



# FINANCIAL LITERACY FOR DIRECTORS



**CA. PRAMOD JAIN**

B. COM (H), FCA, FCS, FCMA, LL.B, MIMA, DISA, IP

Cleared self-assessment test for  
Independent Directors Database

2<sup>nd</sup> November 2022, IOD

# INTRODUCTION

- ✗ Financial failures & scandals in last two decades
- ✗ Enron and Worldcom in 2000-01 in US, Tesco and British Telecom in the UK, Satyam, ILFS in India
- ✗ How have these happened? What can be done to prevent them?
- ✗ Only a few directors of the concerned companies involved
- ✗ Other directors? Total ignorance and not conscious abetment
- ✗ What company directors / Officers should know about Finance, how they should apply the knowledge

# FINANCIAL STATEMENTS

- ✗ **Impact of annual published financial report on the company's stock prices**
- ✗ **Measurement of profit of a business:**
  - + **Surplus/deficit from cash inflows minus cash outflows? X**
  - + **Surplus/deficit from incomes and expenditures? ✓**

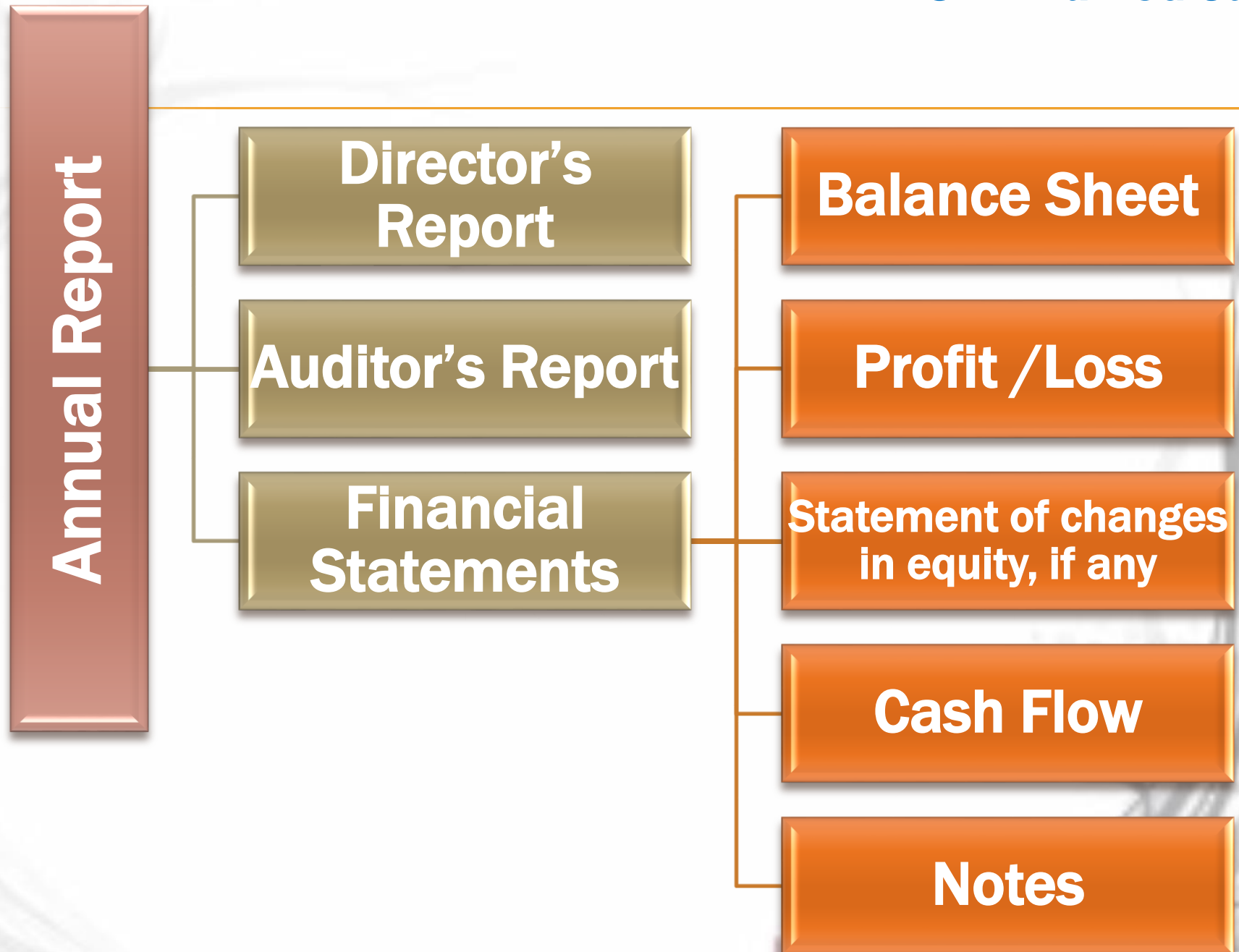
# THE ACCRUAL CONCEPT

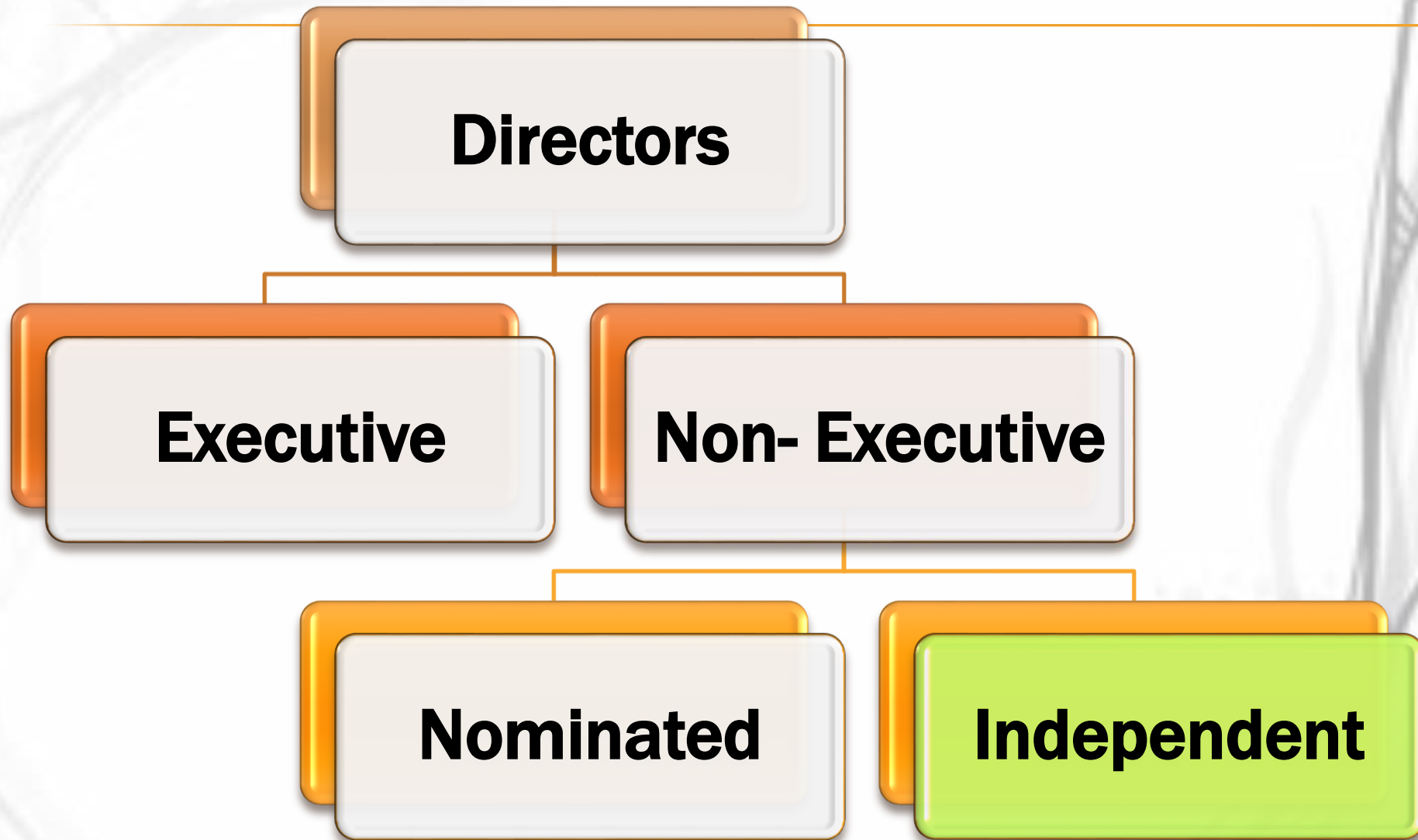
- ✗ **Double entry bookkeeping system**
- ✗ **‘Accrual’ vs. ‘Cash’ concept**
- ✗ **Accrual rules**
  - + **Income accounted when earned, not when received**
  - + **Expense accounted when incurred, not when paid**
- ✗ **Goods / services bought & used but not paid for: recognise expense but record liability too**

