Why Has Schedule VI Outlived its Utility?

Dolphy D'Souza

(The author is a member of the Institute. He can be reached at Dolphy.Dsouza@in.ey.com)

In the case of companies, the presentation and disclosure aspect of financial statements is dealt with under Schedule VI of the Companies Act, 1956 (The Act), in addition to the accounting standards. This Schedule is as old as the Act itself and is outmoded.

More and more people now believe that Schedule VI of the Companies Act, 1956 has become outdated. This deficiency of the Act has been felt time and again, particularly when new standards in respect of deferred taxes, intangibles, leases, consolidation, discontinuing operation, impairment, provisions, etc. were introduced. The big question was how to fit the disclosures under these standards in the Schedule VI format. More often it was like fixing a square peg in a round hole.

Take, for instance, deferred tax asset or liability, which is a non-current item. Schedule VI does not contain any prescription on where and how to disclose non-current assets and liabilities. Schedule VI requires detailed disclosure for fixed assets, but there is no separate line item for intangibles, which under Schedule VI are stacked in the fixed asset line item, contrary to international practice. Schedule VI does not contain any format for consolidated financial statements nor does it deal with disclosure in respect of leases, impairment, discontinuing operations, etc. Schedule VI is also not flexible enough to apply to a wide variety of industries.

Financial statements are predominantly for the benefit of investors and other stakeholders such as lenders, suppliers, tax authorities, etc. If one were to judge financial statements from that perspective, Schedule VI contains a whole host of irrelevant information such as outstanding of small-scale industries, CIF value of imports, expenditure in foreign currency, earnings in foreign currency, capacity details, etc. Other than the fact that such information is meaningless to investors, the purpose for which such disclosures were required is also no longer relevant. For example, with the disbanding of licenses, disclosure of licensed capacity is no longer relevant. Similarly foreign currency is no longer a burning issue as it may have been when Schedule VI was introduced several years ago.

Some of the information required by Schedule VI may be important from a regulatory perspective. However, those could be obtained separately by the regulatory agencies from the company concerned and financial statements need not be burdened with irrelevant information from an investor perspective.

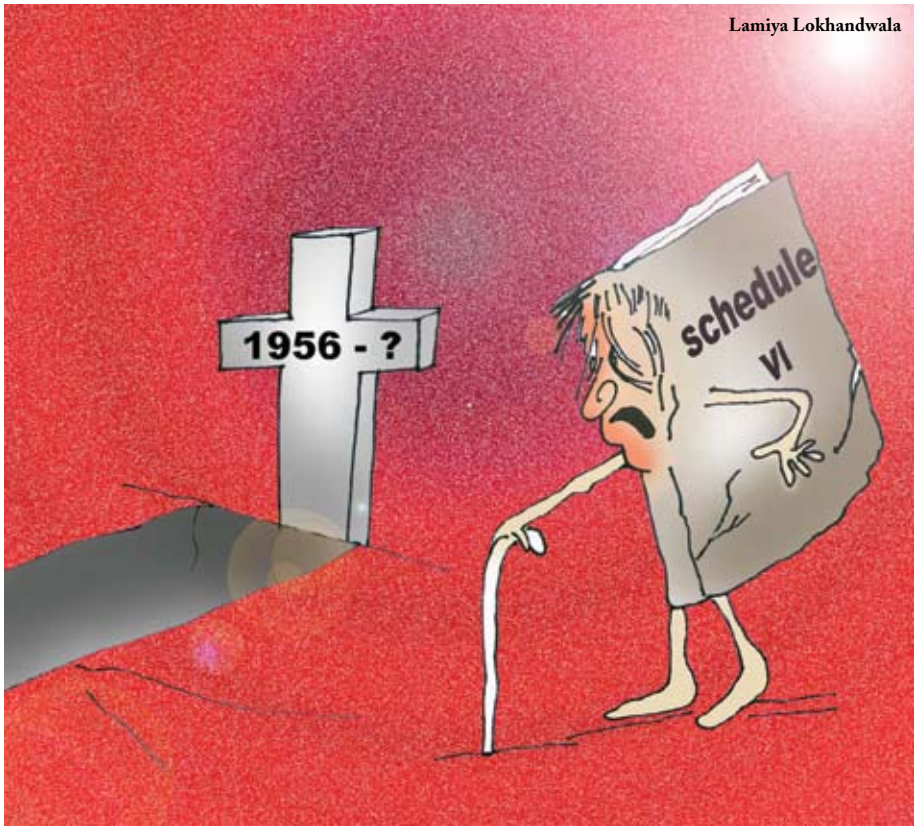
Schedule VI contains detailed disclosure requirements and a detailed format for the balance sheet. Strangely it does not contain any format for the profit and loss account. Only items that need to be disclosed in the profit and loss account are set out, but the format is not specified. Thus it is possible for a company to follow an easy format (and not the usual profit and loss account format) on the profit and loss account and still be compliant with the Act. This is one of the significant deficiencies of Schedule VI.

