounting principles, the provision for dividend is recognised in the financial statements of the year to which the dividend relates.
- In view of this, DDT on dividend, being directly linked to the amount of the dividend concerned, should also be reflected in the accounts of the same financial year even though the actual tax liability in respect thereof may arise in a different year.

3. Disclosure and Presentation of DDT in Financial Statements

- It is noted that clause 3(vi) of Part II of Schedule VI to the Companies Act, 1956, requires the disclosure of "the amount of charge for Indian Income-tax and other Indian taxation on profits, including, where practicable, with Indian income-tax any taxation imposed elsewhere to the extent of the relief, if any, from Indian income-tax and distinguishing, where practicable, between income-tax and other taxation."

- It is also noted that Part II of Schedule VI only lays down the information to be disclosed in the profit and loss account.
- However, as a matter of convention and to improve readability, the information in the profit and loss account is generally shown in two parts, viz., the first part contains the information which is required to arrive at the figure of the current year's profit-often referred to as 'above the line', and
- The second part which discloses, inter alia, information involving the appropriations of the current year's profits - often referred to as 'below the line'.
- Since dividends are disclosed 'below the line', a question arises with regard to disclosure and presentation of DDT, as to whether the said tax should also be disclosed `below the line' or should be disclosed along with the normal income-tax provision for the year `above the line'.
- The liability in respect of DDT arises only if the profits are distributed as dividends whereas the normal income-tax liability arises on the earning of the taxable profits
- Since the DDT liability relates to distribution of profits as dividends which are disclosed `below the line', it is appropriate that the liability in respect of DDT should also be disclosed `below the line' as a separate item.
- It is felt that such a disclosure would give a proper picture regarding payments involved with reference to dividends.
- DDT liability should be recognised in the accounts of the same financial year in which the dividend concerned is recognised.
- DDT liability should be disclosed separately in the profit and loss account, 'below the line', as follows:

Dividend	xxxxx	
Dividend Distribution tax thereon	xxxxx	xxxxx

- Provision for Dividend Distribution tax should be disclosed separately under the head 'Provisions' in the balance sheet.
- The accounting treatment for Dividend Distribution tax in the financial statements of a company can be explained with the help of following example:

X Co. Ltd. proposed dividend amounting to ₹ 500 lacs for the year ended 31st March, 2011. The Dividend Distribution tax liability of ₹ 50 lacs arises as per sections 115 O and 115 Q of the Income-tax Act. In this case, the charge for DDT should be disclosed separately in the Profit and Loss Account, below the line as given below:

Profit and Loss Account
for the year ended 31st March, 2011

	₹ (lacs)	₹ (lacs)
Proposed Dividend	500	
Dividend Distribution tax	50	550

The provision for Dividend Distribution tax should be disclosed separately under, the head 'Short Term Provisions'. The relevant extracts of the Balance Sheet of X Co. Ltd. can be shown as follows:

Balance Sheet as on 31st March, 2011

Short term provisions

Proposed Dividend	500
Dividend Distribution tax	50

Illustration 4

The following are the balances from the Ledger of Mount View Hotel Ltd., on 31st March 2012:

	₹
Share Capital - Credit Balance on 1st January, 2012	*56,685*
Preliminary Expenses	*7,500*
Freehold Premises	*46,800*
Furniture and Fittings	*8,934*
Glass and China	*1,101*
Linen	*840*
Cutlery and Plate	*390*
Rates, Taxes and Insurance	*1,713*
Salaries	*2,400*
Wages	*4,305*
Stocks on 31st March, 2011 :	
Wines, ₹ 1,239 ; Spirits, ₹ 378 ; Beer, ₹ 165 ;	*1,782*
Minerals, ₹ 147 ; Cigars and Cigarettes, ₹ 114	*261*
Sundry Provisions and Stores, ₹ 183; Coal, ₹ 150	*333*
Purchases :	
Meat, ₹ 3,627 ; Fish and Poultry ₹ 3,960	*7,587*
Sundry Provisions and Stores, ₹ 5,220	*5,220*
Wines ₹ 1,881 ; Spirits ₹ 2,190 ; Beer ₹ 1,152	*5,223*
Minerals, ₹ 1,050 : Cigars and Cigarettes, ₹ 240	*1,290*
Laundry	*951*

Coal and Gas	*2,160*
Electric Light	*1,128*
General Expenses	*1,710*
Sales —	
Wines, ₹ 3,870 ; Spirits, ₹ 4,335 ; Beer, ₹ 1,863	*10,068*
Minerals, ₹ 2,160 ; Cigars and Cigarettes, ₹ 390	*2,550*
Meals	*23,829*
Rooms	*9,375*
Fires in Bedrooms	*582*
Washing Charges	*219*
Repairs, Renewals, and Depreciation -	
Premises, ₹ 348 ; Furniture and Fittings, ₹ 660	*1,008*
Glass and China, ₹ 609 ; Linen, ₹ 390	*999*
Cutlery and Plate	*207*
Cash Book - Debit Balances:	*₹*
In Bank	*2,148*
On hand	*219*
Visitors Accounts unpaid	*489*
Sundry Creditors	*3,390*

Stocks on 31st March, 2012 were valued as follows -

Wines, ₹ 1,197; Spirits, ₹ 333 ; Beer, ₹ 174 ;

Minerals, ₹ 357 ; Cigars and Cigarettes, ₹ 69 ;

Sundry Provisions and Stores, ₹ 141 ; Coal, ₹ 99

The Manager is entitled to a commission of 5% of the net profits after charging his commission. The authorised share capital is 10,000 shares of ₹ 10 each of which 5,700 shares were issued, the whole of the amount being called up. The final call on 210 shares @ ₹ 1.50 per share was unpaid ; the directors forfeited these shares at their meeting held on 15th March, 2012.

The tax liability is estimated at ₹ 4,300 and the directors propose to declare a dividend at the rate of 6 per cent. Prepare the Final Accounts for presentation to the shareholders.

Solution:

Balance Sheet of Mount-View Hotel Ltd., as on 31st March, 2012

		Particulars	Note No	Rs.
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	56,685

	b	Reserves and Surplus	2	2,282.6
2		**Current liabilities**		
	a	Trade Payables	3	3,900
	b	Short-term provisions	4	7,923.4
		Total		**70,791**
		Assets		
1		**Non-current assets**		
	a	Fixed assets		
	i	Tangible assets	5	55,734
2		**Current assets**		
	a	Inventories	6	4,701
	b	Trade receivables		489
	c	Cash and cash equivalents	7	2,367
	e	Other current assets	8	7,500
		Total		**70,791**

Profit and Loss Account of Mount-View Hotel Ltd.,

for the year ended 31st March, 2012

	Particulars		**Notes**	**Rs.**
I.	Revenue from operations	(A)	9	46,623.0
II	Expenses:			
	Cost of materials consumed		10	7,587.0
	Purchases of Stock-in-Trade		11	11,733.0
	Changes in inventories of finished goods work-in-progress and Stock-in-Trade		12	6.0
	Employee benefits expense		13	2,910.0
	Other operating expenses		14	10,758.0
	Administrative and general expenses		15	3,423.0
	Total expenses	**(B)**		**36,417.0**
III	Profit before tax (VII- VIII)	(A – B)		**10,206.0**
IV	Provision for tax			4,300.0
V	**Profit (Loss) for the period**			**5,906.0**
VI	Proposed Dividend			3,294.0
	Dividend Distribution tax (3,294 ×0.10)			329.4
VII	**Profit (Loss) carried forward to Balance Sheet**			**2,282.6**

