ABSTRACT

Proposed dividend is the dividend recommended by the Board of directors of a company in relation to a certain financial year after the expiry of the financial year but before the approval of the concerned financial statements and is shown in the Balance sheet of the said financial year as a liability. The basic question is whether such proposed dividend should be presented in the balance sheet of the said concerned financial year? However, the fact is that such proposed dividend is shown in the Balance sheet of the said concerned financial year. In this article, an attempt has been made to analyze the provisions of the Companies Act, 2013 read with schedule III thereof and the provisions of the Accounting Standards related to the “Proposed dividend” specifically emphasizing upon the contradictions between the provisions of schedule III to the Companies Act, 2013 and the Accounting Standards under the Companies (Accounting Standards) Rules, 2006 as amended from time to time. Finally, it has been emphasized that though there seems to be a contradiction that proposed dividend, though not a liability, as per the definition of liability given in schedule III is shown in the Balance sheet as a liability, yet it is not so simple because of the overriding preference of the provisions of the Accounting standards over those of the schedule III of the recently enacted Companies Act, 2013 because general instruction no. 1 given in the beginning of schedule III itself states that where the compliance with the requirements of the Act including Accounting Standards as applicable to the companies require any change in the treatment or disclosure in the financial statements or statements forming part thereof, the same shall be made and the requirements of the schedule III shall stand modified accordingly.

Keywords: Schedule III; Accounting standards; The companies Act 2013; AS 4; AS 29

INTRODUCTION

Section 2(35) of the Companies Act, 2013 defines dividend to include any interim dividend.

The definition of dividend is inclusive but does not clearly explain dividend. One has, therefore, to depend on the ordinary commercial meaning of this term. As held in Esso Petroleum Ltd. v. Ministry of Defence [1990] Ch 163, dividend refers to a payment out of a part of profits for a period in respect of a share in a company. According to ICAI’s Guidance Note, dividend connotes a return on the share held in an entity which is payable out of distributable profits.

Dividend, therefore, means the part of divisible profits of the company distributed among the shareholders. Thus, dividend can be said to be the return on the share capital subscribed for by the shareholders.
Types of dividend: Dividend is of two types- interim dividend and final dividend. Interim dividend is the dividend which is declared by the Board of a company between the two annual general meetings of the said company. Interim dividend is not proposed or recommended by the Board but is declared by the Board and distributed to the shareholders. Final dividend is first recommended by the board and then it is be declared by the shareholders in the Annual general meeting. In the annual general meeting, the rate or amount of final dividend recommended by the Board may be reduced by the shareholders even up to zero but can’t be increased by them.

It may be noted that the dividend once declared becomes a kind of debt to the shareholders in the legal sense.

Proposed dividend of a company in relation to the concerned financial year is shown in the Balance sheet of the concerned financial year though its recommendation by the Board takes place after the expiry of the concerned financial year.

OBJECTIVE

The main objective of the study is to analyze the provisions of the recently enacted Companies Act, 2013 read with the provisions of schedule III thereof along with the provisions of the notified Accounting Standards given in the Companies (Accounting Standards) Rules, 2006 as amended from time to time and to find out the real legal provisions supporting the treatment and presentation of the ‘Proposed dividend’ in the Balance sheet of the concerned financial year even though the recommendation of the dividend by the Board of a company as such takes place after the expiry of the concerned financial year.

RESEARCH METHODOLOGY

To find out the legal provisions supporting the treatment and presentation of ‘Proposed dividend’ in the balance sheet, first, the provisions of the recently enacted Companies Act, 2013 have been analyzed with special emphasis on the schedule III dealing with the financial statements of the companies. Further, the provisions of the accounting standards given in the Companies (Accounting Standards) Rules, 2006 as amended from time to time have been analyzed. Further, the “Guidance Note on the Revised Schedule VI to the Companies Act, 1956” issued by the ICAI which is similar to the provisions of schedule III to the Companies Act, 2013 has also been studied with reference to the treatment and presentation of proposed dividend.

RESULT OF THE STUDY

The provisions of the schedule III to the recently enacted Companies Act, 2013 and accounting standards in the companies (Accounting Standards) Rules, 2006 as amended from time to time both support the presentation of the proposed dividend in the Balance sheet.

DISCUSSION

Provisions in the Companies Act, 2013: Section 129(1) of the Act, inter alia, states that the financial statements shall give a true and fair view of the state of affairs of the company or companies, comply with the accounting standards notified under section 133 and shall be in the form or forms as may be prescribed for different class or classes of companies in schedule III.

