

# Additional Disclosure Statements

## Learning Outcomes

- To understand the need for additional disclosure statements
- To know about the auditor's report in detail
- To understand the funds flow statement and statement of changes in equity.
- To understand the purpose and features of corporate governance report
- To understand the need and contents of director's report

## 4.1 Introduction

During the last few decades, there have been numerous financial frauds and scandals across the globe. Enron, World com, Xerox are some of the well-known accounting scandals at the international level. At the national level, we have heard of UTI scam, Coal-gate scam, Harshad Mehta fraud, 2G scam, Satyam fraud and the most recent ones-PNB fraud. The frauds are increasing both in numbers and magnitude. This recent wave of increased fraudulent practices has prompted global action for reforms in financial reporting, by governments and accounting and auditing standard setting bodies. These reforms are largely in the form of additional disclosure requirements in financial reporting. Companies Act, 2013 has made it compulsory to prepare the Auditor's report, Director's report, the Corporate Governance report, Business Responsibility report etc. as parts of the annual report.

## 4.2 Need for Additional Disclosure Statements

Additional Disclosure is required in order to satisfy the varying informational needs of the different user groups. Accountant's limited knowledge of users' preferences and behaviour makes it difficult to defend a

single reporting option against available competing alternatives. As a consequence, it is argued that these difficult choices can be avoided by presenting more detailed disclosures or by reporting simultaneously several alternatives that satisfy some logical criteria (Jawahar Lal, 1985, p.48).

The recurring frauds and scandals have eroded the investors' confidence in financial reports to a very large extent. Through the provisioning of additional disclosure statements, an attempt has been made to restore the investors' confidence in financial reporting. These statements contain vital information about the company's operations, which can have a significant impact on decision making of various stakeholders in the company. The information needs of the stakeholders are met comprehensively through the qualitative information in these statements, which does not form part of financial statements. Besides the present position of the company, the future prospects and planning and the strategic focus areas are also hinted at. Since investors and creditors operate in uncertainties, trust the role of enhanced information lies in reducing this uncertainty and thus altering their beliefs and in proving decision making (Beaver, 1981, pp. 24-26).

One of the major limitation of accounting process is that it is necessary to make certain assumptions about the future and depending on these assumptions, various estimates are made with respect to many expenditure and benefits while reporting them in the financial statements. These assumptions may turn out to be false in the future actual conditions, and thereby, the estimates depending on them would be inaccurate. Thus, the financial results based on these estimates would be misleading for the stakeholders. The additional disclosure requirements are meant to address this kind of limitation by providing the supplementary information about these assumptions and estimates.

Accounting process is also criticised for its inability to incorporate qualitative information in producing of financial statements. This concern is addressed through the mandatory provisioning of additional disclosure statements. The other plausible reasons for increasing need of additional disclosure statements can be the increasing complexity of business world today, the diverse nature of stakeholders' needs and the increasing financial and all kinds of other risks surrounding the companies.

## 4.3 Auditor's Report

### 4.3.1 Need for Auditor's Report

In order to increase the credibility of the financial statements, it is necessary that an independent third person should certify the reliability and validity of financial statements. This is the purpose served by an auditor's report. According to SA 200 (*Standards on Auditing as issued by ICAI*), which talks about the overall objectives of the independent auditor and the conduct of an audit, the purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by an expression of an opinion by the auditor on whether the financial statements are prepared, in all material aspects, in accordance with an applicable financial reporting framework adopted by the company. The audit is conducted on the assumption that the management and those charged with governance, have responsibilities which are fundamental to the conduct of audit.

Many companies make use of this report to certify their information so as to attract the investors, obtain loans, enhance public image and improve corporate relations. But, it should be noted that the scope of auditor's report is limited to document the reasonable assurance that the financial statements

are free from material mis-statement, whether fraudulent or erroneous. Nowhere it establishes the creditworthiness of the entity or good performance or guaranteed returns by it.