Notes to accounts

			Rs.
1	**Share Capital**		
	Equity share capital		
	Authorised		
	10,000 Shares of Rs. 10 each		100,000
	Issued & subscribed & called up		
	5,490 Equity Shares of Rs. 10 each	54,900	
	Forfeited Shares	1,785	56,685
	Total		**56,685**
2	**Reserves and Surplus**		
	Surplus (Profit & Loss A/c)		2,282.6
	Total		**2,282.6**
3	**Trade Payables**		
	Sundry Creditors		3,390
	Manager's Commission Outstanding		510
	Total		**3,900**
4	**Short-term provisions**		
	Provision for taxation		4,300
	Proposed Dividend		3,294
	Dividend Distribution tax		329.4
	Total		**7,923.4**
5	**Tangible assets**		
	Freehold Premises	47,148	
	Less: Depreciation	(348)	46,800
	Furniture & Fittings	9,594	
	Less: Depreciation	(660)	8,934
	Total		**55,734**

6	**Inventories**		
	Raw Material		
	Wines, Spirits & Beer	1,704	
	Minerals, Cigars & Cigarettes	426	
	Sundry Provisions & Stores and Coal	240	2,370
	Loose tools		
	Linen	1,230	
	Less: Depreciation	(390)	840
	Cutlery & Plate	597	
	Less: Depreciation	(207)	390
	Glass & China	1,710	
	Less: Depreciation	(609)	1,101
	Total		**4,701**
7	**Cash and cash equivalents**		
	Cash at bank		2,148
	Cash in hand		219
	Total		**2,367**
8	**Other current assets**		
	Preliminary expenses		7,500
	Total		**7,500**
9	**Revenue from operations**		
	Sale of products		
	Wines, Spirits, Beer	10,068	
	Minerals, Cigars and Cigarettes	2,550	12,618.0
	Sale of services		
	Meals	23,829	
	Rooms	9,375	
	Fires in Bed Rooms	582	
	Washing Charges	219	34,005.0
	Total		**46,623.0**
10	**Cost of materials consumed**		
	Meat, Fish and Poultry		7,587.0
	Total		7,587.0

11	**Purchases of Stock-in-Trade**		
	Wines, Spirits, Beer		5,223.0
	Minerals, Cigars & Cigarettes		1,290.0
	Sundry Provisions & Stores		5,220.0
	Total		**11,733.0**
12	**Changes in inventories of finished goods work-in-progress and Stock-in-Trade**		
	Opening stock		
	Wines, Spirit & Beer	1,782	
	Minerals, Cigars & Cigarettes	261	
	Sundry Provisions & Stores and Coal	333	2,376.0
	Less: Closing Stock		
	Wines, Spirit & Beer	(1,704)	
	Minerals, Cigars & Cigarettes	(426)	
	Sundry Provisions & Stores and Coal	(240)	(2,370.0)
	Total		**6.0**
13	**Employee benefits expense**		
	Salaries		2,400.0
	Manager's commission (on Rs. 10,206 @ 5%)		510.0
	Total		**2,910.0**
14	**Other operating expenses**		
	Wages		4,305.0
	Coal and Gas		2,160.0
	Laundry		951.0
	Electricity Light		1,128.0
	Repairs, Renewals and Depreciation		
	Premises	348	
	Furniture & Fittings	660	
	Glass and China	609	
	Linen	390	
	Cutlery & Plate	207	2,214.0
	Total		**10,758.0**

15	**Administrative and general expenses**		
	Rates, Taxes and Insurances		1,713.0
	General Expenses		1,710.0
		Total	**3,423.0**

Illustration 5

The following balances have been extracted from the books of DOW Books Limited as on 31st March, 2012.

Dr.	₹		*Cr.* ₹
Cash in hand	*3,800*	*Share Capital*	*90,000*
Cash at Bank	*12,600*	*9% Debentures*	*30,000*
Bills Receivable	*4,000*	*Sundry Creditors*	*29,000*
Investment	*1,000*	*Profit and Loss A/c*	*2,000*
Security Deposit	*400*	*Secured Loan from bank*	
Advances	*8,500*	*against stock*	*50,000*
Debtors	*75,000*	*Gross Profit*	*1,75,000*
Land and Buildings	*1,05,000*	*Share Suspense*	*3,000*
Furniture	*4,500*	*Liabilities for expenses*	*12,000*
Motor Car	*25,000*	*Sale of Furniture*	*300*
Closing Stock	*95,000*	*Bills Payable*	*3,100*
Establishment expenses	*35,200*	*Miscellaneous Receipts*	*425*
Repairs and renewals	*2,600*		
Motor Car Expenses	*4,200*		
Travelling and Conveyance	*1,600*		
Printing and Stationery	*900*		
Telephone	*1,200*		
Debenture Interest	*2,025*		
Commission on sales	*3,200*		
Advertisement	*3,500*		
Managing Director's remuneration	*3,600*		
Directors fees	*2,000*		
	3,94,825		*3,94,825*

The following further particulars are available:

(1) Amount of share capital has been arrived at as follows -

9,200 equity shares of ₹ 10 each, fully called up	*92,000*
Less : Calls-in-arrear @ ₹ 2 on 1,000 shares	*2,000*
	90,000

(2) The Profit and Loss Account balance has been arrived at after charging ₹ 5,000 on account of short provision of taxation for the earlier year.

(3) A Bank advice, for debit of ₹ 710 on account of interest on loan upto 31st March 2012, was received on 5th April, 2012 the loan having been taken on 1st March, 2012.

(4) The Bank statement shows a wrong credit of ₹ 3,000 on 16th March 2012, the same being detected and adjusted by the Bank on 30th April 2012.

(5) The 1,000 shares, on which calls were forfeited by the Board, and Share Suspense represents the amount received on their reissue, as fully paid, by Board's resolution.

(6) Sale of furniture represents disposals, during the year, of a few old items of furniture having a written-down value of ₹ 400 on 30th September 2012, against their original cost of ₹ 800.

(7) Cost of land ₹ 30,000 is included in the amount of land and buildings.

(8) Sundry debtors, which are all unsecured and considered goods, include ₹ 10,000 due for more than six months.

(9) Advertisement charges include materials of ₹ 1,500.

(10) Advances include ₹ 3,000 paid for a new telephone installed during the year under the OYT Scheme, of which an amount of ₹ 150 has been set off against the current year's bills.

(11) Amounts of ₹ 2,000 and ₹ 1,200 debited to purchases and wages respectively, were for making new furniture during the year.

(12) Investment represents purchase of 200 equity shares of ₹ 10 each, ₹ 5 per share called and paid up.

(13) Charge depreciation on the closing written down amount of -

Buildings	*@ 2.5%*
Furniture	*@ 10%*
Motor Car	*@ 20%*

(14) Original costs of fixed assets were -

	₹
Buildings	*1,00,000*
Furniture	*9,000*
Motor Car	*35,000*

(15) The Managing Director is entitled to 5% of the annual net profits as his remuneration, subject to a minimum of ₹ 300 per month. The net profits, for this purpose, are to be taken without charging income-tax and his remuneration itself.

(16) Bills discounted not matured ₹ 1,500.

(17) Provision for income-tax is to be made, for the year, of ₹ 65,000.

(18) The following appropriations have been proposed by the Board of Directors out of the profit for the year -

(a) Transfer of ₹ 20,000 to General Reserve.

(b) Dividend of 12% on the paid-up capital.

(19) Debentures were issued two years back, and are not secured.

You are required to prepare the Profit and Loss Account for the year ended 31st March, 2012 and the Balance as on that date. Ignore previous year's figures.

Solution:

DOW Books Ltd.