Provided that the items contained in such financial statements shall be in accordance with the Accounting Standards.

Provided further that nothing contained in this sub-section shall apply to an insurance company or a banking company or an electricity Company or 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. Section 133 of the Act provides that the Central Government may prescribe the standards of accounting or any addendum thereto as recommended by the ICAI in consultation with after examination of the recommendations made by National Financial Reporting Authority. Rule 4 of the Companies
(Accounts) Rules, 2014 provides that the standards of accounting as specified under the companies Act, 1956 shall be deemed to be the accounting standards until account standards are specified under section 133. Since, no accounting standards have so far been specified under section 133 of the Act, the standards of accounting under the Companies Act, 1956 vide the Companies (Accounting Standards) Rules 2006 as amended from time to time will apply.

Thus, on the perusal of the above, it is clear that, to prepare the balance sheet of a company(other than banking, insurance or electricity companies or any other class of company governed by any special Act specifying the form of balance sheet), the following points are important:

(i) The financial statements (of course including the balance sheet) shall give a true and fair view of the state of affairs of the company or companies.

It may be noted that the phrase ‘True and fair’ has not been defined in the Companies Act, 2013. ‘True’ means the truth i.e. the factual position or the reality. ‘Fair’ means that the information presented in the financial statement should be ‘true’ or ‘very near to the truth’ or ‘close to the truth’. When the information presented is true, it is called ‘true and correct’. When the information presented is very near to the truth or close to the truth, it is called ‘true and fair’. Hence, there is a difference between the phrases ‘True and correct’ and ‘true and fair’. Practically, it is not feasible to make a true and correct presentation in the accounts because of a variety of reasons including, inter alia, the application of different accounting policies to the same items by different enterprises. Sometimes, the same enterprise applies different accounting policies to the same items in different years. Other such reasons may include use of estimates in accounting which are bound to differ from situation to situation, item to item and enterprise to enterprise.

Application of the principal qualitative characteristics and of appropriate accounting standards normally results in financial statements that convey what is generally understood as a true and fair view of such information. Hence, the two things i.e. the application of principal qualitative characteristics and of the appropriate accounting standards in the preparation of the financial statements would normally make the financial statements represent true and fair view. The four principal qualitative characteristics given in the same compendium are understandability, relevance, reliability and comparability. The appropriate Accounting standards, at present, in the case of companies are the ones given in the Companies (Accounting Standards) Rules, 2006 as amended from time to time.

(ii) The financial statements (including the balance sheet) shall be prepared as per schedule III to the Companies Act which specifies the format thereof and also the general instructions to prepare the same.

(iii) The financial statements (including the balance sheet) shall be prepared in compliance with the Accounting standards specified by the Central Government. At present, the accounting standards applicable to the companies are the Companies (Accounting Standards) Rules, 2006 as amended from time to time.

(iv) The items contained in such financial statements shall be in accordance with the accounting standards.

The balance sheet presents the items under two broad heads i.e. ‘Equity and Liabilities’ and ‘Assets’. Quite naturally, the ‘proposed dividend’ is neither equity nor an asset. Hence, the main question is whether it is a liability in respect of the financial year for which dividend is proposed by the board of directors so that it may be presented in the balance sheet of that financial year itself. For this purpose, let us know what a liability actually is. As mentioned in the first proviso to section 129 of the companies Act, 2013, the items contained in the financial statements shall be in accordance with the accounting standards. Further, instruction no. 6 given in the beginning of schedule III to the companies Act, 2013 also provides that for the purpose of this schedule (i.e. schedule III) the terms used herein shall be as per the applicable accounting standards. Hence, we have to refer to the definition of liability given in the accounting standards.
Definition of liability: A liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

Based on the above definition, the following are the three characteristics of the definition of a liability:

(a) It must be a present obligation. (b) It must arise from past events (c) The settlement of such obligation should result in an outflow of resources in the form of economic benefits.

Let us analyze all the above three characteristics as under:

(a) It must be a present obligation: A present obligation is an obligation, if based on the evidence available, its existence on the balance sheet date is considered probable i.e. more likely than not. It indicates that there must be more than 50% possibility that the obligation exists on the balance sheet date.

