CHAPTER IV

TECHNIQUES OF DISCLOSURE

Disclosure can be defined as a process through which a business enterprise communicates with the external parties. Prior to the nineteenth century, most of the companies were closely held and internally financed. Consequently, the financial statements (to the extent they were prepared at all) were for internal use by management. Outsiders had little or no interest in the financial affairs of most businesses. Later on, as borrowed money became important, two parties were involved—the owners and the creditors. At this time, financial statements were used as a basis for granting credit or making loans.

With the development of the corporation, a new group of people became interested in the financial affairs of business—the stock holders. Because of the divorce between management
and ownership, the number and type of people interested in financial statements have changed radically from the early beginning. Now, financial statements are necessary for stockholders and potential stockholders in addition to managements and creditors.

At present, financial statements are made use of by different groups of persons. Many of them are not at all educated in accountancy. Business enterprises have also realised that the balance sheet and profit and loss account have failed in serving the needs of users. Thus, now, the purpose of disclosure through financial statements is to give meaningful information to or communicate to those who are interested in the firm concerned. For satisfying the above purpose, financial disclosure should be made in such a way that could satisfy the needs of all parties concerned and should be understood by them.

Keeping this view in mind, many big concerns have started including certain new techniques of financial disclosure in their financial reports in order to enhance the usefulness of such financial statements.

Following are the popular techniques of financial disclosure:

01. Segmented Disclosure
02. Inflation Accounting
All diversified companies (companies engaged in different product-lines) are required to make reporting for each individual segment. The statement applies to enterprises whose securities are publicly traded and to other economically significant entities including subsidiaries. For purpose of this statement other economically significant entities including subsidiaries are those whose levels of revenue profits, assets or employment are significant in the countries in which their major operations are conducted.

For both—parent company and subsidiary company—a consolidated financial statement is presented. The information called for by this statement need only be presented on the basis of the consolidated information. If financial statements of subsidiaries are published, the segment information is

1 International Accounting Standard–14, Issued by the Accounting Standards Committee, The Institute of Chartered Accountants of India on "Reporting Financial Information by Segments". 
called for at that level.

Recognising the desirability of more complete disclosure by diversified companies, the Securities Exchange Commission (SEC) in 1969 required "line of business" information in registration statements. By 1974, these requirements had been expanded to include Annual Reports filled with SEC on Form 10-K and annual reports to security holders of companies. The SEC provided for segments meeting certain size limitations to disclose total sales and revenues, and income or loss before income taxes and extra ordinary items. In the private sector the American Institute of Certified Public Accountants (AICPA) issued a statement in 1972 recommending voluntary disclosure of additional information by diversified companies.

A segment may be defined as a part of the business representing a separate major line of business or class of customer. Financial Accounting Standards Board (FASB) Statement No. 14 provides that segments shall be determined by:

a) Identifying product and/or services from which the enterprise derives its revenue;

b) Grouping those products and/or services by industry lines into industry segments.

c) Selecting segments which are significant to the enterprise as a whole.

2 Reporting segments may or may not be the same as segments defined for purposes of reporting results of discontinued operations. Accounting Principles Board opinion No. 30 defines criteria for determining a discontinued segment while FASB Statement No. 14 governs the definition of reporting segments.
The FASB recognised that in spite of several systems which have been developed for classifying business activities, it is very difficult to define "industry lines" or "industry segments". Determination of the industry segments of the enterprises is left to a considerable degree to the judgement of management guided by standard classification systems, the nature of the products and services, the nature of production processes, the similarity of geographic marketing areas, and types of customers or marketing methods.

The Board set forth more explicit guidelines for determining whether a segment is significant to the enterprise as a whole. If any one of the following tests is satisfied, information must be reported for the identified segment.

i) The segment's revenue is 10 per cent or more of the combined revenue of all the enterprise's industry segments.

ii) The absolute amount of the segment's operating profit (or loss) is 10 per cent or more of the greater, in absolute amount of:

a) The combined operating profit of all industry segments that did not incur an operating loss.

b) The combined operating loss of all industry segments that did incur an operating loss.

iii) The segment's identifiable assets are 10 per cent or more of the combined identifiable assets of all industry segments.
In addition, the total revenue for all segments combined must be at least 75 per cent of the revenue of the company as a whole. If this test is not satisfied, it may be concluded that management has not identified an adequate number of reportable segments and the delineation of additional segments is necessary.

The information reported for each reportable segment and for the remainder of the company as a whole is as follows:

i) Revenue from sales to outside customers and revenue or transfers among industry segments.

ii) Operating profit or loss including an explanation of any unusual or infrequently occurring items.

iii) Other profitability information such as contribution margin or net income (at the discretion of management).

iv) The aggregate carrying amount of identifiable assets.

v) Aggregate depreciation, depletion and amortization expense.

vi) Capital expenditures, i.e. for addition to property, plant and equipment.

vii) Other information about investments and effects of changes in accounting principles.

The statement also requires data to be reported for foreign operations, export sales and major customers of the enterprise.
The objective of presenting information by segments is to provide users of financial statements with information on the relative size, profit contribution, and growth trend of the different geographical areas in which a diversified enterprise operates to enable them to make more informed judgments about the enterprise as a whole, which may not be determinable from the aggregated data.

Sometimes a concern has to face certain problems in segment reporting. Firstly, a concern fears that disclosing information about segments may weaken an enterprise's competitive position because detailed information is made available to competitors, customers, suppliers and others. For this reason, some consider it appropriate to allow the withholding of certain segment information where disclosure is deemed to be detrimental to the enterprise.