# THE ACCRUAL CONCEPT

- ✗ **Cash received for service to be rendered in the future: not revenue but liability**
- ✗ **Something bought & used for a few years: recognise cost over its life, show the balance as an asset**
- ✗ **Money paid or material delivered that will give you value even after the period ends: not expense but asset**
- ✗ **Not only transactions but invisible happenings that have a financial impact e. g. asset value reduction, exchange rate fluctuation etc.**







# FINANCIAL PERFORMANCE AND POSITION

- ✗ **Board to approve the audited financials to be adopted by the shareholders at the AGM**
- ✗ **Quarterly financials presented at other Board meetings – in case of listed entities - SEBI**
- ✗ **At all these meetings a few non-executive directors ask some factual questions related to operations ...enough?**



# READING THE ANNUAL REPORT

## ✗ Annual Report

- + Financial performance **during the year** with the help of the Statement of Profit & Loss and the Cash flow; and
  - + Financial position at the **end of the year** with the help of the Balance sheet and Statement of stockholders' equity
- ## ✗ Identify obvious and not-so-obvious issues through the numbers



# ISSUES

```
graph TD; ISSUES[ISSUES] --> Technical[Technical]; ISSUES --> Impacting_Finance[Impacting Finance]; Technical --> Formats[Formats, wordings etc]; Impacting_Finance --> Disclosures[Disclosures impacting Financial Decisions]; Impacting_Finance --> Non_compliances[Non-compliances resulting in Huge fines];
```

**Technical**

**Formats,  
wordings etc**

**Impacting  
Finance**

**Disclosures  
impacting  
Financial  
Decisions**

**Non-  
compliances  
resulting in  
Huge fines**

# FILING OF FS

- ✖ To be filed with ROC in Form AOC -4 within 30 days of AGM
- ✖ Upto 30.6.2018 additional fee till 300 days
- ✖ W.e.f. 1.7.2018 additional fee Rs. 100/- pd
- ✖ Penalty on
  - + Company – 1k p. d > 10 L;
  - + MD, etc in charge by Board- if no one – all directors
    - ✖ Penalty – 1L (Rs. 100/- per day if continuous default) to 5L

# ANNUAL RETURN - PENALTY

- ✗ If filed within 60 days in MGT 7 – normal fee
- ✗ Upto 30.6.2018 additional fee till 300 days
- ✗ W.e.f. 1.7.2018 additional fee Rs. 100/- pd
- ✗ After that penalty (earlier fine w.e.f. 2<sup>nd</sup> November 2018):
  - + On Company and Officer in default
    - ✗ minimum 50K plus Rs. 100/- per day on continuous default.
    - ✗ maximum – 500K

# Audit Trail





# **BASICS – CURRENT VS. NON-CURRENT**

- ✖ **Current Asset - satisfies any of following criteria;**
  - + **In the company's normal operating cycle it is;**
    - ✖ **Intended for sale; or**
    - ✖ **Intended to be consumed; or**
    - ✖ **Expected to be realized.**
  - + **Held primarily for the purpose of being traded; or**
  - + **Expected to be realized within 12 months after reporting date; or**
  - + **Cash or cash equivalent unless it is restricted from being exchanged or used to settle a liability for at least 12 months after reporting date.**

# BASICS - CURRENT LIABILITY

- ✖ A liability would be a current liability if it satisfies any of the following criteria; if it is :
  - + Expected to be settled in the company's normal operating cycle; or
  - + Held primarily for the purpose of being traded; or
  - + Due to be settled within **12** months after reporting date; or
  - + The company does not have an unconditional right to defer settlement of liability for at least **12** months after reporting date. Terms of a liability that could, at option of counterparty, result in its settlement by issue of equity do not affect its classification.