(b) It must arise from past events: It indicates that there must be an obligating event which has occurred in the past. An obligating event is an event that creates an obligation that results in an enterprise having no realistic alternative to settling that obligation. It means that the enterprise is bound to settle the obligation because it has no way other than the settlement of the said obligation.

(c) It must result in an outflow of resources in the form of economic benefits: It indicates that in case of settlement of obligation, an outflow of resources from the enterprise must take place in the form of economic benefits. Such outflow of resources may take place either in cash or in kind.

Thus, based on the above analysis, it may be said that the main characteristic of the liability is that there must be a present obligation. Once, it is established that there is a present obligation, it is quite natural that the present obligation can arise only out of past event which created a present obligation. Then, if such present obligation can result in an outflow of resources in the form of economic benefits because of its settlement, then only it is a liability. If the present obligation is not likely to result in an outflow of resources embodying economic benefits, then the present obligation is not a liability but is a contingent liability which requires only disclosure in the financial statements as per AS 29 and schedule III to the Companies Act, 2013 both.

Based on the above three characteristics of the definition of liability, let us analyze and find out whether the “Proposed dividend” satisfies the above three components and hence is a liability or not.

What is proposed dividend? This is a kind of dividend which is proposed by the Board after the balance sheet date but before the approval of the financial statements in respect of the financial year ending on the said balance sheet date. For example, suppose the financial year is 2013-14 and hence the Balance sheet date is 31-3-2014. Only after this balance sheet date (i.e. 31.3.2014), the financial statements for the year 2013-14 will be approved by the board before submitting the financial statements to the auditors for their report thereon. Let us assume that the board approves the financial statements for the year 2013-14 (including balance sheet) on 31.5.2014. Let us further assume the dividend amounting to Rs. 2,00,000 is proposed by the board for the year 2013-14 on 15.5.2014. Hence, for the year 2013-14, the amount of dividend i.e. Rs. 2,00,000 proposed by the board is called proposed dividend because it is proposed after the balance sheet date i.e. 31-3-2014 and before the date of approval of financial statements i.e. 31.5.2014.

The fundamental question here arises whether to show such proposed dividend amounting to Rs. 2,00,000 in the Balance Sheet as at 31.3.2014 or not as per the Companies Act, 2013 and the Accounting standards.

One point is clear that if the proposed dividend of Rs. 2,00,000 is a liability for the year 2013-14, it must be shown in the balance sheet as at 31.3.2014 otherwise not.

Instruction number 3 of the ‘General Instructions for preparation of Balance Sheet’ in schedule III to the companies Act, 2013, inter alia, states that a liability shall be classified as a current liability when it
is due to be settled within 12 months after the reporting date or the company does not have an unconditional right to defer the settlement of liability for at least 12 months after the reporting date.

In the instant case, the company has to hold the AGM certainly latest by 30.9.2014 i.e. within 9 months from the date of close of the financial year and within 30 days from 30.9.2014 i.e. by 30.10.2014, the dividend declared has to be paid. The dividend which is proposed in the year 2014-15 and is declared in the AGM in the year 2014-15 is a liability for the year 2014-15 and not for the year 2013-14. It is, therefore, undoubtedly clear that proposed dividend is not a liability at all on 31.3.2014. Hence, it should not be presented in the Balance sheet as on 31.3.2014. However, general instruction no. 1 given in the beginning of schedule III provides that where the compliance with the requirements of the Act including Accounting Standards as applicable to the companies require any change in the treatment or disclosure in the financial statements or statements forming part thereof, the same shall be made and the requirements of the schedule III shall stand modified accordingly. Let us, therefore, refer to the provisions of the Accounting standards to find out whether they support the presentation of the proposed dividend in the Balance sheet as on 31.3.2014. It may be noted that two accounting standards i.e. AS 4 “Contingencies and Events Occurring after the Balance Sheet Date” and AS 29 “Provisions, contingent Liabilities and contingent Assets” are relevant in this context. Based on the three components of definition of liability as per AS 29, let us find out whether proposed dividend is a liability as under:

(a) Whether it is a present obligation? Fundamentally, dividend if and when declared becomes a debt to the shareholders which can’t be withdrawn by the company and proposed dividend may be withdrawn by the board at any time before the same is declared by the shareholders in the annual general meeting. Based on this, Legally speaking, proposed dividend of Rs. 2,00,000 for the year 2013-14 is not a present obligation on the balance sheet date i.e. on 31.3.2014 because of the following reasons:

(A) The dividend has been proposed on 15.5.2014 i.e. after the balance sheet date i.e. 31.3.2014.

