

## The Company Audit – II

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### Learning Objectives

After studying this chapter, you will be able to understanding –

- ◆ The general considerations in a company audit.
- ◆ The procedure of auditing of share capital, debentures, dividends and verification of issue of bonus shares.
- ◆ The presentation of financial statement, such as, balance sheet and statement of profit and loss.

The previous chapter basically dealt with provisions relating to company auditor i.e. his qualifications, disqualifications, rights, duties, rotation of auditor etc. In this Chapter, we shall concentrate on provisions relating to company accounts, some specific items of financial statements relating to companies and audit thereof. Students are also expected to know in detail the requirements of Schedule III to the Companies Act, 2013, while auditing different items contained in financial statements.

### 8.1 General Considerations in Company Audit

These have to be determined on a consideration of:

- (1) objectives of audit;
- (2) various provisions in the Companies Act, 2013, especially those concerning accounts and audit; and
- (3) the scope of the report that the auditor of a company is required to make in pursuance of the provisions contained in section 143 of the Act.

The objectives of an audit are:

- (i) Verification of statements of account so as to express an opinion;
- (ii) Detection of errors and frauds; and
- (iii) Prevention of occurrence of errors and frauds.

(Student may note that objective of an audit are discussed in detail in initial chapters.)

## 8.2 Specific Provisions as Regards Accounts in the Companies Act, 2013

**8.2.1 Books of Account, etc., to be kept by Company:** The provisions in the matter of books of account which a company is required to maintain are contained in section 128 of the Companies Act, 2013 (hereinafter referred as the Act).

The term “**Book and paper**” and “**Book or paper**” has been defined under section 2(12) of the Act, which includes books of account, deeds, vouchers, writings, documents, minutes and registers maintained on paper or in electronic form.

Further, “**Books of account**”, as defined under section 2(13) of the Act, includes records maintained in respect of—

- (a) all sums of money received and expended by a company and matters in relation to which the receipts and expenditure take place;
- (b) all sales and purchases of goods and services by the company;
- (c) the assets and liabilities of the company; and
- (d) the items of cost as may be prescribed under section 148 in the case of a company which belongs to any class of companies specified under that section.

**Provisions of section 128 of the Act are summarised below:**

- (i) **Maintenance of books of accounts:** Sub-section (1) of section 128 requires every company to prepare and keep at its registered office books of account and other relevant books and papers and financial statement for every financial year which give a true and fair view of the state of the affairs of the company, including that of its branch office or offices, if any, and explain the transactions effected both at the registered office and its branches.

Such books of Accounts are required to be kept on accrual basis and according to the double entry system of accounting.

- (ii) **Place of maintenance of books of accounts:** As discussed above, sub-section (1) requires the company to keep its books of account and other relevant papers at the registered office of the company.

The company may also keep all or any of the books of accounts at any other place in India as the Board of directors may decide. In such a case, the company should file with the Registrar of Companies, a notice in writing giving the full address of that place within 7 days of the Boards' decision.

- (iii) **Electronic form of Books of accounts:** Second proviso to section 128(1) read with the Companies (Accounts) Rules, 2014 allows a company to keep its books of account or other relevant papers in electronic mode.

However, the books of account and other relevant books and papers maintained in electronic mode shall comply with the following conditions:

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- (a) the books of account and other relevant books and papers shall remain accessible in India so as to be usable for subsequent reference.
- (b) the books of account and other relevant books and papers shall be retained completely in the format in which they were originally generated, sent or received, or in a format which shall present accurately the information generated, sent or received and the information contained in the electronic records shall remain complete and unaltered.
- (c) the information received from branch offices shall not be altered and shall be kept in a manner where it shall depict what was originally received from the branches.
- (d) the information in the electronic record of the document shall be capable of being displayed in a legible form.
- (e) there shall be a proper system for storage, retrieval, display or printout of the electronic records as the audit committee, if any, or the board may deem appropriate and such records shall not be disposed of or rendered unusable, unless permitted by law.
- (f) the back-up of the books of account and other books and papers of the company maintained in electronic mode, including at a place outside India, if any, shall be kept in servers physically located in India on a periodic basis.

The company is required to intimate to the Registrar on an annual basis at the time of filing of financial statement, the following-

- (a) The name of the service provider;
  - (b) The internet protocol address of service provider;
  - (c) The location of the service provider (wherever applicable);
  - (d) Where the books of account and other books and papers are maintained on cloud, such address as provided by the service provider.
- (iv) **Proper Books of Account in relation to a Branch of the Company:** In case the company has a branch office in/or outside India, it shall be deemed to have complied with the provisions of section 128(1) if -
- (a) Proper books of account relating to the transactions effected at the branch office in India or outside India are kept at that branch office; and
  - (b) Proper summarised returns periodically are sent by the branch office to the company at its registered office or the other place as decided by the Board of directors.
- (v) **Persons who can inspect books of account & other books and papers:**
- (a) The books of account and other books and papers maintained by the company within India shall be open for inspection at the registered office of the company or at such other place in India by any director during business hours.

- (b) In the case of financial information, if any, maintained outside the country, copies of such financial information shall be maintained and produced for inspection by any director subject to such conditions as prescribed under the Companies (Accounts) Rules, 2014 which provides that-
    - (1) The summarised returns of the books of account of the company kept and maintained outside India shall be sent to the registered office at quarterly intervals, which shall be kept and maintained at the registered office of the company and kept open to directors for inspection.
    - (2) Where any other financial information maintained outside the country is required by a director, the director shall furnish a request to the company setting out the full details of the financial information sought, the period for which such information is sought.
    - (3) The company shall produce such financial information to the director within 15 days of the date of receipt of the written request.
    - (4) The financial information required under sub-rules (2) and (3) above shall be sought for by the director himself and not by or through his power of attorney holder or agent or representative.
  - (c) The inspection in respect of any subsidiary of the company shall be done only by the person authorised in this behalf by a resolution of the Board of Directors.
  - (d) The officers and other employees of the company shall give to the person making such inspection all assistance in connection with the inspection which the company may reasonably be expected to give.
- (vi) Period of Maintenance:** According to section 128(5), the books of account of every company together with the vouchers relevant to any entry in such books of accounts shall be kept in order by the company for a minimum period of 8 financial years immediately preceding a financial year.
- However, where the company had been in existence for a period of less than 8 years, it shall maintain the books in respect of all such preceding years.
- Where an investigation has been ordered in respect of the company, the Central Government may direct that the books of account may be kept for such longer period as it may deem fit.
- (vii) Persons responsible for Maintenance & Penalty:** Section 128(6) deals with the matters related to persons responsible for maintenance of books of account, and other relevant books and papers, and financial statement; and penalty in case of non-compliance. Provisions in brief are discussed below -
- (a) The following persons are responsible for the maintenance of proper books of account-

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- (1) The managing director, the whole-time director in charge of finance, the Chief Financial Officer; or
  - (2) any other person of a company charged by the Board.
- (b) If any of the persons mentioned above contravenes such provisions, they shall be punishable with:
- (1) Imprisonment for a term which may extend to 1 year; or
  - (2) Fine which shall not be less than ` 50,000 but which may extend to ` 5 lakh; or
  - (3) Both with imprisonment or fine.

**8.2.2 Financial Statements:** As per section 2(40) of the Companies Act, 2013, "Financial Statement" in relation to a company, includes—

- (a) a balance sheet as at the end of the financial year;
- (b) a profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year;
- (c) cash flow statement for the financial year;
- (d) a statement of changes in equity, if applicable; and
- (e) any explanatory note annexed to, or forming part of, any document referred above.

However, the financial statement, with respect to One Person Company, small company and dormant company, may not include the cash flow statement.

**Section 129 prescribes norms for financial statements which are as under:**

- (i) **Form of Financial statements:** Sub-section (1) of section 129 provides that the financial statements shall-
- (a) give a true and fair view of the state of affairs of the company or companies,
  - (b) comply with the accounting standards notified under section 133 and
  - (c) be in the form or forms as may be provided for different class or classes of companies in Schedule III<sup>1</sup> (Given as Appendix at the end of this chapter).

However, the items contained in such financial statements shall be in accordance with the accounting standards.

It may be noted that the above provisions relating to nature and content of financial statement shall not apply to following companies:

- (a) Insurance Companies
- (b) Banking companies

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<sup>1</sup> Students are advised to go through Schedule III to the Companies Act, 2013 carefully for preparation of financial statements of companies including consolidated financial statements reproduced in Appendix given at the end of this chapter.

- (c) Company engaged in the generation or supply of electricity
- (d) Any other class of company for which a form of financial statement has been specified in or under the Act governing such class of company.

However, the financial statements shall not be treated as not disclosing a true and fair view of the state of affairs of the company, if the following disclosures are not made-

Type of Company	Matters
Insurance Company	Matters which are not required to be disclosed by the Insurance Act, 1938, or the Insurance Regulatory and Development Authority Act, 1999
Banking company	Matters which are not required to be disclosed by the Banking Regulation Act, 1949
Company engaged in the generation or supply of electricity	Matters which are not required to be disclosed by the Electricity Act, 2003
Company governed by any other law	Matters which are not required to be disclosed by that law

Here, any reference to the financial statement shall include any notes annexed to or forming part of such financial statement, giving information required to be given and allowed to be given in the form of such notes under this Act.