Profit and Loss Account for the Year ended 31st March, 2012

Particulars	**Notes**	**Amount**
Gross profit from operations		1,75,000
Other income		425
Total revenue		**1,75,425**
Expenses:		
Employee benefits expense	12	7,723
Other operating expenses	13	43,600
Selling and administrative expenses	14	4,250
Finance costs	15	3,410
Depreciation and amortization expense	16	7,605
Other expenses	17	100
Total expenses		**66,688**
Profit before tax		**1,08,737**
Provision for tax		65,000
Short Provision for Income tax in the previous year*		5,000
Profit (Loss) for the period		**38,737**
Balance from previous year		7,000
Less: Transfer to General Reserve (porposed)		20,000
Proposed Dividend		11,040
Dividend Distribution tax (3,294 ×0.10)		1,104
Profit (Loss) carried forward to Balance Sheet		**13,593**

*The excess tax liability is to be considered as change in accounting estimate and the effect of such change should be included in the determination of net profit or loss of the affected period, in accordance with para 23 of AS 5 (Revised).

Note on Remuneration to Managing Director:	₹
Profit as disclosed	43,737
Add : Provision for Taxation	65,000
Managing Director's Remuneration	5,723
Profit before calculating the Remuneration	1,14,460
Remuneration @ 5%	5,723

Balance Sheet of DOW Books Ltd., as at 31st March, 2012

			Particulars	Note No	Rs.
			Equity and Liabilities		
1			**Shareholders' funds**		
	a		Share capital	1	92,000
	b		Reserves and Surplus	2	34,593
2			**Non-current liabilities**		
	a		Long-term borrowings	3	80,000
3			**Current liabilities**		
	a		Trade Payables	4	46,223
	b		Other current liabilities	5	1,385
	c		Short-term provisions	6	77,144
			Total		**3,31,345**
			Assets		
1			**Non-current assets**		
	a		Fixed assets		
		i	Tangible assets	7	1,29,695
	b		Non-current investments	8	1,000
2			**Current assets**		
	a		Inventories		95,000
	b		Trade receivables	9	75,000
	c		Cash and cash equivalents	10	16,400
	d		Short-term loans and advances	11	14,250
			Total		**3,31,345**

Note : There is contingent liability for calls that may be made on partly paid shares, ₹ 1,000 and for Bills under discount, ₹ 1,500.

Notes to accounts

			Rs.
1	**Share Capital**		
	Equity share capital		
	Issued & subscribed & paid up		
	9,200 Equity Shares of Rs. 10 each fully paid		92,000
		Total	**92,000**
2	**Reserves and Surplus**		
	Capital reserve		1,000
	General reserve (proposed transfer)		20,000
	Surplus (Profit & Loss A/c)		13,593
		Total	**34,593**
3	**Long-term borrowings**		
	Secured		
	Loan from bank (secured against stock)		50,000
	Unsecured		
	9% Debentures		30,000
		Total	**80,000**
4	**Trade Payables**		
	Sundry Creditors		43,123
	Bills Payable		3,100
		Total	**46,223**
5	**Other current liabilities**		
	Interest due on bank loan		710
	Interest accrued on debentures		675
		Total	**1,385**
6	**Short-term provisions**		
	Provision for taxation		65,000
	Proposed Dividend		11,040
	Dividend Distribution tax		1,104.0
		Total	**77,144**

7	**Tangible assets**			
	Land			30,000
	Building		100,000	
	Less: Depreciation		(26,875)	73,125
	Furniture		9,000	
	Less: Disposed off		(800)	
	Add: Addition during the year		3,200	
	Less: Depreciation		(4,830)	6,570
	Motor Car		35,000	
	Less: Depreciation		(15,000)	20,000
		Total		**129,695**
8	**Non-current investments**			
	Other investments			
	Partly paid shares			1,000
		Total		**1,000**
9	**Trade receivables**			
	Unsecured but considered good			
	More than6 months		10,000	
	Others		65,000	75,000
		Total		**75,000**
10	**Cash and cash equivalents**			
	Cash at bank			12,600
	Cash in hand			3,800
		Total		**16,400**
11	**Short-term loans and advances**			
	Bills Receivable			4,000
	Deposits			8,350
	Advertisement material on hand			1,500
	Security Deposit			400
		Total		**14,250**
12	**Employee benefits expense**			
	Managing Director's Remuneration			5,723
	Directors' Fees			2,000
		Total		**7,723**

13	**Other operating expenses**		
	Establishment Expenses		35,200
	Repairs, Renewals		2,600
	Motor Car Expenses		4,200
	Travelling & Conveyance		1,600
		Total	**43,600**
14	**Selling and administrative expenses**		
	Sales Commission		3,200
	Advertisement		2,000
	Printing & Stationery		900
	Telephone		1,350
	Cost of furniture (to be capitalised)		(3,200)
		Total	**4,250**
15	**Finance costs**		
	Debenture Interest		2,700
	Bank Interest		710
		Total	**3,410**
16	**Depreciation and amortization expense**		
	Buildings		1,875
	Furniture & Fittings		730
	Motor Car		5,000
		Total	**7,605**
17	**Other expenses**		
	Loss on sale of furniture		100
		Total	**100**

Working Notes :

(*i*) ₹ 710, interest due to Bank, may also be adjusted against the bank balance, specially when the Bank is entitled to debit to company's accounts under the Loan Agreement.

(*ii*) The wrong credit given by the Bank, subsequently adjusted, is only an item for the Bank Reconciliation Statement.

(*iii*) The Share Suspense Account has a balance of ₹ 1,000 after adjustment of the amount in arrear. It has to be credited to Capital Reserve.

(*iv*) ₹ 150 out of OYT deposit has to be treated as telephone charges.

(*v*) Previous year's figures have not been given since these are not available. Stastical information required to be disclosed under Schedule VI has also not been given for the same reason.

Illustration 6

You are required to prepare a Profit and Loss Account and Balance Sheet from the following Trial Balance extracted from the books of the International Hotels Ltd., on 31st March, 2012:

	Dr. ₹	Cr. ₹
Authorised Capital-divided into 5,000 6% Preference Shares of ₹ 100 each and 10,000 equity Shares of ₹ 100 each		15,00,000
Subscribed Capital -		
5,000 6% Preference Shares of ₹ 100 each		5,00,000
Equity Capital		8,05,000
Purchases - Wines, Cigarettes, Cigars, etc.	45,800	
- Foodstuffs	36,200	
Wages and Salaries	28,300	
Rent, Rates and Taxes	8,900	
Laundry	750	
Sales - Wines, Cigarettes, Cigars, etc.		68,400
- Food		57,600
Coal and Firewood	3,290	
Carriage and Cooliage	810	
Sundry Expenses	5,840	
Advertising		8,360
Repairs	4,250	
Rent of Rooms		48,000
Billiard		5,700
Miscellaneous Receipts		2,800
Discount received		3,300
Transfer fees		700
Freehold Land and Building	8,50,000	
Furniture and Fittings	86,300	
Stock on hand, 1st April, 2011		
Wines, Cigarettes. Cigars,etc.	12,800	
Foodstuffs	5,260	
Cash in hand	2,200	
Cash with Bankers	76,380	
Preliminary and formation expenses	8,000	

2,000 Debentures of ₹ 100 each (6%)			*2,00,000*
Profit and Loss Account			*41,500*
Sundry Creditors			*42,000*
Sundry Debtors		*19,260*	
Investments		*2,72,300*	
Goodwill at cost		*5,00,000*	
General Reserve			*2,00,000*
		19,75,000	*19,75,000*
Wages and Salaries Outstanding	*1,280*		
Stock on 31st March, 2012			
Wines Cigarettes and Cigars, etc.	*22,500*		
Foodstuffs	*16,400*		

Depreciation :

Furniture and Fittings @ 5% p.a. : Land and Building @ 2% p.a.

The Equity capital on 1st April, 2011 stood at ₹ 7,20,000, that is 6,000 shares fully paid and 2,000 shares ₹ 60 paid. The directors made a call of ₹ 40 per share on 1st October 2011. A shareholder could not pay the call on 100 shares and his shares were then forfeited and reissued @ ₹ 90 per share as fully paid. The Directors propose a dividend of 8% on equity shares, transferring any amount that may be required from General Reserve. Ignore Taxation.