# BALANCE SHEET AS AT ... (IND AS)

<b><i>Particulars</i></b>	<b><i>Note No.</i></b>	<b><i>Figures as at the end of the current reporting period</i></b>	<b><i>Figures as at the end of the previous reporting period</i></b>
<b>I. ASSETS</b>			
(1) Non-Current Assets			
(2) Current Assets			
<b>TOTAL</b>			
<b>I. EQUITY AND LIABILITIES</b>			
(1) Equity			
(2) Liabilities			
(2) (a) Non-Current Liabilities			
(2) (b) Current Liabilities			
<b>TOTAL</b>			

# FORM OF B/S (IND AS) (PART II)

<i>Particulars</i>	<i>Note No.</i>	<i>Figures as at the end of the CRP</i>	<i>Figures as at the end of the PRP</i>
<b>II. EQUITY AND LIABILITIES</b>			
<b>EQUITY</b>			
(a) Equity Share capital	1		
(b) Other Equity	2		
<b>LIABILITIES</b>			
<b>Non-current Liabilities</b>			
(a) Financial Liabilities			
(a) Borrowings	3		
(b) Lease Liabilities	4		
(c) Trade Payables	5		
(d) Other financial liabilities	6		
(b) Provisions	7		
(c) Deferred tax liabilities (net)	8		
(d) Other Non-current Liabilities	9		

# FORM OF B/S (IND AS) (PART II)

<i>Particulars</i>	<i>Note No.</i>	<i>Figures as at the end of the CRP</i>	<i>Figures as at the end of the PRP</i>
<b>Current Liabilities</b>			
<b>(a) Financial Liabilities</b>			
(a) Borrowings	10		
(b) Lease Liabilities	11		
(c) Trade Payables	12		
(a) Due to MSME	13		
(b) Due to Other than MSME	14		
(d) Other financial liabilities	15		
(b) Other current liabilities	16		
(c) Provisions	17		
(d) Current Tax Liabilities (Net)	18		
<b>TOTAL</b>			

# BALANCE SHEET AS AT ... (AS)

<b><i>Particulars</i></b>	<b><i>Note No.</i></b>	<b><i>Figures as at the end of the current reporting period</i></b>	<b><i>Figures as at the end of the previous reporting period</i></b>
<b>I. EQUITY AND LIABILITIES</b>			
(1) Shareholders' Funds			
(2) Share Application Money Pending Allotment			
(3) Non-Current Liabilities			
(4) Current Liabilities			
<b>TOTAL</b>			
<b>II. ASSETS</b>			
(1) Non-Current Assets			
(2) Current Assets			
<b>TOTAL</b>			



# FORM OF BALANCE SHEET (PART 1)

<i>Particulars</i>	<i>Note No.</i>	<i>Figures as at the end of the CRP</i>	<i>Figures as at the end of the PRP</i>
<b>I. EQUITY AND LIABILITIES</b>			
<b>(1) Shareholders' Funds</b>			
(a) Share capital	1		
(b) Reserve and Surplus	2		
(c) Money received against share warrants			
<b>(2) Share application money pending allotment</b>	3		
<b>(3) Non-current Liabilities</b>			
(a) Long term borrowings	4		
(b) Deferred tax liabilities (net)	5		
(c) Other long term liabilities	6		
(d) Long term provisions	7		
<b>(4) Current Liabilities</b>			
(a) Short term borrowings	8		
(b) Trade payables			
(c) Other current liabilities	9		
(d) Short term provisions	10		
<b>TOTAL</b>			

# **IMPORTANT ITEMS – EQUITY & LIAB.**

- ✖ **Reserves – Revaluation?**
- ✖ **Trade Payables - ageing**
- ✖ **Share Application Money pending allotment**
- ✖ **Loans from friends – not allowed**
- ✖ **Loans – Current / Non-Current**
- ✖ **Advances from customers – are they advances??**

# FORM OF B/S (IND AS) (PART 2)

Particulars	Note No.	Figures as at the end of the CRP	Figures as at the end of the PRP
<b>I. ASSETS</b>			
<b>(1) Non-current assets</b>			
(a) Property, Plant & Equipment	1		
(b) Capital work-in-progress	2		
(c) Investment Property	3		
(d) Goodwill	4		
(e) Other Intangible assets	5		
(f) Intangible assets under development	6		
(g) Biological assets other than bearer plants	7		
(h) Financial Assets			
(a) Investments			
(b) Trade Receivables			
(c) Loans			
(d) Others			
(i) Deferred tax assets (Net)			
(j) Other non-current assets			