Section 129(2) requires the Board of directors of the company to lay the financial statements for the financial year at every annual general meeting of the company.

- (ii) **Consolidated Financial Statements:** According to Section 129(3), where a company has one or more subsidiaries (including associate company and joint venture), it shall, in addition to its own financial statements prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own.

The Consolidated financial statements shall also be laid before the annual general meeting of the company along with the laying of its own financial statement.

The company shall also attach along with its financial statement, a separate statement containing the salient features of the financial statement of its subsidiary or subsidiaries in Form AOC-1.

According to Companies (Accounts) Rules, 2014, the consolidation of financial statements of the company shall be made in accordance with the provisions of Schedule III to the Act and the applicable accounting standards. However, a company which is not required to prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with provisions on consolidated financial statements provided in Schedule III of the Act.

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Further, section 129(4) of the said Act provides that the provisions applicable to the preparation, adoption and audit of the financial statements of a holding company shall, mutatis mutandis, also apply to the consolidated financial statements.

- (iii) **Deviations from Accounting Standards:** If the financial statements of a company do not comply with the accounting standards referred to in sub-section (1) of section 129, the company shall disclose in its financial statements the following namely:
- (a) the deviation from the accounting standards,
  - (b) the reasons for such deviation, and
  - (c) the financial effects, if any, arising out of such deviation.
- (iv) **Exemptions:** Section 129(6) states about exemptions as follows-
- (a) The Central Government may, on its own or on an application by a class or classes of companies, by notification, exempt any class or classes of companies from complying with any of the requirements of section 129 or the rules made thereunder, if it is considered necessary to grant such exemption in the public interest.
  - (b) Any such exemption may be granted either unconditionally or subject to such conditions as may be specified in the notification.
- (v) **Contravention:** Sub-section (7) levies the penalty in case of contravention of the provisions of section 129. It states that if a company contravenes the provisions of this section, the managing director, the whole-time director in charge of finance, the Chief Financial Officer or any other person charged by the Board with the duty of complying with the requirements of this section and in the absence of any of the officers mentioned above, all the directors shall be punishable with
- (a) Imprisonment for a term which may extend to 1 year; or
  - (b) Fine which shall not be less than ` 50,000 but which may extend to ` 5 Lakhs; or
  - (c) Both with imprisonment and fine.

**8.2.3 Central Government to prescribe Accounting Standards:** Section 133 of the Companies Act, 2013 provides the provisions for Central Government to prescribe accounting standards. According to section 133 of the Companies Act, 2013, "Accounting Standards" means the standards of accounting or any addendum thereto as recommended by the Institute of Chartered Accountants of India (ICAI), as may be prescribed by the Central Government in consultation with and after examination of the recommendations made by the National Financial Reporting Authority constituted under section 132 of the Companies Act, 2013.

In respect of accounting standards, the role of National Financial Reporting Authority is limited to advise the Central Government on the accounting standards recommended by ICAI for adoption by companies.

The Ministry of Corporate Affairs (MCA) vide General Circular No. 15/2013 dated 13th September, 2013 has clarified that till the Standards of Accounting or any addendum thereto are prescribed by Central Government in consultation and recommendation of the National Financial Reporting Authority, the existing Accounting Standards notified under the Companies Act, 1956 shall continue to apply.

**8.2.4 Financial Statement, Board's Report etc.:** Section 134 of the Companies Act, 2013 provides for financial statement, Board's report, etc.

**Provisions of section 134 are briefly summarised below:**

- (i) **Authentication of Financial Statements:** Section 134(1) provides that the financial statements, including consolidated financial statement, if any, shall be approved by the board of directors before they are signed on behalf of the board at least by the following-
- (a) The chairperson of the company where he is authorised by the Board; or
  - (b) By two directors out of which one shall be managing director and
  - (c) The Chief Executive Officer, if he is a director in the company,
  - (d) The Chief Financial Officer, wherever he is appointed; and
  - (e) The company secretary of the company, wherever he is appointed.

However, in the case of a one person company, the financial statement shall be signed by only one director, for submission to the auditor for his report thereon.

As per section 134(2), the auditors' report shall be attached to every financial statement.

According to section 134(7), a signed copy of every financial statement, including consolidated financial statement, if any, shall be issued, circulated or published along with a copy each of—

- (a) Any notes annexed to or forming part of such financial statement;
  - (b) The auditor's report; and
  - (c) The Board's report.
- (ii) **Board's Report:** According to Companies (Accounts) Rules, 2014, the board's report shall be prepared based on the stand alone financial statements of the company and the report shall contain a separate section wherein a report on the performance and financial position of each of the subsidiaries, associates and joint venture companies included in the consolidated financial statement is presented.

Section 134(3) provides that there shall be attached to statements laid before a company in general meeting, a report by its board of directors, which shall include —

- (a) the extract of the annual return as provided under sub-section (3) of section 92;
- (b) number of meetings of the Board;
- (c) Directors' Responsibility Statement;

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- (d) a statement on declaration given by independent directors under sub-section (6) of section 149;
- (e) in case of a company covered under sub-section (1) of section 178, company's policy on directors' appointment and remuneration including criteria for determining qualifications, positive attributes, independence of a director and other matters provided under sub-section (3) of section 178;
- (f) explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made—
  - (1) by the auditor in his report; and
  - (2) by the company secretary in practice in his secretarial audit report;
- (g) particulars of loans, guarantees or investments under section 186;
- (h) particulars of contracts or arrangements with related parties referred to in sub-section (1) of section 188 in Form AOC-2;
- (i) the state of the company's affairs;
- (j) the amounts, if any, which it proposes to carry to any reserves;
- (k) the amount, if any, which it recommends should be paid by way of dividend;
- (l) material changes and commitments, if any, affecting the financial position of the company which have occurred between the end of the financial year of the company to which the financial statements relate and the date of the report;
- (m) the conservation of energy, technology absorption, foreign exchange earnings and outgo, in such manner as prescribed under the Companies (Accounts) Rules, 2014 which provides for:
  - (A) Conservation of energy-
    - (1) the steps taken or impact on conservation of energy;
    - (2) the steps taken by the company for utilising alternate sources of energy;
    - (3) the capital investment on energy conservation equipments;
  - (B) Technology absorption-
    - (1) the efforts made towards technology absorption;
    - (2) the benefits derived like product improvement, cost reduction, product development or import substitution;
    - (3) in case of imported technology (imported during the last three years reckoned from the beginning of the financial year)-
      - (i) the details of technology imported;
      - (ii) the year of import;

- (iii) whether the technology been fully absorbed;
  - (iv) if not fully absorbed, areas where absorption has not taken place, and the reasons thereof; and
- (4) the expenditure incurred on Research and Development.
- (C) Foreign exchange earnings and Outgo- The Foreign Exchange earned in terms of actual inflows during the year and the Foreign Exchange outgo during the year in terms of actual outflows.
- (n) a statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, which in the opinion of the Board may threaten the existence of the company;
- (o) the details about the policy developed and implemented by the company on corporate social responsibility initiatives taken during the year;
- (p) in case of a listed company and every other public company having a paid up share capital of 25 crore rupees or more calculated at the end of the preceding financial year shall include (as prescribed under the Companies (Accounts) Rules, 2014), in the report by its Board of directors, a statement indicating the manner in which formal annual evaluation has been made by the Board of its own performance and that of its committees and individual directors.
- (q) The report of the Board shall also contain (as prescribed under the Companies (Accounts) Rules, 2014 –
  - (1) the financial summary or highlights;
  - (2) the change in the nature of business, if any;
  - (3) the details of directors or key managerial personnel who were appointed or have resigned during the year;
  - (4) the names of companies which have become or ceased to be its subsidiaries, joint ventures or associate companies during the year;
  - (5) the details relating to deposits like-
    - (i) accepted during the year;
    - (ii) remained unpaid or unclaimed as at the end of the year;
    - (iii) whether there has been any default in repayment of deposits or payment of interest thereon during the year and if so, number of such cases and the total amount involved-
      - (a) at the beginning of the year;
      - (b) maximum during the year;
      - (c) at the end of the year;

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- (6) the details of deposits which are not in compliance with the requirements of Chapter V of the Act;
- (7) the details of significant and material orders passed by the regulators or courts or tribunals impacting the going concern status and company's operations in future;
- (8) the details in respect of adequacy of internal financial controls with reference to the Financial Statements.

**Board's Report in case of OPC:** As per sub-section (4) of section 134, in case of a one person company, the report of the board of directors to be attached to the financial statement under this section shall, mean a report containing explanations or comments by the board on every qualification, reservation or adverse remark or disclaimer made by the auditor in his report.