Solution

Profit and Loss Account of International Hotels Ltd.
for the year ended 31st March, 2012

	Particulars	Notes	Amount
I.	Revenue from operations	**10**	183,200
II.	Other income (Discount received)		3,300
III.	**Total Revenue (I + II)**		**186,500**
IV.	**Expenses:**		
	Cost of materials consumed	**11**	25,060
	Purchases of Stock-in-Trade	**12**	45,800
	Changes in inventories of finished goods work-in-progress and Stock-in-Trade	**13**	(9,700)
	Employee benefits expense	**14**	29,580
	Other operating expenses	**15**	18,000
	Selling and administrative expenses	**16**	14,200
	Finance costs	**17**	12,000
	Depreciation and amortization expense	**18**	21,315
	Total expenses		**156,255**

V.	**Profit (Loss) for the period (III - IV)**	**30,245**
	Balance from previous year	41,500
	Transfer from General Reserve	22,255
	Less: Proposed Dividend	94,000
	Profit (Loss) carried forward to Balance Sheet	**0**

Balance Sheet of International Hotels Ltd. as on 31st March, 2012

			Particulars	Note No	Rs.
			Equity and Liabilities		
1			**Shareholders' funds**		
	a		Share capital	1	13,00,000
	b		Reserves and Surplus	2	1,82,745
2			**Non-current liabilities**		
	a		Long-term borrowings	3	2,00,000
	b		Other long term liabilities (Interest on debentures)		12,000
3			**Current liabilities**		
	a		Trade Payables	4	43,280
	b		Short-term provisions	5	94,000
			Total		**18,32,025**
			ASSETS		
1			**Non-current assets**		
	a		Fixed assets		
		i	Tangible assets	6	9,14,985
		ii	Intangible assets (Goodwill)		5,00,000
	b		Non-current investments		2,72,300
2			**Current assets**		
	a		Inventories	7	38,900
	b		Trade receivables		19,260
	c		Cash and cash equivalents	8	78,580
	d		Other current assets	9	8,000
			Total		**18,32,025**

Notes to accounts

			Rs.
1	**Share Capital**		
	Equity share capital		
	Authorised		
	10,000 Equity shares of Rs 100 each		10,00,000
	Issued & subscribed		
	8,000 Equity Shares of Rs. 100 each		8,00,000
	Preference share capital		
	Authorised		
	5,000 6% Preference shares of Rs 100 each		5,00,000
	Issued & subscribed		
	5,000 6% Preference shares of Rs 100 each		5,00,000
	Total		**13,00,000**
2	**Reserves and Surplus**		
	Capital reserve		5,000
	General reserve	2,00,000	
	Less : Amount used to pay dividend	(22,255)	1,77,745
	Total		**1,82,745**
3	**Long-term borrowings**		
	Secured		
	6% Debentures		200,000
	Total		**200,000**
4	**Trade Payables**		
	Sundry Creditors		42,000
	Wages and Salaries Outstanding		1,280
	Total		**43,280**
5	**Short-term provisions**		
	Proposed dividend		
	Preference Dividend		30,000
	Equity Dividend		64,000
	Total		**94,000**

6	**Tangible assets**			
	Freehold land & Buildings		8,50,000	
	Less: Depreciation		(17,000)	8,33,000
	Furniture and Fittings		86,300	
	Less: Depreciation		(4,315)	81,985
		Total		**9,14,985**
7	**Inventories**			
	Wines, Cigarettes & Cigars, etc.			22,500
	Foodstuffs			16,400
		Total		**38,900**
8	**Cash and cash equivalents**			
	Cash at bank			76,380
	Cash in hand			2,200
		Total		**78,580**
9	**Other current assets**			
	Preliminary Expenses			8,000
		Total		**8,000**
10	**Revenue from operations**			
	Sale of products			
	Wines, Cigaretters, Cigars etc.		68,400	
	Food		57,600	1,26,000
	Sale of services			
	Room Rent		48,000	
	Billiards		5,700	
	Miscellaneous Receipts		2,800	
	Transfer fees		700	57,200
	Total			**1,83,200**
11	Cost of materials consumed			
	Opening Stock		5,260	
	Add: Purchases during the year		36,200	
	Less: Closing stock		(16,400)	25,060
	Total			**25,060**

12	Purchases of Stock-in-Trade		
	Wines, Cigarettes etc.		45,800
	Total		**45,800**
13	Changes in inventories of finished goods work-in-progress and Stock-in-Trade		
	Wines, Cigarettes etc.		
	Opening stock	12,800	
	Less: Closing Stock	(22,500)	(9,700)
	Total		**(9,700)**
14	Employee benefits expense		
	Wages and Salaries	28,300	
	Add: Wages and Salaries Outstanding	1,280	29,580
	Total		**29,580**
15	Other operating expenses		
	Rent, Rates and Taxes		8,900
	Coal and Firewood		3,290
	Laundry		750
	Carriage and Cooliage		810
	Repairs		4,250
	Total		**18,000**
16	Selling and administrative expenses		
	Advertising		8,360
	Sundry Expenses		5,840
	Total		**14,200**
17	Finance costs		
	Interest on Debentures		12,000
	Total		**12,000**
18	Depreciation and amortization expense		
	Land and Buildings	17,000	
	Furniture & Fittings	4,315	21,315
	Total		**21,315**

Illustration 7

From the following particulars furnished by Pioneer Ltd., prepare the Balance Sheet as at 31st March, 2012 as required by Part I, Schedule VI of the Companies Act. Give notes at the foot of the Balance Sheet as may be found necessary -

		Debit	Credit
		₹	₹
Equity Capital (Face value of ₹ 100)			10,00,000
Calls in Arrears		1,000	
Land		2,00,000	
Building		3,50,000	
Plant and Machinery		5,25,000	
Furniture		50,000	
General Reserve			2,10,000
Loan from State Financial Corporation			1,50,000
Stock :			
Finished Goods	2,00,000		
Raw Materials	50,000	2,50,000	
Provision for Taxation			68,000
Sundry Debtors		2,00,000	
Advances		42,700	
Proposed Dividend			60,000
Profit and Loss Account			1,00,000
Cash Balance		30,000	
Cash at Bank		2,47,000	
Preliminary Expenses		13,300	
Loans (Unsecured)			1,21,000
Sundry Creditors (For Goods and Expenses)			2,00,000
		19,09,000	19,09,000

The following additional information is also provided :

(1) *Miscellaneous expenses included ₹ 5,000 audit fees and ₹ 700 for out of pocket expenses paid to the auditors.*

(2) *2,000 equity shares were issued for consideration other than cash.*

(3) *Debtors of ₹ 52,000 are due for more than six months.*

(4) *The cost of assets:*

Building	₹ 4,00,000
Plant and Machinery	₹ 7,00,000
Furniture	₹ 62,500

(5) The balance of ₹ 1,50,000 in the loan account with State Finance Corporation is inclusive of ₹ 7,500 for interest accrued but not due. The loan is secured by hypothecation of the Plant and Machinery.

(6) Balance at Bank includes ₹ 2,000 with Perfect Bank Ltd., which is not a Scheduled Bank.

(7) Bills receivable for ₹ 2,75,000 maturing on 30th June, 2012 have been discounted.

(8) The company had contract for the erection of machinery at ₹ 1,50,000 which is still incomplete.