# FORM OF B/S (IND AS) (PART 2)

Particulars	Note No.	Figures as at the end of the CRP	Figures as at the end of the PRP
<b>I. ASSETS</b>			
<b>(2) Current assets</b>			
(a) Inventories			
(b) Financial Assets			
(a) Investments			
(b) Trade Receivables			
(c) Cash and cash equivalents			
(d) Bank balance other than above			
(e) Loans			
(f) Others			
(e) Current Tax Assets (Net)			
(f) Other current assets			
<b>TOTAL</b>			

# FORM OF B/S (AS) (PART 2) *Pramod Jain*

Particulars	Note No.	Figures as at the end of the CRP	Figures as at the end of the PRP
<b>II. ASSETS</b>			
<b>(1) Non-current assets</b>			
(a) Property, Plant & Equipment	11		
(i) Tangible assets	12		
(ii) Intangible assets			
(iii) Capital work-in-progress			
(iv) Intangible assets under development	13		
(b) Non- current investments			
(c) Deferred tax assets (Net)	14		
(d) Long term loans and advances	15		
(e) Other non-current assets			
<b>(2) Current assets</b>			
(a) Current investments	16		
(b) Inventories	17		
(c) Trade receivables			
(d) Cash and cash equivalents	18		
(e) Short term loans and advances	19		
(f) Other current assets	20		
<b>TOTAL</b>			

# IMPORTANT ITEMS - ASSETS

- ✗ **Tangible Assets – Immovable property?**
- ✗ **Tangible Assets – Non earning assets– vehicles?**
- ✗ **Depreciation as per Schedule II**
- ✗ **Intangible assets – Real? – self generated?**
- ✗ **Investments – required? – Subsidiary & Associates - CFS**
- ✗ **Loans & Advances – business? - Subsidiary & Associates – directors?**
- ✗ **Inventory – valuation? – slow/ non-moving - INSURANCE**
- ✗ **Trade Receivables > 6 Months – ageing > 1 yr – Doubtful – Provision**
- ✗ **Cash in Hand**



# FORM OF STATEMENT OF PROFIT AND LOSS

Particulars	Note No.	Figures for the CRP	Figure for the PRP
I. Revenue from operations	21		
II. Other income	22		
<b>III Total Revenue (I + II)</b>			
IV. Expenses	23		
<b>V. Profit before exceptional and extraordinary items and tax (III - IV)</b>			
VI. Exceptional items	24		
<b>VII. Profit before extraordinary items and tax (V-VI)</b>			
VIII. Extraordinary items	25		
<b>IX. Profit before tax (VII-VIII)</b>			
X. Tax Expenses	26		
<b>XI. Profit (loss) for the period from continuing operations (IX-X)</b>			
XII Profit (Loss) from the discontinuing business	27		
XIII Tax expenses of discontinuing operations	28		
<b>XIV. Profit (Loss) from discontinuing operations (after tax) (XII-XIV)</b>			
<b>XV. Profit (Loss) for the period (XI+XIV)</b>	29		
XVI. Earnings per equity share			

# NOTES TO THE ACCOUNTS

- ✗ Notes to the accounts classified into
  - + Significant Accounting Policies and
  - + Explanatory information on P&L a/c and Balance Sheet
- ✗ Accounting, reporting and disclosure norms as per Accounting Standards
- ✗ Sensitive and control information not apparent from the financials: contingent liabilities and commitments, various segments, related party disclosures audit expenses
- ✗ Many shades of grey and hence room for manipulation: for example, off-balance sheet financing

# OTHER IMPORTANT ITEMS - NOTES

- ✖ **Contingent Liabilities – Pending Litigation, tax disputes, claims against company**
- ✖ **Commitments – future commitments**
- ✖ **Foreign Currency Transactions**
- ✖ **Loans given – Interest charged**
- ✖ **Segment Reporting**
- ✖ **Related Party Transactions**
- ✖ **Related to Natural Calamity like COVID-19**