(iii) **Directors' Responsibility Statement:** According to section 134(3)(c) of the Companies Act, 2013, the report of board of directors on annual accounts shall also include a 'Directors' Responsibility Statement'. However, the provisions related to Directors' Responsibility Statement are provided under section 134(5) of the Companies Act, 2013 which requires to state that-

- (a) in the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures;
- (b) the directors had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit and loss of the company for that period;
- (c) the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;
- (d) the directors had prepared the annual accounts on a going concern basis;
- (e) the directors, in the case of a listed company, had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively.

Here, the term "internal financial controls" means the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information; and

- (f) the directors had devised proper systems to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively.

- (iv) **Signing of Board's Report:** Section 134(6) requires the Board's report and any annexures thereto to be signed by its chairperson of the company if he is authorised by the Board and where he is not so authorised, to be signed by at least two directors, one of whom shall be a managing director, or by the director where there is one director.
- (v) **Contravention:** Sub-section (8) levies the penalty in case of contravention of the provisions of section 134. It states that-
- (a) If a company contravenes any provisions of this section, the company shall be punishable with fine which shall not be less than ` 50,000 but which may extend to ` 25 Lacs.
- (b) Every officer of the company who is in default shall be punishable with:
- (1) Imprisonment for a term which may extend to 3 years; or
  - (2) fine which shall not be less than ` 50,000 but which may extend to ` 5 Lacs; or
  - (3) Both with imprisonment and fine.

### 8.3 Special Requirements of Company Audit

(i) **Verification of the constitution and powers -** A company can function within the limits prescribed by the documents on the basis of which it has been registered. It raises its capital from the public on certain conditions, specified in the Prospectus. Before commencing business, to purchase a property or to have subscription to its capital underwritten on this account, it is essential that the auditor, prior to starting the audit of a company, shall examine:

- (a) The Memorandum of Association.
- (b) The Articles of Association.
- (c) Contracts entered into with vendors and other persons relating to purchase of property, payment of commission, etc.

A company cannot enter into a contract before it has been registered. What is more, a public company cannot commence business until the certificate of commencement of business has been granted to it by the Registrar of Companies. It is, therefore, the duty of the auditor to take into account, while examining the transaction entered into by the company, the dates when these were entered into for confirming the validity.

With a view to carrying out the audit effectively, it is necessary that the auditor should know the authority structure of the company and ensure the compliance of the same. For example as per Section 179 of the Act, the Board of Directors of a company are entitled to exercise all such powers, and to do all such acts and things, as the company is authorised to do. However, the Board shall not exercise any power or do any act or thing which is directed or required by any legislation (including the Companies Act) or by the memorandum or articles of the company, to be exercised or done by the company, in general meeting.

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**Section 179 specifies various types of decisions that can be taken by way of resolution by the Board of Directors only in Board's meetings, namely;**

- (a) to make calls on shareholders in respect of money unpaid on their shares;
- (b) to authorise buy-back of securities under section 68;
- (c) to issue securities, including debentures, whether in or outside India;
- (d) to borrow monies;
- (e) to invest the funds of the company;
- (f) to grant loans or give guarantee or provide security in respect of loans;
- (g) to approve financial statement and the Board's report;
- (h) to diversify the business of the company;
- (i) to approve amalgamation, merger or reconstruction;
- (j) to take over a company or acquire a controlling or substantial stake in another company;
- (k) any other matter which may be prescribed:

Apart from the above, a number of **other functions** are also carried out by the Board. A few of such functions are stated herein by way of examples:

- (a) Adopting of accounts before the same submitted to the auditor for their report as given under section 134.
- (b) Appointment of the first auditors and filling of casual vacancy as provided under section 139.
- (c) Investment in shares of companies within the limits specified in Section 186.
- (d) Entering into contracts with persons who are directors of the company or related to or associated with the directors as are specified in Section 188 of the Act.

Whereas some of the matters which only the shareholders can sanction at a general meeting like Appointment and fixation of remuneration of auditors in the annual general meeting - Section 139 and 142, Declaration of dividends etc.

### **(ii) Special considerations involved in the examination of certain documents**

- (a) **Memorandum of Association** - It is a charter containing particulars of business activities that the company can undertake and the powers it can exercise in regard thereto. Only on a consideration thereof it is possible for the auditor to determine whether a transaction which has been entered into by the company is *intra vires*, i.e. the company is authorised to enter into it. If a company enters into a transaction which is *ultra vires*, the shareholders, though entitled to claim the profit arising on such a transaction, may restrain the management from charging the loss, if any, has been suffered thereon, to the company. If the auditor fails to detect and report the transactions which are *ultra vires* the company, he would be guilty of negligence.

Generally the Memorandum of Association of companies is drawn up comprehensively in order that the company may be able to enter into a wide variety of transactions which it may be required to do for carrying out one or more of its objects. Nevertheless, sometimes occasions arise when a company, inadvertently, or deliberately, enters into a transaction which is *ultra vires* objects to powers. In such a case, the shareholders may decide to restrain the management from charging to the company the losses suffered by the company in respect of such a transaction.

- (b) **Articles of Association** - These are rules and regulations for the internal management of the company; and they define the rights of different classes of shareholders, conditions under which calls can be made, the maximum and minimum number of directors the company can have, their qualifications, disqualifications and removal, etc. The terms and conditions of these provisions have relevance to the examination of transaction, that the auditor is required to carry out. He should, therefore, study the Articles and include extracts from them in his permanent audit file. The auditor, who fails to take note of the provisions in the Articles in the verification of statements of accounts, would be guilty of professional negligence. While delivering judgment in the case, *Leeds Estate Building and Investment Co. v. Shepherd, Starling J.* said, "It is the duty of the auditor to see that the balance sheet is a true and correct representation of the company's affairs. It was no excuse that the auditor had not seen the articles when he knew of their existence."

The auditor must, therefore, acquaint himself with the provision of the Articles of the company and should apply this knowledge in the verification of the transactions of the company.

- (c) **Prospectus** - It is a formal document which a public company must issue before it makes the allotment of shares. It must contain all the terms and conditions on which subscription to the shares is sought to be obtained from the public e.g. the company may stipulate, that it would obtain a quotation for its shares at a Stock Exchange or that it shall purchase a property which is considered valuable for the company or that it has obtained the services of technical experts whose services will be valuable for setting up the factory. In case the company fails to carry out any of these undertakings or if any statement made by it ultimately is proven to be false, the shareholder has the option to claim refund of the amount paid by him. The auditor should, therefore, study carefully all the conditions and stipulations made in the prospectus and, in case any of them has not been carried out, to draw the attention of shareholders thereto. It may be noted that the right to claim refund is restricted to such of the shareholders who subscribed for shares on the basis of prospectus. A shareholder who has purchased the shares from stock exchange or otherwise cannot claim refund.

## 8.4 Audit of Share Capital

Almost the first function of a company is to raise capital. Excepting a private company, every other company issues a prospectus, which may be in the abridged form, or a Statement in lieu of Prospectus, before it proceeds to allotment, share capital. The object is to publicly announce the conditions on which allotment will be made, to specify the projects on which the amount raised will be spent (when these have been decided upon in advance) and to specify limits on certain expenses incidental to raising of capital. The receipt of applications for shares and allotment of shares in pursuance thereto are two important aspects of every issue of capital in so far as these constitute the legal basis of the transactions in the matter of purchase of shares. These, therefore, should receive a careful attention of the auditor. He also must verify that each party, has performed his part of the contract, within the allotted time.

The audit of share capital is necessary both on incorporation and afterwards whenever the directors decide to increase the subscribed share capital. However, except when fresh capital has been issued during the year under audit, for verification of capital it is enough if transfers of shares registered during the year are verified and the total number and value of shares held by different shareholders are reconciled with the total paid-up capital of the company.

### 8.4.1 General Programme for Verification of Share Capital

**(a) Nominal or Authorised or Registered capital:** This form of capital has been defined in section 2(8) of the Companies Act, 2013. "Authorised capital" or "Nominal capital" means such capital as is authorised by the memorandum of a company to be the maximum amount of share capital of the company. Thus it is the sum stated in the memorandum as the capital of the company with which it is to be registered being the maximum amount which it is authorised to raise by issuing shares, and upon which it pays the stamp duty. It is usually fixed at the amount, which, it is estimated, the company will need, including the working capital and reserve capital, if any.

The authorised capital may be verified with reference to the amount shown in the Memorandum of Associations. Previous year audited balance sheet may also be seen.

**(b) Issued Capital:** Section 2(50) of the Companies Act, 2013 defines "issued capital" which means such capital as the company issues from time to time for subscription; It is that part of authorised capital which is offered by the company for subscription and includes the shares allotted for consideration other than cash.

Schedule III of the Companies Act, 2013, makes it obligatory for a company to disclose its issued capital in the balance sheet.

Verify the amount of issued capital with reference to last year audited balance sheet. Also see whether the Central Government has issued any notification for conversion of debenture or loan into equity share under section 62(4).

Further for verification of issue of capital the general points are given as under:

- (i) Study the conditions of issue contained in the Memorandum and Articles of Association, Prospectus or Statement in lieu of Prospectus, shelf prospectus, red-herring prospectus

and information memorandum, as the case may be, and see that all of them have fully been complied with.