Part IV of Schedule VI contains certain statistical data and EPS disclosures. The statistical data is meaningless to shareholders. The EPS disclosures are set out in greater depth and detail in Accounting Standard 20 – Earnings Per Share. Part III of Schedule VI, contains interpretation of certain terms such as liability and provisions. These are defined more elaborately in Accounting Standard 29 – Provisions, Contingent Liabilities and Contingent Assets. Further the contingent liabilities to be disclosed under Schedule VI are not as comprehensive as AS 29.

Related party disclosures are spread across various captions in the financial statements under Schedule VI. Under AS 18 – Related Party Disclosures, these disclosures are comprehensively and meaningfully disclosed at one place in the financial statements. The segmental information under AS 17 – Segment Reporting, is far more meaningful than the detailed quantitative information under Schedule VI. Infact many companies approach the Department of Company Affairs, to seek exemption from such cumbersome disclosures.

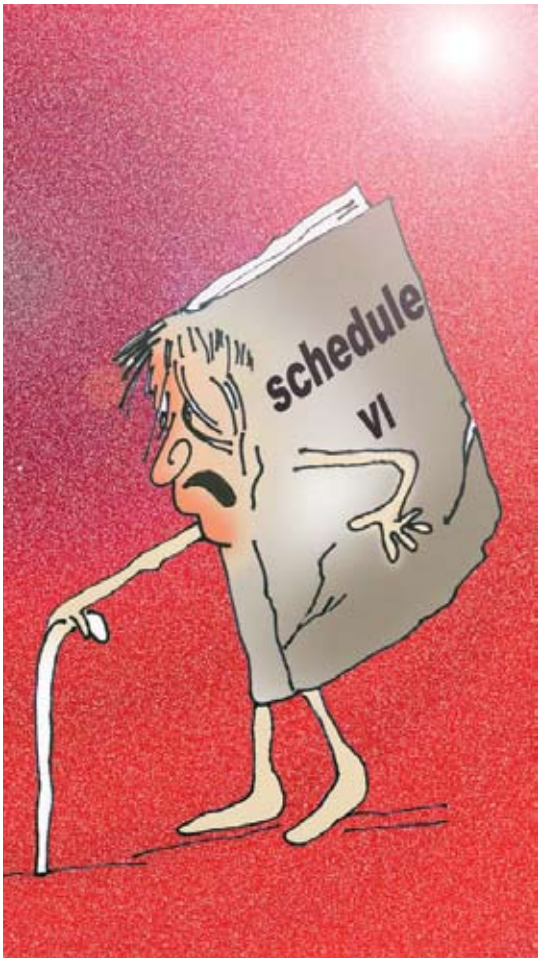
Even assuming that the deficiencies can be set right under Schedule VI, it would still be a good idea to withdraw Schedule VI, since with rapid changes in socio-political-legal and economic environment, Schedule VI would need constant tinkering. Schedule VI would also need to be constantly updated for new standards that may be introduced in the future (eg derivatives) and improvement of existing standards. These modifications to Schedule VI would demand a change in legislation, which could make the whole process of change very slow, tedious, costly, inflexible and on many occasions, impossible.

