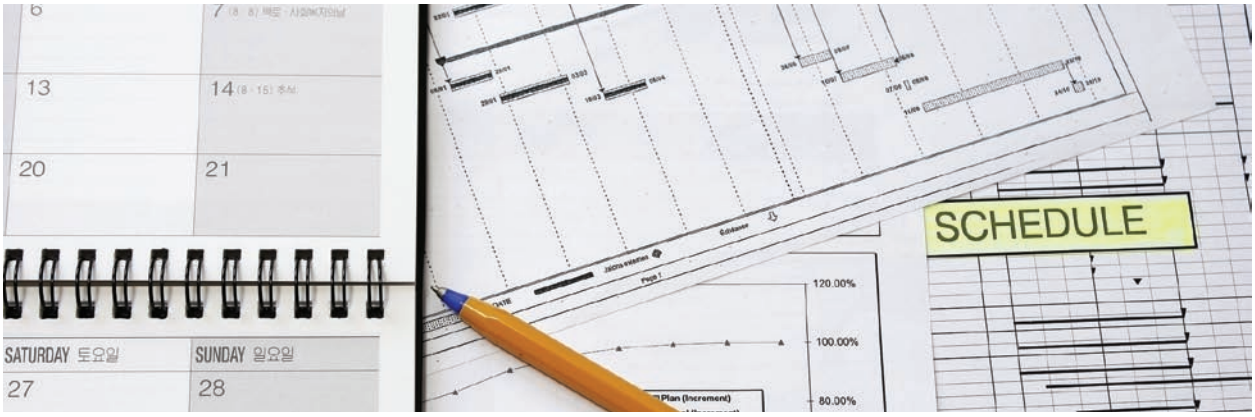
Distinctive Features of Schedule VI (Revised)



Schedule VI to the Companies Act 1956 was replaced by the Ministry of Corporate Affairs by a new (Revised) schedule. There are many distinctive features of the new schedule. The first distinctive feature is recognition to accounting standards in preparation and presentation of financial statements. The second distinctive feature is a move in the direction of converging with/adopting IFRS. In the new Schedule VI, presentation of assets and liabilities is to be made strictly on the basis of permanency. It specifically requires a company to present the debit balance of Statement of Profit and Loss as a negative figure under sub-head 'Surplus' within the main head 'Reserves and Surplus'. The final figure under the head 'Reserves and Surplus' is required to be shown under that head only, even if the final figure is negative. All the features described will have their effects prominently displayed in the first set of financial statements prepared after coming into force of new Schedule VI. An attempt has been made in this article to bring out the important features and their impact that needs to be considered while preparing and presenting the financial statements for the first time under the Revised Schedule VI.

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Schedule VI to the Companies Act 1956 was replaced by the Ministry of Corporate Affairs on 28th February, 2011. However, its application was postponed for a year and now is set to come into effect for the accounting period beginning on or after 1st April 2011. In common parlance this schedule is referred to as 'revised'. But it is in fact replacement of old schedule as the relevant notification clearly states "…the Central Government hereby replace the existing Schedule VI to the said Act by the following Schedule…" Even when one studies the new schedule, it is amply clear that its disclosure and presentation requirements for many items are different from the current schedule.

Recognition to Accounting Standards

The first distinctive feature of the new Schedule VI is much needed recognition to accounting standards in preparation

and presentation of financial statements. It can be safely stated that now onwards, accounting standards prescribed under the Companies (Accounting Standard) Rules 2006 (notified AS) will prevail over the new schedule if the presentation and disclosure requirements of any item specified therein are at variance with the prescribed accounting standards. This is demonstratively brought out in the opening Para of the new schedule.

That due recognition to accounting standards is given in the new schedule can be ensured by the following assertions made therein:

- Requirements of Schedule VI shall stand modified to conform to any treatment or disclosure as stated in notified AS.
- Disclosures required by notified AS to be made in the notes to accounts or by way of additional statements unless required to be disclosed on the face of the financial statements. In fact, disclosure requirements of Schedule VI are in addition to and not in substitution of disclosure requirements of notified AS.
- Terms used in the schedule are as per the applicable notified AS.
- Line items, sub-line items and subtotals are to be added or substituted in any item of the Balance Sheet, Statement of Profit & Loss and Notes to Accounts to comply with notified AS (including any change therein at later stage).

At present there are 28 notified ASs (AS-1 to AS-7 and AS9- to AS-29). With exception of AS-3 (Cash Flow Statements), AS-17 (Segment Reporting) and AS-25 (Interim Financial Reporting), notified standards apply to all companies, whether public or private. While the two standards AS-3 and AS-17 do not apply to small and medium sized companies (SMCs) as defined in the extant rules, AS-25 applies to listed companies. Apart from this, partial relaxation has been given to SMCs from presentation and disclosure requirements of standards AS-15 (Employee Benefits), AS-19 (Leases), AS-20 (Earnings per Share), AS-28 (Impairment of Assets) and AS-29 (Provisions, Contingent Liabilities and Contingent Assets).