- (ii) Verify that the first allotment was not made until the amount of minimum subscription stated in the Prospectus had been subscribed and until then the amount received was kept deposited in a Scheduled bank as required by Section 39 of the Act.
- (iii) Confirm that the brokerage and underwriting commission was paid only at the rates authorised by the Prospectus or the Articles of Association, having regard to the provisions contained in Section 40 of the Act.
- (iv) Ensure that legal requirements as laid down in section 62 (dealing with right shares) have been complied with.
- (v) Verify that preliminary contracts, if any, entered into for purchase of a property or business, for creating an organisation for management of the company, etc. have been carried out strictly according to the terms stated in the Prospectus.
- (vi) Ensure that the company intending to offer shares to the public for subscription by the issue of a Prospectus has, before such issue, made an application to one or more recognised stock exchanges for permission for the shares intending to be so offered within the stock exchange or each stock exchange as required by the Companies Act, 2013.
- (vii) Confirm that the guidelines issued by the Securities and Exchange Board of India (SEBI) have been followed. Compliance reports submitted by lead managers and reports submitted to SEBI may be examined in this regard.
- (viii) Ascertain that there exists an internal check on receipt of amounts along with the application and that the same throughout has continued to function satisfactorily.
- (ix) Verify compliance with legal provision relating to issue of shares at premium (section 52), Prohibition on issue of shares at discount (section 53), and issue of sweat equity shares (section 54).

**8.4.2 Verification of Shares Issued for Cash:** Usually, there are three stages in the issue of shares for cash, viz.-

- (i) Receipt of applications for shares alongwith application money;
- (ii) Allotment of shares and receipt of allotment; and
- (iii) Making calls and receipt of call money.

The programme of work to be carried out in respect of each of the above mentioned three stages is stated below-

- (1) **Applications:** Verify the amount received along with the applications for shares in the following manner-

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- (i) Check entries in the Application and Allotment Book (or Sheets) with the original applications;
  - (ii) Check entries in the Application and the Allotment Book as regards deposits of money, received with the applications, with those in the Cash Book;
  - (iii) Vouch amounts refunded to the unsuccessful applicants with copies of Letters of Regret;
  - (iv) Check the totals columns in the Application and Allotment Book and confirm the journal entry debiting Share Application Account and crediting Share Capital Account.
- (2) **Allotment:**
- (i) Examine Director's Minutes Book to verify approval of allotments.
  - (ii) Compare copies of letters of allotment with entries in the Application and Allotment Book.
  - (iii) Trace entries in the Cash book into the Application and Allotment Book for the verification of amounts collected on allotment.
  - (iv) Trace the amount collected on application as well as those on allotment from the Application and Allotment Book into the Share Register.
  - (v) Check whether the amount stated in the prospectus as the minimum amount has been subscribed and the sums payable on such application have been received by the company.
  - (vi) Check that the amount payable on the application on every security is not less than five percent of the nominal amount of security or such other percentage or amount as may be prescribed by the SEBI.
  - (vii) If the stated minimum amount has not been subscribed and the sum payable on subscription is not received within a period of thirty days from the date of issue of the prospectus or such period as may be specified by the SEBI, check that the amount received above is returned within a period of fifteen days from the closure of the issue and if in case the amount is not repaid within such period, the directors in default shall jointly and severally be liable to repay that amount with interest at the rate of fifteen percent per annum.
  - (viii) Check totals of amounts payable on allotment and verify the journal entry debiting Share Allotment Account and crediting Share Capital Account.
- (3) **Calls:**
- (i) Examine the Director's resolution making the call.
  - (ii) Vouch amounts received with the counterfoils of receipts.

- (iii) Trace postings of the amounts received from the Calls Book (for calls due) and the Cash Book (for calls collected) into the Share Register.
- (iv) Verify the journal entry, debiting the Call Account and crediting Share Capital with totals of the amounts due.
- (v) Note the calls in arrears.

(4) **General:**

- (i) Ascertain that the nominal value of shares allotted does not, exceed the authorised and issued capital and that allotments were made in accordance with conditions contained in the Prospectus.
- (ii) See the returns of allotment have been filed with the Registrar of Companies.
- (iii) Extract balances of shareholders' accounts contained in the Share Register and tally their total with the balance in the Share Capital Account.
- (iv) If the issue was underwritten, examine the contract with the underwriters to ensure that all obligations under the contracts have been fully satisfied.
- (v) Vouch payment of commission and brokerage, the first by reference to the underwriting contract and the second by reference to stamps of brokers on application forms.
- (vi) See that the company has delivered share certificates within three months after the allotment of any of its shares in accordance with the procedure laid down under Section 53.

**Note:** The signatories to the Memorandum of Association being the first shareholder of the company, it is usual to make allotment in their favour.

**8.4.3 Shares Issued for Consideration other than Cash:** The contract, on the basis of which the shares have been allotted, should be referred to and the allotment confirmed by reference to the Minutes of the Board of Directors.

Sometimes, in view of the nature of the transaction, it may be difficult to know whether an allotment is for cash or for a consideration, other than cash, for instance, allotment of shares in adjustment of a debt owed by the company. In such a case, if the allotment is made in adjustment of a *bonafide* debt payable in money at once, the allotment should be considered as against cash. (Spargo's Case 1873, 3 Ch. A 407). This position should be kept in view when inquiring into matters stated in Section 143(1). Again if the shares are allotted on a cash basis, though the amount is actually paid later, it should constitute an allotment against cash.

**8.4.4 Shares Issued at a Premium:** Where a company has issued shares at a premium, that is, at amount in excess of the nominal value of the shares, whether for cash or otherwise, section 52 of the Companies Act, 2013 provides that a company shall transfer the amount received by it as securities premium to securities premium account and state the means in

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which the amount in the account can be applied. According to the section where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium received on those shares shall be transferred to a “securities premium account” and the provisions of this Act relating to reduction of share capital of a company shall apply as if the securities premium account were the paid-up share capital of the company.

**Application of securities premium account:** The securities premium account may be applied by the company—

- (a) towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares;
- (b) in writing off the preliminary expenses of the company;
- (c) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;
- (d) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or
- (e) for the purchase of its own shares or other securities under section 68.

**8.4.5 Shares Issued at a Discount:** A company cannot issue shares in disregard of Section 53 of the Companies Act, 2013. According to section 53, a company shall not issue shares at a discount, except in the case of an issue of sweat equity shares given under section 54 of the Companies Act, 2013.

Any share issued by a company at a discounted price shall be void. Where a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees and every officer who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees, or with both.

**8.4.6 Issue of Sweat Equity Shares:** As per section 54 of the Companies Act, 2013, the employees may be compensated in the form of ‘Sweat Equity Shares’.

“Sweat Equity Shares” means equity shares issued by the company to employees or directors at a discount or for consideration other than cash for providing know-how or making available right in the nature of intellectual property rights or value additions, by whatever name called.

The auditor may see that the Sweat Equity Shares issued by the company are of a class of shares already issued and following conditions are fulfilled:

- (a) the issue is authorised by a special resolution passed by the company;
- (b) the resolution specifies the number of shares, the current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued;

- (c) not less than one year has, at the date of such issue, elapsed since the date on which the company had commenced business; and
- (d) where the equity shares of the company are listed on a recognised stock exchange, the sweat equity shares are issued in accordance with the regulations made by the Securities and Exchange Board in this behalf and if they are not so listed, the sweat equity shares are issued in accordance with such rules as may be prescribed.

The rights, limitations, restrictions and provisions as are for the time being applicable to equity shares shall be applicable to the sweat equity shares issued under this section and the holders of such shares shall rank *pari passu* with other equity shareholders.

**8.4.7 Power of Company to Purchase its Own Securities:** The Companies Act, 2013 under Section 68(1) permits companies to buy-back their own shares and other specified securities out of:

- (i) its free reserves; or
- (ii) the securities premium account; or
- (iii) the proceeds of the issue of any shares or other specified securities.

It may be noted that no buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

The other important provisions relating to the buyback are:

- (1) Section 68(2) further states that no company shall purchase its own shares or other specified securities unless—
  - (a) the buy-back is authorised by its articles;
  - (b) a special resolution has been passed in general meeting of the company authorising the buy-back;

However, the above provisions do not apply where the buy back is 10% or less of the paid up equity capital + free reserves and is authorized by a board resolution passed at a duly convened meeting of the directors. Hence, in case the buy back is upto 10% of paid up equity + free reserves, the same may be done with the authorization of the Board Resolution without the necessity of a special resolution of its members being passed at a general meeting of the company.

- (c) the buy-back is equal or less than 25% of the total paid-up capital and free reserves of the company.

It may be noted that in respect of the buy-back of equity shares in any financial year, the reference to 25% shall be construed with respect to its total paid-up equity capital in that financial year.

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- (d) the ratio of the debt owed by the company (both secured and unsecured) after such buy - back is not more than twice the total of its paid up capital and its free reserves:

However, the Central Government may prescribe a higher ratio of the debt to capital and free reserves than that specified under this clause for a class or classes of companies.