Secondly, it is difficult to identify the segments to be reported upon. In this regards, the guidelines set forth in the statement leave management with several alternatives each of which may be possible for the firm to use. In deciding which classification scheme to be used, management should select the breakdown that best represents the underlying activities of the business. As firms gain experience with reporting segment information, the apprehension surrounding segment definition should disappear.
Further, another problem encountered in the preparation of disaggregated information is that of common costs. Common costs are those incurred for the benefit of more than one segments and whose nature make a clear objective division impossible. For example, the President's salary or the cost of running a company-wide legal, accounting and research department would be difficult to allocate objectively among segments. Allocation basis such as sales contribution margin, assets employed and investment have been suggested but no resolution of this problem has yet occurred. FASB statement No.14 takes no position on this issue and merely requires that the method used to allocate operating expenses be disclosed.

Despite of all the above difficulties, the users of financial statements need segment information to assess the products and risks of a diversified enterprise which may not be determinable from the aggregated data. This is because the rates of profitability, opportunities for growth, future prospects and risk to investments may vary greatly among industry and geographical segments. Analysis by segments of the aggregated financial information of a diversified enterprise is widely deemed to provide useful data that enable the users to make a better assessment of the past performance and future prospect of the enterprise.
Exhibit-1 shows the appropriate disclosure taking imaginary figures which would be made by a company operating in several different industries and defining segments by industry.

02 INFLATION ACCOUNTING

The preparation of inflation accounts either as part of companies' audited accounts or as a supplement to them is becoming necessary for companies now-a-days, although it is not required by law. The Accounting Standards Committee in the United Kingdom has recommended that the published financial statements of companies listed on the stock exchange should include a separate statement showing important inflation accounting computation for accounting periods ending on or after December 31, 1977. In the U.S.A. also, it is now required that certain companies should file inflation adjusted information with Securities and Exchange Commission.

The need for inflation accounting has arisen primarily because of the acute inflation which has almost been a universal phenomenon in the twentieth century economies.

This illustration was adapted from the illustration in Appendix F of Statement of Financial Accounting Standards No. 14.

One typical example could be that of France where one franc in 1914 could buy as much as 192.53 francs could do in 1961. Socialist economies, due to their price fixation and distribution control mechanism have not experienced acute inflationary trends.
## EXHIBIT I

**INFORMATION ABOUT THE COMPANY'S OPERATIONS IN DIFFERENT INDUSTRIES**

**FOR YEAR ENDED**

<table>
<thead>
<tr>
<th></th>
<th>Wood products</th>
<th>Electronic components</th>
<th>Chemicals</th>
<th>Other industries &amp; eliminations</th>
<th>Consolidated figure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales to unaffiliated customers</td>
<td>Rs. 1,000</td>
<td>Rs. 2,000</td>
<td>Rs. 1,500</td>
<td>Rs. 200</td>
<td>Rs. 4,700</td>
</tr>
<tr>
<td>Intersegment sales</td>
<td>200</td>
<td>500</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Revenue</td>
<td>Rs. 1,200</td>
<td>Rs. 2,000</td>
<td>Rs. 2,000</td>
<td>Rs. 200</td>
<td>Rs. 4,700</td>
</tr>
<tr>
<td>Operating profit</td>
<td>Rs. 200</td>
<td>Rs. 290</td>
<td>Rs. 600</td>
<td>Rs. 50</td>
<td>Rs. 1,100</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity in net income of XYZ Co.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>100</td>
</tr>
<tr>
<td>General corporate expenses</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(100)</td>
</tr>
<tr>
<td>Interest expense</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(200)</td>
</tr>
<tr>
<td>Income from continuing operations before income taxes</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Rs. 900</td>
</tr>
<tr>
<td>Identifiable assets at the end of the year</td>
<td>Rs. 2,000</td>
<td>Rs. 4,050</td>
<td>Rs. 6,000</td>
<td>Rs. 1,000</td>
<td>Rs. (50)</td>
</tr>
<tr>
<td>Investment in net assets of XYZ Co.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>400</td>
</tr>
<tr>
<td>Corporate assets</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>1600</td>
</tr>
<tr>
<td>Total Assets at the end of the year</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Rs. 15,000</td>
</tr>
</tbody>
</table>
Inflation has resulted in a number of distortions in accounting statements. Firstly, it is irrational to add together various assets purchased at different periods of time at their acquisition costs, simply because the value of rupee at all such points of time is not the same. Secondly, inflationary trend exaggerate the figure of net profits because of two reasons:

1) In an inflationary situation the closing stock of each succeeding year is valued at a higher figure. Suppose, a shoemaker has in his stock a pair of shoes which cost him Rs.30/- to make. He sells them at Rs.35/- making a profit of Rs.5/-. However, by the time he makes an identical pair of shoes to replace the sold one, the price rises and now it costs him Rs.35/- to make the pair. According to conventional way of looking at profits, this shoe-maker has made a profit of Rs.5/- since his closing stock will be valued at Rs.35/-. However, in reality there is no profit. He is simply back where he started with one pair of shoes on the shelf. The profit of Rs.5/- is an illusion. It is obvious, therefore, that inflation creates false profits on paper. These profits are created because of our particular way of looking at profits.

ii) Another factor giving rise to illusory profits is the inadequate provision on account of depletion and depreciation. This is due to the fact that depreciation is charged on the historical cost of the fixed assets. In a period of rising costs, this charge will not affect the current costs. Suppose a boiler is purchased in 1960 for Rs.25,000/- and its normal life is 15 years.
By the end of 1975 the company would have provided for Rs.25,000/- less the scrap value. But this sum would not be adequate to purchase a new boiler which may now cost as high as Rs.70,000/- in 1975. In short, throughout the period -- 1960-1975, the company has been making inadequate provisions for depreciation. Consequently, the profits have been shown higher than what they actually were.