## RELATED PARTY

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graph TD; RP[RELATED PARTY] --> AS[Accounting Standards]; RP --> CA[Companies Act]; RP --> IT[Income Tax]; AS --> AS18[AS 18]; AS --> IndAS24[Ind AS 24]; CA --> S276[S. 2(76)]; S276 --> S184[S. 184]; S276 --> S188[S. 188]; IT --> 40A2b[40A(2)(b)];
```

**Accounting  
Standards**

**AS 18**

**Ind AS 24**

**Companies Act**

**S. 2(76)**

**S. 184**

**S. 188**

**Income Tax**

**40A(2)(b)**

# NOTES – CHANGES FROM FY 2021-22

## ❖ Ageing:

- ❖ Trade Payables – MSME / Disputed
- ❖ Trade Receivable – Disputed / Doubtful / Unbilled Dues
- ❖ CWIP / Intangible Asset under Development – in Progress / temporarily suspended - overdue or has exceeded its cost compared to its original plan CWIP separately (ageing of to be completed)

# NOTES – CHANGES FROM FY 2021-22

- ❖ Title deeds of Immovable Property not held in name of the Company – Includes ...if held in name of promoter, director or relative of promoter / director or employee of promoter / director
- ❖ Loans or Advances in nature of loans **granted** to promoters, directors, KMPs & related parties (Companies Act) either severally or jointly - repayable on demand or without specifying any terms / period of repayment... along with % to total advances



# NOTES – CHANGES FROM FY 2021-22

- ❖ Where company has not used borrowings from banks & FIs for specific purpose for which it was taken at B/S date - Details of where used
- ❖ Where Co. has borrowings from banks or FIs against current assets - Quarterly returns filed are in agreement with books of a/cs - if not, reco. & reasons of material discrepancies
- ❖ Relationship with struck-off Company – Investment, Drs, Crs, Shareholders, Others
- ❖ CSR disclosure
- ❖ Undisclosed Income in search / survey

# STANDARDS

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- ✖ **Accounting Standards**
- ✖ **IFRS**
- ✖ **Convergence to IFRS – Ind AS**
- ✖ **Standards on Auditing**
- ✖ **Secretarial Standards**
- ✖ **Standards on Internal Audit**
- ✖ **Income Computation & Disclosure Standards (ICDS)**
- ✖ **ICAI Valuation Standards**

# AUDIT COMMITTEE

## ✗ Following Cos to constitute Audit committee:

- + Listed companies
  - + Public companies having capital > Rs. 10 Crore ;
  - + Public companies having turnover > Rs. 100 Crore;
  - + Public companies, having in aggregate, outstanding loans, borrowings, deposits, etc > Rs. 50 Crore
- ✗ Limits as per last audited FS

# AUDIT COMMITTEE - SEBI

- ✖ **SEBI (Listing Obligation & Disclosure Req.)**
  - **Listed Co to constitute qualified and Independent Audit Committee**
  - + **Minimum 3 directors as members**
  - + **2/3<sup>rd</sup> to be independent directors**
  - + **All members of audit committee shall be financially literate (read and understand basic FS) and at least 1 member shall have accounting or related financial management expertise**

# AUDIT COMPLIANCE REQUIREMENTS

- ✗ All companies to get their annual accounts audited by a practicing member of the ICAI
- ✗ Provisions on auditor's appointment, rotation of auditors, content of audit report, fraud reporting etc.
- ✗ Auditor to comply with **the standards on auditing**

# REPORT - COMPANIES

- **Inquiry u/s 143(1) – 6 points – only to be reported when comments required**
- **Report to include:**
  - **Matters specified u/s 143(3) - 9 points**
  - **Matters specified in Rules - 3 points**
  - **Any order made u/s 143(3) for specified Companies in consultation with NFRA – CARO 2020 – 21 points**

# IMPORTANT IN AUDITOR REPORT

## ✗ CARO 2020

- + Deposits / Loans given – 185 / 186
- + CC Limits – statements variation
- + Statutory dues payable
- + Any adverse comment

## ✗ Audit report

- + Modified Report?
  - ✗ Qualification
  - ✗ Adverse / Disclaimer
- + Emphasis of matter / Other matter
- + KAM w.e.f. FY 2018-19 – SA 701



# FINANCIAL ISSUES AT BOARD MEETING

- ✗ **Dividend: dividend that can be declared out of the profit for the year and the accumulated profits till end of PY subject to Dividend Rules**
- ✗ **Important statutory and governance issues**
- ✗ **Review of statutory matters**
- ✗ **Statutory checklist preferable for every meeting**
- ✗ **Voluntary reopening / revision of accounts & financial report for earlier periods: up to 3 years – NCLT approval required**

# INVESTMENT DECISIONS

## ✖ Three types:

- + **Project capital expenditure: major initiatives of expansion and diversification**