- (e) all the shares or other specified securities for buy-back are fully paid-up;
- (f) the buy-back of the shares or other specified securities listed on any recognised stock exchange is in accordance with the regulations made by the Securities and Exchange Board of India in this behalf;
- (g) the buy-back in respect of shares or other specified securities other than those specified in clause (f) is in accordance with the guidelines as may be prescribed.

It may be noted that no offer of buy back under this sub section shall be made within a period of one year reckoned from the date of closure of a previous offer of buy back if any. This means that there cannot be more than one buy back in one year.

- (2) Every buy-back shall be completed within 1 year from the date of passing the special resolution, or the resolution passed by the board of directors where the buy back is upto 10% of the paid up equity capital + free reserves.
- (3) The notice of the meeting at which special resolution is proposed to be passed shall be accompanied by an explanatory statement stating—
  - (a) a full and complete disclosure of all material facts;
  - (b) the necessity for the buy-back;
  - (c) the class of shares or securities intended to be purchased under the buy-back;
  - (d) the amount to be invested under the buy-back; and
  - (e) the time limit for completion of buy-back.
- (4) The buy-back may be—
  - (a) from the existing shareholders or security holders on a proportionate basis; or
  - (b) from the open market; or
  - (c) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.
- (5) Where a company has passed a special resolution under clause (b) of Sub-section (2) or a resolution under item (ii) of the proviso thereto, to buy-back its own shares or other securities under this section, it shall, before making such buy-back, file with the Registrar and the Securities and Exchange Board of India a declaration of solvency in the form as may be prescribed and verified by an affidavit to the effect that the Board has made a full inquiry into the affairs of the company as a result of which they have formed an opinion

that it is capable of meeting its liabilities and will not be rendered insolvent within a period of one year of the date of declaration adopted by the Board, and signed by at least two directors of the company, one of whom shall be the managing director, if any.

However, no declaration of solvency shall be filed with the Securities and Exchange Board of India by a company whose shares are not listed on any recognised stock exchange.

- (6) Where a company buys-back its own securities, it shall extinguish and physically destroy the securities so bought-back within 7 days of the last date of completion of buy-back.
- (7) Where a company completes a buy-back of its shares or other specified securities under this section, it shall not make further issue of same kind of shares (including allotment of new shares under clause (a) of Sub-section (1) of Section (62) or other specified securities within a period of 6 months except by way of bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option scheme, sweat equity or conversion of preference shares or debentures into equity shares.
- (8) If a company makes default in complying with the provisions of this section or any regulations made by SEBI in this regard, the company shall be punishable with fine which shall not be less than ₹ 1 Lakh but which may extend to ₹ 3 lakh and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to 3 years or with fine of not less than ₹ 1 lakh but which may extend to ₹ 3 lakh, or with both.
- (9) Section 69(1) states that where a company purchases its own shares out of the free reserves or securities premium account, a sum equal to the nominal value of shares so purchased shall be transferred to the Capital Redemption Reserve Account and details of such account shall be disclosed in the Balance Sheet.
- (10) The Capital Redemption Reserve Account may be applied by the company in paying up unissued shares of the company to be issued to the members of the company as fully paid bonus shares.
- (11) Where a company buy-back its securities under this section, it shall maintain a register of the securities so bought, the consideration paid for the securities bought-back, the date of cancellation of securities, the date of extinguishing and physically destroying of securities and such other particulars as may be prescribed.
- (12) A company shall, after the completion of the buy-back under this section, file with the Registrar and the Securities and Exchange Board of India, a return containing such particulars relating to the buy-back within 30 days of such completion, as may be prescribed, provided that no return shall be filed with the Securities and Exchange Board of India by a company whose shares are not listed on any recognised stock exchange.

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### Some Important Terms

- (a) “**specified securities**” includes employees’ stock option or other securities as may be notified by the Central Government from time to time;
- (b) “**free reserves**” constitute those reserves which, as per latest audited balance-sheet of the company, are free for distribution as dividend and shall include balance to the credit of the securities premium account but shall not include share application money.]

**Note:** According to Section 69(1), where a company purchases its own shares out of free reserves or the securities premium account, then a sum equal to the nominal value of the share so purchased shall be transferred to the capital redemption reserve account and details of such account shall be disclosed in the balance sheet.

The auditor should ensure that the proper accounting entries have been passed immediately after the buy-back.

**Prohibition for buy back in certain circumstances:** As per provisions of Section 70 of the Companies Act 2013-

- (1) No company shall directly or indirectly purchase its own shares or other specified securities—
  - (a) through any subsidiary company including its own subsidiary companies; or
  - (b) through any investment company or group of investment companies; or
  - (c) if a default, by the company, in repayment of deposit or interest payable thereon, redemption of debentures or preference shares or payment of dividend to any shareholder or repayment of any term loan or interest payable thereon to any financial institutions or bank, is subsisting. Provided that the buy – back is not prohibited if the default is remedied and a period of three years has elapsed since the cessation of the default.
- (2) No company shall directly or indirectly purchase its own shares or other specified securities in case such company has not complied with provisions of Sections 92, 123, 127 and 129. Section 92 relates to the filing of Annual Return, Section 123 and 127 to declaration and payment of dividend and Section 129 to the financial statement of the company.

**8.4.8 Calls Paid in Advance:** A company, if permitted by the articles, may accept from members, either the whole or part of the amount remaining unpaid on any shares held by him as calls in advance; but the amount so received cannot be treated as a part of the capital for the purpose of any voting rights until the same becomes presently payable and duly appropriated. A company, if so authorised by its Articles, may pay dividend in proportion to the amount paid upon each share, where a larger amount is paid up on some shares than that on other.

Unless the company exercises the right as aforementioned, the shareholders who have paid calls in advance would be entitled to receive interest at the rate specified in the Articles. The

interest on calls in advance, though chargeable against profits, also can be paid out of capital when profits are not available for such a payment. In the event of a winding up, calls in advance repayable along with interest accrued thereon before any part of the capital is returned to shareholders.

**8.4.9 Calls in Arrears:** The amounts due from shareholders in respect of calls in arrears should be verified by reference to the Share register. If any calls are due from Directors, they should be shown separately in the balance sheet. Often the Articles provide that interest be charged on calls in arrears. The adjustment of interest in such a case should be verified.

**8.4.10 Issue and Redemption of Preference Shares:** "Preference share capital", with reference to any company limited by shares, means that part of the issued share capital of the company which carries or would carry a preferential right with respect to—

- (i) payment of dividend, either as a fixed amount or an amount calculated at a fixed rate, which may either be free of or subject to income-tax; and
- (ii) repayment, in the case of a winding up or repayment of capital, of the amount of the share capital paid-up or deemed to have been paid-up, whether or not, there is a preferential right to the payment of any fixed premium or premium on any fixed scale, specified in the memorandum or articles of the company;

**Issue of Preference Shares:** As per Section 55 of the Companies Act, 2013, no company limited by shares shall issue any preference shares which are irredeemable. Whereas a company limited by shares may, if so authorised by its articles, issue preference shares which are liable to be redeemed within a period not exceeding twenty years from the date of their issue subject to such conditions are prescribed in rules which are discussed below-

- (1) A company having a share capital may, if so authorised by its articles, issue preference shares subject to the following conditions, namely:
  - (i) the issue of such shares has been authorized by passing a special resolution in the general meeting of the company
  - (ii) the company, at the time of such issue of preference shares, has no subsisting default in the redemption of preference shares issued either before or after the commencement of this Act or in payment of dividend due on any preference shares.
- (2) A company issuing preference shares shall set out in the resolution, particulars in respect of the following matters relating to such shares, namely:
  - (i) the priority with respect to payment of dividend or repayment of capital vis-a-vis equity shares;
  - (ii) the participation in surplus fund;
  - (iii) the participation in surplus assets and profits, on winding-up which may remain after the entire capital has been repaid;
  - (iv) the payment of dividend on cumulative or non-cumulative basis;

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- (v) the conversion of preference shares into equity shares;
  - (vi) the voting rights;
  - (vii) the redemption of preference shares.
- (3) The explanatory statement to be annexed to the notice of the general meeting pursuant to section 102 shall, inter-alia, provide the complete material facts concerned with and relevant to the issue of such shares, including-
- (i) the size of the issue and number of preference shares to be issued and nominal value of each share;
  - (ii) the nature of such shares i.e. cumulative or non - cumulative, participating or non - participating , convertible or non – convertible;
  - (iii) the objectives of the issue;
  - (iv) the manner of issue of shares;
  - (v) the price at which such shares are proposed to be issued;
  - (vi) the basis on which the price has been arrived at;
  - (vii) the terms of issue, including terms and rate of dividend on each share, etc.;
  - (viii) the terms of redemption, including the tenure of redemption, redemption of shares at premium and if the preference shares are convertible, the terms of conversion;
  - (ix) the manner and modes of redemption;
  - (x) the current shareholding pattern of the company;
  - (xi) the expected dilution in equity share capital upon conversion of preference shares.
- (4) Where a company issues preference shares, the Register of Members maintained under section 88 shall contain the particulars in respect of such preference share holder(s).
- (5) A company intending to list its preference shares on a recognized stock exchange shall issue such shares in accordance with the regulations made by the Securities and Exchange Board of India in this behalf.