(B) The dividend proposed on 15.5.2014 is certainly not a present obligation even on 15.5.2014, not to speak of its being a present obligation on 31.3.2014, because the same may or may not be declared by the shareholders in the annual general meeting which will be held after 31-5-2014 and if the shareholders declare the dividend proposed by the board in the AGM to be held after 31-5-2014, it will become a legal liability on the date of declaration in the AGM i.e. on the date on which the AGM is held and not before that date. The shareholders have a right to reduce the dividend proposed by the board even up to a nil figure but they can’t increase the amount of dividend proposed by the board i.e. in the instant case, they can’t increase the amount beyond Rs. 2,00,000 but they can reduce Rs. 2,00,000 up to any amount including nil amount also. Further, presuming that the shareholders will declare the proposed dividend in the AGM which normally happens in practice, the declared dividend will become a legal liability for and in the year 2014-15 and in no case a legal liability for 2013-14.

Based on the situation in (A) and (B) above, it may undoubtedly be concluded that proposed dividend is not a debt on 15.5.2014 and hence the question of its being a debt on 31.3.2014 (i.e. before 15.5.2014) does not arise at all. Because it is not a debt on 31.3.2014, it is not a present obligation on 31.3.2014 in respect of such proposed dividend amounting to Rs. 2,00,000. Thus, there is no need to apply the remaining two tests given in the remaining two characteristics of the analysis of the definition of liability given above.

Thus, based on the above, it is clear that the proposed dividend is not a liability for 2013-14 as per AS 29 and hence it should not be presented in the balance sheet as at 31.3.2014.

But, the fact remains that it is always presented in the balance sheet of the financial year for which the dividend is proposed for that year after the date of the concerned balance sheet but before the approval of the financial statements of that financial year. The question is what is the legal basis to support the
presentation of the proposed dividend is a liability in the Balance sheet. For this purpose, let us analyze the provisions of AS 4 as under:

Events Occurring after the Balance sheet date: Events occurring the balance sheet date are those significant events, both favourbale and unfavourable, which occur after the balance sheet date but before the date of approval of financial statements by the board in the case of a company. As per paragraph 8.1, such events may need the adjustment to the assets and liabilities as at the balance sheet date or may need only disclosure. As per paragraph 13, adjustment to assets and liabilities should be made for the events that provide additional evidence to assist the estimation of amount relating to conditions or situations existing on the balance sheet date or that indicate that the fundamental accounting assumption of going concern is not appropriate.

Based on the above, proposed dividend does not relate to the estimation of amount related to the conditions or situations existing on the balance sheet date and hence, the same need not be adjusted to the liabilities as at the balance sheet date i.e. on 31-3-2014 in the case taken above and simply requires disclosure in the notes to accounts for the financial statements for the year 2013-14. However, an exception to this general principle as given in paragraph 13 of AS 4 provides that dividend stated to be in respect of the period covered by the financial statements which are proposed or declared by the enterprise after balance sheet date but before the approval of the financial statements, should be adjusted.

Thus, proposed dividend for the year 2013-14 should be presented in the balance sheet as at 31.3.2014 merely because of an exceptional provision of paragraph 14 of AS 4 presuming that it is a liability of the company towards the shareholders.

Thus, when it is clear that the proposed dividend for the year 2013-14 recommended after 2013-14 has to be presented in the balance sheet as at 31.3.2014 and so on, the next question arises what kind of liability it is i.e. whether it is a current liability or a long term liability.

The sub-head ‘Current Liabilities’ in the balance sheet format given in schedule III has four sub-sub-heads i.e. (a) Short term Borrowings, (b) Trade payables (c) Other Current liabilities and (d) Short term provisions. Hence, the question arises as to under which sub-sub head, the proposed dividend has to be presented. There is no doubt that proposed dividend is neither a short term borrowing nor a trade payable and hence, the question of presentation of proposed dividend under either of the two sub-sub heads does not arise. Now, the question is whether proposed dividend is ‘other current liability’. There is no doubt that the proposed dividend is not ‘other current liability’ because for an item to be other current liability, it has, first of all, to be a liability. When the proposed dividend as analyzed above is not a liability, the question of its being other current liability does not arise. Now, there is only one remaining sub-sub-head i.e. ‘short term provision’ under which proposed dividend may be shown.