Solution :

Pioneer Ltd.
Balance Sheet as on 31st March, 2012

		Particulars	Notes	Rs.
		Equity and Liabilities		
1		**Shareholders' funds**		
	a	Share capital	1	9,99,000
	b	Reserves and Surplus	2	3,10,000
2		**Non-current liabilities**		
	a	Long-term borrowings	3	2,63,500
3		**Current liabilities**		
	a	Trade Payables		2,00,000
	b	Other current liabilities	4	7,500
	c	Short-term provisions	5	1,28,000
		Total		**19,08,000**
		Assets		
1		**Non-current assets**		
	a	Fixed assets		
		Tangible assets	6	11,25,000
2		**Current assets**		
	a	Inventories	7	2,50,000
	b	Trade receivables	8	2,00,000
	c	Cash and cash equivalents	9	2,77,000
	d	Short-term loans and advances		42,700
	e	Other current assets	10	13,300
		Total		**19,08,000**

Notes to accounts

			Rs.
1	**Share Capital**		
	Equity share capital		
	Issued & subscribed & called up 10,000 Equity Shares of Rs. 100 each (Of the above 2,000 shares have been issued for consideration other than cash)	10,00,000	
	Less: Calls in arrears	(1,000)	9,99,000
	Total		**9,99,000**
2	**Reserves and Surplus**		
	General Reserve		2,10,000
	Surplus (Profit & Loss A/c)		1,00,000
	Total		**3,10,000**
3	**Long-term borrowings**		
	Secured		
	Term Loans Financial Corporation (Secured by hypothecation of Plant and Machinery)		1,42,500
	Unsecured		1,21,000
	Total		**2,63,500**
4	**Other current liabilities**		
	Interest accrued but not due on loans (SFC)		7,500
	Total		**7,500**
5	**Short-term provisions**		
	Provision for taxation		68,000
	Proposed Dividend		60,000
	Total		**1,28,000**
6	**Tangible assets**		
	Land		2,00,000
	Buildings	4,00,000	
	Less: Depreciation	(50,000)	3,50,000
	Plant & Machinery	7,00,000	
	Less: Depreciation	(1,75,000)	5,25,000

	Furniture & Fittings	62,500	
	Less: Depreciation	(12,500)	50,000
	Total		**11,25,000**
7	**Inventories**		
	Raw Material		50,000
	Finished goods		2,00,000
	Total		**2,50,000**
8	**Trade receivables**		
	Debts outstanding for a period exceeding six months		52,000
	Other Debts		1,48,000
	Total		**2,00,000**
9	**Cash and cash equivalents**		
	Cash at bank		
	with Scheduled Banks	2,45,000	
	with others (Perfect Bank Ltd.)	2,000	2,47,000
	Cash in hand		30,000
	Total		**2,77,000**
10	**Other current assets**		
	Preliminary expenses		13,300
	Total		**13,300**

Notes:

(*a*) Estimated amount of contract remaining to be executed on capital account and not provided for ₹ 1,50,000.*

(*b*) Bills receivable discounted maturing on 31st June, 2012 amount to ₹ 2,75,000.

* It has been assumed that the company had given this contract for purchase of machinery.

Summary

1. Meaning of Company has been defined in section 3 of companies act 1956
2. Books of accounts should be maintained at Registered office of company unless BOD otherwise decide.
3. In case of Branch office proper books should be kept at intervals of not more than 3 months.

4. Proper books are not deemed to be kept if they do not provide a true and fair view of state of affairs of company.
5. A number of Statutory Books have been prescribed under Companies' Act which is to be maintained along with statistical books to keep a record of all transactions.
6. Annual Return is to be filed by every company having a share capital within 60 days of holding AGM.
7. Final accounts include balance sheet and profit and loss account in case of entity carrying on business for profit and income and expenditure instead of profit and loss account in case of business not carrying on for profit.
8. They should give a true and fair view of state of affairs of company.
9. Balance sheet may be prepared either in horizontal form or vertical form where as no format is prescribed for profit and loss account.
10. Off lately presentation of final accounts is being done in a summarized form as per which figures of income and expenditure, assets and liabilities grouped under main heads are shown in the profit and loss account and the balance sheet and their details and other information requiring disclosure are also disclosed in summarized form.
11. Managerial Remuneration calculated as a percentage on profit and is governed by various sections of the Companies Act, 1956 and also Schedule XIII of the Companies Act, 1956.
12. Following things have been dealt with under various sections :
    (a) Overall maximum managerial remuneration payable
    (b) Managerial remuneration in case of absence or inadequacy of profits
    (c) Remuneration payable to whole-time directors and part-time directors
    (d) Ascertaining net profit of company
    (e) Remuneration of manager
13. Determining amount of profits available for distribution is an important function and depends on a number of factors, like their composition, the amount of provisions and appropriations that must be made out of them in priority, etc.
14. Capital cannot be returned to shareholders by way of dividend.
15. Appropriating a part of profits may be done as a result of decision of BOD or as per law. Though percentages have been prescribed but voluntary transfer in excess of that is permitted.
16. Dividend may be declared out of reserves subject to certain conditions.
17. Interest on capital may be paid in certain cases subject to approval of government

specially in projects involving long gestation period.

18. Part II of Schedule VI of the Companies Act prescribe the appropriations to be shown In the Profit and Loss Account of the year: which includes amounts provided for:
    (i) Repayment of share capital; and
    (ii) Repayment of loans [clause (vii)].
19. Capital reserves include reserves which are not intended for distribution and include profit prior to incorporation, on sale of fixed assets profit on reissue of forfeited shares, credit balance in capital reduction account. In short only profits or a surplus of a capital nature can be credited to such a reserve.
20. Dividend implies distribution of divisible profit of a company among the members according to the number of shares held by each of them in the capital of the company and the rights attaching thereto.
21. Declaration is done in the annual general meeting on the basis of the recommendation of the Board of Directors.
22. Payment of interim dividend is done on basis of decision of BOD.
23. Holders of preference shares are entitled to receive a dividend at a fixed rate before any dividend is declared on equity shares.
24. Dividend on partly paid shares is done as per articles of company and in its absence as per table A
25. Payment must be done with within 30 days of declaration and separate provisions are applicable in case of non payment including penalty for non compliance with the given provisions
26. Dividend Distribution Tax is the amount charged on amount declared as dividend distributed or paid by such company by way of dividends (whether interim or otherwise)
27. It shall be treated as the final payment of tax on the dividends and no further credit therefore shall be claimed by the company or by any person in respect of the tax so paid.
28. As far as disclosure is concerned income tax and other taxation shall be separately shown
29. Dividend Distribution Tax liability is generally shown as below the line item should be recognized in the accounts of the same financial year in which the dividend concerned is recognized
30. Dividends cannot be declared except out of profits
31. Capital cannot be returned to the shareholders by way of dividend

Unit – 2 : Cash Flow Statement

Learning Objectives

After studying this unit, you will be able to:

- Define cash low statement as per AS 3
- Differentiate operating, investing and financing activities
- Learn the various elements of cash and cash equivalents
- Prepare cash flow statement both by direct method and indirect method.

2.1 Introduction

Accounting Standard 3, Cash Flow Statements, was issued in March, 2004. It is based on cash concept of profit

Benefits:

(a) Cash flow statement provides information about the changes in cash and cash equivalents of an enterprise.

(b) identifies cash generated from trading operations

(c) The operating cash surplus which can be applied for investment in fixed assets.

(d) Portion of cash from operations is used to pay dividend and tax and the other portion is ploughed back.

(e) Very useful tool of planning.

Purpose:

Cash flow statements are prepared to explain the cash movements between two points of time.

Sources of Cash:

1. Issue of shares and debentures and raising long-term loan.
2. Sale of investments and other fixed assets.
3. Cash from operations.
4. Decrease in Cash.

Applications of Cash

1. Redemption of preference shares and debentures and repayment of long-term loan.
2. Purchase of investments and other fixed assets.
3. Payment of tax.

4. Payment of dividend.
5. Increase in cash.

Increase in cash or decrease in cash is put in the applications and the sources respectively just to balance the cash flow statement.