Further, as per proviso the section, a company may issue preference shares for a period exceeding twenty years for infrastructure projects, subject to the redemption of such percentage of shares as may be prescribed on an annual basis at the option of such preferential shareholders.

**Redemption of Preference Shares:** A company may redeem its preference shares only on the terms on which they were issued or as varied after due approval of preference shareholders and the preference shares may be redeemed-

- (a) at a fixed time or on the happening of a particular event;
- (b) any time at the company's option; or

(c) any time at the shareholder's option.

The Auditor should ensure that —

- (a) no such shares shall be redeemed except out of the profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of such redemption;
- (b) no such shares shall be redeemed unless they are fully paid;
- (c) where such shares are proposed to be redeemed out of the profits of the company, there shall, out of such profits, be transferred, a sum equal to the nominal amount of the shares to be redeemed, to a reserve, to be called the Capital Redemption Reserve Account, and the provisions of this Act relating to reduction of share capital of a company shall, except as provided in this section, apply as if the Capital Redemption Reserve Account were paid-up share capital of the company; and the capital redemption reserve account may, notwithstanding anything in this section, be applied by the company, in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.
- (d) (i) in case of such class of companies, as may be prescribed and whose financial statement comply with the accounting standards prescribed for such class of companies under section 133, the premium, if any, payable on redemption shall be provided for out of the profits of the company, before the shares are redeemed:  

Provided also that premium, if any, payable on redemption of any preference shares issued on or before the commencement of this Act by any such company shall be provided for out of the profits of the company or out of the company's securities premium account, before such shares are redeemed.
- (ii) in a case not falling under sub-clause (i) above, the premium, if any, payable on redemption shall be provided for out of the profits of the company or out of the company's securities premium account, before such shares are redeemed.

Where a company is not in a position to redeem any preference shares or to pay dividend, if any, on such shares in accordance with the terms of issue (such shares hereinafter referred to as unredeemed preference shares), it may, with the consent of the holders of three-fourths in value of such preference shares and with the approval of the Tribunal on a petition made by it in this behalf, issue further redeemable preference shares equal to the amount due, including the dividend thereon, in respect of the unredeemed preference shares, and on the issue of such further redeemable preference shares, the unredeemed preference shares shall be deemed to have been redeemed.

It is provided that the Tribunal shall, while giving approval under this sub-section, order the redemption forthwith of preference shares held by such persons who have not consented to the issue of further redeemable preference shares.

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Explanation—For the removal of doubts, it is hereby declared that the issue of further redeemable preference shares or the redemption of preference shares under this section shall not be deemed to be an increase or, as the case may be, a reduction, in the share capital of the company.

**8.4.11 Alteration of Share Capital:** Section 61 of the Companies Act, 2013 lays down power of limited company to alter its share capital. According to the provision a limited company having a share capital may, if so authorised by its articles, alter its memorandum in its general meeting to—

- (a) increase its authorised share capital by such amount as it thinks expedient;
- (b) consolidate and divide all or any of its share capital into shares of a larger amount than its existing shares, however no consolidation and division which results in changes in the voting percentage of shareholders shall take effect unless it is approved by the Tribunal on an application made in the prescribed manner;
- (c) convert all or any of its fully paid-up shares into stock, and reconvert that stock into fully paid-up shares of any denomination;
- (d) sub-divide its shares, or any of them, into shares of smaller amount than is fixed by the memorandum, so, however, that in the sub-division the proportion between the amount paid and the amount, if any, unpaid on each reduced share shall be the same as it was in the case of the share from which the reduced share is derived;
- (e) cancel shares which, at the date of the passing of the resolution in that behalf, have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled.

It may be noted that the cancellation of shares shall not be deemed to be a reduction of share capital.

Section 64 of the Companies Act, 2013 provides that within 30 days of the shares having been consolidated, converted, sub-divided, redeemed, or cancelled or the stock having been reconverted, notice should be given to the Registrar in the prescribed form along with an altered memorandum.

The auditor's duties in the circumstances shall be:

- (i) to verify that the alteration of capital is authorised by the Articles;
- (ii) to inspect the minutes of the shareholders authorising the alteration;
- (iii) to obtain Allotment Lists containing details of the new holdings of share or stock by each member and to verify the same with the entries;
- (iv) to inspect the directors' resolution in regard to allotment, consolidation, conversion or sub-division passed pursuant to the resolution of the members;
- (v) to examine the cancelled share certificates, if any, and agree the same with the counterfoils of new certificates issued;

- (vi) to see that the procedure, prescribed by the Articles in this regard, has been complied with;
- (vii) to verify that the share capital account is correctly shown in the Balance Sheet; and
- (viii) to see that the necessary intimation to the Registrar contemplated by Section 64 has been sent.

**8.4.12 Reduction of Capital\*:** The duties of the auditor in this regard are following-

- (i) Verifying that the meeting of the shareholder held to pass the special resolution was properly convened; also that the proposal was circularised in advance among the members.
- (ii) Confirming that the Articles of Association authorise reduction of capital.
- (iii) Examining the order of the Tribunal confirming the reduction and seeing that a copy of the order and the minutes have been registered and filed with the Registrar of Companies.
- (iv) Inspecting the Registrar's Certificate as regards reduction of capital.
- (v) Vouching the journal entries recorded to reduce the capital and to write down the assets by reference to the resolution of shareholders and other documentary evidence; also seeing that the requirements of Schedule III, Part I, have been complied with.
- (vi) Confirming that the revaluation of assets have been properly disclosed in the Balance Sheet.
- (vii) Verifying the adjustment made in the members' accounts in the Register of Members and confirming that either the paid up amount shown on the old share certificates have been altered or new certificates have been issued in lieu of the old, and the old ones have been cancelled.
- (viii) Confirming that the words "and reduced", if required by the order of the Tribunal, have been added to the name of the company in the Balance Sheet.
- (ix) Verifying that the Memorandum of Association of the company has been suitably altered.

\*[Note: Reduction of Capital is discussed in section 100 of the Companies Act, 1956, which is replaced by the section 66 of the Companies Act, 2013. This section is not yet notified.]

**8.4.13 Forfeiture of Shares**

**(a) Verification of Forfeiture of Shares:** The auditor should-

- (i) ascertain that the Articles authorise the Board of Directors to forfeit shares and that the power has been exercised by the Board in the best interest of the company;
- (ii) verify the amount of call or instalment of calls which was outstanding in respect of each of the share forfeited;

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- (iii) ascertain that the procedure in the Articles has been followed, viz., the notice given to the defaulting shareholders, warning them that in the event of non-payment, by a specified date, of the amount of call already made on the shares standing in their names, together with interest, if any, the shares shall be forfeited; see that the proper resolutions of Directors, first as regards issuance of notice and afterwards in respect of forfeiture of shares; and
- (iv) verify the entries recorded in the books of account consequent upon forfeiture of shares to confirm that the premium, if any, received on the issue of shares has not been transferred to the Forfeited Shares Account.

**(b) Re-issue of Forfeited Shares:** The auditor should-

- (i) ascertain that the Board of Directors has the authority under the Articles to re-issue forfeited shares;
- (ii) refer to the resolution of the Board of Directors, re-allotting forfeited shares;
- (iii) vouch the amounts collected from person to whom the shares have been allotted and verify the entries recorded from re-allotment and see that the total amount received on the share, including that received prior to forfeiture, is not less than the par value;
- (iv) verify that computation of the amount of surplus resulting on the reissue of shares credited to the Capital Reserve Account; and
- (v) Where partly paid shares are forfeited for non-payment of call, and re-issued as fully paid, the reissue is considered as an allotment at a discount and compliance of the provisions of Section 53 of the Companies Act, 2013 is essential as issuance of shares at discount other than sweat equity share are void.

## 8.5 Option on Share Capital

Schedule III, Part I, requires disclosure of the particulars of any option on unissued share capital. An option on shares arises when a person has acquired a right under an agreement with the company to subscribe for share in the company if he so chooses.

Such options generally arise under the following circumstances:

- (i) Under the promoter's agreements, subsequently ratified by the company;
- (ii) Collaboration agreement;
- (iii) Loan agreements, debenture deeds (Refer to Section 81 of the Companies Act);
- (iv) Agreements to convert preference shares into equity shares; and
- (v) Other contracts, such as for supply of capital goods and/or merchandise.

## 8.6 Shares Transfer Audit

Frequently, big companies require auditors to undertake audit of share transfer recorded by the company during the previous year. The object of such an audit is detection of mistakes in the registration of transfers which may have the effect of saddling the company with the liability for damages claimed by a shareholder on account of losses suffered in consequence thereof.