- + **Other capital expenditure: routine expenditure on replacement of capacity**
- + **Investment of surplus funds: return v. risk of the selected channel**

## ✖ **Systems for Board approval based on the Memorandum and Articles of Association**

## ✖ **Significant area of director participation in growth companies**

# PROJECT CAPITAL EXPENDITURE

- ✗ **Expansion, diversification or acquisition of a business**
- ✗ **Required of the director: a fairly good grasp of the business as well as knowledge in financial evaluation**
- ✗ **Three key dimensions in project capex evaluation**
  - + **Investment proposed: amount, timing and horizon**
  - + **Expected cash flows from the project and the risk that they may not happen**
  - + **Required rate of return**
- ✗ **Discounting of cash flows to build in time value of money, using required rate of return as discount rate**
- ✗ **The concept of weighted average cost of capital (WACC)**

# OTHER CAPITAL EXPENDITURE

- ✗ Replacement of equipment, overhead capex, enhancements in processes
- ✗ Routine capex that does not add directly to the bottom line
- ✗ Payback approach for small cost reduction initiatives
- ✗ Innovation to figure in annual capex budget
- ✗ Every item of capital expenditure to be evaluated in terms of return except CSR initiatives
- ✗ CSR not to be based on return to the investor but on return to the community

# OTHER INVESTMENTS

- ✖ **Surplus cash to yield a decent return without undue risk**
- ✖ **Short-term parking of funds using interest arbitrage to increase shareholder wealth**
- ✖ **Diversion of funds – a danger to look for**
- ✖ **Acquisitions and diversifications that yield economic rents**
- ✖ **Buyback of shares, substantial dividends**

# FINANCING DECISIONS

- ✗ **Three distinct financing decision areas:**
  - + **Financing of capital expenditure and investments (balance sheet)**
  - + **Financing of working capital (P&L Account)**
  - + **Financing strategy for revival of sick companies**
- ✗ **When project capital investment to be proposed together with the financing plan**
- ✗ **Funding of other capex items**
- ✗ **Working capital financing by banks with diverse *ad hoc* ideas**
- ✗ **Sanctioning changes in bank limits**

# SOURCES OF FINANCE

- ✗ **Two broad sources of funds: equity and debt**
- ✗ **Avatars of equity:**
  - + Initial investment by the owners
  - + Rights issues
  - + Other types of shares – preference capital and hybrid securities
  - + Use of retained earnings
- ✗ **Balancing two contrary objectives:**
  - + Cost of money
  - + Risk involved
- ✗ **Importance of capital market conditions and shareholder preferences**



# CSR COMPLIANCE

- ✖ **Co. to constitute CSR Committee consisting of 3 or more directors, out of which at least one director shall be independent director & spend at least 2% of average net profits of company made during 3 immediately preceding FYs, if during immediately preceding FY:**
  - + net worth of Rs. 500 Cr. or more, or
  - + turnover of Rs. 1000 Cr. or more, or
  - + net profit of rupees Rs. 5 Cr or more
- ✖ **If not spent:**
  - + On Going Project – trf within 30 days to special A/c – spend within 3 years. If not trf to Sch. VII fund in 30 days
  - + Not a ongoing project - trf to Sch. VII fund in 6 months

# CSR COMPLIANCE

- ✗ **If not complied, penalty:**
  - + **On Company - twice the amount required to be transferred by the company to the Fund specified in Schedule VII or the Unspent CSR Account, as the case may be, or Rs. 1 Cr, whichever is less**
  - + **On every officer in default - 1/10th of the amount required to be transferred by the company to such Fund specified in Schedule VII, or the Unspent CSR Account, as the case may be, or Rs. 2 L, whichever is less**

# OTHER STATUTORY COMPLIANCES

- ✗ **Three distinct domains:**
  - + **Company law and secretarial compliances**
  - + **Compliance with other applicable statutes**
  - + **Compliance for listed companies (Listing Obligations and Disclosure Requirements)**
- ✗ **Companies Act 2013, Rules and Notifications**
- ✗ **Other statutes: Foreign Exchange, PMLA, Labour Laws, Laws specific to the industry**
- ✗ **Know what questions to ask and where to look for answers**

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1

answer

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