A company must guard against an inadequate provision for depreciation. A company declaring very high dividend in an inflationary situation may actually be liquidating its fixed assets unless it re-states their values. It was said in the case of a leading consumer goods company. A watchful eye is kept on the capital employed in both fixed and current assets ... to make it more realistic, for the purpose of this exercise, the fixed assets are not taken at their net book value as shown in the balance sheet but on the basis of their current replacement value with a suitable adjustment for depreciation based on the replacement value. Its realism lies in the fact that it takes into account the changes in the value of money and shows the capital employed in the business by management on the basis of present day values. After all, the historic value of money is not of relevance and in an economy a management has to be alert to any depreciation of money—

5 "Accounting and Finance in Hindustan Lever"--Speech delivered by Mr. P.L. Tandon, Chairman, at the Annual General Meeting of Hindustan Lever Ltd., held at Bombay on April 8, 1962.
A number of solutions have been presented by various accountants regarding recognition of inflation in accounts. International Accounting Standard-6, "Accounting Responses to Changing Prices"; notes the fact that there are three types of solutions to this problem.

i) Financial information could be prepared in terms of current values instead of historical costs. This financial information would recognize changes in specific prices of assets while they are held but would not recognize changes in the general price level. In other words, financial statements would reflect the current values of the assets and the profit and loss account would show the charge for the current costs of assets consumed. Under this category, the techniques of current cost accounting, revaluation accounting and replacement accounting etc. fall.

ii) Financial information could be prepared on the basis of historical costs but with amounts stated in terms of current purchasing power of rupee. In other words, changes in the value of rupee or the general inflation or deflation would be reflected in financial information. Under this method, current purchasing power or general purchasing power will fall.

iii) Financial information could be prepared by combining features of each of the two methods given above. Accordingly, the financial statements would recognize both the changes in specific prices and the influence of inflation or deflation.
The re-statement of profits on account of inflation adjustments would have far-reaching effects on the various financial policies specially those connected with distribution of profits. Since the inflation-adjusted figure of profits would be lower than the figure of profits as shown by the conventional accounts, the various claims of profits will have to be suitably adjusted.

The first major change would be in the area of dividend policy. Prior to the dividend ordinance in 1974 most of the companies declared and paid a high percentage of their conventional profits as dividends. However, to the extent that the profits would be lower under inflation-adjusted-accounts, dividends would have to be reduced. This may be resented by the shareholders in the initial stages but the shareholders would realise, that on a long term basis, it is in their own interest that the company does not pay dividend by liquidating its capital assets. The retention of adequate profits would ensure sufficient funds for capital replacement.

Another area where a change would be necessary, will be taxation. At present a large part of the conventional profits of business are due to inflation. The Government takes away a large part of such profits by way of taxation. To the extend the Government is taking away tax on inflationary profits, it becomes a tax on liquidation of capital assets. Obviously, there should not be any income-tax on a capital
asset being liquidated. In a sense, therefore, the present way of computing profits and of levying income-tax thereon is in reality a payment out of capital. It is against public policy to raise taxes in such a manner. Therefore, it is neither in the interest of companies nor in the interest of the government to levy taxes on historical profits. Once, supplementary statements are prepared on the basis of inflation adjustments, the real profits of the companies would be shown. The Government should then allow a rebate in income tax in a manner that part of inflationary profits are retained in company by way of tax-shield. This is essential in order to build and maintain a sound industrial structure through internal financing.

An adjustment in the claims of the labour unions will also have to be made in case the true nature of profit is brought out. At the moment, the labour unions, specially in inflationary situation, claim large amounts as bonus and wage increases. When they realise that a large part of conventional profits is not profit in the real sense, they should tone down their demands.

Inflation accounting should also bring about changes in the capital structure of the companies from another point of view also. In view of the fact that companies having real assets financed by long term monetary liabilities are the
gainers in inflationary situations, more and more companies would seek to raise long-term monetary liabilities keeping in view the requirements of financial solvency. Companies would also like to have as little cash as possible. In addition, they would seek to restrict debtors. It is obvious, therefore, that once inflation adjusted accounts are adopted and the fact of long-term monetary gains is clearly brought out by the financial statements, there would be a greater emphasis on loan funds for long term purposes.

Inflation-adjusted-accounts would also be useful for inter-unit, inter-firm, and intra-firm comparisons specially when the same are attempted through selected accounting ratios like return on investment, etc. It is obvious that the return on investment calculated on the basis of the present day accounts always shows an older unit at an advantage in an inflationary economy. This is because such a unit has a lower investment base, due to lower cost of fixed assets. It also has a lower depreciation charge and, consequently, a higher net profit. It is, therefore, not possible to compare the various units on the basis of historical costs figures. Such comparison would be erroneous and lead to wrong conclusion. The age of machinery and other fixed assets is an important factor before return on investment is calculated for the purpose of comparison.