As per section 56 of the Companies Act, 2013 read with Rule 11 of the Companies (Share Capital and Debentures) Rules, 2014, the following aspects are required to be examined by the auditor in conducting the share transfer audit:

- (1) No transfer of securities or the interest of a member takes place in case of a company having no share capital, other than the transfer between persons both of whose names are entered as holders of beneficial interest in the records of a depository.
- (2) Check where an instrument of transfer of securities held in physical form is in Form No. SH. 4 duly stamped, dated and executed by or on behalf of the transferor and the transferee and specifying the name, address and occupation, if any, of the transferee has been delivered to the company by the transferor or the transferee within a period of sixty days from the date of execution, along with the certificate relating to the securities, or if no such certificate is in existence, along with the letter of allotment of securities.
- (3) Check where the instrument of transfer has been lost or the instrument of transfer has not been delivered within the prescribed period, the company registers the transfer on such terms as to indemnity as the Board may think fit.
- (4) Company has the power to register, on receipt of an intimation of transmission of any right to securities by operation of law from any person to whom such right has been transmitted.
- (5) Where an application is made by the transferor alone and relates to partly paid shares, examine that the transfer is not registered, unless the company gives the notice of the application in Form No. SH. 5 to the transferee and the transferee gives no objection to the transfer within two weeks from the receipt of notice.
- (6) Examine that the company, unless prohibited by any provision of law or any order of Court, Tribunal or other authority, delivers the certificates of all securities allotted, transferred or transmitted—
  - (a) within a period of two months from the date of incorporation, in the case of subscribers to the memorandum;
  - (b) within a period of two months from the date of allotment, in the case of any allotment of any of its shares;
  - (c) within a period of one month from the date of receipt by the company of the instrument of transfer under sub-section (1) or, as the case may be, of the intimation of

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transmission under sub-section (2), in the case of a transfer or transmission of securities;

- (d) within a period of six months from the date of allotment in the case of any allotment of debenture:
- (7) where the securities are dealt with in a depository, examine that the company intimates the details of allotment of securities to depository immediately on allotment of such securities.
- (8) If there any default made in complying with the provisions. Verify the amount of fine paid.

**Note** - Students should also refer to study material on Company Law for restrictions on transfer of shares.

### 8.7 Verification of Issue of Bonus Shares

Section 63 of the Companies Act, 2013 allows a company to issue fully paid-up bonus shares to its members, in any manner whatsoever, out of-

- (i) its free reserves;
- (ii) the securities premium account; or
- (iii) the capital redemption reserve account.

The auditor should ensure that no issue of bonus shares shall be made by capitalising reserves created by the revaluation of assets.

Further, he should also ensure the compliance of condition for capitalization of profits or reserves for the issuing fully paid-up bonus shares like-

- (a) it is authorised by its articles;
- (b) it has, on the recommendation of the Board, been authorised in the general meeting of the company;
- (c) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;
- (d) it has not defaulted in respect of the payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus;
- (e) the partly paid-up shares, if any outstanding on the date of allotment, are made fully paid-up;
- (f) it complies with such conditions as may be prescribed like the company which has once announced the decision of its Board recommending a bonus issue, shall not subsequently withdraw the same.
- (g) The bonus shares shall not be issued in lieu of dividend.

## 8.8 Audit of Debentures

**8.8.1 Allotment of Debentures:** As in the case of shares, in the case of debentures also, it is necessary for the auditor to verify whether allotment was made having regard to the terms and conditions contained in the prospectus or the Statement in lieu of Prospectus. The Companies Act, has made it compulsory for every company intending to offer debentures to the public for subscription by the issue of a prospectus shall, before such issue, make an application to one or more recognised stock exchanges for permission for the debentures intending to be so offered to be dealt with in the stock exchange or each such stock exchange. The auditor also must ascertain that the directors, while issuing the debentures, had acted within their powers having regard to restrictions contained in Section 180 and any further restrictions which may be contained in the Articles of Association. Section 71 has now made it compulsory for filing of Debenture Trust Deed and creation of Debenture Redemption Reserve as per section 71. It is specified that Debenture Trust Deed shall be open for inspection and can be made available on payment. Section 71 has also made it compulsory appointment of debenture trustees and specified their duties. Further, the auditor should ensure that the issue of debentures with an option to convert such debentures into shares, wholly or partly at the time of redemption, are approved by a special resolution passed at a general meeting.

In addition the auditor should verify that no company shall issue any debentures carrying any voting rights and he should also confirm the compliance of terms and conditions for issuance of Secured debentures which are given below:

- (i) an issue of secured debentures may be made, provided the date of its redemption shall not exceed ten years from the date of issue. It is also provided that a company engaged in the setting up of infrastructure projects may issue secured debentures for a period exceeding ten years but not exceeding thirty years;
- (ii) such an issue of debentures shall be secured by the creation of a charge, on the properties or assets of the company, having a value which is sufficient for the due repayment of the amount of debentures and interest thereon;
- (iii) the company shall appoint a debenture trustee before the issue of prospectus or letter of offer for subscription of its debentures and not later than sixty days after the allotment of the debentures, execute a debenture trust deed to protect the interest of the debenture holders; and
- (iv) the security for the debentures by way of a charge or mortgage shall be created in favour of the debenture trustee on any specific movable property of the company (not being in the nature of pledge); or any specific immovable property wherever situate, or any interest therein.

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**Debenture Redemption Reserve Account:** Where debentures are issued by a company under this section, the company shall create a debenture redemption reserve account out of the profits of the company available for payment of dividend and the amount credited to such account shall not be utilised by the company except for the redemption of debentures.

The company should create Debenture Redemption Reserve for the purpose of redemption of debentures, in accordance with the conditions given below-

- (a) the Debenture Redemption Reserve shall be created out of the profits of the company available for payment of dividend;
- (b) the company shall create Debenture Redemption Reserve equivalent to notified rate i.e at least 25 percent of the amount raised through the debenture issue before debenture redemption commences;
- (c) every company required to create Debenture Redemption Reserve shall on or before the 30th day of April in each year, invest or deposit, as the case may be, a sum which shall not be less than fifteen percent, of the amount of its debentures maturing during the year ending on the 31st day of March of the next year, in any specified method;
- (d) in case of partly convertible debentures, Debenture Redemption Reserve shall be created in respect of non-convertible portion of debenture issue in accordance with this sub-rule;
- (e) the amount credited to the Debenture Redemption Reserve shall not be utilised by the company except for the purpose of redemption of debentures.

Normally the auditor should take following steps for such verification:

- (i) Verify that the Prospectus or the Statement in lieu of Prospectus had been duly filed with the Registrar before the date of allotment.
- (ii) Check the applications for debentures with the Application and Allotment Book to verify that the name, address of the applicants and the number of debentures applied for are correctly recorded.
- (iii) Verify the allotment of debentures by reference to the Directors' Minute Book.
- (iv) Vouch the amounts collected as are entered in the Cash Book with the counterfoils of receipts issued to the applicants; also trace the amounts into the Application and Allotment Book.
- (v) Check postings of allotments of debentures and the amounts received in respect thereof from the Application and Allotment Book, into the Debentures Register.
- (vi) Verify the entries on the counterfoils of debentures issued with the Debentures Register.

- (vii) Extract balances in the Debentures Register in respect of amounts paid by the debenture holders and agree their total with the balance in the Debentures Account in the General Ledger.
- (viii) Examine a copy of the Debenture Trust Deed and note the conditions including creation of Debenture Redemption Reserve contained therein as to issue and repayment.
- (ix) If the debentures are covered by a mortgage or charge, it should be verified that the charge has been correctly recorded in the Register of Mortgages and Charges and that it has also been registered with the Registrar of Companies. Further, that the charge is clearly disclosed in the Balance Sheet.
- (x) Compliance with SEBI Guidelines should also be seen.

Where debentures have been issued as fully paid up to vendors as a part of the purchase consideration, the contract in this regard should be referred to.

**8.8.2 Issue of Debentures:** Debentures may be issued at par or at a premium or at a discount. When these are issued at a premium, the amount of premium collected should be credited to Premium on Debenture Account. Since it would be a capital profit, the balance to the credit of this account subsequently should be transferred to the Capital Reserve Account.

Where debentures have been issued at a discount, the amount of discount should be debited to Discount on Debenture Account so that the Debenture Account is credited with the full normal value of debentures. The balance in this account shall appear in the Balance Sheet until written off. Usually, the debentures will continue to stand in the books of the company. Where, however, the debentures are irredeemable, the amount of discount should be written off over a reasonable period of the time.

**8.8.3 Redemption of Debentures at a Premium:** The provision for the premium payable on redemption of debentures may be made in either of the following two ways-

- (i) The total amount of premium payable on redemption may be debited to an account denominated as "Loss on Issue of Debentures" and credited to "Premium payable on Redemption of Debentures Account" or subsequently, the debit balance in the first mentioned account should be carried forward till it is written off, while the latter account would be closed on payment of the premium, on redemption of debentures.
- (ii) The fact that the debentures will have to be redeemed at a premium may be disclosed by way of a note in the Balance Sheet along with the date of redemption and, as and when redemption is made, the amount paid as a premium should be debited to the Premium on Redemption of Debentures Accounts.

It may be noted that the second method is only a slight variation of the first in so far that, in the latter case, the premium paid on debentures is written off subsequent to the redemption.