### 4.3.2 Relevant Provisions of Companies Act, 2013 for Auditor's Report

- **Section 143(2) and (3)** provides that the auditor's report shall state the following:
  - (a) To the best of his (auditor's) knowledge, the financial statements give a true and fair view of the state of company's affairs as at end of its financial year.
  - (b) Whether he has **obtained all information and explanations**, which to the best of knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements.
  - (c) Whether proper books of accounts, as required by law, have been maintained by the company.
  - (d) Whether in his opinion the balance sheet and profit and loss account of the company comply with the Accounting Standards prescribed by the Central Government;
  - (e) The observations or comments of the auditors on financial transactions which have any adverse effect on the functioning of the company;
  - (f) **Whether any Director is disqualified** from being appointed as Director under section 164(2).
  - (g) Whether the report on the accounts of any branch office audited by a person other than company's auditors has been sent to him and the manner in which he has dealt with it in preparing his report;
  - (h) Whether the company has adequate internal financial control system in place and the operative effectiveness of such control.
  - (i) Any **qualification, reservation or adverse remarks** relating to the maintenance of accounts and other matters.
- **Section 143(10)** provides that the Central Government can prescribe the Standards of Auditing as recommended by ICAI in consultation with NFRA (National Financial Reporting Authority). A range of auditing standards have been issued for the auditors to follow.
- **Rule 11 of Companies (Audit and Auditors) Rules, 2014** provides that the Auditors Report should also include their views and comments on the following matters:
  - (i) Whether the company has disclosed the **impact**, if any of **pending litigations** on its **financial position** in its financial statement;
  - (ii) Whether the company has **made provision for foreseeable losses**, if any, on long-term contracts including derivative contracts;
  - (iii) Whether there has been **delay in depositing money into the investor education and protection fund** by the company.

### 4.3.3 Types of Audit Reports

1. **Unqualified Audit Report:** Popularly called clean report, this report is so issued by the auditor, certifying that the financial statements are prepared in conformity with GAAP and are free from any misrepresentations. This is the best report which any business can receive. The auditor states that: *The financial statements give a true and fair view of the state of affairs and the profit and loss account for the period.*
2. **Qualified Audit Report:** If the Audit Report contains qualification, reservation or adverse remarks, such an audit report is called a Qualified Audit report. It contains a qualified opinion by the auditor that the financial information presented in the annual report does not confirm to GAAP (Generally Accepted Accounting principles). This report contains an additional paragraph stating the reasons why it is not unqualified. The auditor has to quantify the effect of all qualifications on the financial statements as a whole as well as on individual items. If he is not able to quantify the effects, he can make use of reasonable estimates.
3. **Adverse Audit Report:** When the auditor is of the opinion that the financial information is not prepared or represented as per GAAP and also contain many errors, fraudulent or otherwise, he issues an adverse report, which is considered to be the worst kind of a report for any business to receive. This report is not accepted by the investors, lenders and other stakeholders without being re-audited.
4. **Disclaimer of Opinion:** If the company's management fails to provide all the relevant information, records, documents etc to the auditor for carrying out the audit, the auditor may issue a report containing a disclaimer that he was unable to form any opinion regarding the financial information reported by the enterprise.

**Question:** An auditor determines that a company's financial statements are prepared in accordance with applicable accounting standards except with respect to inventory reporting. This exception *most likely* results in an audit opinion that is:

- A. adverse.
- B. qualified.
- C. unqualified.

**Answer:** B is correct. A qualified audit opinion is one in which there is some scope limitation or exception to accounting standards. Exceptions are described in the audit report with additional explanatory paragraphs so that the analyst can determine the importance of the exception.

### 4.3.4 Contents of Auditor's Report

The contents of the auditor's report can be divided in the routine parts of any report like the title, addressee, signature, date etc; and the more specific contents like introductory paragraph, management's responsibility for the financial statement, auditor's responsibility etc. These are discussed below.

## Routine Contents

This means the general contents which are essentially present in any kind of report, like, the title, the addressee to whom the report is addressed to, signatures, date and place of signing the report.

The Auditor's Report shall have a title clearly indicating that it is the report of its independent auditor. It should be addressed as required by the persons appointing them. Usually, the addressee are the members of the company. The Auditor's Report shall be duly signed. When audit is performed by an audit firm, the person so authorised by the firm, will sign the report. Signatures are obviously put at the end of the report. The Auditor's Report shall be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements, including evidence that; (a) All the statements that comprise the financial statements, including the related notes, have been prepared; and (b) Those with the recognized authority have asserted that they have taken responsibility for those financial statements. The Auditor's Report shall name specific location, which is ordinarily the city where this report is signed.

## Other Contents

- (A) **Introductory Paragraph:** The Introductory paragraph in the Auditor's report shall:
- Identify the entity whose financial statements have been audited;
  - State that the financial statements have been audited;
  - Identify the title of each statement that comprises the financial statements;
  - Refer to the summary of significant accounting policies and other explanatory information; and
  - Specify the date or period covered by each financial statement comprising the financial statements.
- (B) **Management's Responsibility for the Financial Statements:** This section of the Auditor's Report describes the responsibilities of those in the organisation that are responsible for the preparation of the financial statements. The description shall include an explanation that management is responsible for the preparation of the financial statements in accordance with the applicable financial reporting framework; this responsibility includes the design, implementation and maintenance of internal control relevant to the preparation of financial statements that are free from material mis-statement, whether due to fraud or error.
- (C) **Auditor's Responsibility:**
- The Auditor's Report shall state that the responsibility of the auditor is to express an opinion on the financial statements based on the audit. The Auditor's Report shall state the audit was conducted in accordance with SAs (Standards of Auditing) issued by the ICAI.
  - The Auditor's Report shall describe the audit procedures carried out to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial statements.