At this juncture students may note that in cash flow statement changes in all balance sheet items are to be taken into consideration separately for explaining movement of cash.

2.2 Elements of Cash Fund

As per AS 3, issued by the Council of the ICAI, 'Cash Funds' include:

(i) Cash in hand,

(ii) Demand deposits with banks, and

(iii) Cash equivalents.

 (a) Components

  - Short term highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value
  - Securities with short maturity period of, say, three months or less from the date of acquisition

 (b) Objective

  - Deploy, for a short period, idle cash required to meet short-term cash-commitments.

 (c) Examples

  - Acquisition of preference shares, shortly before their specified redemption date, bank deposits with short maturity period, etc.

Conclusion: Thus, cash flow statement deals with flow of cash funds but does not consider the movements among cash, bank balance payable on demand and investment of excess cash in cash equivalents. Examples are cash withdrawn from current account, cash deposited in bank for 60 days, etc.

2.3 Classification of Cash Flow Activities

1. Inflow of Activities

   Which increase cash

2. Outfow of Activities

   Decrease cash

3. In Short: provides explanation for changes in cash position of the business entity.

4. As Per Accounting Standard 3 cash flows during the period are classified as
   (a) Operating Activities
   (b) Investing activities
   (c) Financing activities

2.3.1 Operating Activities

1. Definition

   These are the principal revenue generating activities of the enterprise.

2. Net Impact

   Net impact of operating activities on flow of cash is reported as 'Cash flows from operating activities' or 'cash from operation'.

3. Key Indicator

   The amount of cash flows from operating activities is a key indicator of the extent to which the operations of the enterprises have generated sufficient cash flows to :
   (a) Maintain the operating capability of the enterprise,
   (b) Pay dividends, repay loans, and
   (c) Make new investments without recourse to external sources of financing.

4. Information Provided

   It provides useful information about internal financing.

5. Benefits

   Information about the specific components of historical operating cash flows is useful, in conjunction with other information, in forecasting future operating cash flows.

2.3.2 Investing activities

1. Definition

   These are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

2. Separate Disclosure

   The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the :
   (a) Extent to which the expenditures have been made for resources intended to generate future incomes and cash flows.

2.3.3 Financing activities

1. Definition

   These are the activities that result in changes in the size and composition of the owner's capital (including preference share capital) and borrowings of the enterprise.

2. Separate Disclosure

   The separate disclosure of cash flows arising from financing activities is important because it is useful in predicting claims on future cash flows by providers of funds (both capital and borrowings) to the enterprise.

2.4 Calculation of Cash Flows from operating Activities

1. Components:

   Cash flows from operating activities result from the transactions and other events that enter into the determination of net profit or loss.

2. Examples

   (a) cash receipts from the sale of goods and the rendering of services;

   (b) cash receipt from fees, commission and other revenue;

   (c) cash payments to suppliers for goods; cash payments to employees and so on.

3. Methods

   An enterprise can determine cash flows from operating activities using either:

   (a) Direct Method

   The direct method, whereby major classes of gross cash receipts and gross cash payments are considered; or

   (b) Indirect Method

   the indirect method, whereby net profit or loss is adjusted for the effects of transactions of a non-cash nature, deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing activities.

2.4.1 Direct Method

1. Information Required

   (a) Gross receipts and gross cash payments may be obtained from the accounting records to ascertain cash flows from operating activities.

   (b) For example,

   (i) information about cash received from debtors,

   (ii) payment to creditors, cash expenses etc., which may be obtained by an analysis of cash book.

   (c) In actual practice, the relevant information is obtained by adjusting sales, cost of sales and other items in the profit and loss accounts for:

   ➢ Changes during the period in inventories and operating receivables and payables;

- Other non-cash items such as depreciation on fixed assets, goodwill written off, preliminary expenses written off, loss or gain on sale of fixed assets etc.; and
- Other items for which the cash effects are investing or financing cash flows. Examples are interest received and paid, dividend received and paid etc., which are related to financing or investing activities and are shown separately in the cash flow statement.
- This procedure of computation of cash flows from operating activities is also known as income statement method.

2. The direct method provides information which may be useful in estimating future cash flows and which is not available under the indirect method and is, therefore, considered more appropriate than the indirect method.

3. However, indirect method of determining the cash from operating activities is more popular in actual practice.

2.4.2 Indirect Method

1. Method of Determination

Under the indirect method, the net cash from operating activities is determined by adjusting net profit or loss instead of individual items appearing in the profit and loss account. Net profit or loss is also adjusted for the effect of:

(a) changes during the period in inventories and operating receivables and payables;

(b) non-cash items such as depreciation; and

(c) all other items for which the cash effects are financing or investing cash flows.

(d) The indirect method is also known as 'reconciliation method'.

2.4.3 Conclusion

1. It is worth noting that both direct and indirect methods adjust current assets and current liabilities related to operating activities to determine cash from operating activities.
2. But direct method adjust individual items of profit and loss account and indirect method adjusts overall net profit (or loss) to determine cash from operation.
3. Therefore, indirect method fails to provide break-up of cash from operations.

Proforma of 'Cash Flow from Operating Activities' by indirect method

		₹
Net Profit for the year		-
Add: Non-Cash Expenses:	-	
Depreciation	-	
Share Discount Written off	-	
Loss on Sale of Assets	-	
Provision for taxation, etc.	-	
Less: Non-Cash Incomes:		
Profit on Sale of Assets	-	
Net Profit after Adjustment for Non-Cash Items		(-)

Cash from operation	=	Net Profit (after adjustment for Non-cash Items)
	-	Increase in Current Assets
	+	Decrease in Current Asset
	+	Increase in Current Liabilities
	-	Decrease in Current Liability

2.5 Calculation of Cash Flows from Investing Activities

1. These activities are related to the acquisition and disposal of long-term assets, non-operating current assets and investments which results in outflow of cash.

2. Disposal of the aforesaid assets results in inflow of cash.

3. Thus, inflows and outflows related to acquisition and disposal of assets, other than those related to operating activities, are shown under this category

2.6 Calculation of Cash Flows from Financing Activities

1. These activities are basically related to the changes in capital and borrowing of the enterprise which affect flow of cash.
2. Redemption of shares and repayment of borrowings results in outflow of cash.
3. Thus inflows and outflows related to the amount of capital and borrowings of the enterprise are shown under this head.

Students are advised to refer full text of revised Accounting Standard on Cash Flow Statements (AS 3) for the better understanding of the chapter.

Illustration 1

The following summary cash account has been extracted from the company's accounting records:

Summary Cash Account

		(₹ '000)
Balance at l.1.2010		*35*
Receipts from customers		*2,783*
Issue of shares		*300*
Sale of fixed assets		*128*
		3,246
Payments to suppliers	*2,047*	
Payments for fixed assets	*230*	
Payments for overheads	*115*	
Wages and salaries	*69*	
Taxation	*243*	
Dividends	*80*	
Repayments of bank loan	*250*	*(3,034)*
Balance at 31.12.2010		*212*

Prepare Cash Flow Statement of this company Hills Ltd. for the year ended 31st December 2010 in accordance with AS-3 (Revised).

The company does not have any cash equivalents.

Solution

Hills Ltd.
Cash Flow Statement for the year ended 31st December 2010
(Using direct method)

		(₹ '000)
Cash flows from operating activities		
Cash receipts from customers	2,783	
Cash payments to suppliers	(2,047)	
Cash paid to employees	(69)	
Other cash payments (for overheads)	(115)	
Cash generated from operations	552	
Income taxes paid	(243)	
Net cash from operating activities		309
Cash flows from investing activities		
Payments for purchase of fixed assets	(230)	
Proceeds from sale of fixed assets	128	
Net cash used in investing activities		(102)
Cash flows from financing activities		
Proceeds from issuance of share capital	300	

Bank loan repaid	(250)	
Dividend paid	(80)	
Net cash used in financing activities		(30)
Net increase in cash and cash equivalents		177
Cash and cash equivalents at beginning of period		35
Cash and cash equivalents at end of period		212

The solution given in above illustration has been prepared using simply the summarised cash account. To team the technique of preparing Cash Flow Statement from comparative balance sheets and profit and loss account, the above illustration has been expanded by giving following further detailed information extracted from the records of Hills Ltd.