In these standards there are many disclosure requirements that are not found in the new schedule. These disclosures will have to be now made as the schedule specifically requires such disclosure.

An illustrative list of typical disclosures required by notified AS but not included in the new Schedule VI could be under:

- Cost Formula used in measuring inventories (AS-2)
- Separation of investments maturing in 90 days from acquisition date from other investments for classification as cash equivalents on the Balance Sheet date (AS-3)
- In case of revaluation of fixed assets, method of valuation used, the nature of indices used, whether an external valuer was involved etc. (AS-10)
- A narrative description of the basis used to determine the overall expected rate of return on assets, including the effect of the major categories of plan assets relating to employee benefit (AS-15)
- Reasons to presume that useful life of an intangible asset will exceed ten years when an intangible asset is amortised over more than 10 years (AS -26)

With notified accounting standards effectively getting precedence over requirements of new Schedule VI, companies will not be at liberty now to bypass any unsuitable presentation and disclosure requirement of notified AS in preparing and presenting financial statements.

The new schedule has given much needed support to the auditors to enforce compliance with accounting standards by the corporate entities. At the same time, auditors will have added responsibility to ensure such compliance. It will not be exaggerated to state that users of financial statements would like the audited statements to clearly reflect professional judgement of the auditors on all material issues in presentation and disclosures.

As regards private limited companies (and to some extent unlisted public companies also) are concerned, the responsibility of the auditors for compliance with notified AS will be much more. It is a known fact that most often, financial statements of such companies are prepared with active help of the auditors (unlike the case where the statements are prepared by the management independently). In a few cases, the auditors themselves have to prepare a 'presentable' set of financial statements from the accounting software generated statements.

In all such cases, management fully relies on the auditors about preparation, presentation and disclosure. Therefore, the auditors of such companies will have greater responsibility to ensure compliance with notified AS in preparation and presentation of the financial statements and disclosures to be made therein.

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Moving Near IFRS

The second distinctive feature of the new schedule is a move (a small one but significant) in the direction of converging with/adopting IFRS.

The first indicator of this move is:

- New schedule has removed the popular concept of 'Schedule' in presentation of financial statements. It has been replaced by the concept 'Note'.
- Each item in the financial statements is to be cross referenced to related information in the notes to accounts.

This is in line with requirements of IndAS-1 'Presentation of Financial Statements' (corresponding to IAS-1 of IASB).

The second indicator of this move is explanation about 'notes to accounts'. The explanation has been virtually imported from the definition of this term given in IndAS-1/ IAS-1. Similar is the case for the explanations for the terms current assets and current liabilities. The explanations have been virtually imported from the explanation of these terms given in IndAS-1/IAS-1.

The third indicator is the information to be provided for each class of share capital. Out of 12 disclosures [clauses (a) to (l) of Para 6A of General Instructions for Preparation of Balance Sheet] to be made about share capital, 7 disclosures [clauses (a) to (f) and clause (h) of the said Para] have been imported almost verbatim from IndAS-1/IAS-1.

Next indicator is the format of newly introduced (earlier schedule did not provide for such format) Statement of Profit and Loss including the heading of the statement, sequencing of items, separation of results of continuing and discontinuing operations, etc.

It may be mentioned here that IndAS -1 IndAS - 105 (corresponding to IFRS 5 of IASB) 'Non Current Assets Held For Sale and Discontinued Operations' requires an entity to disclose separately results of discontinued operations including related tax expense.

Yet another indicator is presentation of allocations and appropriation of profit after tax under the sub-head 'Surplus' in the head 'Reserves and Surplus'. So far we were conversant with presenting these items 'below the line' in the Profit and Loss Account. IndAS-1 (IAS 1) requires an entity to include these items as part of Statement of Changes in Equity or Notes. New Schedule VI has recognised this presentation as allocations and distributions have been moved under the head 'Reserves and Surplus' which is part of main head 'Shareholders' Funds' on the liability side of the Balance Sheet.

All these indicators can be considered as a part of the move to familiarise companies (and auditors also) with (yet to be notified) Ind-ASs (and IFRSs) for smooth transition to them later on.

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Adherence to Permanency in Presentation of Financial Position

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On the Equity and Liability side, presentation of permanency is sought to be achieved in the following sequence:

- Shareholders' Funds
- Share Application Money pending allotment
- Non-Current Liabilities
- Current Liabilities

Shareholders' Funds are permanent source for the company (buyback is an exceptional phenomenon). Share Application Money is to be ultimately converted into share capital hence permanent source of funds. Non-Current Liabilities are for long to very long term maturity and therefore are semi-permanent source of funds. Current Liabilities are temporary source of funds.