Inflation adjustments would also bring about a change in the capital replacement programmes of various companies. At
the moment, a unit manager may keep a very old machine in operation simply because, on the face of it there is no depreciation charge and also for the purpose of evaluation by the head office the value of the machinery would be taken to be low given a high rate of return to that unit. There is, therefore, a tendency amongst the departmental managers not to replace assets even though they may have become obsolete and may entail very high repair costs. The disadvantage of the high repair cost, it is argued, would be set off against the advantage of an almost nil depreciation and a much lower capital base. Once the figures are restated in terms of rupees of current value, it would be easier to take a decision regarding the replacement of old assets.

On the macro level, cumulative inflation adjustments should help in arresting the degree of inflation. As we know, inflation is a vicious circle; it generates self-consuming fuel and unless cut off brutally, it can take a very vicious turn. Inflation adjustments would help in slowing down the tempo of inflation due to the following reasons:

i) The dividends to the shareholders which normally represent consumption expenditure and additional purchasing power, would be reduced.

ii) The tax paid to the Government may also be reduced.

iii) The bonus and other wage increase, etc. may also be contained.
Money thus saved would be used in the company itself in financing its operations. In view of the ultimate high cost of loan funds, etc., the companies would attempt to improve their input-output ratio in terms of capital. This would lead to overall efficiency in the economy. It can thus be seen that inflation adjustments would have far-reaching effects on the financial structure and policies of various companies.

03 **HUMAN RESOURCE ACCOUNTING**

Human resource accounting has gained growing recognition in recent years, although there is no generally accepted method of putting a value on the vital asset and showing it as part of or along with financial statements. The traditional system of company financial reporting tends to concentrate on accounting for tangible resources for which transactions have taken place. Little or no account is usually taken of intangible resources which can include the skill and experience of the company's labour force including its management. Presumably because human beings in industry and commerce are 'rented' or leased for their services rather than purchased outright (as in slavery), they have not been treated for reporting purpose as measurable assets.

In India, it is only a recent tendency to include such a statement in financial reports, that too, by a very few
companies. Bharat Heavy Electricals Ltd. (BHEL) is one of them. Both the statement form and the diagrammatic form are prevalent. In the West, attempts are now being made to evaluate the human resources available to a concern and to put it on the balance sheet.

Further, a significant body of literature has been built up advocating the incorporation of human resource values into the traditional reporting system. The concept involves the identification of historic costs incurred on expenditure relating to human resources employed by the company, which, if estimated, will have an expected value stretching beyond the period in which the outlay took place.

The total human resource at the disposal of an organisation may broadly be divided into three categories:

1) Workers and similar employees at the shop-floor or in the office who do not have to exercise much judgement in their work.

2) Middle management executives who work within somewhat detailed policy decisions but who nevertheless exercise a fair degree of judgement in their work. Team work is desirable which is not of vital consequence. Departmental superintendents, area sales managers, accountants come under this category.

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iii) Top management including the managing director, various functional directors/managers such as Marketing Director, Finance Director, Production Director and the Secretary. At this level, all work require constant exercise of judgement and team work is of vital importance. The usefulness of human resource accounting is evident as follows:

i) There is generally good deal of turnover of personnels at various levels. Some of the expenditure on human machinery is unavoidable and is absolutely necessary and so cannot be avoided. But much of it is avoidable and costly also. Human resource accounting will highlight this desirable/undesirable expenditure and show the full cost of such turnover and compel the management to think of ways to reduce it.

ii) Development of human resources, e.g., executives' development, will be viewed as an investment programme to be judged against expected benefits and results. It can be a wastage of money on some programmes which must be avoided. It is also essential to have some programmes that will prove useful. For example, a company must consider whether it will build up its management cadres through a system of recruiting a number of management trainees and then giving them the requisite training and experience or it will resort to taking managers from outside whenever the need arises.
iii) The real rate of return on investment cannot be computed unless the investment in human resources is taken into account. It is possible that a firm's return on investment (ROI) may be poor only because there has been no such investigation or it may be exceptionally good because a good investment was made in human resources even though it is not shown in the balance sheet.

Thus, valuation of human resources is likely to be significant for both the internal management and the outside world for proper decision making and for motivating executives in the right direction. Information about the value of human resources available to a firm for various divisions will play an important role.

The method followed for valuation of this asset must however, take note of its versatility and the attendant uncertainty. Thus, while valuating this asset, one should keep in mind the above three types of personnel in an organisation. Generally, two methods (i) cost and replacement cost method; and (ii) economic value method are used to value this assets.

The method of human resource valuation to be followed must take into account the synergic effect that makes this asset most valuable. There have been cases in the past when a single scientist working in Research and Development department may have produced very valuable results, but even in research
and development these days, successful work requires team work or the combined effort of a number of people. To count the value of the efficiency of individuals, even if it were feasible, would be a futile exercise. The human resources should be valued as a whole, though that can be done for each identifiable segment of organisation also.

In valuating human resources, only the permanent factors leading to extra or super profits should be considered, but a careful assessment must be made of the various factors in operation. It will certainly be risky to proceed on the basis of profits alone. The following factors must be considered to assess the continued performance of a company in the future.

i) Return on investment in the light of:
   a) share of the market and the growth rate of sales.
   b) value added.
   c) replacement programme of assets.

ii) Research and Development:
   a) Development of new products.
   b) Development of new market and uses of the product.

iii) Management Capability:
   a) Executive development;
   b) Employee satisfaction and morale;
   c) Customer satisfaction; and
   d) Awareness of change in the social, technological and environment and the ability to meet them.
iv) General:

a) The problem faced by the firm and the manner in which they were tackled; and
b) The general image that the firm enjoys among government, banks, financial institutions etc.