- (c) An audit also includes evaluating the appropriateness of the accounting policies used and the reasonableness of accounting estimates made by management, as well as the overall presentation of the financial statements.
- (d) The Auditor's Report shall state whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.
- (D) **Auditor's opinion:** The fact and reasons as to the opinion of auditors regarding the financial statements; which can be a qualified opinion, or unqualified, or adverse, or a disclaimer.
- (E) **Other Reporting Responsibilities:** This separate section in the report should be sub-titled as "Report on other Legal and Regulatory Requirements" or otherwise as appropriate to the contents of the section. This contains declarations regarding the fulfilment of relevant sections and rules of applicable laws.

### SAMPLE AUDITOR'S REPORT

The following is the Auditor's report 2015-16 of Infosys Limited

Independent Auditor's Report To the Members of Infosys Limited

- (a) **Report on the Standalone Financial Statements:** We have audited the accompanying standalone financial statements of Infosys Limited ('the Company'), which comprise the balance sheet as at 31 March 2016, the statement of profit and loss and the cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.
- (b) **Management's Responsibility for the Standalone Financial Statements:** The Company's Board of Directors is responsible for the matters stated in Section 134(5) of the Companies Act, 2013 ("the Act") with respect to the preparation and presentation of these standalone financial statements that give a true and fair view of the financial position, financial performance and cash flows of the Company in accordance with the accounting principles generally accepted in India, including the Accounting Standards specified under Section 133 of the Act, read with Rule 7 of the Companies (Accounts) Rules, 2014. This responsibility also includes maintenance of adequate accounting records in accordance with the provisions of the Act for safeguarding the assets of the Company and for preventing and detecting frauds and other irregularities; selection and application of appropriate accounting policies; making judgments and estimates that are reasonable and prudent; and design, implementation and maintenance of adequate internal financial controls, that were operating effectively for ensuring the accuracy and completeness of the accounting records, relevant to the preparation and presentation of the financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error.

**Auditor's Responsibility:** Our responsibility is to express an opinion on these standalone financial statements based on our audit. We have taken into account the provisions of the Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of the Act and the Rules made thereunder. We conducted our audit in accordance with the Standards on Auditing specified under Section 143(10) of the Act. Those Standards require that we comply with ethical requirements and

## 4.4 Directors' Report (Board of Directors' Report)

The directors are entrusted with the management of the company. They are responsible for the effective conduct of company's operations and liable towards all the stakeholders in the company for looking after their interest while discharging their duties towards the company. Thus, by making directors' report a mandatory part of the annual report, the idea is to establish their responsibility through mandatory requirement of additional disclosures guided by multiple sections of the Companies Act, 2013 and rules made thereunder; and also through compulsory clauses in the listing agreements governing their membership in the stock exchanges.

### 4.4.1 Disclosure Requirements as per Companies Act, 2013

Sections 131, 134, 135, 149, 177, 178, 188, 197, 204.

- (a) the extract of the annual return in the prescribed form
- (b) number of meetings of the Board;
- (c) Director's Responsibility Statement stating the details in respect of frauds reported by auditors.
- (d) company's policy on director's appointment and remuneration including criteria for determining qualifications.
- (e) particulars of loans, guarantees or investments as specified by the Act;
- (f) particulars of contracts or arrangements with related parties with respect to sale, purchase or supply of any goods or materials; selling or otherwise disposing of, or buying, property of any kind; leasing of property of any kind; availing or rendering of any services; appointing of any agent for purchase or sale of goods, materials, services or property.
- (g) the state of the company's affairs;
- (h) the amounts, of any, which it proposes to carry to any reserves;
- (i) the amount, if any, which it recommends should be paid by way of dividend;
- (j) 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.