Illustration 2

The following data were provided by the accounting records of Ryan Ltd. at year-end, March 31, 2010:

Income Statement

		₹
Sales		*6,98,000*
Cost of Goods Sold		*(5,20,000)*
Gross Margin		*1,78,000*
Operating Expenses		
(including Depreciation Expense of ₹ 37,000)		*(1,47,000)*
		31,000
Other Income (Expenses)		
Interest Expense paid	*(23,000)*	
Interest Income received	*6,000*	
Gain on Sale of Investments	*12,000*	
Loss on Sale of Plant	*(3,000)*	
		(8,000)
		23,000
Income tax		*(7,000)*
		16,000

Comparative Balance Sheets ₹

	31st March 2010	*31st March 2009*
Assets	*7,15,000*	*5,05,000*
Plant Assets	*(1,03,000)*	*(68,000)*
Less: Accumulated Depreciation	*6,12,000*	*4,37,000*
Investments (Long term)	*1,15,000*	*1,27,000*

Current Assets:	*1,44,000*	*1,10,000*
Inventory	*47,000*	*55,000*
Accounts Receivable	*46,000*	*15,000*
Cash	*1,000*	*5,000*
Prepaid Expenses	*9,65,000*	*7,49,000*
Liabilities		
Share Capital	*4,65,000*	*3,15,000*
Reserves and Surplus	*1,40,000*	*1,32,000*
Bonds	*2,95,000*	*2,45,000*
Current Liabilities:		
Accounts Payable	*50,000*	*43,000*
Accrued Liabilities	*12,000*	*9,000*
income Taxes Payable	*3,000*	*5,000*
	9,65,000	*7,49,000*

Analysis of selected accounts and transactions during 2009-2010

1. *Purchased investments for ₹ 78,000*
2. *Sold investments for ₹ 1,02,000. These investments cost ₹ 90,000*
3. *Purchased plant assets for ₹ 1,20,000*
4. *Sold plant assets that cost ₹ 10,000 with accumulated depreciation of ₹ 2,000 for ₹ 5,000.*
5. *Issued ₹ 1,00,000 of bonds at face value in an exchange for plant assets on 31st March, 2010*
6. *Repaid ₹ 50,000 of bonds at face value at maturity.*
7. *Issued 15,000 shares of ₹ 10 each.*
8. *Paid cash dividends ₹ 8,000.*

Prepare Cash Flow Statement as per AS-3 (Revised), using indirect method.

Solution

Ryan Ltd.
Cash Flow Statement
for the year ending 31st March, 2010

	₹	₹
Cash flows from operating activities		
Net profit before taxation	23,000	
Adjustments for:		
Depreciation	37,000	
Gain on sale of investments	(12,000)	
Loss on sale of plant assets	3,000	

Interest expense	23,000	
Interest income	(6,000)	
Operating profit before working capital changes	68,000	
Decrease in accounts receivable	8,000	
Increase in inventory	(34,000)	
Decrease in prepaid expenses	4,000	
Increase in accounts payable	7,000	
Increase in accrued liabilities	3,000	
Cash generated from operations	56,000	
Income taxes paid*	(9,000)	
Net cash from operating activities		47,000
Cash flows from investing activities		
Purchase of plant assets	(1,20,000)	
Sale of plant assets	5,000	
Purchase of investments	(78,000)	
Sale of investments	1,02,000	
Interest received	6,000	
Net cash used in investing activities		(85,000)
Cash flows from financing activities		
Proceeds from issuance of share capital	1,50,000	
Repayment of bonds	(50,000)	
Interest paid	(23,000)	
Dividends paid	(8,000)	
Net cash from financing activities		69,000
Net increase in cash (and cash equivalents)		31,000
Cash (and cash equivalents) at beginning of period		15,000
Cash (and cash equivalents) at end of period		46,000

*__Working Note:__

	₹
Income taxes paid:	
Income tax expense for the year	7,000
Add: Income tax liability at the beginning of the year	5,000
	12,000
Less: Income tax liability at the end of the year	3,000
	9,000

Illustration 3

The balance sheets of Sun Ltd. for the years ended 31st March 2010 and 2009 were summarised thus:

	2010	2009
	₹	₹
Equity Share Capital	60,000	50,000
Reserves:		
Profit and Loss Account	5,000	4,000
Current Liabilities:		
Creditors	4,000	2,500
Taxation	1,500	1,000
Proposed dividends	2,000	1,000
	72,500	58,500
Fixed Assets (at w.d.v.)		
Premises	10,000	10,000
Fixtures	17,000	11,000
Vehicles	12,500	8,000
Short-term investments	2,000	1,000
Current Assets		
Stock	17,000	14,000
Debtors	8,000	6,000
Bank and Cash	6,000	8,500
	72,500	58,500

and the profit and loss account for the year ended 31st March, 2010 disclosed

	₹
Profit before tax	4,500
Taxation	(1,500)
Profit after tax	3,000
Proposed dividends	(2,000)
Retained profit	1,000

Further information is available:

	Vehicles	Fixtures
	₹	₹
Depreciation for year	1,000	2,500
Disposals:		
Proceeds on disposal	—	1,700
Written down value	—	(1,000)
Profit on disposal		700

Prepare a Cash Flow Statement for the year ended 31st March, 2010.

Solution

Sun Ltd.
Cash Flow Statement
for the year ended 31st March, 2010

	₹	₹
Cash flows from operating activities		
Net Profit before taxation	4,500	
Adjustments for:		
Depreciation	3,500	
Profit on sale of vehicles	(700)	
Operating profit before working capital changes	7,300	
increase in sundry debtors	(2,000)	
Increase in inventories	(3,000)	
Increase in sundry creditors	1,500	
Cash generated from operations	3,800	
Income taxes paid	(1,000)	
Net cash from operating activities		2,800
Cash flows from investing activities		
Sale of vehicles	1,700	
Purchase of vehicles	(8,000)	
Purchase of fixtures	(7,000)	
Net cash used in investing activities		(13,300)
Cash flows from financing activities		
Issue of shares for cash	10,000	
Dividends paid	(1,000)	
Net cash from financing activities		9,000
Net decrease in cash and cash equivalents		1,500
Cash and cash equivalents at beginning of period (See Note 1)		9,500
Cash and cash equivalents at end of period (See Note 1)		8,000

Note to the Cash Flow Statement

Cash and Cash Equivalents

	31.3.2010	*31.3.2009*
Bank and Cash	6,000	8,500
Short-term investments	2,000	1,000
Cash and cash equivalents	8,000	9,500

Working Notes:

			₹
1.	Income taxes paid		
	Income tax expense for the year	1,500	
	Add: Income tax liability at the beginning of the year	1,000	
			2,500
	Less: Income tax liability at the end of the year		1,500
			1,000
2.	Dividend paid		
	Proposed dividend for the year		2,000
	Add: Amount payable at the beginning of the year		1,000
			3,000
	Less: Amount payable at the end of the year		2,000
			1,000

3. Fixed assets acquisitions

	Fixtures	*Vehicles*
	₹	₹
W.D.V. at 31.3.2010	17,000	12,500
Add back:		
Depreciation for the year	1,000	2,500
Disposals	—	1,000
	18,000	16,000
Less: W.D.V. at 31.12.2009	11,000	8,000
Acquisitions during 2009-2010	7,000	8,000