Many of the factors are capable of precise measurement through the use of accounting and statistical techniques though quite a few can be only qualitatively and subjectively judged. It is significant to note that people are already talking of management audit. The professional management consultants are already in existence and therefore, the valuation process should not be too difficult. Human Resource Accounting can be exhibited by taking imaginary figures as under:

**EXHIBIT - 2**

**HUMAN ASSET VALUES**

<table>
<thead>
<tr>
<th>Categories</th>
<th>Rs, in millions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executives</td>
<td>1094</td>
</tr>
<tr>
<td>Supervisors</td>
<td>655</td>
</tr>
<tr>
<td>Skilled Artisans</td>
<td>1291</td>
</tr>
<tr>
<td>Supporting technical staff</td>
<td>199</td>
</tr>
<tr>
<td>Clerical and Office</td>
<td>286</td>
</tr>
<tr>
<td>Unskilled</td>
<td>502</td>
</tr>
<tr>
<td></td>
<td>4027</td>
</tr>
</tbody>
</table>

**Professional Profile**

<table>
<thead>
<tr>
<th></th>
<th>Rs, in millions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Engineers/Technicians</td>
<td>10505</td>
</tr>
<tr>
<td>Accountants</td>
<td>360</td>
</tr>
<tr>
<td>Doctors</td>
<td>220</td>
</tr>
<tr>
<td>Scientists</td>
<td>230</td>
</tr>
<tr>
<td>Artists</td>
<td>28792</td>
</tr>
<tr>
<td>Others</td>
<td>11500</td>
</tr>
<tr>
<td></td>
<td>31707</td>
</tr>
</tbody>
</table>
The valuation of human capital has been made on the model given by Lev and Schwartz.\(^7\) According to this model, the value of human capital embodied in an individual is the present value of future earnings for the remaining service period of a person presuming that the present promotion policy and pay scale will remain constant in future.

**VERTICAL AND HORIZONTAL FORM OF FINAL STATEMENTS**

The final statements i.e. both profit and loss accounts and the balance sheet are presented in two ways:

i) Horizontal Form

ii) Vertical Form.

Horizontal form is also known as traditional form or tabular form or 'T' form of presenting the final statements. This form is the oldest one and figured like a ledger account. Now-a-days the shares in companies are held by a wide variety of persons, a majority of whom are not conversant with the principles of accounting or with the form in which the final statements of accounts are drawn up. As a result there have been complaints from several quarters that the traditional form in which the balance sheet of a company is drawn up, is not satisfactory, for it does not disclose clearly whether the value of the equity shareholders has increased or depreciated and if so, by what amount. Thus the horizontal balance sheet is a clumsy affair. Therefore, it has been suggested that the balance sheet should be drawn up in a vertical form. This

\(^7\) The example has been taken from Bharat Heavy Electrical Limited (BHEL), Annual Accounts of the year 1979 which employs over 56,000 people.
suggestion has now been accepted and Schedule VI of the Companies Act now contains both the horizontal and vertical forms of the balance sheet.

The Hindustan Lever Limited was the first public limited company in India which laid down as on 31st December, 1961, the first statutory balance sheet, in columnar form. Its review reveals that the Hindustan Lever Limited has done a better job by showing 'Borrowing of Fixed Amount', just below the shareholders' funds to give a glimpse of total shareholders' funds and borrowings of fixed amount at one place. This was a variation of the model form prescribed by the Company Law Administration in which secured and unsecured loans are required to be shown after the total of current assets.

When the final statements are drawn up in vertical form, the final position of the company can be readily understood by a layman. The balance sheet shown in vertical form discloses the amount of debt and shareholders' equity distinctly. It further discloses the position of assets and working capital separately. This form is capable of presenting together comparative figures for a number of years. The relationship between the various balances for the current year can be disclosed in the form of accounting ratios by placing the relative data in closer proximity.
The Companies Amendment Act of 1960 has allowed the companies to prepare their Balance Sheets in vertical form or such other form as might be approved by the central government, provided that the prior approval of the central government has been obtained. Accordingly to assist the companies, a model form of balance sheet has also laid down by the Company Law Administration in July 1961, keeping the same notes, instructions and headings with their details as required under Part I of Schedule VI except that the order in which they are to be stated, has been changed a little. Both Vertical and Horizontal forms of balance sheet have been depicted as Appendix II.

**05 VALUE ADDED STATEMENTS**

There is a growing tendency for listed companies to prepare statements of added value, either as part of their audited accounts or more frequently as a supplement to them. In the Government's view the added value statement is a useful addition to the financial information produced by companies.

A company's turnover is in part the result of other people's work, namely the raw materials, products and services which the company has purchased from outside, and in part the result of the efforts of the company's workforce and the use of its physical and financial assets. This latter part is the value added by the company, and can therefore be expressed as turnover less goods and services purchased from outside.
Having identified the added value, it is then of interest to show how it has been distributed by way of payment to employees; by way of dividends to shareholders; through taxation to Government and indicating the balance retained in the business.

Care is needed in using added value as a measure of wealth creation, and in interpreting changes in added value. But with this proviso, the identification of added value provides a useful indication of performance, to supplement other financial information.