- (k) the details about the policy developed and implemented by the company on corporate social responsibility initiatives taken during the year;
- (l) Detailed reasons for revision of the Board Report if its financial statements does not give a true and fair view of the state of affairs of the company or companies or do not comply with the accounting standards notified by the MCA and are not in the form or forms as may be provided for different class or classes of companies in Schedule III of the Act; shall be disclosed in the Board's report in the relevant financial year in which such revision is being made.
- (m) Composition of the Corporate Social Responsibility (CSR) Committee.
- (n) If the company fails to spend CSR amount, the Board of Directors shall, in its report specify the reasons for not spending the amount.
- (o) Disclosure in case of reappointment of Independent Directors.
- (p) Composition of Audit Committee and where the Board of Directors had not accepted any recommendation of the Audit Committee, the same shall be disclosed along with the reasons thereof.
- (q) Details of establishment of vigil mechanism for directors and employees in order to report genuine concerns in such manner as may be prescribed.
- (r) The ratio of the remuneration of each director to the median employee's remuneration and such other details as may be prescribed.

#### 4.4.2 Disclosure Requirements as per Companies (Accounts) Rules, 2014

1. The Board's Report shall be prepared based on the standalone 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.
2. The Report shall contain the particulars of contracts or arrangements related to—
  - (a) Conservation of energy
    - (i) the steps taken or impact on conservation of energy;
    - (ii) the steps taken by the company for utilizing alternate sources of energy;
    - (iii) the capital investment on energy conservation equipment's
  - (b) Technology absorption
    - the details of technology imported;
    - the year of import;
    - whether the technology been fully absorbed;
    - if not fully absorbed, areas where absorption has not taken place, and the reasons thereof; and
    - (iv) 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.
3. A statement indicating the manner in which formal annual evaluation has been made by the Board of Directors of its own performance and that of its committees and individual directors.

4. The Report shall also contain—

- (a) the financial summary or highlights.
- (b) the change in the nature of business, if any;
- (c) the details of directors or key managerial personnel who were appointed or have resigned during the year;
- (d) the names of companies which have become or ceased to be its Subsidiaries, joint ventures or associate companies during the year;
- (e) the details relating to deposits, covered under Chapter V of the Act,
  - (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—
    - at the beginning of the year;
    - maximum during the year;
    - at the end of the year;
- (f) the details of deposits which are not in compliance with the requirements of Chapter V of the Act;
- (g) 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;
- (h) the details in respect of adequacy of internal financial controls with reference to the Financial statements.

#### 4.4.3 Disclosure Requirements as per Listing Agreement (with the stock exchange)

1. The details of establishment of vigil mechanism for directors and employees to report concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy.
2. Management Discussion and Analysis report that should include discussion on the following matters within the limits set by the company's competitive position:
  - Industry structure and developments.
  - Opportunities and threats
  - Segment-wise or product-wise performance.
  - Outlook
  - Risks and concerns
  - Internal control systems and their adequacy
  - Discussion on financial performance with respect to operational performance
  - Material developments in Human Resources / Industrial relations front, including number of people employed.
  - Certificate obtained from either the auditors or practicing company secretaries regarding compliance of conditions of corporate governance.

## 4.5 Funds Flow Statement

The term 'funds' in accounting terminology means working capital, which is equal to current assets minus current liabilities. The funds flow statement lists out the sources of funds and applications of funds during a particular period. The excess of total sources of funds during a period over the total applications of funds results in *net increase in the working capital during a period*, and vice-a-versa. Accounting Standard (Revised)-3 has made Funds Flow Statement obsolete. Hence, it is relevant only where some enterprise prepares it for some specific requirement related to tracking changes in working capital movements during the period. This statement is usually supplemented with another statement called *Schedule of changes in working capital*, which lists out all the current assets and liabilities individually of the current year as well as of the previous year and then, the net increase or decrease in the individual current asset and the current liability is also recorded. The increase in current assets are recorded as 'Increase in working capital', while the increase in current liabilities are recorded as 'Decrease in working capital'; and vice-a-versa. At the end of the statement, 'the increase' is compared with 'the decrease' in the working capital to find out the net increase or decrease (see the format given under 3.7.2, Step 1), which is same as the one reported by the Funds Flow Statement.

### 4.5.1 Benefits of Funds Flow Statement

Funds Flow Statement is useful for Long Term Analysis. It is a very useful tool in the hands of the management for judging the financial and operating performance of the Company. The Balance Sheet and the Profit and Loss A/c (Income Statement) fail to provide the information which is provided by the Funds Flow Statement i.e. Changes in Financial Position of an enterprise. Such an analysis is of great help to the management, shareholders, creditors etc.