Illustration 4

Ms. Jyoti of Star Oils Limited has collected the following information for the preparation of cash flow statement for the year 2010 :

	(₹ in Lakhs)
Net Profit	*25,000*
Dividend (including dividend tax) paid	*8,535*
Provision for Income tax	*5,000*
Income tax paid during the year	*4,248*
Loss on sale of assets (net)	*40*
Book value of the assets sold	*185*

Depreciation charged to Profit & Loss Account	*20,000*
Amortisation of Capital grant	*6*
Profit on sale of Investments	*100*
Carrying amount of Investment sold	*27,765*
Interest income on investments	*2,506*
Interest expenses of the year	*10,000*
Interest paid during the year	*10,520*
Increase in Working Capital (excluding Cash & Bank Balance)	*56,075*
Purchase of fixed assets	*14,560*
Investment in joint venture	*3,850*
Expenditure on construction work in progress	*34,740*
Proceeds from calls in arrear	*2*
Receipt of grant for capital projects	*12*
Proceeds from long-term borrowings	*25,980*
Proceeds from short-term borrowings	*20,575*
Opening cash and Bank balance	*5,003*
Closing cash and Bank balance	*6,988*

Required :

Prepare the Cash Flow Statement for the year 2010 in accordance with AS 3, Cash Flow Statements issued by the Institute of Chartered Accountants of India. (make necessary assumptions).

Solution

Star Oils Limited
Cash Flow Statement
for the year ended 31st December, 2010

(₹ in lakhs)

Cash flows from operating activities		
Net profit before taxation (25,000 + 5,000)	30,000	
Adjustments for :		
Depreciation	20,000	
Loss on sale of assets (Net)	40	
Amortisation of capital grant	(6)	
Profit on sale of investments	(100)	
Interest income on investments	(2,506)	
Interest expenses	10,000	
Operating profit before working capital changes	57,428	
Changes in working capital (Excluding cash and bank balance)	(56,075)	

Cash generated from operations	1,353	
Income taxes paid	(4,248)	
Net cash used in operating activities		(2,895)
Cash flows from investing activities		
Sale of assets	145	
Sale of investments (27,765 + 100)	27,865	
Interest income on investments	2,506	
Purchase of fixed assets	(14,560)	
Investment in joint venture	(3,850)	
Expenditure on construction work-in progress	(34,740)	
Net cash used in investing activities		(22,634)
Cash flows from financing activities		
Proceeds from calls in arrear	2	
Receipts of grant for capital projects	12	
Proceeds from long-term borrowings	25,980	
Proceed from short-term borrowings	20,575	
Interest paid	(10,520)	
Dividend (including dividend tax) paid	(8,535)	
		27,514
Net increase in cash and cash equivalents		1,985
Cash and cash equivalents at the beginning of the period		5,003
Cash and cash equivalents at the end of the period		6,988

Working note :

Book value of the assets sold	185
Less : Loss on sale of assets	40
Proceeds on sale	145

Assumption :

Interest income on investments ₹ 2,506 has been received during the year.

Illustration 5

From the following Summary Cash Account of X Ltd. prepare Cash Flow Statement for the year ended 31st March, 2010 in accordance with AS 3 (Revised) using the direct method. The company does not have any cash equivalents.

Summary Cash Account for the year ended 31.3.2010

	₹ '000		***₹ '000***
Balance on 1.4.2009	*50*	*Payment to Suppliers*	*2,000*
Issue of Equity Shares	*300*	*Purchase of Fixed Assets*	*200*
Receipts from Customers	*2,800*	*Overhead expense*	*200*

Sale of Fixed Assets	*100*	*Wages and Salaries*	*100*
		Taxation	*250*
		Dividend	*50*
		Repayment of Bank Loan	*300*
		Balance on 31.3.2010	*150*
	3,250		*3,250*

Solution

X Ltd.

Cash Flow Statement for the year ended 31st March, 2010

(Using direct method)

	₹ '000	*₹ '000*
Cash flows from operating activities		
Cash receipts from customers	2,800	
Cash payments to suppliers	(2,000)	
Cash paid to employees	(100)	
Cash payments for overheads	(200)	
Cash generated from operations	500	
Income tax paid	(250)	
Net cash from operating activities		250
Cash flows from investing activities		
Payments for purchase of fixed assets	(200)	
Proceeds from sale of fixed assets	100	
Net cash used in investing activities		(100)
Cash flows from financing activities		
Proceeds from issuance of equity shares	300	
Bank loan repaid	(300)	
Dividend paid	(50)	
Net cash used in financing activities		(50)
Net increase in cash		100
Cash at beginning of the period		50
Cash at end of the period		150

Illustration 6

Given below is Profit and Loss Account of ABC Ltd. and relevant Balance Sheet information:

Profit and Loss Account of ABC Ltd.
for the year ended 31st December, 2010

	₹ in lakhs
Revenue:	
Sales	4,150
Interest and dividend	100
Stock adjustment	20
Total (A)	4,270
Expenditure:	
Purchases	2,400
Wages and salaries	800
Other expenses	200
Interest	60
Depreciation	100
Total (B)	3,560
Profit before tax (A – B)	710
Tax provision	200
Profit after tax	510
Balance of Profit and Loss account brought forward	50
Profit available for distribution (C)	560
Appropriations:	
Transfer to general reserve	200
Proposed dividend	300
Distribution tax	30
Total (D)	530
Balance (C – D)	30

Relevant Balance Sheet information	31.12.2010	31.12.2009
	₹ in lakhs	₹ in lakhs
Debtors	400	250
Inventories	200	180
Creditors	250	230
Outstanding wages	50	40
Outstanding expenses	20	10
Advance tax	195	180
Tax provision	200	180
Assessed tax liability		

Compute cash flow from operating activities using both direct and indirect method.

Solution

By direct method

Computation of Cash Flow from Operating Activities

	₹	₹
Cash Receipts:		
Cash sales and collection from debtors		
Sales + Opening debtors – Closing debtors (A)	4,150 + 250 – 400	4,000
Cash payments:		
Cash purchases & payment to creditors		
Purchases + Opening creditors – Closing creditors	2,400 + 230 – 250	2,380
Wages and salaries paid	800 + 40 – 50	790
Cash expenses	200 + 10 – 20	190
Taxes paid – Advance tax		195
(B)		3,555
Cash flow from operating activities (A – B)		445
By indirect method		
Profit before tax		710
Add: Non-cash items : Depreciation		100
Add: Interest : Financing cash outflow		60
Less: Interest and Dividend : Investment cash inflow		(100)
Less: Tax paid		(195)
Working capital adjustments		
Debtors	250–400 (–150)	
Inventories	180–200 (–20)	
Creditors	250–230 20	
Outstanding wages	50–40 10	
Outstanding expenses	20–10 10	(130)
Cash flow from operating activities		445

Summary

- Dealt under AS 3
- Based on cash concept of profit
- Benefits include providing information relating to changes in cash and cash equivalents of an enterprise.

- Useful tool of planning
- Cash funds include :
  - (a) Cash in hand
  - (b) Demand deposits with banks
  - (c) Cash equivalents
- Cash flow activities may be classified as inflow and outflow but as per AS-3 they are classified as Operating Activities, Investing activities, Financing activities
- Operating activities are principal revenue generating activities
- Investing Activities relate to acquisition and disposal of long-term assets and other investments
- Financing Activities include the ones which result in changes in the size and composition of the owner's capital (including preference share capital) and borrowings of the enterprise.
- Methods to calculate cash flow from operating activities include:
  - (a) Direct Method
  - (b) Indirect Method also known as reconciliation method
- In order to calculate cash flow from investing activities inflows and outflows related to acquisition and disposal of assets, other than those related to operating activities, are shown under this category
- In order to calculate cash flow from financing activities inflows and outflows related to the amount of capital and borrowings of the enterprise are shown under this head