The information required to produce an added value statement is readily available to companies. Preparation of the statement calls for the re-ordering of information already revealed in the profit and loss account, together with disclosure of certain information which does not, at present, have to be published. The Government has concluded that there should be a legislative requirement about the publication of such statements by the companies. The Government envisages a requirement framed in general terms, with the detailed rules on the method of preparation and with the form suitable as prescribed by Accounting Standard. This would provide flexibility for companies such as banks or insurance companies where at present, there are special disclosure requirements and where they may be a case for
different forms of added value statements. However, in order to provide a measure of consistency in preparation, the Government believes that added value statements should be subject to audit.

There are a number of issues which will need to be clarified concerning the method of preparation and contents of such statements, including the form of presentation of an added value statement under current cost accounting, but there are two further points which call for particular comments at this stage.

First, the concept of added value also provides the basis for Value Added Tax (VAT). There are many technical rules about the calculation of the liability for VAT, including zero rating, which effectively distinguish questions of tax liability from the information to be provided in an added value statement. In introducing the requirement for an added value statement, it is not the intention to use this statement as a means of checking VAT liability, nor would it be possible to do so. The second point is that it has been argued that the added value statement should allow not simply the Corporation Tax liability on the profits, but also all or as many as possible of the payments made to central and local governments. A similar issue arises in relation to the statement of source and application of funds. In the context of the added value statement, the argument needs to be examined further: there may be grounds for seeking
to distinguish between Corporation Tax liability (directly related to one part of added value, namely profits) and other payments, such as rates or excise duty on petrol, which are frequently indistinguishable from costs payable to third parties for brought-in materials and services. The requirement to show all payments to Government would impose appreciable additional burdens on the companies. A better course would seem to be to follow the normal analysis by type of expenditure, as is adopted in the profit and loss account, and to have the added value statement to be prepared on this basis.

EXHIBIT 3

SUGGESTED PROFORMA OF VALUE ADDED STATEMENT

<table>
<thead>
<tr>
<th>Sources of Income</th>
<th>Current Year</th>
<th>Previous Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales and other income</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Less: Cost of materials and Securities used</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Value added by manufacturing and trading investment income</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Total value added</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

Disposal of Total Value Added

Towards operations                  -            -
Salaries and Wages and other benefits to employees  -            -
Other operating costs                -            -
Towards Financing
Interest on Government loans         -            -
Interest on Working Capital          -            -
Dividends                             -            -
Exhibit-3 shows that value added statement seems to be more important statement than even the profit and loss account, since it gives the total contribution of a company towards the economy of the country. It may be seen that from the realisable value of production, the cost of direct materials has been deducted. This is because the cost of current materials represents the consumption by the company of value produced by somebody else; the company has not produced that value. Hence the value added by the company is value of production minus cost of direct materials and the cost of other items which are produced by somebody else. It also shows that how the labour, capital, government and entrepreneur get their share of payments in the form of wages, financing cost, taxation dividends and retentions respectively.

Convinced of the high informational value of the Value Added Statement, many accountants feel that the traditional form of profit and loss account should be so modified that it shows the value added as well as the profit before tax separately. This can be done without much difficulty. Such
a statement would, of course, be useful in assessing not only what the company earned but also in making a judgement on the overall contribution of the company to the national economy.

**STATEMENT OF SOURCES AND APPLICATION OF FUNDS**

The inclusion of a statement of source and application of funds (or flow of funds statement) is how becoming increasingly common in company accounts. The purpose of the statement is to offer an insight, not otherwise available, from either an earnings statement or a balance sheet. As a performance report, the income statement offers information which relates to only one aspect of financial position, viz., retained earnings. The funds flow statement on the other hand identifies quite explicitly the nature and amount of these various sources and uses. Indeed, it may be useful for an interested external users of a company's financial statement—stockholders, creditors, suppliers, competitors, employees and so forth, to know what sources a company has turned to obtain the funds to meet its obligations.

The statement also provides other information which is of value in understanding company's affairs e.g.,

1) To what extent funds becoming available to the company have been invested in either fixed or working capital.

2) The amount and proportion of funds generated within the company.
iii) The changes in net liquid funds.

The government believes that a statutory requirement for a flow of funds statements would be a useful complement to this current development in accounting practice. It would require the statement to be included as part of the audited accounts and would specify in general terms the contents of the statement.

Flow of funds statements for companies with subsidiaries should be based on the group accounts. The following is the way in which funds flow statement can be shown:

**EXHIBIT-4**

**SUGGESTED PROFORMA OF FUNDS FLOW STATEMENT**

<table>
<thead>
<tr>
<th>A</th>
<th>Sources and Utilization of Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>1)</td>
<td>Cash generated from operations</td>
</tr>
<tr>
<td>11)</td>
<td>Profit after taxes and prior period adjustments</td>
</tr>
<tr>
<td>1ii)</td>
<td>Depreciation</td>
</tr>
<tr>
<td>1iv)</td>
<td>Other write offs</td>
</tr>
<tr>
<td>1v)</td>
<td>Reserves</td>
</tr>
<tr>
<td>1vi)</td>
<td>Net increase in borrowings</td>
</tr>
<tr>
<td>1vii)</td>
<td>Net decrease in Working Capital</td>
</tr>
</tbody>
</table>
B Utilization of Funds

i) Capital investment (net)  
ii) Net increase in Working Capital  
iii) Net decrease in borrowings  