1. The Funds Flow Statement helps in answering the following questions:
  - Where have the profits gone?
  - Why is there an imbalance existing between liquidity position and profitability position of an enterprise?
  - Why is the concern financially solid in spite of losses?
2. The Funds Flow Statement analysis helps the management to test whether the working capital has been effectively used or not and the working capital level is adequate or inadequate for the requirements of the business. The Working Capital Position helps in the management in taking policy decisions regarding payment of dividend etc.
3. The Funds Flow Statement Analysis helps the investors to decide whether the company has managed the funds properly. It also indicates the Credit Worthiness of a company which helps the lenders to decide whether to lend money to the company or not. It helps the management to take policy decisions and to decide about the financing policies and capital expenditure for the future.
4. There may be several reasons for changes in the Working capital position of a company, some of which have been discussed below:

- (a) Purchase of Fixed Assets or Long Term Investments without raising Long Term Funds.
- (b) Payments of Dividends in excess of the Profits earned.
- (c) Extension of Credit to the Customers.
- (d) Repayment of a Long Term Liability or Redemption of Preference Shares without raising Long Term Resources.

## 4.5.2 Preparation of Funds Flow Statement

### Step I: Prepare Statement of changes in working Capital

For preparing the Funds Flow Statement, the first step is to prepare the Statement of Changes in Working Capital.

**Statement of Changes in Working Capital of X Ltd**

Particulars	As on 31.3.20XX	As on 31.3.20XX	Increase in Working capital	Decrease in Working capital
	(₹)	(₹)	(₹)	(₹)
<b>Current Assets:</b>				
Stock				
Debtors				
Cash etc.				
<b>Total</b>				
<b>Current Liabilities:</b>				
Bills payable				
Creditors				
Outstanding expenses etc.				
<b>Total</b>			(a)	(b)
<b>Working Capital</b>	Total current assets <i>minus</i> current liabilities	Total current assets <i>minus</i> current liabilities		

Net increase (or decrease) in the working capital (a) --- (b).

### Step II: Prepare Funds from Operations

The next Step is to prepare the Funds generated only from the Operating Activities of the Business and not from the investing / Financing Activities of the business. The Funds from Operations shall be prepared as follows:

Particulars	Amount
Net Income	xxx
ADD	
1. Depreciation on Fixed Assets	xxx
2. Amortization of Intangible Assets	xxx
3. Loss on Sale of Investments	xxx
4. Loss on sale of Fixed Assets	xxx
5. Losses from other Non-Operating Incomes	xxx
6. Tax Provision (Created out of Current Profits)	xxx
7. Proposed Dividend	xxx
8. Transfer to Reserve	xxx
(Less)	
1. Deferred credit	xxx
2. Profit on Sale of Investments	xxx
3. Profit on Sale of Fixed Assets	xxx
4. Any written back Reserve & Provision	xxx

### Step III: Preparation of Funds Flow Statement:

While preparing the Funds Flow Statement, the Sources and Uses of Funds are to be disclosed clearly so as to highlight the Sources from where the Funds have been generated and the uses to which these Funds have been applied. This Statement is also sometimes referred to as the Sources and Applications of Funds Statement or Statement of Changes in Financial Position.

### Sources of Funds

Items to be shown under the head Sources of Funds are as follows:

- 1. Issue of Shares and Debentures for Cash:** The total amount received from the issue of Shares or Debentures is to be shown under this head. But, the Issue of bonus Shares or Conversion of Debentures into Equity Shares or Shares issued to vendors shall not be shown here as there is no inflow of Cash.
- 2. Long Term Loans:** The amount received on raising Long Term Loans is shown under this head. Short Term Loans are not to be shown here as their treatment has already been done while preparing the Statement of Changes in Working Capital.
- 3. Sale of Investments and other Fixed Assets:** The Total Amount received on the sale of Investments and other Fixed Assets is to be shown under this head.
- 4. Funds from Operations:** The Funds generated from Operations as computed in Step II are also required to be shown here.
- 5. Decrease in Working Capital:** This would be the Balancing Figure of the Statement and will come from change in Working Capital Statement.

## Applications of Funds

Items to be shown under Application of Funds are as follows:

- 1. Purchase of Fixed Assets and Investments:** The Cash Payment made for purchase of Fixed Assets and Investments is an application of Funds. But if the purchase is made by issue of shares or debentures, such a transaction will not constitute application of funds. Similarly, if the purchases are on credit, these will not constitute fund applications.
- 2. Redemption of Debentures, Preference Shares and Repayment of Loan:** Payment made including Premium (or less discount) is to be taken as fund application.
- 3. Payment of Dividend and Tax:** Payment of Dividend and Tax are to be taken as applications of fund if the provisions are excluded from **Current Liabilities** and current Provisions are added back to profit to determine the "Funds from Operations".
- 4. Increase in Working Capital:** This would be the Balancing Figure of the Statement and will come from Changes in Working Capital Statement.