**8.8.4 Interest on Debentures:** The payment of interest should be vouched with the acknowledgment of the debenture holders, endorsed warrants and in the case of bearer

debentures, with the coupons surrendered. The total amount paid should be reconciled with the total amount due and payable with the amount of interest outstanding for payment. Interest on debentures is payable whether or not any profit is made. Therefore, a provision should be made unless it has been specially agreed with the debenture holders that interest in such a case would be waived by them. The interest paid on debentures, like that on other fixed loans, must be disclosed as a separate item in the Statement of Profit and Loss.

## **8.9 Audit of Dividends**

**8.9.1 Verification of Dividends:** In Unit 1 of Chapter-2 of IPCC study material on Accounting, the various conditions subject to which profits earned by a company can be distributed as a dividend have been discussed. Therefore, only the procedure for the verification of payment of dividends is stated below-

- (i) Examine the company's Memorandum and Articles of Association to ascertain the dividend rights of different classes of shares.
- (ii) Confirm that the profits appropriated for payment of dividend are distributable having regard to the provisions contained in Section 123 of the Companies Act, 2013. If the company proposes to pay the dividend out of past profit in reserves, see that either this is in accordance with the rules framed by the Central Government in this behalf or the consent of the Government has been obtained.
- (iii) Inspect the Shareholders' Minute Book to verify the amount of dividend declared and confirm that the amount recommended by the directors.
- (iv) If a separate bank account was opened for payment of dividends, check the transfer of the total amount of dividends payable from the Dividends Accounts.
- (v) Check the particulars of members as are entered in the Dividend Register or Dividend List by reference to the Register of Members, test check the calculation of the gross amount of dividend payable to each shareholder on the basis of the number of the shares held and the amount of CDT, if applicable. Verify the casts and crosscast of the different columns.
- (vi) Check the amount of dividend paid with the dividend warrants surrendered. Reconcile the amount of dividend warrants outstanding with the balance in the Dividend Bank Account.
- (vii) Examine the dividend warrants in respect of previous years, presented during the year for payment and verify that by their payment, any provision contained in the Articles in the matter of period of time during which amount of unclaimed dividend can be paid had not been contravened.
- (viii) According to section 123, it is compulsory for a company to transfer the total amount of dividend which remains unpaid or unclaimed, within 30 days of the declaration of the dividend to a special bank account entitled "Unpaid Dividend Account". Such an account

is to be opened only in a scheduled bank. The transfer must be made within 7 days from the date of expiry of 30 days.

- (ix) In case any money transferred to the unpaid dividend account of a company remain unpaid or unclaimed for a period of 7 years from the date of such transfer shall be transferred to Investor Education and Protection Fund established.
- (x) Ensure the compliance, in case dividend is paid in case of inadequate profits.

**8.9.2 Interim Dividends:** A company may distribute part of its profits during the two annual general meetings. That means, a company may declare dividends before the close of the accounting year and finalisation of accounts. Board may from time to time pay to the members such interim dividend as appeared to be justified by the company. However, the definition of “dividend” includes the interim dividend.

Section 123(3) of the Companies Act, 2013 provides that the Board of directors may declare interim dividend during any financial year. However, sub-section (4) requires the amount of dividend including interim dividend to be deposited in a separate bank account within 7 days from the date of declaration of such dividend.

The provisions contained in sections 123, 124, 125, 126 and 127 shall, as far as may be, also apply to any interim dividend.

Therefore, conditions and procedures laid down in section 123, 124\*, 125\*, 126 and 127 would have to be complied with while declaring interim dividends.

**Right to dividend, Right Shares and Bonus Shares to be held in abeyance pending registration of transfers of shares** - Section 126 of the Companies Act, 2013 requires that where any instrument of transfer of shares has been delivered to any company for registration and a transfer of such shares has not been registered by the company, the company shall transfer the dividend in relation to such shares to the Unpaid Dividend Account unless the company is authorised by the registered holder of such shares in writing to pay such dividend to the transferee specified in such instrument of transfer. Further, the company shall also keep in abeyance in relation to such shares, any offer of right shares and any issue of fully paid up bonus shares in respect of such shares which have not been registered by the company. However, the company may transfer the dividend in case it has been authorised by the registered holder of such shares in writing to pay such dividend to the transferee specified in such instrument of transfer.

Penalty for failure to distribute dividend within the prescribed period, i.e., thirty day, has been made quite stiff by prescribing imprisonment for two year. Rupees one thousand everyday for which the default continues as also liability to pay simple interest at the rate of 18% p.a.

(\* **Note:** Section 124 and 125 of the Companies Act, 2013 are not yet notified)

## APPENDIX

### Schedule III to the Companies Act, 2013

(See section 129)

#### General Instructions for preparation of Balance Sheet and Statement of Profit and Loss of A Company

##### 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 this Schedule shall stand modified accordingly.
2. The disclosure requirements specified in this Schedule are in addition to and not in substitution of the disclosure requirements specified in the Accounting Standards prescribed under the Companies Act, 2013. 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. (i) 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.  
(ii) 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. (i) Depending upon the turnover of the company, the figures appearing in the Financial Statements may be rounded off as given below:

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

- (ii) Once a unit of measurement is used, it shall 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.

**Note:** 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 – BALANCE SHEET**

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

(Rupees in.....)

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

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

See accompanying notes to Financial Statements.

#### 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

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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:
  - (A) Aggregate number and class of shares allotted as fully paid up pursuant to contract(s) without payment being received in cash.
  - (B) Aggregate number and class of shares allotted as fully paid up by way of bonus shares.
  - (C) Aggregate number and class of shares bought back.
- (j) 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
    - (A) From banks.
    - (B) 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 instalments, the date of maturity for this purpose must be reckoned as the date on which the first instalment 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

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### 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
  - (A) From banks
  - (B) 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)

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- (iii) Long term Trade Receivables, shall be sub-classified as:
  - (a) (A) Secured, considered good;
  - (B) Unsecured considered good;
  - (C) Doubtful
  - (b) Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.
  - (c) 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:

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- (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 – 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
1		2	3	4
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		xxx	xxx
	work-in-progress		xxx	xxx
	and Stock-in-Trade		xxx	xxx
	Employee benefits expense		xxx	xxx
	Finance costs		xxx	xxx
	Depreciation and amortization expense		xxx	xxx
	Other expenses		xxx	xxx
	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		<u>xxx</u> xxx	<u>xxx</u> xxx

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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

See accompanying notes to the financial statements.

### GENERAL INSTRUCTIONS FOR PREPARATION OF STATEMENT OF PROFIT AND LOSS

- The provisions of this Part shall apply to the income and expenditure account referred to in sub-clause (ii) of Clause (40) of Section 2 in like manner as they apply to a statement of profit and loss.
- In respect of a company other than a finance company revenue from operations shall disclose separately in the notes revenue from
    - Sale of products;
    - Sale of services;
    - Other operating revenues;Less:
    - Excise duty.
  - In respect of a finance company, revenue from operations shall include revenue from
    - Interest; and
    - Other financial services

Revenue under each of the above heads shall be disclosed separately by way of notes to accounts to the extent applicable.
- Finance Costs  
Finance costs shall be classified as:
  - Interest expense;
  - 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 ₹ 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;

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- (k) In case of companies covered u/s 135, amount of expenditure incurred on corporate social responsibility activities.
- (l) Details of items of exceptional and extraordinary nature;
- (m) 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.
  - (f) Insurance

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

#### **GENERAL INSTRUCTIONS FOR THE PREPARATION OF CONSOLIDATED FINANCIAL STATEMENTS**

1. Where a company is required to prepare Consolidated Financial Statements, i.e., consolidated balance sheet and consolidated statement of profit and loss, the company shall mutatis mutandis follow the requirements of this Schedule as applicable to a company in the preparation of balance sheet and statement of profit and loss. In addition, the consolidated financial statements shall disclose the information as per the requirements specified in the

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applicable Accounting Standards including the following:

- (i) Profit or loss attributable to “minority interest” and to owners of the parent in the statement of profit and loss shall be presented as allocation for the period.
  - (ii) “Minority interests” in the balance sheet within equity shall be presented separately from the equity of the owners of the parent.
2. In Consolidated Financial Statements, the following shall be disclosed by way of additional information:

Name of the entity in the	Net Assets, i.e., total assets minus total liabilities		Share in profit or loss	
	As % of consolidated net assets	Amount	As % of consolidated profit or loss	Amount
1	2	3	4	5
Parent Subsidiaries Indian				
1.				
2.				
3.				
.				
.				
Foreign				
1.				
2.				
3.				
.				
.				
Minority Interests in all subsidiaries Associates (Investment as per the equity method)				
Indian				
1.				
2.				
3.				
.				
.				
Foreign				
1.				

2.				
3.				
.				
.				
Joint Ventures (as per proportionate consolidation/investment as per the equity method)				
Indian				
1.				
2.				
3.				
.				
.				
Foreign				
1.				
2.				
3.				
.				
.				
TOTAL				

3. All subsidiaries, associates and joint ventures (whether Indian or foreign) will be covered under consolidated financial statements.
4. An entity shall disclose the list of subsidiaries or associates or joint ventures which have not been consolidated in the consolidated financial statements along with the reasons of not consolidating.