On the Assets side, presentation of permanency is sought to be achieved in the following sequence:

- Non-current Assets
- Current Assets

Investment in all Non-Current Assets is for long to very long term maturity and therefore almost permanent in nature. A plot of land purchased by a company establishing a manufacturing plant is a permanent investment. Same is the nature of investment in intangible assets. All current assets are temporary investments.

The schedule goes a step further and requires balance of all term liabilities (say term loan from a bank) outstanding on the reporting date to be bifurcated between that maturing for payment within 12 months and others maturing afterwards and requires former to be presented as current liabilities and later as non-current liabilities. Same is the case with loans granted by the company where balance receivable within 12 months of the reporting date to be presented as current assets and balance receivable afterwards as non-current assets. Same analogy is to be applied for investments.

This feature of adherence to permanency in presentation is going to bring out the real picture of asset/liability matching. A user of financial statement with a little effort is going to know whether the fundamental financing principle of long term source for long term use and short term source for short term use is followed by the company or not. In fact, if one prepares a fund flow statement from the financial statements prepared in the format of Revised Schedule VI, he will immediately come to know whether this principle has been followed by the company.

Incidentally, the presentation format of the new Schedule VI, to a great extent, would make the task of bankers easy in assessing working capital requirement of a company.

So far the phase 'asset/liability mismatch' is used mostly in relation to the financial position of a bank or financial institution. It will not be surprising that this phrase is used by bankers themselves, as lenders, while evaluating financial position of a company.

Slowly but surely (and knowingly or unknowingly) this presentation is bound to bring financial discipline in the near future in corporate entities.

Negative Figures in Balance Sheet – Its Impact

So far we were not accustomed to presenting a negative figure in the Balance Sheet with the exception of the figure of net current assets which could be negative in a few cases in a vertically presented Balance Sheet. The debit balance of profit and loss account was placed on the asset side of the Balance Sheet as per the earlier schedule.

But the new schedule specifically requires a company to present the debit balance of Statement of Profit and Loss as a negative figure under sub-head 'Surplus' within the main head 'Reserves and Surplus'. Final figure under the head 'Reserves and Surplus' is required to be shown under that head only even if the final figure is negative.

Mere thought of a negative figure (on the liability side) in the Balance Sheet evokes primarily adverse opinion about the health of the company. When that figure is with respect to profits of the company and ultimately its net-worth, any appearance of such negative figure (even if small one) is bound to catch immediate attention of the users of financial statements. Analysts, lenders, creditors, employees, government and other stakeholders are bound to look at the financial statements of the company with suspicion leading to their intense scrutiny.

In a case where the sum total under the head 'Shareholders' Funds' is negative i.e. net-worth fully eroded, any reader of the financial statements would immediately know that the business of the company is carried out only with the help of outside debt. This will certainly have a serious impact on the business standing of the company. Its operational efficiency, credit worthiness, repaying capacity, all will come under question, though the company may have valid reasons to believe (and to prove also) that the negative net-worth is only a temporary phenomenon. Figure of a small negative net-worth, that too temporary, will require a lot of explaining by the company at a different forum.

Effect of negative 'surplus' will be felt both by an established company as well as a newly formed company. A newly formed company is going to be affected because of absence of the head 'Miscellaneous Expenses to the Extent Not Written Off' on the asset side of the Balance Sheet format prescribed in the new schedule. Under the earlier schedule, newly formed companies were showing preliminary expenses other such expenditure under that head. Such expenses were periodically written off to the profits of the company in subsequent period.

This freedom is now no more available. As stated, there is no such head in the new schedule. In fact a company will require charging off all such expenses as revenue expenditure in the year of its incurrence. There is every possibility that the company may post losses in the very first year of its existence solely because of such write off though it may not have commenced business. Needless to say the loss will not qualify for carry forward under the provisions of Income Tax Act 1961.

Other Features

Some of the known features which are already being brought out by professional fraternity are listed as under:

- Specified format of Statement of Profit and Loss as against no such format in the old Schedule.
- Rounding off related to turnover
- Disclosure of continuing default in repayment of loans and interest.
- Removal of disclosure about managerial remuneration.
- Removal of redundant disclosures like quantitative information.

In the new Schedule VI, figures of previous period have also to be presented in the new format for financial statements as well as notes to accounts. Therefore, the exercise is already underway by the corporate entities and auditors to regroup the figures of previous period to confirm to the new format. This process of regrouping itself will bring out many distinctive features.

Conclusion

One thing is very clear. There is going to be great excitement when the first set of financial statements under Revised Schedule VI is published. Surely many surprises may greet us then. All the features described above will have their effects prominently displayed in the first set of financial statements prepared after coming into force of Revised Schedule VI. ■