As explained above, the **Funds Flow Statement** summarizes for a particular period the resources made available to finance the activities of an enterprise and the uses to which such resources have been put.

Source of Funds	Amt. (₹)	Applications of Funds	Amt. (₹)
Issue of shares for cash	XXX	Purchase of Fixed assets for cash Purchase of Investment for cash	XXX XXX
Issue of Debentures for cash	XXX	Redemption of Debentures Redemption of Preference shares	XXX XXX
Raising of Long-term loans	XXX	Repayment of Long-term loans	XXX
Sale of Investments Sale of Fixed Assets		Payment of Dividends	
Decrease in working capital* (Excess of Applications over sources of Funds) (Bal. Fig.)		Increase in Working Capital* (Excess of sources over Applications of Funds) (Bal. Fig.)	

\* Either of the two can be there.

### 4.5.3 Distinction between Funds Flow Statement and Cash Flow Statement

The following are the points of distinction between Funds Flow Statement and Cash flow statement:

- Funds Flow Statement deals with the change in the working capital position while Cash Flow Statement deals with the change in the cash position between two points of time. Funds Flow Statement is based on the **Accrual System of Accounting**. However, in case of Cash Flow Statement – only the transactions affecting Cash or Cash equivalents are taken into consideration.

- (ii) Funds flow Statement does not contain any opening and closing balances but in the cash Flow Statement, opening as well as closing balances of cash and cash equivalents are given.
- (iii) Funds Flow Statement records sources of funds on one hand and applications of funds on the other hand. If sources of funds exceed applications of funds, the result is an increase in the working capital. If sources of funds fall short of applications of funds, the final figure is a decrease working capital. Cash Flow Statement records inflows and outflows of cash. The difference between total inflows and total outflows is the net increase or decrease in cash and cash equivalents.
- Funds Flow Statement analyses the Sources and Application of Funds of Long Term nature and the Net Increase or Decrease in Long Term Funds will be reflected on the Working Capital of the firm. The Cash Flow Statement only considers the Increase or Decrease in Current Assets or Current Liabilities in calculating the Cash Flow of Funds from Operations.
- (iv) A statement showing changes in working capital is usually prepared along with Funds Flow Statement. No such statement is prepared along with Cash Flows Statement.
- (v) One can prepare Funds Flow Statement if Cash Flow Statement prepared by the indirect method is made available. But one cannot prepare Cash Flow Statement if Funds Flow Statement is made available. To prepare Cash Flow Statement by the indirect method, one will also require statement Showing Changes in Working Capital. To prepare Cash Flow Statement by the direct method, one requires the figures of cash collected from customers and cash payments to suppliers and employees which are not available in Funds Flow Statement and Statement Showing changes in Working Capital.
- (vi) Funds Flow Statement is more relevant in estimating the firm's ability to meet its long term liabilities. However, Cash Flow Statement is more relevant in estimating the firm's capacity to meet its liabilities after a short period of time. Funds Flow Statement is more useful for Long Term Financial Planning. Cash Flow Analysis is more useful for identifying and correcting the liquidity problems of the firm.
- (vii) Funds Flow Statement is not required to be prepared by any business enterprise; it has rather become obsolete. On the other hand, SEBI requires every listed company to prepare Cash Flow Statement in the form prescribed by it.

#### 4.5.4 Distinction between Funds Flow Statement and Income Statement

The following are the points of distinction between Funds Flow Statement and Income Statement (i.e., Profit and Loss Account):

- (i) Funds Flow Statement matches the funds raised during a period with the funds applied during that time whereas Income Statement matches the incomes and expenditure of a particular period.
- (ii) Funds Flow Statement tells us the increase or decrease in net working capital during a period of time whereas Income Statement reveals the net profit earned or net loss incurred during a period of time.
- (iii) Funds Flow Statement deals with revenue as well as capital items whereas Income Statement deals with only revenue items.

- (iv) In order to prepare Funds Flow Statement, Income Statement is required because information contained in the Income Statement forms the basis of a few items appearing in Funds Flow Statement. Income Statement can be prepared without any reference to Funds Flow Statement.
- (v) Preparation of Funds Flow Statement, though advantageous, is optional, Preparation of Income Statement, barring for very small businessmen, is a must.
- (vi) No concern is required to prepare Funds Flow Statement in any particular form. But companies have to prepare Income Statement in a prescribed form.