The next question, therefore, naturally arises whether the proposed dividend is a short term provision. As analyzed above, if it is a provision, it is bound to be short term provision only. Hence, we have to know what a provision is and if the proposed dividend satisfies the definition of provision, it is a short term provision to be shown under this sub-sub-head.

A provision is a liability which can be measured only by using a substantial degree of estimation. In the instant case, proposed dividend can be taken as a provision as on 15.5.2014 because this is the liability which is estimated to be paid by the director in respect of final dividend to the shareholders of the company though, the estimated liability as such may be reduced by the shareholders in the annual general meeting to any figure including the nil figure or may be approved at the same amount as proposed by the directors. Though not as per the provisions given in the main body of AS 29, yet based on the presumption taken form illustration 4 dealing with “Refund Policy” appended to AS 29 to explain the application of the Accounting Standard 29, obligation for the purpose of AS 29 need not be a legal one only for accounting purposes. The said illustration provides that the obligation may be undertaken by the enterprise as a matter of normal business practice, in order to maintain good
business relation or to act in an equitable manner also though legally that may not be required to be undertaken. Hence, based on this, though the proposed dividend is not a legal liability, it is a customary liability as a matter of normal business practice. Because, this is a provision on 15.5.2014, it has to be treated as a provision on 31.3.2014 also only on presumptive basis as per paragraph 14 of AS 4 as given above. The company knows normally as a matter of business practice that whatever amount of dividend is proposed by the Board is normally declared by the shareholders in the AGM though they have the right to reduce the same to any figure including the nil figure. Hence, it may be concluded that proposed dividend is a kind of provision from AS 29 point of view.

Based on the explanations submitted in the foregoing paragraphs, it may be concluded that the proposed dividend should be presented in the balance sheet on 31.3.2014 as a kind of Short term provision. Now, the question arises as to under what category of short term provisions’, the proposed dividend should be shown. Under short term provision, there are two categories i.e. ‘Provision for employee benefits’ and ‘others’. Hence ‘proposed dividend’ should naturally be shown under ‘Others’. Others would include all provisions other than provision for employee benefits such as provision for taxation, provision for dividend, provision for warranties etc.

It may be noted that so far as the treatment and presentation of the proposed dividend is concerned, there is no significant difference between revised schedule VI to the Companies Act, 1956 and schedule III to the companies Act 2013.

CONCLUSION

The main section of the Companies Act, 2013 dealing with the treatment and presentation of the ‘Liabilities’, inter alia, in the Balance sheet is the schedule III, inter alia, defining the liabilities and from the point of view of the definition of liability given in the schedule III under the heading ‘General instructions for preparation of Balance Sheet’, ‘Proposed dividend’ is certainly not a liability and hence from the point of view of schedule III definition, ‘Proposed dividend’ should not be shown in the Balance Sheet. However, schedule III by means of general instruction No. 1 in the very beginning states that if the requirement of the Act including the Accounting Standards requires any change in the treatment or disclosure of any item, the same shall be made and the requirements of schedule III will stand modified accordingly. Hence, schedule III is giving overriding effect to the requirements of the Act including accounting standards over itself. Thus, by reference to the accounting standards i.e. As 29 ‘Provisions, Contingent Liabilities and Contingent Assets’ and mainly As 4 ‘Contingent Liabilities and Events Occurring after the Balance Sheet date’, ‘Proposed dividend’ may be legally shown in the Balance Sheet as one of the items of ‘Short term Provisions’. Hence, in the example stated in the discussion, Rs. 2,00,000 should be shown under ‘Short Term Provisions’ in the Balance sheet on 31.3.2014.

RECOMMENDATION

The proposed dividend should never be presented as a kind of liability in the Balance sheet for the year to which the same relates because the said presentation violates the fundamental principles of accounting which provides that the transactions and events to be shown in the accounts in a particular year must occur in the said year. Because the proposed dividend related to any particular year is recommended after the expiry of that particular year and hence the said event of recommendation of dividend does not occur in the year for which it is recommended, there is no sound basis to present it in the balance sheet. Rather, it should be shown as a kind of transaction in the year in which it is recommended i.e. in the year following the year to which it relates. However, the recommended treatment may be adopted by the companies only when the provision of the Accounting Standard 4 (particularly paragraph 14 thereof) is amended because the companies are under a legal mandate to follow the Companies Act including Accounting Standards in preparing their financial statements.
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