C Changes in Working Capital

i) Cash  
ii) Interest accrued on deposits  
iii) Sundry debtors  
iv) Inventories  
v) Loans and advances  
vi) Total current assets  
vii) Current liabilities and provisions  
viii) Sundry Creditors  
ix) Total current liabilities  
x) Increase/decreases in Working Capital

Thus the growing interest in cash flow and funds flow as analytical techniques used by investors and security analysts led the APB in Opinion No.19 to require companies to include a funds flow statement along with the balance sheet and income statement in annual reports. In addition, the Accounting Principles Board also required funds flow statements to be covered by an auditor's opinion.
The APB in Opinion No.19 described that the objective of funds statements is to summarise the financing and investing activities of a company during the period due:
i) to the changes in financial condition; and
ii) operation

The funds flow statement shows changes in the firm's assets, liabilities and equity accounts during a specified period. In contrast, the balance sheet presents the company's financial position at a glance. The income statement shows revenues, expenses and profit for a specified period and also causes for the changes in the firm's financial position. All these can be readily observed through a well-prepared fund flow statement. Funds flowing from operation, borrowings, sale of properties and equity contribution are related to out-flows or property acquisitions, dividends and debt requirement. Answers are provided to such questions as: what happened to profit generated by operations? How was it possible for the firm to distribute the dividend? What happened to money borrowings during the period?

07 ACCOUNTING POLICIES AND PRACTICES

In recent years, a few enterprises in India have adopted the practice of including a separate statement of accounting policies in their annual accounts. But considerable variations exist among various enterprises in the nature and degree of
disclosure. Also in certain cases, the statement of accounting policies forms part of accounts while in others, it is given as a supplementary information.

The purpose of this statement is to promote better understanding of financial statements by establishing through an accounting standard the disclosure of significant accounting policies and the manner in which accounting policies are disclosed in the financial statements. Such disclosure would also facilitates a more meaningful comparison between financial statements of different enterprises. Also, the disclosure of various relevant accounting policies is necessary as the company's state of affairs and its profit and loss can be significantly affected by the accounting policies followed in the preparation and presentation of the financial statements. The accounting policies vary from enterprise to enterprise. Disclosure of significant accounting policies is necessary if the view presented is to be properly appreciated.

There is no single list of accounting policies which are applicable to all circumstances. The different circumstances in which enterprises operate in a situation of diverse and complete economic activity make alternative accounting principles and methods of applying those principles acceptable. The choice of the appropriate accounting principles and the methods of applying those principles in the specific circumstances of each
enterprise calls for considerable judgement by the management of the enterprise. The various statements of the Institute of Chartered Accountants of India combined with the efforts of government and other regulatory agencies and progressive managements have reduced in recent years the number of acceptable alternatives particularly in the case of corporate enterprises. While continuing efforts in this regard in future are likely to reduce the number still further, the availability of alternatives accounting principles and methods of applying those principles is not likely to be eliminated altogether in view of the differing circumstances faced by the enterprises.

According to AS-I, the following are the examples of the area in which different accounting policies may be adopted by different enterprises:

i) Methods of depreciation, depletion and amortization.
ii) Treatment of expenditure during construction.
iii) Valuation of inventories.
iv) Treatment of goodwill.
v) Conversion or translation of foreign currency items.
vi) Valuation of Investments.
vii) Treatment of retirement benefits.
viii) Recognition of profit on long-term contracts.
ix) Valuation of fixed assets.
x) Treatment of contingent liabilities.

The above list, however, is not intended to be exhaustive.

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8 Accounting Standards-I issued by the Accounting Standards Board, The Institute of Chartered Accountants of India on "Disclosure of Accounting Policies".
Accounting policies encompass the principles, bases, conventions, rules and procedures adopted by management in preparing financial statements. Certain fundamental accounting assumptions underlie the preparation and presentation of financial statements. These are usually not specifically stated because their acceptance and use are assumed. Disclosure is necessary if they are not followed.

The following are the generally accepted accounting assumptions:

1) **Going Concern**

   The enterprise is normally viewed as a going concern, that is, as continuing in operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of the operations.

2) **Consistency**

   It is assumed that accounting policies are consistent from one period to another.

3) **Accrual**

   Revenue and costs are accrued, that is, recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of periods to which they relate.

In the selection of Accounting Policies by an enterprise, various considerations are taken into account. The primary
consideration in the selection is that the financial statement prepared and presented on the basis of such accounting policies should represent a true and fair view of the state of affairs of the enterprise as at the Balance Sheet date and of the profit or loss for the period ended on that date. For this purpose, the major consideration governing the selection and application of accounting policies are:

a) **Prudence:**

In view of the uncertainty attached to future events, profits are not anticipated but recognised only when realised though not necessarily in cash. Provision is made for all known liabilities and losses even though the amount can not be determined with certainty and represents only a best estimate in the light of available information.

b) **Substance over form**

The accounting treatment and presentation in financial statements of transactions and events should be governed by their substance and not merely by the legal form.

c) **Materiality**

Financial statements should disclose all "Material" items, the knowledge of which might influence the decisions of the user of the financial statements.