Schedule VI has a very low materiality threshold for disclosure. Even other provisions of the Act require certain disclosures irrespective of the materiality threshold. For example, political contributions are required to be disclosed under Section 293A(4), irrespective of the amounts involved. Thus even a contribution of Rs. 100 made innocuously by the cashier of a company, will have to be disclosed in the financial statements.



Section 211 of the Act, which prescribes the form and content of balance sheet and profit and loss account, provides for six months imprisonment for violation. In a recent case on the consequences of not making proper disclosures as required by Section 293A of the Act relating to political contribution, the petitioner-company failed to disclose the contribution made to political parties in its accounts and thus contravened the provisions of Section 293A(4). The ROC issued a show cause notice on the company as to why prosecution should not be launched against it and its defaulting officers. The company sought to compound the offence by filing an application with the ROC, which was forwarded to the Regional Director who in turn forwarded the same to the CLB stating that the offence was not compoundable in view of section 293A(5). CLB in its decision has compounded the offence under Section 629A and stated that Section 293A deals with political contribution and connected obligation of the company to disclose the same. Section 293A(4) requires disclosure of the political contribution. Section 293A(5) contains the penal provision and states "if a company makes contribution in contravention of this section the company shall be punishable with fine which may extend to three times the amount so contributed, and every officer in default shall be punishable with *imprisonment for a term which may extend up to 3 years and shall also be liable to fine….*". It was held that the penalty would apply only to contravention

Section 211 of the Act, which prescribes the form and content of balance sheet and profit and loss account, provides for six months imprisonment for violation



of the provisions relating to contribution and not to default in disclosure. Therefore, the contention of ROC that the offence of non-disclosure against the officers in default cannot be compounded in view of the penalty of fine and imprisonment, cannot be sustained. Nevertheless, the company has violated the provisions relating to disclosure and since there is no provision in Section 293A to penalise for such a violation, in accordance with the residuary penal provision under the Act, i.e., Section 629A, the company and every officer in default is punishable with a fine of Rs. 5000 each.

Whilst the petitioner company in the above case got away with it, the point is that unnecessary disclosures cast an onerous responsibility on companies and that too without consideration of materiality.

Schedule VI deals not only with disclosure requirements, but also measurement principles, which could be contrary to the principles of an Accounting Standard. A case in point, is the capitalisation of foreign exchange difference, which AS-11 did not allow, but Schedule VI required. Since law prevails over an accounting standard, exchange differences were required to be capitalised. This difference would also take us one step away from converging with International Financial Reporting Standards (IFRS). This difference also means that companies would be required to capitalise exchange difference, whereas non-corporate entities to whom Schedule VI is not applicable, will not be allowed to capitalise exchange difference in accordance with AS-11.

For various reasons mentioned above, it is not advisable that presentation and disclosure requirements be legislated by way of a Schedule to the Act, rather it should be left to be legislated in the form of an Accounting Standard on the lines of International Accounting Standard (IAS) 1 – "Presentation of Financial Statements" which when read together with other IFRS's would not only provide a true and fair view of financial statements across a wide variety of industries but would also be flexible enough to subject itself to quick changes from time to time. Another point in support of adopting an Indian Standard on the lines of IAS 1 is that it does not contain the deficiencies of Schedule VI.

IAS 1 has the essence of making financial statements very meaningful. It requires disclosure of the judgments the management has made in the process of applying the entity's accounting policies that have the most significant effect on the amounts recognised in the financial statement (e.g. management's judgement in determining provision for impairment); and the key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the financial statements. For example, if product development expenditure has been capitalised, then the assumption on the potential market for the product will need to be disclosed in the financial statements.

If the purpose of financial statements is to contain disclosure requirements, which are considered essential to make the financial statements current, readable, useful, transparent and user friendly without burdening the reader with too much information which may not be relevant, the only remedy seems to be to detach financial statements from the purview of Schedule VI and bring them under the purview of the Accounting Standards. This will also enhance the possibility of amending those provisions promptly in response to the changing environment. If this approach does not find favour with the regulators, then a sub-optimal solution would be to significantly repair Schedule VI and build some flexibility in it, so that changes in disclosure requirements in the future would be automatically taken care of. ❐