## 4.6 Corporate Governance Report

The term 'corporate governance' simply means the way a company is governed. The management or the governance of a company is entrusted with the board of directors of a company and they are expected to discharge their responsibilities in best of interests of the owners (shareholders) of the company. Good governance is one which is transparent, accountable, equitable, efficient, participative and inclusive. Over the period of time, the term has evolved to encompass the interests of all the stakeholders including the society as a whole. According to Solomon and Solomon, "Corporate governance is the system of checks and balances, both internal and external to the companies, which ensures that companies discharge their accountability to all their stakeholders and act in socially responsible way in all areas of their business activity".

**Disclosure Requirements:** The disclosure requirements for corporate governance are:

- (a) Mainly listed in **Clause 49 of the Listing Agreement** issued by SEBI, which is mandatory for all listed companies to follow and,
- (b) Also through certain **other clauses in the listing agreement**, which are there to protect the minority shareholders and ensure proper disclosures.
- (c) **The companies Act, 2013** and Companies (Accounts) Rules, 2014 also prescribe Corporate Governance Disclosures, which are applicable for every company, listed or unlisted.

These are discussed in detail in the following paragraphs.

### 4.6.1 Clause 49 of the Listing Agreement

By virtue of the provisions contained in clause 49 under the Listing Agreement, the company has to provide a **Management Discussion and Analysis report** to the shareholders. This report may be presented as part of the directors' report or as an addition thereto. It should include discussion on the following matters within the limits set by the company's competitive position:

- (i) Industry structure and developments.
- (ii) Opportunities and threats.
- (iii) Segment-wise or product-wise performance
- (iv) Outlook
- (v) Risks and concerns.
- (vi) Internal control systems and their adequacy.
- (vii) Discussion on financial performance with respect to operational performance.

- (viii) Material developments in Human Resources / Industrial Relations front, including number of people employed.

In addition to this, clause 49 also provides for **Management's report on corporate Governance**. The listed companies are required to give a detailed compliance report on corporate governance in the separate section 'Corporate Governance' in their annual reports. The report must specifically highlight non-compliance of any mandatory requirements with reasons thereof and also the extent to which the non-mandatory requirements have been adopted. The company should obtain a certificate from the auditors of the company regarding the compliance with the conditions of corporate governance as stipulated in this clause and annex the certificate with the directors' report which is sent annually to all the shareholders of the company. The following details should be included:

- (A) **Brief statement on company's philosophy on code of governance.**
- (B) **Board of Directors:** Composition and category of directors that comprises of non- directors, executive directors, promoter, independent non-executive, nominee director, women director; attendance of each director at the Board meetings and the last AGM; number of other Boards or Board Committees in which he / she is a member of Chairperson, number of Board meetings held, dates on which held. The board members should be informed about the risk assessment and minimisation procedures, which are to be periodically reviewed to ensure that the executive management controls risk by means of a properly defined framework.
- (C) **Audit Committee:** Brief description of terms of reference, composition including name of members and Chairperson, eligibility of members, number of meetings, number of members present, powers and role of audit committee, review of information by the Audit Committee. The company must formulate a policy on the materiality and dealings with related party transactions. A statement of all transactions with related parties is to be placed before the audit committee for formal approval or ratification. Also, when money is raised through IPO (Initial Public Offering), the audit committee should be informed about the application of funds by major category, like capital expenditure, working capital etc. on quarterly basis as a part of their quarterly declaration of financial results.
- (D) **Remuneration Committee:** Brief description of terms of reference, composition, name of members and Chairperson, attendance, remuneration policy, details of remuneration.
- (E) **Shareholder's Committee:** Name of non-executive director heading the committee, name and designation of compliance officer, number of shareholders' complaints received so far, number not solved to the satisfaction of shareholders; number of pending complaints.
- (F) **General Body Meetings:** Location and time, where last three Annual General Meetings (AGMs) held and any special resolutions passed & whether any special resolution passed last year through postal ballot – details of voting pattern, person who conducted the postal ballot exercise, whether any special resolution is proposed to be conducted through postal ballot, procedure for postal ballot.
- (G) **Disclosures:** Materially significant related party transactions having potential conflict with the interests of company at large; details of non-compliance by the company; penalties; conditions imposed on the company by Stock Exchange or SEBI or any statutory authority, on any matter related to capital markets, during the last three years; whistle blower policy and affirmation that no personnel has been denied access to the audit committee; details of compliance with mandatory requirements and adoption of the non-mandatory requirements.

- (H) **Means of Communication:** Quarterly results; newspapers where published; any website where displayed; whether it also displays official news releases; and the presentations made to institutional investors or to the analysts.
- (I) **General Shareholder Information:** AGM, its Date, time and venue; financial year; date of book closure, dividend payment date; listing on Stock Exchanges; stock code; market price data during each month, performance in comparison to last financial year.