To ensure proper understanding of financial statements, it is necessary that all significant accounting policies
adopted in the preparation and presentation of financial statements should be disclosed. Such disclosure should form part of the financial statement. It would be helpful to the reader of financial statements if they are all disclosed as such in one place instead of being scattered over several statements, schedules and notes. Also, any change in an accounting policy which has a material effect should be disclosed. The amount by which any item in the financial statements is affected by such change should also be disclosed to the extent ascertainable. Where such amount is not ascertainable wholly or in part, the fact should be indicated. If a change is made in the accounting policies which has no material effect on the financial statements for the current period, but is reasonably expected to have a material effect in some later period, the fact of such change should be appropriately disclosed in the period in which the change is adopted. However, accounting policies are not regularly and fully disclosed in all financial statements at present. Many enterprises include in the Notes on the Accounts, descriptions of some of the significant accounting policies. But the nature and degree of disclosure vary considerably between the corporate and non-corporate sectors and between units in the same sector.
The amounts and classifications of items should be supplemented, if necessary, by additional information to make their meanings clear. Significant items should not be included with, or offset against other items, without separate identification.

Financial statements should show corresponding figures for the preceding period.

II Specific Disclosure

Under specific disclosure, each item of balance sheet and Income Statement is disclosed separately under specific heads. In balance sheet, the following disclosures should be made:

a) Restrictions on the title to assets;
b) Security given in respect of liabilities;
c) The methods of providing for pension and retirement plans;
d) Contingent assets and contingent liabilities quantified if possible; and
e) Amounts committed for future capital expenditure.

Long-Term Assets

Under the Long-Term Assets, the following items should be disclosed in respect of plant and equipment:

a) Land and buildings;
b) Plant and equipment;
c) Other categories of assets(suitably identified);
d) Accumulated depreciation
Separate disclosure should be made of leaseholds and of assets being acquired on instalment purchase plans.

The following items should be disclosed separately, including, if applicable, the method and period of depreciation and any unusual write-offs during the period in case of other long-term assets.

(a) Long-term investments

Investments in subsidiaries
Investments in associated companies
Other investments, stating the market value of listed investments, if different from the carrying amount in the financial statements.

(b) Long-term receivables

Accounts and notes receivable-trade
Receivables from directors
Intercompany 10 receivables
Associated company receivables
Other

(c) Goodwill

(d) Patents, trademarks, and similar assets.

(e) Expenditure carried forward, for example, preliminary expenses, reorganisation expenses, and deferred taxes.

10 The term "intercompany" used in this Statement refers to the presentation in the financial statements of balance or transactions between:
(a) A parent company and its subsidiaries
(b) A subsidiary and its parent company or other subsidiaries in the group.
Current Assets

The following items should be disclosed separately in current assets:

(a) Cash
Cash includes cash on hand and current and other accounts with banks. Cash which is not immediately available for use, for example, balances frozen in foreign banks by exchange restrictions, should be disclosed.

(b) Marketable securities other than long-term investments.
The market value should be disclosed if the same is different from the cost price in the financial statements.

(c) Receivables
Accounts and notes receivable (trade)
Receivables from directors
Intercompany receivables
Associated company receivables
Other receivables and prepaid expenses

(d) Inventories

Long-Term Liabilities

The following items should be disclosed separately excluding the portion repayable within one year.

(a) Secured Loans

(b) Unsecured Loans

(c) Intercompany Loans

(d) Loans from associated companies.
A summary of the interest rates, repayment terms, covenants, subordinations, conversion features and amounts of unamortised premium or discount should be shown.

**Current Liabilities**

Under the heading Current Liabilities, the following items should be disclosed separately:

(a) Bank Loans and Overdrafts
(b) Current portions of long-term liabilities
(c) Payables
   - Accounts and notes payable - trade
   - Payables to directors
   - Intercompany payables
   - Associated company payables
   - Taxes on income
   - Dividends payable
   - Other payables and accrued expenses.

**Other Liabilities and Provisions**

The significant items included in other liabilities and provisions and accruals should be separately disclosed. Examples of such items are deferred taxes, deferred income and provisions for pensions.

**Shareholders' Interests**

The following disclosures should be made separately:

(a) Share Capital
   For each class of share capital:
The number and amount of shares authorised, issued and outstanding
The capital not yet paid
The par or legal value per share
The movement in share capital accounts during the period
The rights, preferences, and restrictions with respect to the distribution of dividends and to the repayment of capital
Cumulative preferred dividends in arrears
Reacquired shares
Shares reserved for future issuance under options and sales contracts, including the terms and amounts.

(b) Other equity, indicating the movement for the period and any restrictions on distribution
Capital paid in excess of par value (share premium)
Revaluation surplus
Reserves
Retained earnings.

In addition to balance sheet, the following specific information should be disclosed in Income Statement:
(a) Sales or other operating revenues
(b) Depreciation
(c) Interest income
(d) Income from investments

Shares outstanding refer to shares other than those held as "Treasury Stock". Treasury stock are a company's shares which have been acquired by the issuing company or a consolidated subsidiary company and are legally available for reissue or resale. This practice is not permitted in some countries.
The Securities and Exchange Commission (SEC) has also laid down certain items required to be disclosed in annual report of a company known as 10-K report. These items (given in 10-K report) are given as Appendix III.

The SEC Act also requires public disclosure by corporations of those individuals who control 5 per cent or more of any class of equity security. Officers, directors and the individuals controlling 5 per cent or more shares are required to disclose personal transactions in the related company's securities.

The required disclosures obviously aid investors in evaluating and understanding a company's performance. Unfortunately, most investors do not take advantage of their availability. Realizing this, the commission, in January 1974, proposed that annual reports to shareholders should include much of the 10-K disclosures. In addition, they proposed that proxy statements contain a form for shareholders to use in requesting the company to send them (free) the latest 10-K.