## 6.2 Other Clauses in the Listing Agreement

Apart from Clause 49 of the Equity Listing Agreement, there are certain other clauses in the listing agreement, which are meant for protecting the minority shareholders and ensuring proper disclosures:

- Disclosure of Shareholding Pattern.
- Maintenance of minimum public shareholding (25%).
- Disclosure and publication of periodical results.
- Disclosure of Price Sensitive Information of Disclosure and open offer requirements under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011).

## 4.6.3 The Companies Act, 2013

It prescribes the following as the disclosure requirements of the corporate governance report:

- (i) All elements of remuneration package such as salary, benefits, bonuses, stock options, pension, etc., of all the directors;
- (ii) details of fixed component and performance linked incentives along with the performance criteria;
- (iii) service contracts, notice period, severance fees;
- (iv) stock option details, if any, and whether the same has been issued at a discount as well as the period over which accrued and over which exercisable.

**Question:** Due to immense loss to Nepal in the recent earthquake, one FMCG Company undertakes various commercial activities with considerable discounts and concessions at the related affected areas of Nepal for a continuous period of 3 months after earthquake. In the financial statements for the year 2014-15, the Management has shown the expenditure incurred on such activity as expenditure incurred to discharge corporate Social Responsibility. State whether the intention of Management is correct. Explain with reasons.

**Answer:** To qualify the expenditure to discharge Corporate Social Responsibility, the company has to comply with the provision of section 135(3)(a) of the Companies Act, 2013 which provides that a corporate social responsibility policy as formulated by Board of Directors shall indicate the activities to be undertaken by the company as specified in Schedule-VII. In this question it is stated that the company has done commercial activities at considerable discounts and concessions in Nepal. Such activities are not covered under Schedule VII of the Companies Act, 2013 and therefore, the intention of the management is not correct.

## 4.7 Electronic Dissemination

In the present digital age, it is but natural that the financial information is also and should be electronically disseminated. With the world-wide concern for paper saving and increasing awareness to cut down unnecessary expenditures on printing and sending out annual reports to the shareholders by the companies, the need for carrying out financial disclosure obligations through electronic means is felt strongly and provided for in the regulations. The following are some of those major regulations in this regard:

1. Clause 54 of the Listing agreement mandates all the listed companies to maintain a functional website having all basic information about them. The website should be regularly updated for all the statutory filings. (SEBI circular dated 16 December, 2010)
2. Ministry of Corporate Affairs (MCA) has mandated all the listed companies and their subsidiaries to file their financial statements in the XBRL (Extensible Business Reporting Language Format) from the financial year ended 31 March, 2011 onwards. XBRL is an open Standard XML based language for electronic communication of financial information, which offers various advantages in terms of easy preparation, greater efficiency, improved accuracy and reliability of the financial information. It also facilitates quick and easy analysis of financial information required to facilitate decision making on the part of various investors, who have different needs. Their different requirements are not adequately met by the present system of financial reporting, wherein only the *general purpose financial statements* are prepared. Lots of time and energy is spent on data mining and data gathering to prepare multiple reports for the different users and thus, little time and energy is left for data analytics. XBRL offers to provide effective solution to this problem.
3. MCA launched MCA 21, which is an e-filing portal where the companies are required to upload their documents online. The public can easily access the documents of companies through this portal as well as can download them. A monthly bulletin that provides some basic statistics of the Indian Corporate sector is uploaded every month onto the tab titled 'Statistics & Reports' on this portal's homepage. Further, the master data of various companies and Limited Liability Partnerships (LLPs) are also available under this tab.
4. A new system called CFDS (Corporate Filing and Dissemination System) has been put jointly by the BSE and NSE, which offers a XBRL enabled platform to the listed companies to file their returns with the stock exchanges. Its URL is [www.corpfiling.co.in](http://www.corpfiling.co.in). It has been developed and being maintained by IRIS Business Services (India) Pvt. Ltd. It acts as a common place for the investors to view all kinds of information related to the listed companies and provides a single interface to them to keep a track of the latest filings of all the listed companies in India irrespective of the stock exchange these are listed with. All kinds of corporate announcements regarding dividend, bonus, issue of right shares, notice of meetings etc. are regularly uploaded by the companies on this platform.

The companies act recognises the right of shareholders to decide for the electronic means of publishing annual reports to be implemented as the chief means of publishing and disseminating annual reports among the shareholders, based on the reasoning that only the owners should